# *Intelligence* MEMOS

From: Adam Found and Peter Tomlinson

To: The Hon. Bill Morneau, Minister of Finance

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Re: **It's Time You Measure Business Tax Burdens in Canada's Major Cities**

Suppose we discovered that the Consumer Price Index (CPI) covered less than 40 percent of the goods and services consumers actually buy. In that case the federal government's CPI would be a misleading inflation indicator. So why does the federal government make an equivalent omission — by leaving out business property taxes — when estimating the marginal effective tax rate (METR) on business investment?

The METR is the percentage difference between before- and after-tax rates of return on investment. For instance, if the required after-tax return is 5 percent and the before-tax return must be 7 percent to cover taxes, then the METR is (7-5)/5 = 40 percent.

Our estimates of METRs for the largest city in each Canadian province incorporate all major business taxes levied by all levels of government (i.e. taxes on corporate income, retail sales, business property, and land transfers). Averaging our results across these cities, business property taxes account for over 60 percent of the METR, a large share for governments to ignore.

Our estimates of METRs give a dramatically different picture of tax competitiveness than more common estimates that omit business property taxes. For instance, when provincial and local business property taxes are accounted for, Saskatoon rises from eighth to first place for business tax competiveness among our ten cities, while Saint John falls from second place to dead last.

Why are governments omitting business property taxes from METR estimates?

Some officials argue that cutting business property taxes would only reduce public services, leaving businesses no better off. A key defect in this argument, however, is its disregard for the subsidy to residential taxpayers embedded in the business property tax. This subsidy is typically a substantial part of the total tax, invalidating a claim that business property taxes simply finance services to business.

Other officials argue that the only impact of cutting business property taxes would be higher land values. They're right in predicting higher land values but wrong in saying nothing else happens. Land values increase because investors — attracted by the tax cut — compete for sites to improve with investment.

The only apparent reason to leave business property taxes out of METR estimates is a reason that needn't exist — the complexity and opaqueness of property tax regimes in most provinces. Our report card compares jurisdictions with respect to the ease or difficulty of estimating effective tax rates. "D" grades go to Manitoba, Ontario and Quebec; only British Columbia, New Brunswick and Prince Edward Island get an "A".

Provincial governments should make effective provincial and local property tax rates readily available, so that federal estimates of METRs can incorporate them. The result will be substantially more accurate official estimates. Building on that result, economists will be able to extend their own METR estimates to every urban and suburban jurisdiction in the country.

*Adam Found and Peter Tomlinson are co-authors of the C.D. Howe Institute publication "Business Tax Burdens in Canada's Major Cities: The 2016 Report Card"*