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Business Tax Burdens in Canada's Major Cities: The 2015 Report Card

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 localities 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 local 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.
- 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 – i.e., combined federal, provincial and local rates. Saskatoon and Calgary lead the pack with the most competitive overall business tax environments. Calgary, Saint John and Halifax are the only three cities in which we find higher taxes in 2015 than 2014, mainly because of higher provincial taxes.

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

The authors thank reviewers of this year's and previous versions of our business tax burden measure. Any remaining errors are our own. As this is an update of our 2014 edition in this series, we have repeated some text from that edition that did not require updating.

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

In this E-Brief, we quantify the extent of the METR burden for the largest city in each province, focusing on the following taxes: federal and provincial corporate income taxes, the retail sales tax,[3] local and provincial land transfer taxes and local and provincial business property taxes. Our calculation of the METR, however, excludes taxes not directly related to capital investment costs.[4] Working with the general modelling framework applied in Found (2013a), our METR reflects the tax burden on a hypothetical investment that would have the same pre-tax value regardless of the municipality in which it is located.

The federal government and many provinces have been reducing business taxes – such as those on corporate income, retail sales and capital – that they include in their METR estimates. However, these estimates are incomplete because they exclude business property taxes and land transfer taxes. These taxes are not only salient from the investor's perspective; they also have an appreciable effect on the 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 large share for governments to continue ignoring.

Comparing the largest cities in each province, we find that Saint John and Charlottetown have the highest overall tax burdens, followed by Montreal, Winnipeg and Halifax. At the other end of the spectrum, with Alberta's 2015 increase in its corporate income tax rate, Saskatoon has overtaken Calgary as having the lowest overall METR among our 10 cities. Since, in this third edition, we include multiyear results to allow comparisons over time, it becomes apparent that the consistently large share of the tax burden accounted for by business property taxes shows the importance of including such taxes in governments' METR estimates. Doing so would demonstrate the large potential benefits for new investment of lower rates for such taxes.

Many governments have business property tax regimes that are complex and opaque, making them difficult for investors and other taxpayers to understand. In this edition, we thus include a report card that evaluates these aspects of such regimes.

1 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 – that is, (6 – 4) / 4 – using the net-of-tax rate as the baseline.

2 For a discussion of how investors respond to higher business property taxes, for example, through lower investment, see Found (2013b), which 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 By retail sales tax, we mean provincial sales taxes that, unlike a harmonized sales tax (HST), increase the cost of capital inputs that businesses purchase. Even in provinces that have recently adopted an HST, the sales tax impact on capital inputs has not yet been fully phased out.

4 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

As we have noted, most measures of the tax burden on corporate investment include only federal and provincial corporate income taxes and provincial retail sales taxes. On top of these taxes, we continue to layer business property taxes and land transfer taxes, both at provincial and local levels.

Provincial and Local Business Property Taxes

The level and mix of public services differ across cities, just as they do across provinces. 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 be able to rely less on property taxes than 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 we encourage other METR analysts and governments to adopt this approach as well.

Typically, governments structure their business property tax regimes such that effective rates for these taxes differ from their statutory rates.[5] Although each provincial and local property tax system is unique, we have developed a standardized methodology to transform statutory business property tax rates into effective ones for each jurisdiction (Tables 1 and 2). Depending on the availability and quality of the data, however, we need to make certain assumptions on a case-by-case basis, as detailed in the online appendix and in our previous editions.

In addition to traditional business property taxes, we continue to include business occupancy taxes in the METR, as they are a variant of business property tax. The negative investment effect of a business occupancy tax is equivalent to that of a business property tax; whether the legal incidence falls on the building's owner or on tenants is irrelevant.[6] However, 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 accountable to member businesses.

Business property tax rates often differ across municipalities due to differential statutory rates and differences in provincial and municipal assessment mixes. For greater intermunicipal consistency, we now calculate

5 The difference between the statutory and 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 – that is, 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 over $100 million).

6 In contrast, a study of tax burdens by KPMG (2014) includes commercial property taxes billed directly to tenants and owner-occupants, such as business occupancy taxes, while excluding property taxes billed separately to building owners. Among the jurisdictions we study, only Winnipeg and Calgary continue to levy a business occupancy tax, although the latter is expected to phase out its tax by 2019.

Table 1: Statutory Business Property Tax and Land Transfer Tax Rates – 2015

Municipality	BPT			LTT		
	Provincial	Local	Total	Provincial	Local	Total
	Percent					
Vancouver	0.584	0.937	1.521	2.000	0.000	2.000
Calgary	0.346	1.301	1.647	0.020	0.000	0.020
Saskatoon	0.828	0.840	1.668	0.300	0.000	0.300
Winnipeg	1.175	3.439	4.614	2.000	0.000	2.000
Toronto	1.190	1.488	2.678	2.000	2.000	4.000
Montreal	0.000	3.881	3.881	1.500	0.500	2.000
Saint John	2.205	2.678	4.883	0.500	0.000	0.500
Halifax	0.325	3.031	3.356	0.000	1.500	1.500
Charlottetown	1.500	2.360	3.860	1.000	0.000	1.000
St. John's	0.000	2.620	2.620	0.400	0.000	0.400

Source: Government websites and authors' calculations as discussed in online appendix.

Table 2: Effective Business Property Tax and Land Transfer Tax Rates Rates – 2015

Municipality	BPT			LTT		
	Provincial	Local	Total	Provincial	Local	Total
	Percent					
Vancouver	0.584	0.937	1.521	2.000	0.000	2.000
Calgary	0.321	1.301	1.622	0.020	0.000	0.020
Saskatoon	0.523	0.619	1.143	0.300	0.000	0.300
Winnipeg	0.679	1.993	2.672	2.000	0.000	2.000
Toronto	0.980	1.225	2.205	2.000	2.000	4.000
Montreal	0.000	3.417	3.417	1.500	0.500	2.000
Saint John	2.205	2.678	4.883	0.500	0.000	0.500
Halifax	0.292	2.726	3.018	0.000	1.500	1.500
Charlottetown	1.500	2.360	3.860	1.000	0.000	1.000
St. John's	0.000	2.113	2.113	0.400	0.000	0.400

Source: Authors' calculations as discussed in online appendix.

Box 1: Capitalization of Business Property Taxes into Land Values

The notion that property taxes affect only land values, with no impact on investment, retains support in some government ministries – despite the implausible assumptions required to support it. Its proponents cite this notion as a rationale for leaving business property taxes out of METR estimates. In a detailed discussion in the online appendix, we recognize the likelihood that an increase in any business tax will reduce land prices, as part of an adjustment process in which investment is reduced. Market conditions will affect the degree to which investment is reduced. However, we also view as appropriate the existing methodology for estimating the METR, which assesses only tax competitiveness, with the degree of investment response to tax changes set aside – and no less appropriate when business property taxes are added to the estimates.

Box 2: Business Taxes and Benefits of Public Services

If any tax a business pays resulted in a direct benefit equal to the tax, then there would be no net tax burden on businesses. Taxes would then have no effect on the location and quantity of capital investment. Jurisdictions with relatively high tax rates would deliver superior services, which would balance the extra taxes from the standpoint of investors. Public officials, in commenting to the authors, have suggested that the business property tax is a type of benefit tax, and argue that this provides a rationale for excluding business property taxes from METR estimates.

A number of studies, however, undermine the benefit-tax scenario's plausibility; see, for example, Kitchen and Slack (1993) and Mintz and Roberts (2006). They find that municipal property tax burdens – levied on businesses as a class – substantially exceed businesses' benefits from services financed by property tax. Given the imbalance of tax burdens and benefits for businesses as a class, it follows that a typical business would view its property tax payment as a net burden to some degree. Accordingly, we view the business property tax as partially a net tax and partially a payment for services that benefit businesses.

Studies that estimate benefits to businesses financed by property taxes limit their scope to municipal taxes. Provincial property taxes, like provincial corporate income taxes, are sources of general revenue – despite the "education tax" label used in a majority of provinces. All provincial governments budget school spending independently of property tax revenue, and supplement that revenue with other general revenue sources to reach budgeted spending levels.

Apart from property taxes, other business taxes – for example, the corporate income tax – also finance public services, and many of these services benefit businesses. Thus all business taxes are, in part, benefit taxes. Ideally, METR estimates would adjust each jurisdiction's overall tax rates to reflect the jurisdiction's overall public service benefits. To our knowledge, however, no one has attempted to estimate METRs with an adjustment along these lines. The obstacles encountered no doubt would be insurmountable so existing METR estimates – of necessity – measure tax burdens only with benefits set aside. This same methodology remains appropriate when business property taxes are included in METR estimates.

effective provincial business property tax rates on a municipality-specific, as opposed to a province-wide, basis.[7] Governments, however, make it difficult to convert statutory rates to effective rates, which, in turn, makes it difficult to include business property taxes in METR estimates. Governments create additional barriers when they lend support to views of the economic role of business property taxes that, we argue, are incorrect. One such view is the notion that land prices neutralize the effect of such taxes on investment (see Box 1 and further discussion in the online appendix). A further view that we disagree with is the notion that business property taxes are fully offset by the benefits of public services (see Box 2).[8]

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

We have developed 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. Obtaining these estimates 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, 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, there would be just one effective tax rate, and it would be the rate shown on tax bills. Typically, however, 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.

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 written in obscure terms, investors will have difficulty estimating effective tax rates – even in jurisdictions with 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 investors need, or make it available only for a price, thereby compromising efforts to attract investment.

For our report card, we evaluate simplicity and transparency separately using numerical scores, and then translate these into letter grades. We evaluate each jurisdiction against the following ideal: the effective business property tax rate applicable to a property investment is readily ascertainable from a government website. That

7 Combining this refinement with Quebec's 2015 elimination of equalization grants for school boards with tax rates under the provincial maximum of 0.35 percent, we now consider the school tax levied in Montreal (and other Quebec municipalities where the school tax rate is less than the provincially imposed maximum of 0.35 percent) as being local, rather than provincial, in nature.

8 Our own perspective on whether METR estimates should take public service benefits into account has evolved over time. Found and Tomlinson (2012) maintained that provincial property taxes alone should be included in METR estimates, since net municipal taxes on businesses are too difficult to measure. Found, Dachis, and Tomlinson (2013) adopted a proxy measure of the net municipal tax burden on businesses – namely, a municipality's business property tax rate minus its residential property tax rate. Found, Dachis, and Tomlinson (2014), however, discussed drawbacks to using this proxy, and adopted the view we continue to hold today – that METR estimates should be restricted to assessing tax competitiveness only, with benefits set aside.

Table 3: Business Property Tax Report Card – 2015			
Component of BPT	**Jurisdiction**	**Simplicity**	**Transparency**
Provincial	British Columbia	B	A
	Alberta	B	D
	Saskatchewan	C	D
	Manitoba	C	D
	Ontario	F	F
	Quebec	D	D
	New Brunswick	B	A
	Nova Scotia	C	F
	Prince Edward Island	A	A
	Newfoundland	-	-
	Group Average	C	C
Local	Vancouver	B	A
	Calgary	C	B
	Saskatoon	C	B
	Winnipeg	F	C
	Toronto	C	B
	Montreal	C	B
	Saint John	A	A
	Halifax	D	B
	Charlottetown	A	B
	St. John's	B	B
	Group Average	C	B

Source: Authors' review and interpretation of government documents and website content.

is, the business property tax regime should be simple, and the jurisdiction should calculate and advertise applicable effective business property tax rates so that an investor can readily determine the effective tax rate by type and location of property investment. As none of our 20 jurisdictions (10 provinces and the largest city in each province) currently meets this ideal, our results point to few good tax systems. The two top provinces are New Brunswick and Prince Edward Island, while Manitoba and Ontario are our lowest performers on both the simplicity and transparency criteria (see Table 3). But all provinces with below average scores should improve their business property tax regimes.

In the online appendix, we provide our numerical scores, supported by qualitative observations and comments on our 20 jurisdictions, as well as our methodology for converting these scores into representative letter grades. As we discuss in the online appendix, the report card evaluates provincial performance only, even though it has separate provincial and local sections. The two sections apply to the provincial and local 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.

Land Transfer Taxes

Many provinces, and some cities, apply a land transfer tax, which is a percentage of the value of real estate (land and buildings) when property changes ownership. As a transaction tax, a land transfer tax has the same effect on business investment decisions as a retail sales tax that makes structure and machinery purchases more expensive. Like a retail sales tax on capital purchases, a land transfer tax can apply multiple times during the life of a structure, resulting in a cascading effect. By contrast, a harmonized sales tax avoids this problem through input tax credits, but there is no such input tax credit for land transfer tax paid on business real estate.[9]

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

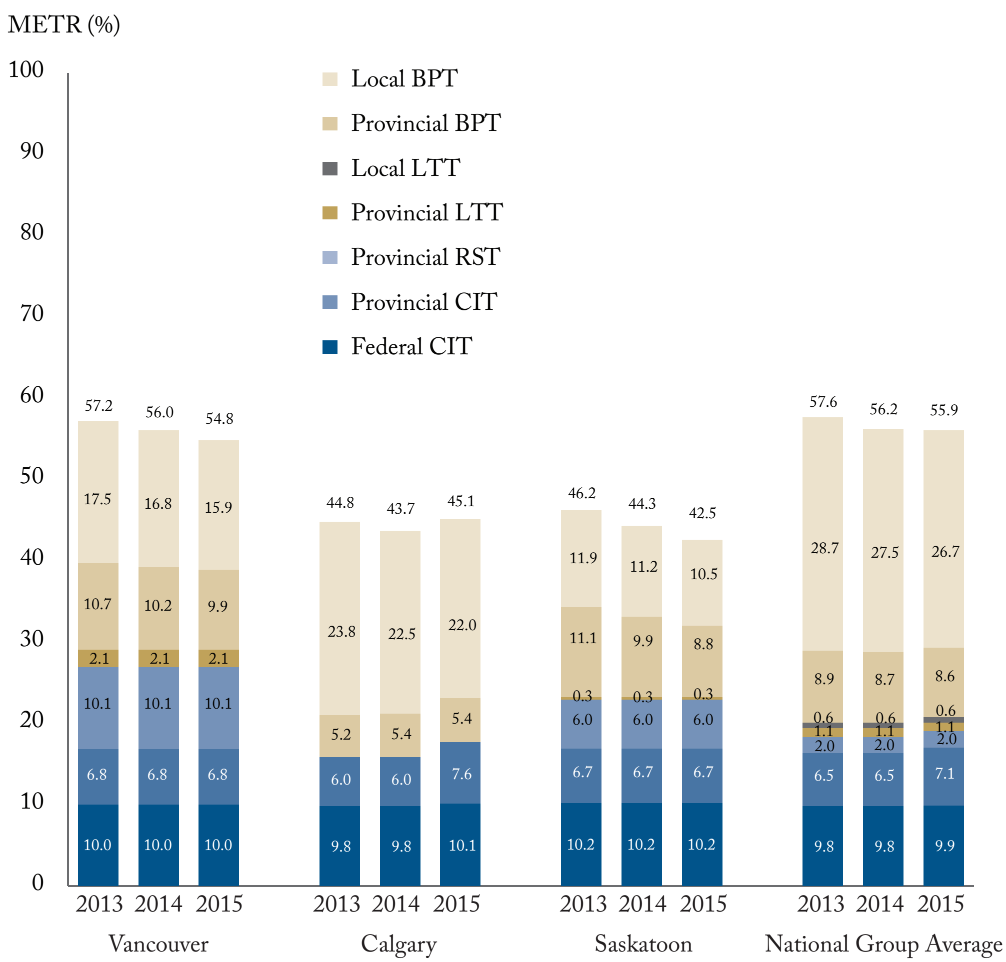
Traditional METR estimates, such as those presented by the federal Department of Finance, indicate that the four Atlantic provinces have the lowest METRs. Our results, which take property taxes into account, are inconsistent with this claim. We find that, while St. John's has a below-average METR, the largest cities in the other Atlantic provinces, along with those in Quebec and Manitoba, have the highest tax burden on investment. Calgary and Saskatoon have the lowest, and Toronto and Vancouver are in the middle of the pack, although their METRs are still above the group average. (See Figures 1 through 3, which show overall METRs by city for the 2013–15 period, and the component contributions of taxes.)

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 major tax costs imposed on new investment. Land transfer taxes and retail sales taxes also increase investment costs measurably in the provinces that impose them, with the highest combined land transfer tax cost in Toronto, at 4.2 percent, and the largest retail sales tax cost in Manitoba, which now has the highest such tax in the country after increasing the rate from 7 to 8 percent in 2013.

Which provincial governments have done the most to reduce tax burdens over the past three years? Ontario and British Columbia have shaved nearly a percentage point off their METRs through reductions in provincially levied business property tax rates. Saskatchewan, however, has led the pack in reducing provincial tax barriers to investment, cutting the business property tax component of the METR by more than two percentage points. At the other end, Alberta's much-publicized corporate income tax hike led to the second-highest increase in provincial tax burdens between 2014 and 2015. However, indicative of the lack of attention paid to business property taxes,

9 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 2015 METR on Capital Investment for Largest Municipality – Western Provinces



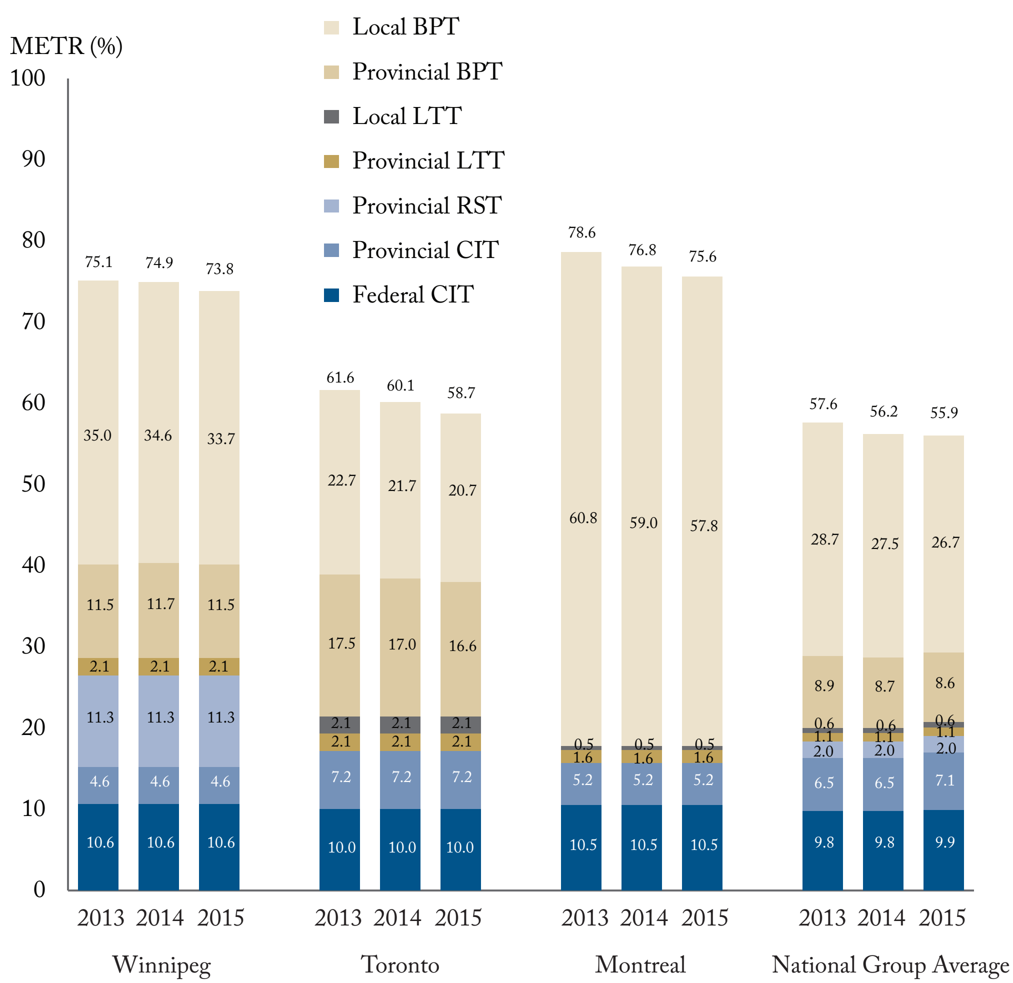
Source: See online appendix.

New Brunswick's 2015 cancellation of planned cuts to such taxes resulted in the largest increase in the METR we have recorded in our three years of conducting our analysis.

Montreal continues to have the largest total local METR, which, for 2015, stands at 58.3 percent (a 0.5 percent local land transfer tax and 57.8 percent local business property tax), followed by the four Atlantic Canada cities. Saskatoon has consistently had the lowest local business property tax rate in our series, and has reduced it the most of all the cities we studied, on a proportionate basis, followed by Vancouver.

Which municipal governments have taken the lead in reducing tax barriers to investment? Halifax recorded a major drop in its business property tax between 2013 and 2014. St. John's has also seen a large drop in its business property tax rate. No municipal government in our sample, other than Halifax, increased the local

Figure 2: Composition of 2013 to 2015 METR on Capital Investment for Largest Municipality – Central Provinces



Source: See online appendix.

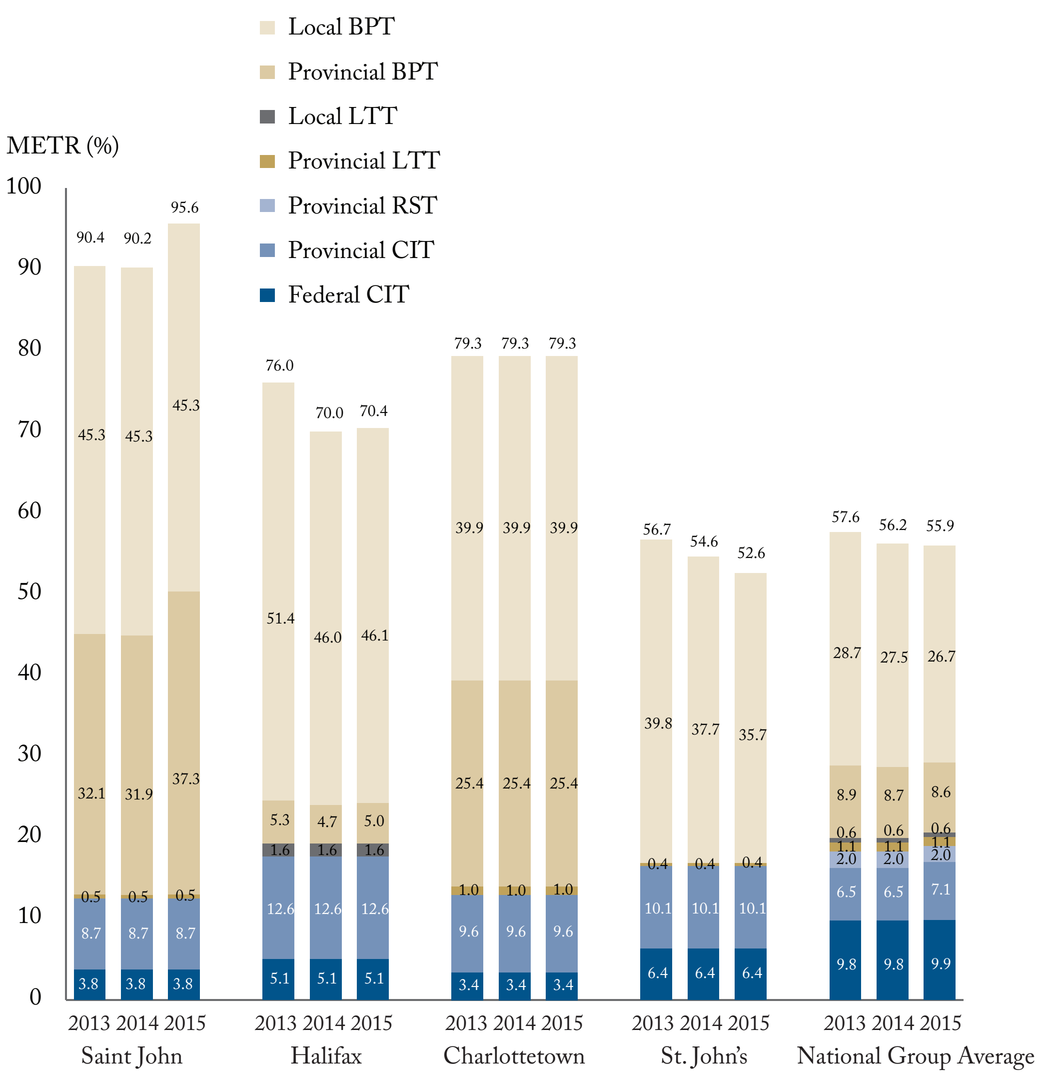
business property tax burden over the past three years. The total business tax burden, which includes taxes levied by all levels of government, has risen the most in Saint John and fallen the most in Halifax over the 2013–15 period.

Recommendations

Our first recommendation is for the federal Department of Finance – which provides the provinces with METR estimates – to include business property taxes in its interprovincial comparison of METRs.[10] Once governments

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

Figure 3: Composition of 2013 to 2015 METR on Capital Investment for Largest Municipality – Atlantic Provinces



Source: See online appendix.

better understand the effect of business property taxes on the cost of investing in their province or municipality, it will become clear that they should act to reduce the burden that 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, both for provincial and local property taxes.

Also, as we have argued previously (Found, Dachis, and Tomlinson 2013, 2014), 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 investment – by lowering corporate income and capital taxes 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 this tax in their METR measures, which would prompt a closer examination of the potential detrimental effect of the tax on business investment.

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