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FISCAL AND TAX POLICY

Business Tax Burdens in Canada's Major Cities: The 2017 Report Card

by
Adam Found and Peter Tomlinson

- Before a business decides to locate or expand in a given jurisdiction, it must consider the tax implications. Heavy tax burdens reduce potential returns, driving investment away to other jurisdictions and, with it, the associated economic benefits. Interjurisdictional comparisons of tax regimes are, therefore, 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 and land transfer taxes. As in previous editions in this series on inter-municipal business tax burden comparisons, we find this oversight of major significance: business property and land transfer taxes represent about two-thirds of the total investment tax burden.
- Bringing these taxes into the mix for this study, we estimate the burdens of various business taxes for each province's largest city, 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 an investment

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decision, 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 capital stock will be smaller than it otherwise would be. The higher the METR, the greater the business investment loss and overall economic harm arising from business taxation (Found 2017).[2]

In this E-Brief, we build on our 2013–16 annual evaluations by quantifying the 2017 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 METR calculations exclude taxes not directly related to capital investment costs.[3] Working with the general modelling framework developed in Found (2014a), our METR findings reflect the tax burden on a hypothetical investment that has the same before-tax value regardless of where in Canada it is located.

Since METRs on capital investment began appearing in government budgets in 2006, the federal government and many provinces have reduced business taxes – such as those on corporate income, retail sales and corporate capital stock. However, their METR estimates still exclude business property taxes and land transfer taxes, which are not only salient to investors but also have an appreciable effect on the before-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, a share much too large for Canadian governments to continue ignoring.

Having examined the largest municipality in each province, we find that Saint John, Montreal and Charlottetown have the highest overall tax burdens in 2017, followed by Halifax and Winnipeg.[4] At the other end of the spectrum, second-place Calgary continues to decline in competitiveness as first-place Saskatoon widens its lead and third-place Vancouver closes in. 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. As in recent editions in this series, we include a

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 5 percent, and if investors in a specific city need a before-tax rate of return of 7 percent to pay their taxes and leave shareholders with the acceptable after-tax return, the METR, using the after-tax rate of return as the baseline, would be 40 percent – that is, (7 – 5)/5.

2 See the Appendix for a discussion of the relationship between the METR and the economic harm arising from business taxation.

3 For example, general payroll taxes, pension contributions, employment insurance premiums and municipal user fees do not directly affect capital investment costs. However, we as much as is practicable include tax-based incentives, 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.

4 The 2016 Census indicates Moncton has overtaken Saint John as the most populous municipality in New Brunswick. However, we did not become aware of this development in time to replace Saint John with Moncton, including development of a times series of results for Moncton, for this edition.

report card that evaluates business property tax regimes with respect to simplicity and transparency, given the relative importance of business property taxes in the METR.

Business Property Taxes and Land Transfer Taxes

The level and mix of public services differ across provinces and, by extension, their municipalities. For example, highways, 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 so that effective tax rates differ from their statutory counterparts.[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 estimated effective rates (Tables 1 and 2).[6] 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 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.[7]

We also 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 impact 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 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.

5 The difference between the statutory and the effective tax rate is illustrated by the following example. Suppose an investor owns real property that 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).

6 As is done to calculate national average METRs, national average tax rates are calculated by weighting individual rates by corresponding provincial corporate capital investment shares. Similarly, and as shown in the Appendix, business property tax rates in Table 1 and Table 2 are assessment-weighted averages across business property classes (where applicable).

7 For 2017, we have updated the following Statistics Canada background modelling data: corporate capital investment shares across major asset classes (i.e., land, buildings, machinery and inventories) and provinces, economic depreciation and capital cost allowance rates by major asset class, corporate debt-to-equity ratio, corporate retained earnings-to-equity ratio, along with marginal personal income tax rates on investment income.

Table 1: Statutory Business Property and Land Transfer Tax Rates (2017)

Municipality	Business Property Tax			Land Transfer Tax		
	Provincial	Municipal	Total	Provincial	Municipal	Total
			percent			
Vancouver	0.484	0.733	1.217	3.000	0.000	3.000
Calgary	0.386	1.521	1.908	0.000	0.000	0.000
Saskatoon	0.627	0.695	1.322	0.300	0.000	0.300
Winnipeg	1.049	3.273	4.322	2.000	0.000	2.000
Toronto	1.140	1.346	2.486	2.000	2.000	4.000
Montreal	0.000	3.757	3.757	1.500	1.000	2.500
Saint John	2.205	2.678	4.883	1.000	0.000	1.000
Halifax	0.338	2.980	3.318	0.000	1.500	1.500
Charlottetown	1.500	2.360	3.860	1.000	0.000	1.000
St. John's	0.000	2.470	2.470	0.400	0.000	0.400
National Average	**0.608**	**1.782**	**2.391**	**1.238**	**0.713**	**1.951**

Source: Authors' calculations from government websites.

Table 2: Effective Business Property and Land Transfer Tax Rates (2017)

Municipality	Business Property Tax			Land Transfer Tax		
	Provincial	Municipal	Total	Provincial	Municipal	Total
			percent			
Vancouver	0.483	0.733	1.216	3.000	0.000	3.000
Calgary	0.399	1.434	1.833	0.000	0.000	0.000
Saskatoon	0.538	0.712	1.249	0.300	0.000	0.300
Winnipeg	0.578	1.808	2.386	2.000	0.000	2.000
Toronto	0.861	1.018	1.879	2.000	2.000	4.000
Montreal	0.000	3.610	3.610	1.500	1.000	2.500
Saint John	2.205	2.678	4.883	1.000	0.000	1.000
Halifax	0.338	2.980	3.318	0.000	1.500	1.500
Charlottetown	1.500	2.360	3.860	1.000	0.000	1.000
St. John's	0.000	2.211	2.211	0.400	0.000	0.400
National Average	**0.511**	**1.579**	**2.089**	**1.238**	**0.713**	**1.951**

Source: Authors' calculations from government websites.

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).[8] 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 a one-time inter-corporate property transaction, which is a conservative approach since the tax applies each time property ownership is transferred.[9]

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

In a previous edition (Found, Tomlinson and Dachis 2015), 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 in a particular jurisdiction (see Table 3). This determination can be easy – or almost impossible – depending on (i) structural features of a jurisdiction's 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 the year of taxation, while a uniform tax rate would apply to all business property. In this ideal state, the jurisdiction would levy a uniform effective tax rate, and this is the rate that would be shown on tax bills. Typically, however, provincial governments introduce complexities such as multiple business classes with differential tax rates, discounts applying to specific assessment categories and valuation dates several years behind the year of taxation. Such complexities needlessly undermine 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. By contrast, the public availability of relevant information can mitigate the difficulties of accounting for 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 editions, the report card evaluates only provincial performance, even though it has separate provincial and municipal assessment sections. 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 fairly, given the different constraints imposed by their provincial governments.

Using the methodology we developed in 2015, we again evaluate simplicity and transparency separately by assigning numerical scores based on a qualitative assessment of the provincial-municipal business property tax regime and then translating these scores into letter grades (Table 3). With the exception of Nova Scotia, our

8 Alberta levies a land transfer tax rate of 0.02 percent, which we continue to treat as negligible and therefore omit from the analysis.

9 Like a retail sales tax on capital purchases, a land transfer tax can apply multiple times during the life of a property, resulting in a cascading effect. 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.

Table 3: Business Property Tax Report Card (2017)

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	B	D	D	B	C
Prince Edward Island	A	A	A	B	A
Newfoundland and Labrador	-	-	B	B	B
National Average	**C**	**D**	**C**	**B**	**C**

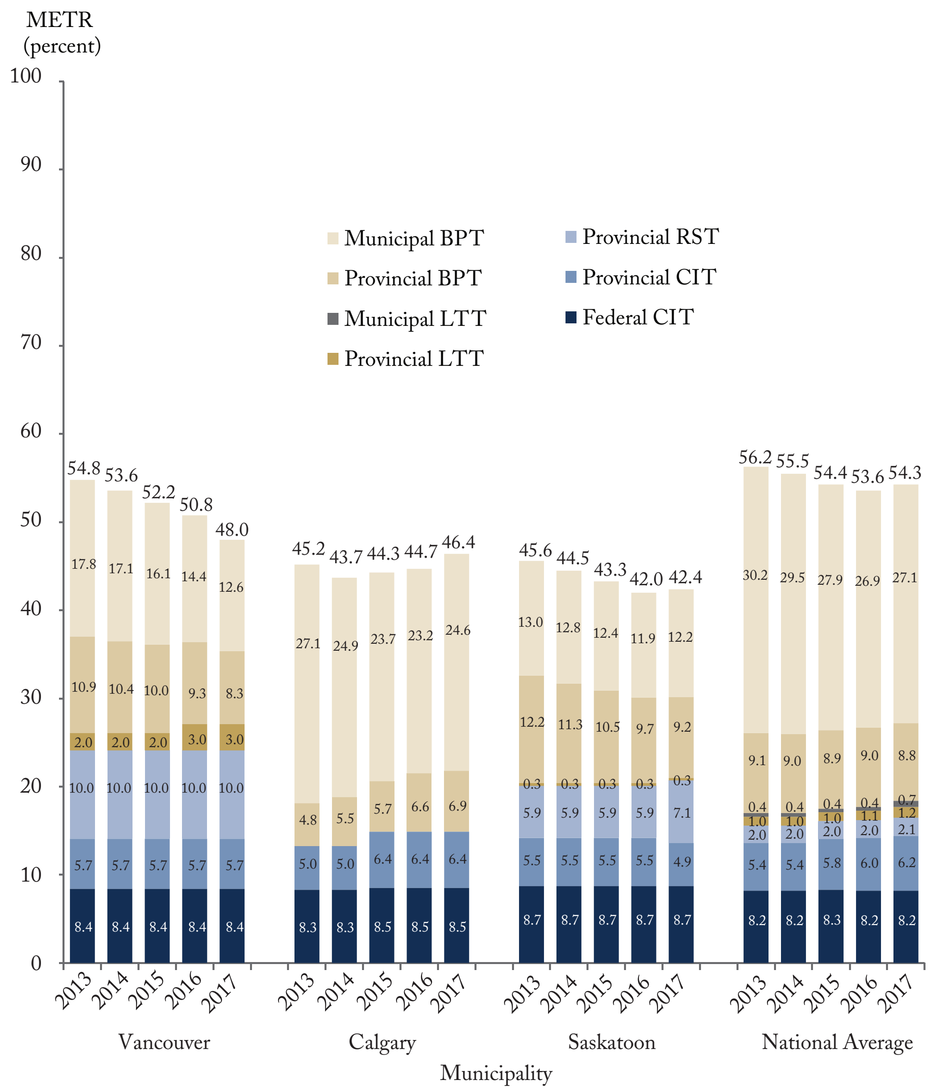
Source: Authors' assessments.

qualitative assessments behind the grades remain the same as for 2016, so we do not repeat the assessments in this edition. We have improved Nova Scotia's rating to reflect its decision to reduce the assessed-to-market property value lag from two years to one year. The overall assessment of a province is the simple average across its four scores, whereas national scores are weighted averages with provincial capital investment shares applied as weights, as done in Table 1 and Table 2.[10]

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. None of our 20 jurisdictions (10 provinces and the largest city in each province) currently meets this ideal; Canadian governments have much to improve upon in making their business property tax systems simpler and more transparent. 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 (see Table 3).

10 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 1: Composition of 2013 to 2017 METR on Capital Investment for Largest Municipality in Western Provinces

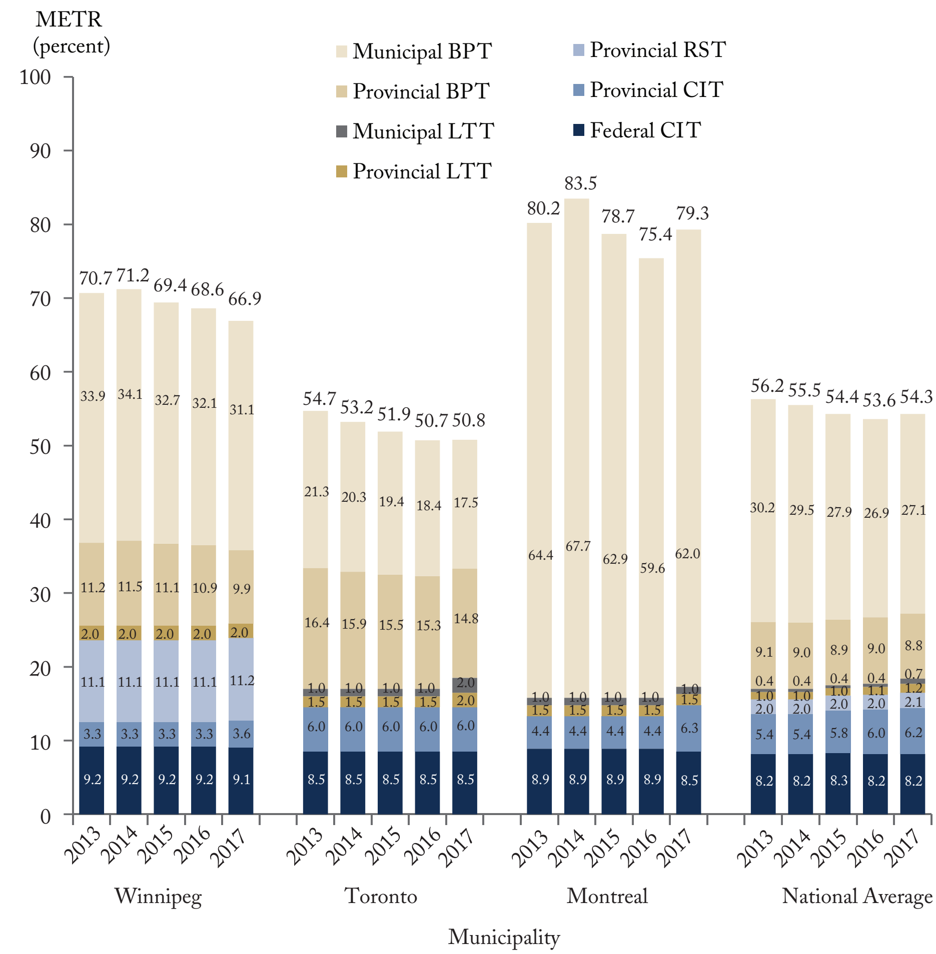


Source: See online appendix.

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. However, with business property and land transfer taxes taken into account, our results are inconsistent with this conclusion. Other than for St. John's, we find that the largest cities in the Atlantic provinces have the overall highest tax burdens on investment, followed by those in Quebec and Manitoba. Saskatoon, Calgary and Vancouver have the lowest tax burdens, while Toronto and St. John's are on par with the national average (see Figures 1-3).

Figure 2: Composition of 2013 to 2017 METR on Capital Investment for Largest Municipality in Central Provinces



Source: See online appendix.

Looking only at provincial and federal taxes, the largest burdens are in New Brunswick, Prince Edward Island, Manitoba, British Columbia and Ontario. 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.

Turning to municipal taxes, Montreal continues to have the most burdensome local METR (63 percent), followed by the four Atlantic municipalities and Winnipeg. In Vancouver, Calgary and Toronto, local business property tax burdens remain below that of the national average. Saskatoon continues to showcase the most competitive local (and overall) tax environment in our group, but Vancouver is catching up.

METR reductions relating to the business property tax are typically the result of business property appreciation outpacing levy increases (rather than levy decreases) on business property classes. However,

Box 1: Business Property Tax Rates in Toronto: Still Going Down – But New Policies Are Slowing the Pace

Business property tax rates in Toronto usually go down from year to year. To see why, consider what would happen if (hypothetically) the city and province left their tax rates unchanged over time.

In that scenario the city's property tax revenue from businesses would increase by almost 8 percent per year; Toronto business assessment has appreciated that rapidly. However, the city collects considerably smaller revenue increases from business (this year about 2 percent: Toronto 2017a). Conforming to provincial regulations, the city calculates a tax rate yielding last year's revenue if levied on this year's assessments; this revenue-neutral rate is then increased by city council to reflect the tax increase imposed on businesses.

How is this tax increase determined? City council begins the budget process by fixing the residential tax increase to be reported on tax bills. This increase indirectly – via budget policy – determines the tax load on businesses. In 2017, the city changed its policy so that more revenue from businesses results from a given residential tax increase. (As Toronto 2017a notes, residential and business tax increases are linked via a complex series of steps.) If continued in future, the policy change will cause business tax rates to go down less rapidly, thus adversely affecting the Toronto METR.

So far as provincial tax rates are concerned, the impact of (hypothetically) constant tax rates would depend on whether industrial or commercial properties are considered. For the industrial class, revenue would increase by about 3 percent per year, because industrial assessment is appreciating at that rate.[a] As in previous years, the province budgets for a zero increase in revenue from Toronto's industrial class. A revenue-neutral tax rate is the rate actually shown on tax bills.

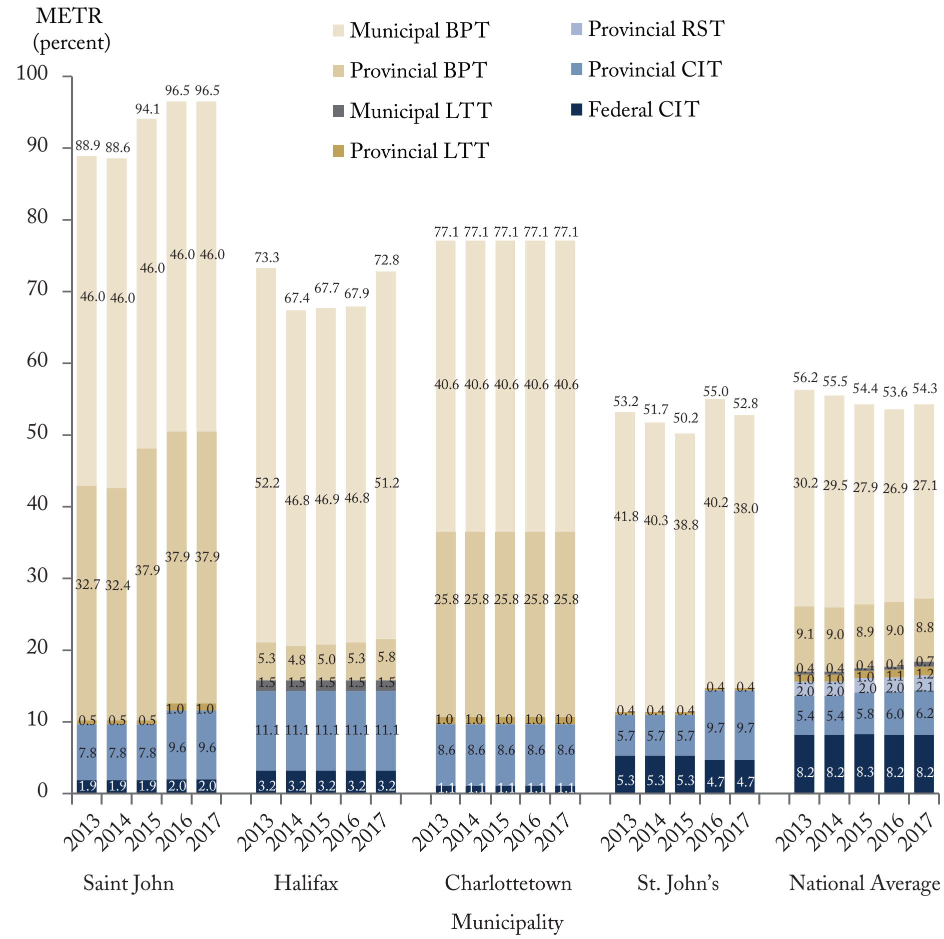
Until 2016, the province adjusted its commercial tax rate on the same revenue-neutral basis. Now, however, the province includes Toronto commercial properties in a group of properties spanning scores of municipalities; all properties in the group are taxed at a uniform rate. A revenue-neutral rate adjustment, therefore, depends on assessment appreciation for the group as a whole. Toronto appreciation clearly exceeds appreciation for the rest of the group, as evidenced by a substantial tax shift onto Toronto from elsewhere in the group.

The shift amounts to about $25 million this year, and that is just the first of four phased installments for the current 2017-2020 assessment cycle (Toronto 2017b). The uniform rate on the group is lower this year than last, but Toronto commercial properties would have seen a larger rate reduction had it not been rolled into a relatively slowly appreciating group. The slower tax rate decrease affects the Toronto METR adversely.

As reported in Toronto 2017b, this year's commercial tax increase imposed by the province goes beyond the tax shift from elsewhere in the uniform-rate group. The city report calls this further increase a "levy increase." The levy increase, if repeated in future, will slow reductions to the provincial tax rate on Toronto commercial properties, again affecting the Toronto METR adversely.

a Industrial appreciation is slower than for businesses overall since rapidly appreciating commercial property dominates the assessment base.

Figure 3: Composition of 2013 to 2017 METR on Capital Investment for Largest Municipality in Atlantic Provinces



Source: See online appendix.

property tax policy developments respecting Toronto are now slowing such improvements to the METR – see Box 1 for a discussion.

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.[11] Once governments better understand the

11 This might require Statistics Canada to allocate more resources to collecting property tax data.

effect of business property taxes on the cost of investing, they are more likely 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 and 2015; Found and Tomlinson 2016), 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. Provincial 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-related 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.

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Adam Found is Metropolitan Policy Fellow at the C.D. Howe Institute and Course Instructor, Department of Economics, Trent University.

Peter Tomlinson is a Sessional Lecturer, Department of Economics, University of Toronto.

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