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The Corporate Capital Tax Canada's Most Damaging Tax

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Foreword by Herbert G. Grubel

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Foreword

by Herbert G. Grubel

Taxes on capital lower the return to investment and, therefore, depress the rate at which capital is formed. Since capital is the main source of labour productivity, any reduction in the rate of capital formation results in lower average incomes and living standards.

For this reason, many economists argue for the elimination of the Corporation Income Tax, the Capital Gains Tax, and the Corporation Capital Tax analyzed in this study. They believe that the revenue lost in the longer run through the elimination of these taxes on capital will be more than made up by higher revenues from other taxes, as the economy is induced to grow more rapidly.

During the last decade, Canada has become a net exporter of capital, after having been a net importer for most of its history. It is no coincidence that this change more or less coincided with the increased use of the Corporation Capital Tax and higher Capital Gains Taxes. It is also no coincidence that during this period Canada's labour productivity rose at a slower rate than that in the United States and that a wide gap in the per-capita incomes of the two countries opened up.

The Corporate Capital Tax: Canada's Most Damaging Tax explains the nature of the Corporation Capital Tax and documents the extent to which it is used in different jurisdictions within Canada. The explanation makes it clear that the tax is probably the most damaging of all of the taxes on capital, primarily because it is payable whether or not a company has a profit. This study also shows that the cost of compliance with the tax is very high, which further adds to its burden. In addition, the study provides strong evidence that the tax has detrimental effects on productivity and economic growth.

I hope that this study will be read carefully by Canadians interested in reversing the country's poor economic performance relative to the United States and setting this country on a path towards greater economic prosperity. After reviewing this study, I am thoroughly convinced that there are few other simple and relatively costless tax policy changes with a higher return than the elimination of the capital tax that now fetters the Canadian economy.

Executive summary

Introduction

The corporate capital tax is a tax on business that is little known outside the circles of academia, tax planning, and corporate boardrooms. Of the taxes currently imposed by governments in Canada, however, the corporate capital tax is one of the most—if not the most—damaging to the economy. There are both absolute reasons, based on its cost and complexity, and relative reasons, grounded in the fact that few other industrialized countries impose such a tax, that it should be eliminated by all governments. (The official name is “Corporation Capital Tax” but it is commonly called “corporate capital tax,” a practice we follow in this study.

This executive summary provides a brief overview of the analysis in this study, which contains four analytical chapters. The first describes corporate capital taxes, the second evaluates their use and the third measures the use of corporate capital taxes in jurisdictions across Canada. The fourth gives a profile of the use of the corporate capital tax in each jurisdiction—the federal government and the ten provincial governments.

(1) What is corporate capital tax?

The corporate capital tax generates revenue for governments by assessing a levy on corporations based on the amount of capital (essentially debt and equity) employed. There are two major categories of corporate capital taxes in Canada: tax assessed on financial institutions and tax assessed on non-financial or general corporations.¹ The applicable rates vary from 0.0% in Alberta (i.e. there are no corporate capital taxes) for both financial and non-financial corporations to 0.64% in Quebec for non-financials and 4.0% in Newfoundland for financial institutions.

Like all business taxes, the burden of the corporate capital tax, both the general and that levied on financial institutions, is borne by ordinary citizens through higher prices for goods and services, lower wages, or reduced rates of return on savings and investments.

(2) Evaluating corporate capital tax

There are three traditional measures of tax effectiveness: efficiency, fairness (also referred to as equity), and simplicity.

Efficiency

Efficiency, as applied to taxation, requires that tax revenues be raised in the least distortionary manner in order to maximize economic growth. The Marginal Efficiency Cost (MEC) of taxation measures the incremental cost of raising an additional dollar of tax revenue from an existing tax. Both the core study assessing MECs in the United States and Canada’s Federal Ministry of Finance’s 1997 MEC analysis of taxes in Canada concluded that business taxes like the corporate income tax were far less efficient than those with a labour income or consumption base. Both studies found that using business taxes—particularly corporate income taxes—imposed a substantially higher cost to the economy than either sales or payroll taxes. Thus, considerable efficiency gains can be achieved by simply reconfiguring the tax mix to move away from corporate income and capital bases and toward labour income and consumption bases.

Fairness (Equity)

The main concern for a corporate capital tax in terms of fairness is whether or not it achieves horizontal fairness: firms with similar amounts of capital should face similar corporate capital tax bills. There are several reasons that explain why corporate capital taxes fail the test of horizontal fairness. First, the varying definitions of what constitutes a “large corporation” and thus the exempted level of capital results in a situation where firms with equivalent capital are not treated equally across jurisdictions. Second, financial institutions are taxed more heavily by the corporate capital tax than non-financial institutions. Finally, corporate capital taxes fail the test of fairness by placing a higher burden on industries whose activities are more capital-intensive than others. Growth-enhancing industries like software, biotechnology, and communications are penalized by this tax more than other industries.

Simplicity

Simplicity refers to the cost to the government of collecting taxes as well as the costs incurred by businesses and individuals in complying with a tax system. The principle of simplicity requires that both sets of costs be minimized.

The *Technical Committee on Business Taxation* (1997), one of the most important commissions to evaluate taxation in recent times concluded that “capital taxes are becoming increasing[ly] complex.” This is due to the inherent administrative complexity of taxing capital and to the lack of uniform interpretation of the legislation on corporate capital tax both in, and across, jurisdictions.

Corporations are required to calculate total corporate capital tax payable by determining the taxable capital, investment allowance, and applicable exemptions, deductions, and credits. One study concluded that it requires accounting for 103 items simply to determine corporate capital tax payable in a single jurisdiction.

Evaluative Conclusion

The corporate capital tax is a poor way to raise revenues for government because it violates the principles of fairness, simplicity, and efficiency, and ultimately impedes economic growth. Its failure to meet any of the traditional measures of the effectiveness of tax policy provides an absolute reason for its elimination.

(3) Measuring the use of corporate capital taxes

International comparison

Canada is almost unique in its use of corporate capital taxes. Canada is one of only three countries in the OECD that levies a direct tax on the capital of corporations at the federal level. The other two OECD countries that impose corporate capital taxes are Germany and Japan but they do so to a much lesser extent. The United States does not assess a corporate capital tax at the federal level although several American states levy a minor tax equivalent to a corporate capital tax, although the amount and effect is negligible. Canada’s corporate capital tax is levied at the highest rates, extracted from the broadest bases, and administered with the greatest degree of complexity compared to the few other countries using corporate capital taxes. This provides a strong relative reason for its elimination.

Intra-Canadian Comparisons

Four measures were used to rank the jurisdictional use of corporate capital taxes from 1989/90 to 2000/01: corporate capital tax as a percent of: (1) own-source revenue (i.e., the revenues collected within a particular jurisdiction and excluding transfers), (2) business profits, (3) gross domestic product (GDP), and (4) corporate income tax. The results are summarized in table Exec 1 and discussed below.

Table Exec 1: Summary ranks of corporate capital tax usage measures (2000/01)

	Corporate capital tax as a percent of own-source revenue	Corporate capital tax as a percent of business profits	Corporate capital tax as a percent of GDP	Corporate capital tax as a percent of corporate income tax revenues	Average rank
Canada	8	8	8	10	8.5
BC	5	4	4	3	4.0
AB	11	11	11	11	11.0
SK	1	2	1	1	1.3
MB	4	3	3	4	3.5
ON	3	5	5	7	5.0
QC	2	1	2	2	1.8
NB	7	7	7	6	6.8
NS	6	6	6	5	5.8
PEI	10	9	10	9	9.5
NF	9	10	9	8	9.0

In general, Saskatchewan and Quebec use the corporate capital tax to the greatest extent. In fact, Saskatchewan's corporate capital tax consistently generates more revenue than its corporate income tax. British Columbia is a relatively high user of corporate capital taxes although it has announced it will eliminate its non-financial corporate capital tax late in 2002. Finally, Manitoba rounds out the group of Canadian jurisdictions that use corporate capital taxes to a relatively high degree.

At the other end of the spectrum, Alberta no longer has a corporate capital tax, having eliminated its financial institutions corporate capital tax on April 1st, 2001. The federal government along with Newfoundland and Prince Edward Island are also relatively low users of corporate capital taxes. Sections 3 and 4 of the study provide an overview and detailed analysis of these measures for all relevant Canadian jurisdictions.

(1) Corporate corporate capital tax as a percent of own-source revenue

This measures the proportion of own-source revenues (i.e., the revenues collected within a particular jurisdiction and excluding transfers) that is collected in the form of corporate capital taxes. In 2000/01, Saskatchewan was the leader in corporate capital tax revenue as a percentage of own-source revenues (5.40%). Quebec ranked second with 3.48%. Ontario, Manitoba, and British Columbia ranked third, fourth, and fifth, respectively. Alberta ranked last in the percentage of its own-source revenues (0.14%) provided by corporate capital taxes.

During the period from 1989/90 to 2000/01 that was examined, Saskatchewan and Quebec maintained first and second positions, exclusively. Alberta frequently ranked last, indicating the lowest reliance on corporate capital taxes as a percent of own-source revenues over this 12-year period. The federal government along with the Atlantic provinces generally also ranked relatively low.

(2) Corporate capital tax as a percent of business profits

This indicator measures the amount of corporate capital tax collected compared to the profits generated by corporations. In 2000/01, Quebec's corporate capital tax extracted the greatest amount of revenue as a percent of business profits (6.9%), followed closely by Sas-

katchewan (6.1%). Manitoba (5.1%) and British Columbia (4.3%) followed in third and fourth positions.

Alberta was again ranked last with corporate capital taxes representing 0.1% of business profits. Prince Edward Island was in ninth place and Newfoundland, tenth.

Over the period examined, Quebec ranked first in every year but one. Saskatchewan ranked second in every year but one (1999/00), in which it was ranked first. Manitoba was usually ranked third. Alberta, Prince Edward Island, Newfoundland, and New Brunswick generally extracted the least amount of corporate capital tax revenues relative to business profits.

(3) Corporate capital tax as a percent of gross domestic product (GDP)

This indicator measures the use of corporate capital tax relative to the size of the economy. Saskatchewan ranked first in this indicator in 2000/01, with corporate capital taxes representing 0.98% of GDP. Quebec followed in second position with corporate capital taxes representing 0.73% of GDP. Manitoba (0.40%) and British Columbia (0.34%) ranked third and fourth, respectively.

Alberta was ranked last with corporate capital taxes representing a mere 0.03% of GDP in 2000/01. Prince Edward Island and Newfoundland followed closely, tying for tenth position. Saskatchewan and Quebec consistently ranked first and second over the period examined. Manitoba and British Columbia (after 1992/93) consistently held positions three or four. Alberta ranked last for 10 of the 12 years. Prince Edward Island and Newfoundland also regularly ranked low.

(4) Corporate capital tax as a percent of corporate income tax

The fourth indicator compares the amount of corporate capital tax revenue with the amount of revenue collected by the corporate income tax. Saskatchewan ranked the highest of all jurisdictions. Saskatchewan was the only jurisdiction in which more revenues were raised from corporate capital taxes than from corporate income taxes; \$1.05 in corporate capital taxes for every \$1 in corporate income tax in 2000/01. Quebec ranked second in the amount of corporate capital taxes raised relative to corporate income taxes. British Columbia and Manitoba ranked third and fourth, respectively. Alberta, Prince Edward Island, and the federal govern-

ment ranked low in terms of their usage of corporate capital taxes relative to corporate income taxes.

Over the period from 1989/90 to 2000/01, Saskatchewan collected, on average, \$1.21 in corporate capital tax revenue for every \$1 of corporate income tax revenue collected. Saskatchewan is the only province to collect more, consistently, in corporate capital taxes than from corporate income taxes. Quebec consistently ranked second but was far behind Saskatchewan's usage rates. Manitoba and British Columbia commonly alternated between third and fourth places.

Alberta collected relatively low amounts of corporate capital tax revenues compared with corporate income taxes consistently over the period. The federal government also received low rankings over the period.

Section 4 of the study provides a profile giving much greater detail of the use of corporate capital tax in each jurisdiction.

Recommendation and conclusion

Given the high and unnecessary costs associated with using corporate capital taxes and the rarity of their use by competing nations in the OECD, it is imperative for all Canadian jurisdictions to follow the lead of Alberta and eliminate their use. At the very least, corporate capital taxes should be replaced with more efficient taxes such as payroll or sales taxes. However, the best option for every jurisdiction in Canada is the straightforward elimination of corporate capital taxes, a tax reduction rather than a tax replacement.

Introduction

Every other country in the world save two recognize how damaging corporate capital taxes are and do not levy them. The following quotations are from a few of the Canadian experts and politicians that have spoken up about the problems arising from the use of corporate capital taxes in Canada.

[T]he NDP introduced the corporate capital tax in 1992. It sent an immediate, negative message to Asian and other potential investors. But this tax doesn't just affect big investors outside BC. It's also paid—indirectly—by small business and start-up companies ... We're phasing out the corporate capital tax on non-financial institutions ... (It will) leverage significant new investment in our province. (Honourable Gary Collins, Minister of Finance, Government of British Columbia, Economic and Fiscal Update, July 30, 2001)

Capital taxes should also be cut since they particularly hit businesses just when they face financial instability. (Jack Mintz, President and CEO, C.D. Howe Institute, "We Need a Budget," *National Post*, September 21, 2001).

[T]here were a few initiatives announced over the past year aimed at reducing the high rates of capital tax in Canada (i.e. taxes based on the value of capital in the firm). These taxes—of which about two-thirds are levied at the provincial level—are arguably the most damaging tax, since they effectively raise the cost of capital, impeding productivity and growth, and must be paid whether or not a firm is profitable. (TD Economics, October 12, 2001, *Report on Government Finances: Federal and Provincial Fiscal Outlook to 2005-06*; available at <http://www.td.com/economics/finances/>)

Some jurisdictions have started to move on reducing capital taxes—arguably the most damaging tax since it taxes productive invest-

ment—but much more needs to be done. (Don Drummond, Chief Economist and Senior Vice-President, Toronto-Dominion Financial Group, "Fiscal Forecast Report," *National Post*, October 25, 2001)

Capital taxes act as a disincentive to new investment, and discriminate unfairly against capital-intensive industries. (Sab Meffe, Chair, Taxation Committee, Railway Association of Canada. Included in *Securing Our Future*, a Report of the Standing Committee on Finance, November 2001).

Capital tax is tantamount to a tax on innovation and productivity. (Canadian Manufacturers and Exporters. Included in *Securing Our Future*, a Report of the Standing Committee on Finance, November 2001)

[C]apital taxes discourage investment, reduce productivity, and disproportionately affect capital intensive industries. (Highlight from the Federal Government's Standing Committee on Finance's Report, *Securing Our Future*, November 2001).

Taxes on capital or the returns from capital tend to reduce the returns from investment and hence reduce the amount of investment that is undertaken. This means a smaller stock of capital as well as an older stock of capital. Both of these factors will lead to lower productivity and hence lower real wages. (Highlight from the Federal Government's Standing Committee on Finance's Report, *Securing Our Future*, November 2001)

Capital taxes are arguably the most detrimental of all taxes ... It's a tax on the building of productivity in this country. (Derek Burleton, Senior Economist, Toronto-Dominion Bank, *National Post*, November 27, 2001)

I would have liked to have seen additional tax cuts, especially the phase-out of the capital tax on corporations ... Canada is the only G-7 country with a federal capital tax—and it is a deterrent to business investment. (Sherry Cooper, Executive Vice-President, Bank of Montreal, “Responding to the Federal Budget,” *National Post*, December 11, 2001)

The quotations above indicate how urgent it is that Canadian governments deal with what many agree is a damaging and highly detrimental tax to the Canadian economy. As the following study will show, there are both absolute and relative (i.e. competitive) reasons for abandoning the use of corporate capital taxes across all Canadian jurisdictions.

This study provides information for three separate areas regarding corporate capital taxes in Canada. Section 1 provides some general information regarding corporate capital taxes: what they are, how they operate, what the varying rates are in different jurisdictions, and who actually ends up paying them.

Section 2 outlines the reasons why so many people are concerned with the continuing use of corporate capital taxes and evaluates corporate capital taxes according to the traditional evaluative criteria for taxes: efficiency,

fairness (equity), and simplicity. It also discusses the impact of corporate capital taxes on economic growth.

Section 3 presents relative measures of corporate capital tax usage for all the provinces and the federal government. Specifically, this section presents the measurement of corporate capital tax usage as a percent of: (1) own-source revenue, (2) business profits, (3) gross domestic product (GDP), and (4) corporate income tax revenues. Each of the four measures presents a unique picture of the relative use of corporate capital taxes across jurisdictional lines in Canada. Section 4 presents jurisdictional profiles for each of the provinces and the federal government.

For reference purposes, the table 8 on pages 52–53 summarizes the statutory corporate capital tax rates imposed by the various jurisdictions over the 12-year period from 1989/90 to 2000/01 examined in this study.

Discussion in this paper is largely restricted to the corporate capital taxes imposed on financial institutions and non-financial institutions. However, it is important to remember that there is a third category of corporate capital tax, that assessed on the insurance industry, which is separate and distinct from the corporate capital tax imposed on financial institutions. For further information, see Witol 1998.

1. Corporate capital taxes in Canada

The federal government and nine² provincial governments currently levy a direct tax on the capital of corporations. The objective of this tax is to raise revenue based on the capital employed by corporations within each jurisdiction, with the broad aim of ensuring that corporations pay their “fair share” of taxes (Milner 1999; Federal Budgets 2000 and 2001; Provincial Budgets 2000).

The corporate capital tax is designed to generate revenue from all direct and indirect forms of capital. The most common forms of capital making up the tax base are debt, equity, and capital stock, all of which are of absolute importance for initiating, maintaining, and advancing the productive and competitive position of Canadian corporations in the global economy (Haymes 1998; Boadway and Kitchen 1999).

The tax was originally levied on large financial institutions, which generally include banks, trusts, and loan companies. However, many jurisdictions have broadened the applicability of the corporate capital tax to include large corporations, where “large” is defined as corporations with capital above a prescribed threshold. The two groups of corporations, namely financial and non-financial, are taxed in separate categories and at different rates due to the differences in their capital structure.

The provincial and federal governments set their own, distinct corporate capital tax regimes and therefore administer and extract corporate capital tax revenue independent of any interjurisdictional consultation (Boadway and Kitchen 1999). This independence has created large variations in tax rates, bases, and deductions from jurisdiction to jurisdiction.

This section provides an overview of the design and structure of the corporate capital tax in Canada. It begins with a general discussion of how capital is taxed and follows with a general overview of the federal and provincial corporate capital tax systems. A general, comparative analysis of the federal and provincial

systems is also presented. Finally, a discussion of who actually pays the corporate capital tax, both for financial and non-financial corporations is presented.

How does the corporate capital tax, tax capital?

The primary objective of the corporate capital tax is to generate revenue from the capital employed by corporations within the applicable federal and provincial jurisdictions (Milner 1999). To do this, each jurisdiction must define the taxable capital base. This base includes a combination of instruments that are tangible forms of capital such as equity and debt.

The taxable capital items that constitute the capital base vary considerably across Canada. However, in broad terms, it includes the following: debt (long or short term), capital stock, retained earnings, contributed surplus, any other surplus, and non-deductible reserves (Haymes 1998: 2).

In many cases, the capital of one corporation will be invested in that of another. This is problematic for the administration of the corporate capital tax because it means a firm's capital could unintentionally be taxed twice. In order to prevent this double taxation, all intertwined investments of firms are subtracted from the capital base through what is called the “investment allowance” (Haymes 1998: 2). The generosity of this allowance varies across jurisdictions (Milner 1999).

Once the taxable capital base is determined, credits and deductions are permitted, depending on the jurisdiction. Often, a deduction will take the form of a flat, lump-sum amount of capital that can be subtracted from the taxable capital base. This reduces the tax burden of qualifying corporations and also excludes small firms, whose taxable capital base is less than the prescribed amount. Credits are usually allocated to industries that are deemed to warrant lower capital taxation of corporations.

As illustrated in figure 1, calculating “taxable capital” involves adding together all items that make up the gross capital of a firm and subtracting the appropriate deductions and credits. This “taxable capital” is then multiplied by the applicable corporate capital tax rate to yield the amount of corporate capital tax payable.

In order to clarify the calculation of corporate capital tax payable, consider the following fictitious example. ABC Corporation is located in Saskatchewan and has one subsidiary in British Columbia. It has the following amounts of gross capital:

- (1) \$20 million in shareholders’ equity;
- (2) \$40 million in long-term debt;
- (3) \$750,000 in retained earnings.

Of the \$40 million in long-term debt, \$5 million was invested in a subsidiary. ABC Corporation’s taxable capital will consist of the sum of (1), (2), and (3), which equals \$60.75 million, minus the investment allowance (\$5 million).³ Since the corporation is located in Saskatchewan, it will be allowed to deduct a further \$10 million from the gross capital amount,⁴ yielding taxable capital of \$45.75 million. The tax rate in Saskatchewan is 0.6%, which will result in corporate capital tax payable by ABC Corporation of \$274,500.

Corporate capital tax rates in Canada

The federal government and seven provincial governments currently levy the corporate capital tax on financial institutions and non-financial institutions; Prince Edward Island and Newfoundland levy the

tax only on financial institutions; Alberta taxes neither. The statutory tax rates are presented in table 1.

Federal corporate capital taxes

Corporate capital tax on “large corporations”

The Large Corporations Tax⁵ was introduced in 1989 and was implemented to “ensure that all large corporations pay at least a minimum amount of tax each year” (Federal Budget 1985; McQuillan and Cochrane 1996: 3). The tax rate has increased since its inception and has, along with its financial institutions equivalent, been a steady and increasing source of revenue for the federal government.

The federal government imposes a rate of 0.225% on corporation’s taxable capital over \$10 million (McQuillan and Cochrane 1996). Corporations are permitted to deduct the corporate income surtax (1.12% of corporate income tax payable) from their corporate capital tax payable, which means that the greater of the two taxes forms the tax liability (Haymes 1998). Besides firms with less than \$10 million in taxable capital, a number of other corporations can be exempted from the corporate capital tax (Milner 1999).⁶

The taxable capital base includes, but is not restricted to, the following items: the sum of the corporation’s capital stock, retained earnings, surpluses, reserves (one year’s worth), loans and advances, and any outstanding debt (*Master Tax Guide* 2000).⁷

Corporations are provided with an investment allowance, which attempts to include all amounts that are

Figure 1: Procedure for determining a corporation’s corporate capital tax payable

Preliminary Question: Is the corporation exempt from taxation?

Many jurisdictions have exemptions for industry-specific corporations, and for those that have capital of less than a basic amount.

(1) Determine the Taxable Capital Base using the following formula:

Gross Capital (debt + capital stock + retained earnings + contributed surplus + any other surplus + non-deductible reserves) MINUS Investment Allowance (investments in other firms) and Deductions and Credits (if applicable) EQUALS Taxable Capital

(2) Apply the appropriate rate and determine the corporate capital tax payable

Taxable capital TIMES corporate capital tax RATE = corporate capital tax PAYABLE

Source: Haymes 1998: 2; McQuillan and Cochrane 1996: 1; Ostfield (1992).

Table 1: Federal and Provincial corporate capital tax rates (July 2001)

	Non-Financial Rate (%)	Financial Rate (%)
Canada	0.225 ^A	1.0 / 1.25 / 1.40 ^B
British Columbia	0.30 ^C	1.0 / 3.0 ^D
Alberta	Nil	Nil ^E
Saskatchewan	0.6 ^F	0.7 / 3.25 ^G
Manitoba	0.3 / 0.5 ^H	3
Ontario	0.3	0.6 / 0.9 ^I
Quebec	0.64	1.28
New Brunswick	0.3 ^J	3
Nova Scotia	0.25 / 0.5 ^K	3
Prince Edward Island	Nil	3 ^L
Newfoundland	Nil	4 ^M

Notes

A A \$10 million taxable capital deduction is allowed.

B The lower rate is applied to firms with taxable capital of between \$200 and \$300 million; the middle rate is imposed on corporations with taxable capital of over \$300 million. The rate of 1.40% is the result of a 12% surcharge, which is applied to corporations with taxable capital of over \$400 million.

C This rate will be eliminated by September 1st, 2002.

D The lower rate applies to financial institutions with taxable capital of less than \$400 million, and the higher to those with over \$400 million.

E This tax was eliminated on April 1, 2001.

F The first \$15 million in taxable capital is deductible. This amount was increased from \$10 million in Saskatchewan's 2002/03 budget.

G The lower rate applies to financial institutions with taxable capital of less than \$400 million, and the higher to those with taxable capital over \$400 million. In addition, resource companies are subject to a 3.6% surcharge on the difference between total sales and the corporate capital tax liability.

H The lower rate applies to those corporations with total taxable capital between \$5 and \$10 million. The higher rate includes a surcharge of 0.2% on corporations with taxable capital of over \$10 million.

I The rates apply to various amounts of taxable capital. Due to the complicated nature of the rate schedules, it is best to refer to the Ontario Capital Tax Act for the exact application of the rates and bases.

J A \$5 million taxable capital deduction is allowed.

K If a corporation has taxable capital of \$5 million to \$10 million, it is entitled to a \$5 million dollar deduction, but are taxed at the higher rate. Those with over \$10 million in taxable capital are not entitled to the deduction but are taxed at the lower rate. Those with taxable capital of less than \$5 million are exempt from taxation.

L A \$2 million deduction is allowed.

M A \$5 million taxable capital deduction is allowed for those firms with total taxable capital of less than \$10 million.

Sources: *Provincial and Federal Capital Tax Acts; Federal and Provincial Budgets 2000 and 2001; Milner 1999; Treff and Perry 2000.*

invested in other firms that could unintentionally be taxed twice.⁸ The allowance provides a dollar-for-dollar reduction for qualifying capital that is invested in other corporations (McQuillan and Cochrane 1996: 8).

In order to provide corporations with an opportunity to spread the corporate capital tax liability over the business cycle, the government allows corporations to carry forward and carry back corporate capital tax liabilities. Generally, a corporation whose surtax exceeds its corporate capital tax payable may use the difference to reduce corporate capital tax liabilities incurred three years back or seven years ahead (Haymes 1998). For example, a corporation that has a \$1 million corporate capital tax bill and paid \$2 million as a result of the corporate income surtax, may eliminate the present corporate capital tax bill completely and use the difference of \$1 million to reduce the corporate capital tax liability incurred three years back or seven years forward. The result is an ability to smooth the corporate capital tax liability over a 10-year period.

Corporate capital tax on “large financial institutions”

The federal government introduced its first corporate capital tax in 1985 and imposed it on large financial institutions⁹ (McQuillan and Cochrane 1996). It was implemented as a temporary tax to fight the deficit but the definition of “temporary” was not clearly set out in the explanatory budget papers and the tax remains in effect even though the federal deficit has been eliminated. Both the applicable rate and the amount of revenue collected by the financial institutions corporate capital tax have increased since its implementation.

A variable corporate capital tax rate schedule, which is based on taxable amounts of capital,¹⁰ is used to determine the liability of financial institutions.¹¹ The first \$200 million in taxable capital is deductible (exempt) and corporations with less than this amount of capital are exempt.¹² Those with capital between \$200 million and \$300 million are taxed at a rate of 1%, while firms with \$300 million worth or more pay the slightly higher rate of 1.25% (*Master Tax Guide* 2000).

In determining total corporate capital tax payable, financial institutions corporate income tax payable is deducted from the corporate capital tax payable. This is similar to the process used by non-financial institutions that are allowed to use the corporate income surtax as a credit. It is important to note that financial in-

stitutions pay both the large corporations tax and the prescribed financial institutions corporate capital tax. The carry-backs and carry-forwards are used in the same way as they are with the large corporations tax.

In calculating corporate capital tax payable, financial institutions can deduct an investment allowance that is made up of any investments in related financial institutions other than those that are exempt from the large corporations tax. The allowance is applied in the same manner as with the large corporations tax.

Provincial corporate capital taxes

Presently, all provinces, with the exception of Alberta, levy a corporate capital tax on non-financial institutions, financial institutions or both (see table 1). The first corporate capital tax was introduced in Quebec in 1947 and, by 1982, Ontario, British Columbia, Manitoba, Saskatchewan, and Newfoundland had all introduced corporate capital taxes (Milner 1999). New Brunswick and Nova Scotia introduced corporate capital taxes in the late 1980s and Alberta did the same in 1990.

Corporate capital tax on “large corporations”

Table 1 contains the statutory corporate capital tax rates for all of the provinces for 2000/01. Corporate capital taxes on non-financial institutions are currently levied by British Columbia,¹³ Saskatchewan, Manitoba, Ontario, Quebec, New Brunswick, and Nova Scotia (*Provincial Budgets* 2001). The highest statutory rate is assessed by Saskatchewan at 0.50% and the lowest by Nova Scotia at 0.25% (*Provincial Budgets* 2001).

Saskatchewan is the only province to use a surtax, which it imposes at a rate of 3.6% on the capital of large resource corporations, but it also provides the most generous deduction (exemption) at \$15 million (raised from \$10 million in the 2002/03 budget). Ontario, Quebec, and British Columbia, all use variable deduction schedules that do not have a minimum deduction (exemption) level (Milner 1999).¹⁴

Corporations are allowed to deduct the corporate capital tax payable from the taxable income used to calculate corporate income tax payable (Haymes 1998). For example, if a corporation has a provincial corporate capital tax bill of \$10 million and income before taxes of \$100 million, its net taxable income for income tax

purposes would be \$90 million (Haymes 1998: 7). This is, in fact, the opposite of the federal system, where the corporate income surtax payable is deductible from the corporate capital tax payable. The provincial systems do not provide a mechanism to smooth corporate capital tax liabilities over time.

Because of the number of provinces, it is difficult to provide an exact, comprehensive definition of the corporate capital tax base. However, in general, most provincial corporate capital tax bases will consist of capital stock, earned capital and any other surplus, and reserves (Milner 1999). Each of these categories consists of specialized components.¹⁵ First, capital stock generally refers to the corporation's share capital, usually a combination of common, preferred, and special category shares. Special regulations are provided to determine the taxability of each item. Second, earned surplus or retained surplus basically refers to the corporation's accumulated annual profits, capital and other gains, and any other items of income available for distribution as dividends. And, last, all reserves, whether created from income or otherwise, are regarded as reserves to be included in the computation of taxable capital (Milner 1999).

From the taxable capital base, most provinces provide a flat, lump-sum amount that can be deducted before the tax rate is applied. This sum varies across jurisdictions, from a high of \$15 million in Saskatchewan to zero in Quebec and British Columbia.

All provinces provide corporations with access to an investment allowance to ensure that a corporation's capital that is invested in another corporation is not taxed twice. The only difference in the generosity of the allowance across provinces is how components in the formula are defined (Ostfield 1992). Another common deduction is the discount on the sale or issue of shares. This discount can be deducted from taxable capital. Last, many mining-intensive provinces allow the deduction of deferred exploration and development expenses (Milner 1999). The form of this deduction varies from province to province.

Corporate capital tax on "large financial institutions"

In Canada, nine provinces levy a distinct corporate capital tax on financial institutions. The rates applicable to financial institutions are higher than those for non-financial institutions (*Provincial Budgets 2001*).

Many provinces use two different rates that apply to corporations with greater than, or less than, a certain amount of taxable capital. For example, in Saskatchewan a financial corporation with less than \$400 million in taxable capital faces a rate of 0.7% while those with over \$400 million are taxed at 3.25% (*SK Budget 2000*). In 2000/01, the highest statutory rate imposed on the capital of a financial institution was in Newfoundland (4.0%) while the lowest was in Ontario (1.12%) (*Provincial Budgets 2001*).

The taxable capital base varies depending on the type of financial institution and in what province it is located. However, in general, the following items are included: capital stock, contributed surplus, retained earnings, and general reserves (Milner 1999).¹⁶ An investment allowance is provided in all provinces and is implemented in the same manner as it is for non-financial institutions. No carry-forwards or carry-backs are provided under this category of taxation.

Comparing the federal and provincial corporate capital tax systems

From the discussion of the nine provincial and the federal corporate capital tax systems, it is apparent that some important similarities and differences exist. This section briefly highlights both the similarities and the differences.

(1) Insensitivity to profits

Both the federal and provincial governments use corporate capital taxes that are, by design, insensitive to profitability. Put simply, the taxable capital base is not made up of components that are affected by short-term fluctuations in corporate profits.

This insensitivity to profit is one of the concerns that many have raised about the corporate capital tax (Kesselman 2000; Ostfield 1992; Mintz 2001). Profits are usually a good indicator of corporations' financial health and a tax that is imposed regardless of profitability could destabilize corporations that are suffering from low profitability or even financial losses.

(2) Direction of deductions

The most obvious difference between the federal and provincial systems is the way in which they allow corporations to deduct corporate income tax (and/or sur-

tax federally) and corporate capital tax payable from one another. The provincial systems allow the corporate capital tax payable to be deducted from the pre-tax corporate income that is used to determine corporate income tax liabilities. Conversely, the federal system, loosely speaking, allows the corporate income payable or the corporate income surtax payable to be deducted from the corporate capital tax payable.

(3) Smoothing the corporate capital tax liability

The federal government uses a 10-year carry-over system to allow corporations to spread the corporate capital tax liability over the business cycle. The provinces do not have an equivalent smoothing mechanism. The implication, then, is that the provinces are less sensitive to corporations' financial situations when collecting corporate capital tax revenues.

(4) Investment allowance

The investment allowance is more generous at the federal government level than at the provincial level. The federal government provides a dollar-for-dollar allowance on any capital that is invested in other firms, while the provinces base it on the following formula:

$$\begin{aligned} & (\text{total eligible investments} / \text{total assets}) \\ & * (\text{capital}) = \text{investment allowance} \end{aligned}$$

This method is inferior because it is quite possible that corporations will not receive a fair investment allowance. Many corporations often have more total assets than capital so the allowance will be lower than the investment (McQuillan and Cochrane 1996).

Who pays the corporate capital tax?

Unfortunately, business taxes are generally misunderstood in Canada and, indeed, in most western nations. The prevailing wisdom is that corporations (i.e. business) actually bear the burden of such taxes. The reality is quite different: the burden of business taxes ultimately falls on individuals rather than on businesses. The Carter Commission,¹⁷ one of Canada's most important inquiries into taxation, concluded that businesses ultimately do not bear the burden of taxation. Rather, they simply pass them on to individuals (owners, employees, or customers). More specifically, business taxes are passed on to customers in the form of higher prices, to shareholders and owners in

the form of lower returns, and to employees in the form of lower wages.

There is, however, an important reason for assessing business taxes. The recent report of the Technical Committee on Business Taxation succinctly summarized this rationale:

(B)ecause businesses organize so much of our economic activity, there are circumstances that require them to be taxed so that the overall tax system is more efficient, fairer and easier to administer. One of the primary roles of business taxation, and particularly of the corporate income tax, is to help ensure that all income of individuals is fully taxed, including corporate income accruing to their benefit. (In the absence of the corporate income tax, individuals could avoid or defer the payment of income tax by leaving income undistributed in corporations in which they are shareholders.) (Technical Committee on Business Taxation 1997).

In other words, business taxes are incorporated into the tax mix to ensure that all sources of income are taxed rather than from some notion that corporations pay taxes.

There is an additional quirk associated with corporate capital taxes in Canada due to the presence of a sector-specific corporate capital tax, namely the financial institutions corporate capital tax. As explained previously, financial institutions are taxed more heavily by a sector-specific corporate capital tax levied in addition to the general corporate capital tax. Kevin Dancy of Coopers and Lybrand completed one of the more thorough analyses of the corporate capital tax imposed on financial institutions in Canada for the *Task Force on the Future of the Canadian Financial Service Sector*¹⁸ and concluded that corporate capital taxes on financial institutions:

- increase the cost of raising new capital by roughly 1.5%;
- discourage greater levels of capital in the financial services sector; greater levels of capital translates into greater safety and soundness;
- raises the cost of loans by as much as 12 to 13 basis points, and;

- act as a barrier to entry, thus reducing potential and current competitiveness (Dancey 1998).

This is an important finding since it means that all customers of financial institutions and particularly borrowing customers bear the cost of the financial institutions corporate capital tax. This is critical to understand since there is an emerging trend in the use of corporate capital taxes to relieve non-financial corporations from

paying corporate capital taxes while maintaining the financial institutions-specific corporate capital tax.

Like all business taxes, the burden of the corporate capital tax—both the general corporate capital tax and that specific to financial institutions—is borne by ordinary citizens through higher prices for goods and services, lower wages, and reduced rates of return on savings and investments.

2. Evaluating the corporate capital tax

This chapter of the report provides a broad evaluation of the corporate capital tax in Canada. Given that Canada uses this tax widely while competing nations do not, it is important to evaluate the tax critically and determine if it is an effective way to raise government revenue.

Canada is almost alone in using the corporate capital tax: it is one of only three countries in the OECD that levies a direct tax on the capital of corporations at the federal level (Haymes 1998; McQuillan and Cochrane 1996). Germany and Japan, the other two OECD countries that impose corporate capital taxes, do so to a much lesser extent. Germany, for instance, levies a corporate capital tax on the net assets of corporations in addition to a municipal trade tax (Haymes 1998). Japan imposes a tax on the fixed assets of its corporations. The United States does not assess a corporate capital tax at the federal level although several American states levy a minor tax approximately equivalent to a corporate capital tax (Haymes 1998).¹⁹ Canada's corporate capital taxes are levied at the highest rates by far, extracted from the most broadly defined bases, and administered with the greatest degree of complexity.

Evaluation

The framework that economists have traditionally used to evaluate taxes is based on three intertwined principles: efficiency, fairness (or equity), and simplicity (Boadway *et al.* 1987; Emes *et al.* 2001; and Kesselman 1999, 2000).²⁰

(1) Efficiency

Efficiency, in the broadest sense, requires that an economy's resources are allocated to their best use and thus produced at the least cost (Boadway and Kitchen 1999: 73). A market is said to be efficient when the price of the last unit of output sold equals the cost of producing that unit of output. The principle of efficiency, as applied to taxation, requires that tax revenues be raised in the least distortionary manner, thus allowing the maximization of economic growth.

Taxes are problematic for market efficiency because they can fundamentally alter the optimal demand for, and supply of, investment and consumption goods and capital and labour services. In other words, they can distort the natural market forces that ensure the optimal supply of, and demand for, goods and services. One example of this is when a government raises personal income taxes. This action will increase personal income tax paid, which will lead to a reduction in purchasing power (consumption distortion) and a percentage decrease in the amount saved (investment distortion). As well, a lower amount of savings will reverberate into a reduction in the investment in productive resources (capital distortion), less capital will subsequently result in a reduction in the number of workers demanded (labour distortion). Taxes have a unique ability to distort the allocation of resources in all areas of the goods and services markets.

Measurement of tax efficiency Economists are aware that taxes interfere in the movement of resources to their first-best use in an economy. This fact has motivated them to develop two theoretical measures that help to determine the relative burden of employing different types of taxes to raise revenue.²¹

Social cost of taxation The first theoretical measure is the social cost of taxation, which measures directly the impact a tax change has on the welfare of society. Generally, social cost is inversely related to market output: the more a tax reduces market output, the higher the drop in the welfare of a society's people and the greater the increase in social cost. For example, a tax on cigarettes has a smaller social cost than most taxes because people's post-tax demand for cigarettes changes only slightly. The result is an insignificant reduction in market output. However, a tax on capital will have a high social cost, not only because small changes in its rate can cause large capital disinvestments but also because capital may move to jurisdictions with a (now) higher post-tax rate of return. Market output may be greatly affected. Overall, taxes that minimize market output disruptions have the lowest social cost.²²

Marginal efficiency cost of taxation The marginal efficiency cost (MEC) of taxation measures the incremental cost of raising an additional dollar of tax revenue from an already existing tax (Ballard *et al.* 1985). For example, let us say that property tax already exists with an MEC of 21¢. If the government wants to raise another dollar of property tax revenue, it knows that on top of that \$1.00, it will, at the same time, impose an additional cost of 21¢ on society. It should be noted that this measure is sensitive to market output: the greater the decrease in market output, due to an increase in the tax rate, the higher the MEC.²³

Although the social cost measure is important in understanding the overall efficiency costs of a tax on society, it is the MEC measure that will take an overriding importance in our analysis. The concept of social cost shows how the substitution of a distorting tax with a non-distorting tax can benefit society as a whole. Since policy makers do not have the option of this form of substitution, social cost is not as useful a tool for policy analysis (Diamond and Mirlees 1971b). Also, the MEC measure is much more robust. It can show policy makers how much distortion is present given a system's current tax mix and provide an understanding of how a reconfiguration of the tax mix can affect the overall economic efficiency of an economy.

MEC of corporate capital taxes Due to the rarity of corporate capital taxes in industrialized countries, no studies to date have measured the specific marginal efficiency cost of corporate capital taxes in Canada. However, taxes levied on the same types of activities or entities, but in slightly different ways, misallocate resources in similar ways. In other words, these taxes are comparable in terms of their MEC. In order to estimate the MEC of the corporate capital tax, it is imperative that we find a comparable tax instrument that has been subjected to an empirical analysis to determine its MEC.

The logical candidate for this analysis is the capital gains tax. It is comparable because it taxes the same capital as the corporate capital tax at a different time in the investment process. The capital gains tax is imposed when a shareholder sells a capital asset for a gain (or loss) that is not included in the tax base under any other definition of income (Boadway and Kitchen 1999; Grubel 2000, 2001). Similarly, the corporate capital tax is imposed on the capital that will eventually

become available for capital gains taxes in the future. The corporate capital tax is a more direct tax on the ability of capital to be productive. So, both taxes reduce the overall rate of return on capital investment and, therefore, reduce the incentive to invest, causing resources to be moved to less productive uses. The capacity of both taxes to misallocate resources in this way is the primary rationale for asserting that their MECs should be similar.

Another reasonable candidate for comparison is the corporate income tax. In general terms, the corporate income tax and the corporate capital tax reduce the overall amount of capital investment in the economy by lowering the saver's post-tax rate of investment return. In addition, both taxes discourage foreign corporations from investing in Canada. Since both taxes misallocate resources in related ways, their MECs should also be comparable.

MEC calculations & comparisons Throughout studies of the MEC of taxation, the common finding is that business taxes are much less efficient than those with a labour income or consumption base. There are two core studies referred to when discussing MECs in Canada. The first (table 2) presents the MECs calculated by the Federal Ministry of Finance (1997) for select Canadian taxes. The second set of estimates (table 3) are drawn from a study by Jorgensen and Yun (1991). This study calculates the MEC of various taxes before-and-after the implementation of the 1986 tax reforms in the United States. These values are among the most widely cited measures of the marginal efficiency costs of taxation.

Both MEC estimates show that considerable efficiency gains can be achieved by simply reconfiguring the tax mix to move away from income and capital bases and toward consumption bases. In fact, table 2 indicates that a shift from the corporate income tax base to a consumption (sales) tax base could yield a real economic gain of \$1.38 per dollar of revenue raised. Given the similar way that the corporate capital tax and the corporate income tax misallocate corporate resources, it is clear that movement away from the corporate capital tax will enhance the efficiency and growth of the Canadian economy.

The efficiency gain associated with the movement toward lower MEC tax mixes has encouraging implica-

Table 2: Estimates of marginal efficiency cost (MEC) for select canadian taxes

Tax	MEC (In CDN\$)
Corporate Income Tax	\$1.55
Personal Income Tax	\$0.56
Payroll Tax	\$0.27
Sales Tax	\$0.17

Source: Organisation for Economic Cooperation and Development 1997.

tions for fiscal policy in Canada. A revenue-neutral shift toward more efficient taxes will allow government to maintain its spending levels and will spur additional growth in the economy.

The high MEC associated with business taxes in general and capital-based taxes in particular strongly suggests that the corporate capital tax fails to achieve relative efficiency.

(2) Fairness

The principle of fairness,²⁴ as it applies to tax policy, has two components: horizontal and vertical. Horizontal fairness requires that individuals with similar incomes pay similar or proximate tax burdens. In the case of the corporate capital tax, horizontal fairness or equity requires that corporations with a similar capital base face proximate corporate capital taxes. Vertical fairness or equity requires that individuals or corporations with higher incomes face higher tax burdens.

The main concern with a corporate capital tax in terms of fairness is whether or not it achieves horizontal fairness: firms with similar amounts of capital face similar corporate capital tax burdens. As the following brief discussion will illustrate, there are a number of deficiencies within Canada's corporate capital tax regime that result in the unfair treatment of firms depending on size, industry, and location.

Varying definitions of "large corporation"

Corporate capital taxes are used to tax the capital of large corporations (Haymes 1998). The term "large" is implicitly defined by the minimum exemption that is applied to total taxable capital in any particular juris-

Table 3: Estimates of marginal efficiency cost (MEC) for various taxes

Tax	MEC (in US\$)
Capital Income Taxes (individ. & corp.)	\$0.924
Corporate Income Tax	\$0.838
Individual Income Tax	\$0.598
Labour Income Tax	\$0.482
Sales Tax	\$0.256
Property Taxes	\$0.174

Source: Jorgenson and Yun 1991.

diction. For example, in Saskatchewan the exempted amount of capital is \$10 million (Milner 1999). This means that any corporation with less than \$10 million in capital is deemed to be small and thus exempt from the corporate capital tax.

Unfortunately, exemptions and the definition of what constitutes a large corporation vary considerably from jurisdiction to jurisdiction (Milner 1999). In British Columbia and Quebec, for example, there is no exemption. In Manitoba, on the other hand, all corporations with less than \$5 million in taxable capital are exempt from the corporate capital tax. These varying definitions of what constitutes a "large corporation" mean that firms with equivalent capital are not treated equally across jurisdictions.

Sector-specific corporate capital taxes

As shown in table 1, financial institutions are taxed more heavily by the corporate capital tax system than non-financial institutions regardless of the jurisdiction. This heavier taxation comes in the form of higher corporate capital tax rates and broader corporate capital tax bases.

The argument provided by government for this higher rate of taxation on financial institutions is that they owe society and should pay a "fair share" because of their profitability and overall financial success.²⁵ This argument is flawed for several reasons. One, banks and trust companies are owned by shareholders, ordinary people who invest part of their income in the hopes of earning an acceptable rate of return on their investments (Emes 2001). A tax on the capital of the firm reduces shareholders' returns and therefore lowers their overall welfare. As discussed above, business

taxes are not only paid by the shareholders or owners of a firm but also by the customers of a company in the form of higher prices and by the employees of the company in the form of lower wages. Thus, the ultimate bearer of the financial services-specific capital tax, like any other tax, is the customers, the owners, and the employees.

Second, the applicable corporate capital tax rates for financial institutions are often increased during recessions when governments are suffering from declining revenues. The most recent example of this was during the recession of the early 1990s: British Columbia, Alberta, Ontario, Quebec, Prince Edward Island, and the federal government all increased their financial institutions corporate capital tax rates (*Provincial Budgets 1990–1993; Federal Budgets 1990–1993*). This varying of the applicable rates by government in response to the business cycle has nothing whatsoever to do with making financial institutions pay “their fair share”; it is rather a political means by which governments attract revenue from society.

Bias inherent in the corporate capital tax system

Corporate capital taxes also fail the test of fairness by placing a higher burden on industries whose activities are more capital-intensive than others. These types of industries tend to have high start-up costs, heavy initial investment requirements, and no income tax liabilities (McQuillan and Cochrane 1996). Growth-enhancing industries like software, biotechnology, and communications are all characterized by these financial states and are taxed more heavily by the corporate capital tax than other corporations of equal size and worth (McQuillan and Cochrane 1996). The corporate capital tax fails the test of fairness on a number of different measures including varying rates and bases, different definitions of applicability, and sectoral biases.

(3) Simplicity

Simplicity refers to the cost to the government of collecting the tax as well as the costs incurred by businesses and individuals in complying with the tax system. The principle of simplicity requires that both sets of costs be minimized. It can also generally refer to society’s ability to adequately understand a tax.

Complexity of the corporate capital tax

The focus of our evaluation of corporate capital tax simplicity focuses on the administrative burden

placed on corporations rather than on the costs incurred by government in collecting and maintaining the corporate capital tax system. The main reason for this focus is the lack of specific information about the costs incurred by governments in collecting corporate capital taxes apart from other business taxes. This should not be seen as an indication that governments achieve simplicity (cost minimization) in their administration of the corporate capital tax but rather that there is not enough information available to assess these costs adequately.

Administrative complexity

As McQuillan and Cochrane stated in their working paper for the Technical Committee on Business Taxation: “Capital taxes have the appearance of being simple to understand and administer in comparison to income taxes. In reality, capital taxes are becoming increasingly complex” (1996). This increasing complexity is due to the inherent administrative complexity of taxing capital and to the lack of uniform interpretation of the corporate capital tax legislation both within and across jurisdictions.

The present structure of the corporate capital tax requires corporations to calculate total corporate capital tax payable by determining the taxable capital, investment allowance, and applicable exemptions, deductions, and credits. McQuillan and Cochrane (1996) determined that 103 items must be accounted for in determining corporate capital tax payable in a single jurisdiction.

The determination of the applicability of these taxable items would be straightforward if there were generally accepted definitions. However, each item is defined in the applicable Capital Tax Act, which are subject to interpretation. As a result, as Milner writes, “from time to time, [a] number of inconsistencies in interpretation arise, leading to a certain amount of confusion and making an accurate application of the requirement virtually impossible” (1999: 3). Therefore, the complexity is not just in the breadth of taxable items but also in the amount of time it takes corporations to understand how the items are interpreted by each jurisdiction’s tax authority.

Many large corporations have subsidiary companies in other corporate capital taxing jurisdictions. Since the taxable items are not uniform across jurisdictions

this adds another level of administrative complexity. As Milner states, “provinces with certain or even identical wording in certain aspects of their acts or in instances where acts are silent on certain points, may interpret the application of the Law quite differently” (1999: 2).

Compliance costs—tax minimization not growth maximization

Throughout the 1980s and up until the recession of the early 1990s, corporations were not overly concerned about the steady increase of corporate capital tax rates on their overall financial performance. Corporations were generally earning income during this period and directed their tax planners to focus mainly on the management and strategic minimization of taxable corporate income. In a sense, the corporate income tax overshadowed the rising burden of corporate capital taxation during this period (Tobias and Tunney 1994).

When the 1990 recession began and taxable corporate income fell, the full burden of corporate capital taxes *insensitive* to income were felt. Corporations used the carry-forward-and-back provisions to spread the corporate capital tax liability across time but were inevitably left with large corporate capital tax bills that inhibited their financial recovery (Tobias and Tunney 1994). The result was a new interest among corporate tax planners and management in methods to reduce corporate capital tax liabilities by altering business practices and financial structures.

Ostfield (1992) and Tobias and Tunney (1994) outline the opportunities available to tax planners for minimizing corporate capital tax liabilities. These generally involve a combination of the following: minimizing the amount of taxable capital; increasing the investment allowance; and moving operations to a jurisdiction with lower corporate capital tax rates. Canadian corporations have increasingly used valuable corporate resources to pay for advisors to minimize their corporate capital tax liability and have deviated from their optimal productive behaviour in order to avoid corporate capital taxes.

The corporate capital tax fails to achieve simplicity (cost minimization) and, in fact, creates a strong incentive for using tax planning and other measures to minimize the incurrence of this tax.

Conclusion

The corporate capital tax is a poor way to raise revenues for government because it violates the principles of fairness, simplicity, and efficiency, and ultimately impedes economic growth.

The MEC literature provides evidence that, for every additional dollar of corporate capital tax revenue raised, society incurs a relatively high cost in terms of efficiency and growth. Specifically, the federal government estimates that corporate income taxes (comparable to corporate capital taxes in cost) have a marginal efficiency cost of \$1.55 compared with an MEC of 17¢ for sales taxes. Similarly, Jorgenson and Yun (1991) estimate that corporate income taxes in the United States have an MEC of 84¢, considerably higher than the MECs estimated for sales taxes and property taxes: 26¢ and 17¢, respectively. A move away from corporate capital taxes and, business taxes in general, would enhance efficiency and thus economic growth.

The tax is not fair because it is imposed in a horizontally inequitable manner and is biased against capital-intensive industries comprising firms with high start-up costs, heavy initial investment, and no income tax liability.

The corporate capital tax has become increasingly burdensome and is generally considered to be administratively complex. The reason for this is the inherent difficulty of taxing capital and the lack of uniform interpretation of the corporate capital tax legislation both within, and across, jurisdictions. In addition, because of the increasing burden of the tax, many companies are spending a great deal of time and resources attempting to find ways to reduce this tax’s liability through increased tax planning.

One of the fundamental prerequisites for economic growth is capital accumulation. Since the corporate capital tax lowers the rate of return on capital investment, the supply of capital is systematically reduced. Therefore, the existence of the corporate capital tax impedes the accumulation of capital and slows economic growth.

The corporate capital tax is an inferior instrument for collecting tax revenue. The existence of the tax lowers the economic welfare of society.

3. Ranking the use of the corporate capital tax in Canada

This section of the report ranks the federal and provincial governments according to the amount of corporate capital tax collected. The first portion of this section introduces the measurements and rankings for each jurisdiction. The section ends with a discussion of the broad trends found in corporate capital tax usage over the last 12 years (1989/90–2000/01).²⁶

Four ratios are used to rank the jurisdictional usage of the corporate capital tax over the last 12 years: corporate capital tax as a percent of (1) own-source revenue, (2) business profits, (3) gross domestic product (GDP), and (4) corporate income tax.

(1) Corporate capital tax as a percent of own-source revenue

This measures the proportion of total revenues collected in a particular jurisdiction (i.e. own-source revenue) in the form of a corporate capital tax, both financial and non-financial. Put simply, it is the percentage of total revenues collected, excluding transfers, that are generated by corporate capital taxes. It captures how dependent a jurisdiction is on corporate capital tax revenue to fund government activities relative to other, potentially less costly (in terms of MEC), sources of revenue.

Current year analysis

As depicted in figure 2 and summarized in table 4, Saskatchewan was the leader in corporate capital tax revenue as a percentage of own-source revenues collected in 2000/01. Corporate capital taxes constituted 5.40% of provincial own-source revenues collected in Saskatchewan. In other words, for every \$1 of own-source revenue collected in Saskatchewan, 5.4¢ came from corporate capital taxes.

Quebec ranked second with 3.48% of its own-source revenues coming from corporate capital taxes, nearly two percentage points less than in Saskatchewan. Quebec committed itself to reducing its non-financial corporate capital tax to 0.3% by 2007 in its 2001 Budg-

et. The exact plans of how the reductions will be made were left vague. Ontario, Manitoba, and British Columbia ranked third, fourth, and fifth, respectively.

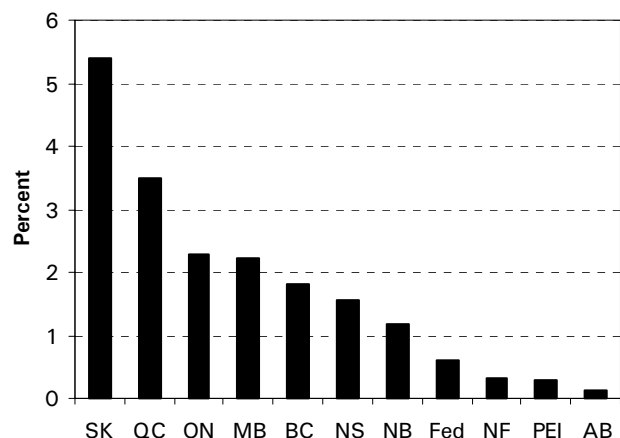
At the opposite end of the spectrum, Alberta ranked last in the percentage of its own-source revenues provided by corporate capital taxes. For every \$1 of own-source revenue collected in Alberta, only 0.14¢ came from corporate capital taxes.

Historical analysis

The rankings and percentage of own-source revenues collected from corporate capital taxes over the last 12 years are contained in table 4. Over the 12-year period from 1989/90 to 2000/01, Saskatchewan and Quebec maintained first and second positions, exclusively, in terms of the percent of own-source revenue provided by corporate capital taxes.

Alberta frequently ranked last, indicating the lowest reliance on corporate capital taxes as a percent of own-source revenues over the 12-year period. The federal government along with the Atlantic provinces generally also ranked relatively low, although both Nova Scotia and New Brunswick moved up in the rankings after 1997. British Columbia experienced a significant upward shift after 1992.

Figure 2: Corporate capital tax as a percent of own-source revenue, 2000/01



(2) Corporate capital tax as a percent of business profits

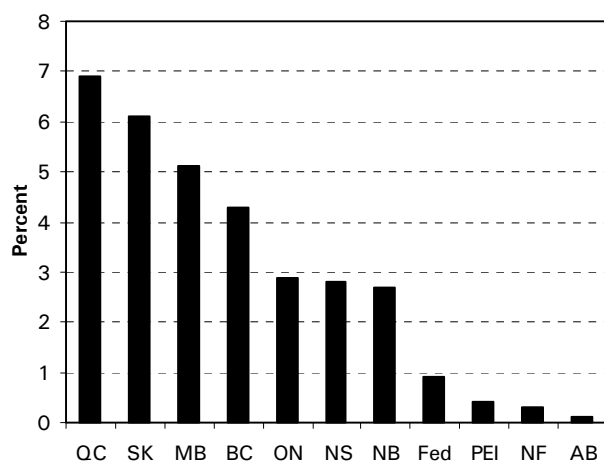
This indicator measures the amount of corporate capital tax collected compared to the profits generated by corporations in a specific jurisdiction. It is useful because it provides an indication of how much corporate capital tax is extracted from business profits as the economy goes through varying economic conditions. It further provides a measure of the burden placed on corporate cash flows and corporate resources by the corporate capital tax. The results are shown in figure 3 and table 5.

Current year analysis

As depicted in figure 3, Quebec's corporate capital tax extracted the greatest amount of revenue as a percent of business profits earned in the province. Corporate capital taxes collected in Quebec represented 6.9% of all business profits recorded in 2000/01. Quebec was followed closely by Saskatchewan with corporate capital taxes representing 6.1% of business profits. Manitoba occupied third position with corporate capital taxes representing 5.1% of business profits; British Columbia was fourth with 4.3%.

At the other end of the scale, Alberta was ranked last with corporate capital taxes representing 0.1% of business profits earned in the province. Newfoundland ranked ninth, with corporate capital taxes at 0.4% of business profits, and Prince Edward Island was tenth, with corporate capital taxes at 0.3% of business profits.

Figure 3: Corporate capital tax as a percent of business profits, 2000/01



Historical analysis

Over the last 12 years, as table 5 shows, Quebec ranked first in every year but one, 1999/2000. Quebec did, however, experience a drop in the percent of business profits taken in corporate capital taxes between 1993/94 and 1994/95.

Saskatchewan ranked second in every year but one (1999/2000) in which it was ranked first for the amount of corporate capital tax revenues collected compared to business profits. Manitoba usually ranked third.

Alberta, Prince Edward Island, Newfoundland, and New Brunswick generally extracted the least amount of corporate capital tax revenues relative to business profits over this period. Alberta ranked last in every year but two, 1990/91 and 1991/92.

British Columbia experienced the most pronounced change in rankings over the period. Its ranking increased from last (eleventh in 1990/91 and 1991/92) or second last (tenth in 1989/90) to third or fourth position for the years between 1992/93 and 2000/01.

(3) Corporate capital tax as a percent of gross domestic product (GDP)

The third indicator measuring corporate capital tax usage in Canada compares the amount of corporate capital tax revenues collected with the size of the economy. It is a measure of the burden corporate capital taxes place on the economy, as measured by GDP. Figure 4 graphically illustrates the results for the current year and table 6 contains the historical results for the last 12 years.

Current year analysis

As with the two previous measures, Saskatchewan and Quebec dominate the top of the rankings. Saskatchewan ranked first in its use of corporate capital taxes relative to the size of the economy (GDP) with corporate capital taxes representing 0.98% of GDP in 2000/01. Quebec followed in second position with corporate capital taxes representing 0.73% of GDP. Manitoba (0.40%) and British Columbia (0.34%) ranked third and fourth, respectively.

Table 4: Corporate capital tax as a percent of own-source revenue and rank by jurisdiction, 1990–2001

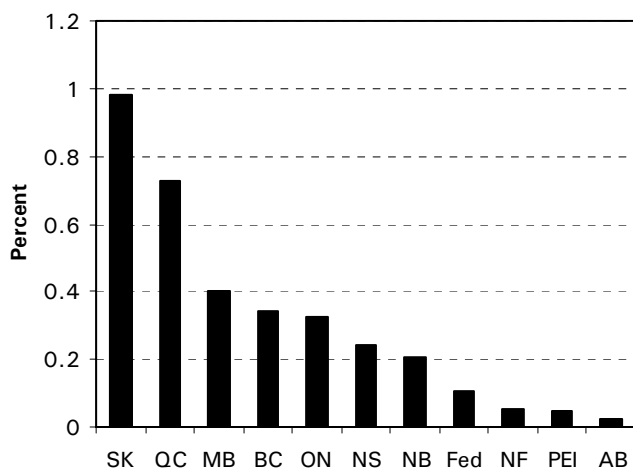
	89/90		90/91		91/92		92/93		93/94		94/95		95/96		96/97		97/98		98/99		99/00		00/01	
	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%
Fed	9	0.11	6	0.62	5	0.92	6	0.91	6	0.84	6	0.80	6	0.70	6	0.69	8	0.61	8	0.67	8	0.63	8	0.59
BC	10	0.03	11	0.07	11	0.09	4	1.73	3	2.10	4	1.94	5	1.78	5	1.81	5	1.79	4	2.12	5	2.07	5	1.80
AB	11	0.00	9	0.31	9	0.35	11	0.30	9	0.35	11	0.28	10	0.24	11	0.23	11	0.21	11	0.20	11	0.18	11	0.14
SK	2	2.26	2	2.59	2	2.96	2	3.01	1	3.69	1	4.03	1	4.31	1	4.48	1	4.76	1	4.16	1	4.87	1	5.40
MB	4	1.72	3	1.76	3	1.73	5	1.58	5	1.52	5	1.77	3	1.98	3	2.07	3	2.21	5	2.02	3	2.27	4	2.23
ON	3	1.91	4	1.64	4	1.46	3	1.83	4	1.67	3	1.99	4	1.91	4	2.01	4	2.15	3	2.14	4	2.26	3	2.29
QC	1	3.30	1	3.18	1	3.03	1	3.20	2	3.22	2	3.15	2	3.53	2	3.98	2	3.92	2	3.67	2	3.52	2	3.48
NB	5	0.37	7	0.38	8	0.40	9	0.34	10	0.30	9	0.30	9	0.27	10	0.25	7	1.07	7	1.01	7	1.10	7	1.19
NS	6	0.36	5	0.77	6	0.69	7	0.55	7	0.52	7	0.53	7	0.48	7	0.44	6	1.46	6	1.69	6	1.57	6	1.55
PEI	7	0.24	8	0.35	7	0.44	8	0.38	8	0.36	8	0.35	8	0.32	8	0.30	9	0.31	10	0.30	10	0.30	10	0.28
NF	8	0.21	9	0.31	10	0.30	10	0.32	10	0.30	9	0.30	11	0.23	9	0.28	9	0.31	9	0.32	9	0.34	9	0.33

Source: Statistics Canada, Public Institutions Divisions, FMS Data 1989-2001; calculations by the authors.

Table 5: Corporate capital tax as a percent of business profits and rank by jurisdiction, 1990–2001

	89/90		90/91		91/92		92/93		93/94		94/95		95/96		96/97		97/98		98/99		99/00		00/01	
	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%
Fed	9	0.2	6	1.8	5	3.7	6	3.8	6	2.7	6	1.7	6	1.3	6	1.3	8	1.1	8	1.3	8	1.1	8	0.9
BC	10	0.1	11	0.3	11	0.5	4	8.6	3	9.5	4	6.1	4	5.2	4	5.7	4	4.9	3	6.2	4	5.0	4	4.3
AB	11	0.0	10	0.6	10	0.9	11	0.8	11	0.7	11	0.4	11	0.3	11	0.3	11	0.2	11	0.3	11	0.2	11	0.1
SK	2	7.1	2	9.0	2	12.1	2	11.6	2	11.8	2	7.9	2	7.5	2	7.1	2	7.1	2	7.9	1	7.9	2	6.1
MB	3	4.1	3	5.9	3	8.9	3	9.1	4	8.7	3	7.1	3	7.5	3	6.1	3	5.1	4	5.4	3	5.5	3	5.1
ON	4	2.9	4	3.6	4	4.1	5	5.0	5	4.0	5	3.2	5	2.8	5	2.9	6	2.9	6	3.0	6	2.8	5	2.9
QC	1	7.3	1	10.4	1	14.2	1	15.6	1	12.9	1	8.0	1	8.3	1	9.5	1	9.1	1	8.6	2	7.5	1	6.9
NB	5	0.8	8	1.2	7	1.9	9	1.8	9	1.5	9	0.9	10	0.6	10	0.6	7	2.8	7	2.6	7	2.5	7	2.7
NS	6	0.7	5	2.4	6	2.9	7	2.4	7	2.0	7	1.5	7	1.2	7	1.1	5	3.2	5	4.1	5	3.2	6	2.8
PE	8	0.5	9	1.0	9	1.5	10	1.3	10	1.2	10	0.8	9	0.7	9	0.6	10	0.7	10	0.5	10	0.5	9	0.4
NF	7	0.6	7	1.3	8	1.6	8	2.3	8	1.9	8	1.1	8	0.8	8	1.0	9	1.0	9	0.8	9	0.6	10	0.3

Source: Statistics Canada, Public Institutions Divisions, FMS Data 1989-2001; calculations by the authors.

Figure 4: Capital tax as a percent of GDP, 2000/01

Alberta was ranked last with corporate capital taxes representing a mere 0.03% of GDP in 2000/01. Newfoundland (ninth) and Prince Edward Island (tenth) followed closely, with corporate capital taxes were approximately 0.05% of GDP. The federal government also ranked relatively low, eighth in 2000/01.

Historical analysis

Saskatchewan and Quebec consistently ranked the highest in terms of corporate capital taxes as a percent of the economy over the entire period from 1989/90 to 2000/01. Manitoba consistently ranked third or fourth. British Columbia also ranked consistently high after 1992/93, occupying third and fourth positions intermittently with Manitoba.

Alberta ranked last for ten of the 12 years. Prince Edward Island and Newfoundland also regularly ranked low in terms of the level of corporate capital tax collected compared with the size of the economy.

(4) Corporate capital tax as a percent of corporate income tax

This final indicator compares the amount of corporate capital tax revenue with the amount of revenue collected by the corporate income tax. The relationship between corporate capital tax and corporate income tax is important because one of the reasons for the corporate capital tax's popularity with government's is its ability to ensure that corporations pay a minimum amount of tax each year.

Corporate income tax revenues fluctuate dramatically depending on the profitability of corporations. Corporate capital tax revenue, on the other hand, is relatively stable because the amount of taxable capital stays relatively fixed over time. This is why corporate capital taxes are referred to as "profit-insensitive." This indicator highlights the degree of this "insensitivity" across jurisdictions. Figure 5 illustrates the current year results while table 7 contains the results for the past 12 years.

Current year analysis

Saskatchewan ranked the highest of all jurisdictions in terms of the amount of corporate capital tax collected compared with the amount of corporate income tax collected. Saskatchewan collected \$1.05 in corporate capital tax revenues for every \$1 of corporate income taxes collected in 2000/01. Saskatchewan was the only jurisdiction in which more revenues were raised from corporate capital taxes than from corporate income taxes.

Quebec ranked second in the amount of corporate capital taxes raised relative to corporate income taxes. However, its reliance on the corporate capital tax relative to corporate income taxes was significantly less than top ranked Saskatchewan: for every \$1 raised from corporate income taxes, Quebec raised 63¢ from corporate capital taxes.

British Columbia and Manitoba ranked third and fourth, respectively. Both provinces generated about 40¢ in corporate capital tax revenues for every \$1 raised through corporate income taxes.

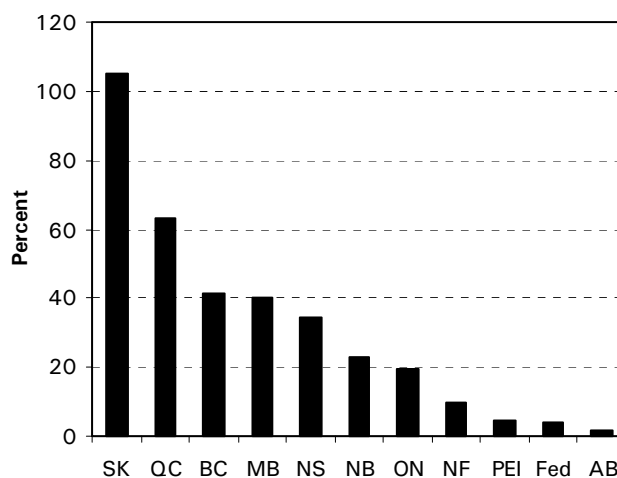
Figure 5: Capital tax as a percent of corporate income tax, 2000/01

Table 6: Corporate capital tax revenue as a percentage of Gross Domestic Product (GDP) and rank by Jurisdiction, 1990–2001

	89/90		90/91		91/92		92/93		93/94		94/95		95/96		96/97		97/98		98/99		99/00		00/01	
	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%
Fed	9	0.02	6	0.11	5	0.17	6	0.17	6	0.15	6	0.14	6	0.12	6	0.13	8	0.11	8	0.12	8	0.12	8	0.11
BC	10	0.01	11	0.01	11	0.02	3	0.32	3	0.42	3	0.40	4	0.36	4	0.37	4	0.35	3	0.39	4	0.38	4	0.34
AB	11	—	10	0.05	10	0.06	11	0.05	11	0.05	11	0.05	11	0.04	11	0.04	11	0.03	11	0.03	11	0.03	11	0.03
SK	2	0.49	2	0.54	2	0.55	1	0.63	1	0.74	1	0.80	1	0.84	1	0.83	1	0.92	1	0.80	1	0.97	1	0.98
MB	3	0.31	3	0.31	3	0.32	4	0.29	4	0.29	4	0.34	3	0.38	3	0.38	3	0.40	4	0.39	3	0.42	3	0.40
ON	4	0.28	4	0.25	4	0.21	5	0.25	5	0.23	5	0.28	5	0.27	5	0.29	5	0.31	5	0.32	5	0.33	5	0.33
QC	1	0.62	1	0.61	1	0.60	2	0.62	2	0.63	2	0.60	2	0.70	2	0.78	2	0.79	2	0.77	2	0.74	2	0.73
NB	5	0.07	7	0.07	8	0.07	10	0.06	10	0.06	10	0.06	9	0.05	10	0.05	7	0.20	7	0.18	7	0.20	7	0.21
NS	6	0.05	5	0.12	6	0.11	7	0.08	7	0.08	7	0.08	7	0.07	7	0.07	6	0.23	6	0.27	6	0.24	6	0.24
PEI	8	0.04	8	0.07	7	0.08	8	0.07	8	0.07	8	0.07	8	0.06	9	0.05	10	0.06	10	0.05	10	0.06	10	0.05
NF	7	0.04	9	0.06	9	0.06	9	0.06	9	0.06	9	0.06	10	0.05	8	0.06	9	0.06	9	0.06	9	0.06	9	0.05

Source: Statistics Canada, Public Institutions Divisions, FMS Data 1989-2001; calculations by the authors.

Table 7: Corporate capital tax as a percent of corporate income tax and rank by jurisdiction, 1990–2001

	89/90		90/91		91/92		92/93		93/94		94/95		95/96		96/97		97/98		98/99		99/00		00/01	
	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%
Fed	9	1.1	9	6.7	6	12.7	9	14.6	9	10.9	9	8.8	10	6.7	9	6.3	10	4.5	10	5.2	10	4.8	10	4.1
BC	10	0.7	11	1.7	11	2.3	3	52.0	3	57.0	4	40.4	4	31.3	4	30.1	4	36.0	4	41.7	3	49.0	3	41.5
AB	11	0.0	10	4.7	10	5.6	11	5.5	11	5.2	11	3.9	11	2.7	11	2.6	11	2.0	11	1.9	11	2.8	11	1.9
SK	2	89.6	1	173.2	1	155.9	1	146.5	1	119.8	1	123.0	1	93.9	1	105.6	1	124.5	1	117.7	1	106.8	1	104.8
MB	3	44.8	3	84.6	3	65.8	4	47.8	4	53.7	3	60.4	3	57.9	3	45.1	3	58.7	3	53.1	4	41.7	4	40.4
ON	4	21.8	4	24.6	5	24.6	5	42.7	5	32.9	5	29.5	5	22.3	5	22.3	6	19.4	7	20.9	7	20.7	7	19.8
QC	1	98.7	2	118.8	2	101.1	2	98.2	2	87.6	2	71.0	2	80.1	2	79.8	2	68.7	2	69.4	2	63.8	2	63.4
NB	5	7.5	6	12.1	9	11.1	6	23.4	10	9.7	10	5.7	9	7.7	10	3.5	7	16.6	6	27.0	6	26.1	6	23.2
NS	6	6.9	5	23.7	4	45.2	8	18.1	6	20.2	6	14.3	6	16.3	6	10.0	5	34.0	5	41.6	5	37.4	5	34.2
PEI	8	5.9	7	11.6	7	11.9	7	18.4	8	11.7	8	8.9	7	9.4	8	7.6	9	6.3	9	6.1	9	9.0	9	4.4
NF	7	6.7	8	11.0	7	11.9	10	14.3	7	15.9	7	12.2	8	8.0	7	9.9	8	8.2	8	8.2	8	9.2	8	10.0

Source: Statistics Canada, Public Institutions Divisions, FMS Data 1989-2001; calculations by the authors.

Alberta, Prince Edward Island, and the federal government ranked low in terms of their usage of corporate capital taxes relative to corporate income taxes. All three jurisdictions raised less than 5¢ of corporate capital tax for every dollar of corporate income taxes raised.

Historical analysis

Over the period from 1989/90 to 2000/01, as indicated in table 7, Saskatchewan collected more corporate capital tax revenue than corporate income tax revenue in every year except 1989/90 and 1995/96. For every \$1 of corporate income tax revenue collected, Saskatchewan, on average, collected \$1.21 in corporate capital tax revenues. Saskatchewan is the only province to collect more, consistently, in corporate capital taxes than from corporate income taxes. In fact, over the 12-year period, there is only one year (1989/90) in which Saskatchewan was not ranked first on this measure.

Quebec consistently ranked second but was far behind Saskatchewan's usage rates, averaging a collection of 83¢ in corporate capital taxes for every \$1 of corporate income taxes collected. Manitoba and British Columbia commonly alternated between third and fourth places.

Alberta collected relatively low amounts of corporate capital tax revenues compared with corporate income taxes consistently over the period. The federal government also received low rankings over the period.

Conclusion

Across all four measures of corporate capital tax usage, Saskatchewan and Quebec emerge as the two jurisdictions that use corporate capital taxes to the greatest extent. Further, Manitoba and British Columbia also rank as relatively heavy users of corporate capital taxes.

Saskatchewan's top ranking is not surprising considering that it has the highest corporate capital tax rates of all the jurisdictions. This high relative rate coupled with a moderately broad base accounts for the high proportion of corporate capital tax collected as a percentage of own-source revenue. It also explains why

Saskatchewan remains the only province to consistently collect more corporate capital tax revenues than corporate income tax revenues. Saskatchewan's high usage of the corporate capital tax will be offset, to some degree, by the increase, announced in the Budget for 2002/03, of the deduction for the corporate capital tax from \$10 million to \$15 million (Saskatchewan Finance 2002).

Quebec's rankings indicate that it continues to be a heavy user of the corporate capital tax. In contrast to Saskatchewan, Quebec's corporate capital tax rate is low but is applied to one of the widest and deepest corporate capital tax bases of all Canadian jurisdictions (Haymes 1966: 17). This broad base accounts for why it ranks first in the corporate capital taxes as a percentage of business profits measure and second in the three other performance measures.

Alberta, on the other hand, consistently emerged as the lowest user of corporate capital taxes in Canada. This trend will continue since Alberta is now the only jurisdiction to have eliminated corporate capital taxes completely. Prince Edward Island, Newfoundland, and the federal government were also shown to be relatively low users of corporate capital taxes.

Points of interest

British Columbia, which had been a low-ranked user of corporate capital taxes prior to 1992 moved up dramatically in the rankings after 1992. This change was brought about by the introduction of a non-financial institutions corporate capital tax and the raising of the financial institutions corporate capital tax rate. In fact, British Columbia between 1992/93 and 1993/94, experienced a 2,130% increase in the amount of revenue collected in the form of corporate capital taxes.

Another policy change that resulted in a major change in rankings occurred in 1997 when New Brunswick and Nova Scotia established a federally harmonized, non-financial institutions corporate capital tax (Milner 1999: 203). The result was a dramatic rise in corporate capital tax revenue, which is reflected in the large percentage increases in the corporate capital tax usage measurements. Interestingly, the idea of harmonizing provincial bases has been around for some time although it was not formalized as a government objective until 1997 when a federally

commissioned report on business taxation concluded there were benefits to harmonization for corporate capital taxes. However, the spirit of the recommendation was that *existing* provincial corporate capital tax bases should be harmonized with the federal base rather than establishing new taxes that are harmonized with the federal corporate capital tax base.

Newfoundland and Prince Edward Island extract very little corporate capital tax revenue. Although both impose a high rate of corporate capital tax on financial institutions, the number of eligible and taxable institutions is small, so the amount of revenue collected remains negligible.