Chambre de commerce
du Montréal métropolitain
Board of Trade
of Metropolitan Montreal

# Federal pre-budget submission 2003

**"Competitive cities and businesses
for a prosperous Canada"**

**presented to**

**The Honourable John Manley**

**Deputy Prime Minister
Minister of Finance**

**by the**

**Board of Trade of Metropolitan Montreal**

**December 2002**

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# Summary of recommendations

## *City financing*

The Board of Trade recommends:

- that as of the next budget year, the federal government either exempt municipalities from the GST or reimburse them in full in this regard;
- that the compensation in lieu of taxes paid by the federal government and its Crown corporations to municipalities equal 100% of the local taxes on the property value of all buildings owned by the government, as of the next budget year.

## *Business competitiveness*

The Board of Trade recommends:

- that the federal government immediately and completely eliminate the large corporations tax – or *capital tax* – given that this tax measure is extremely detrimental to business productivity;
- that in its next budget the government adopt the following measures to support exporters:
    - A tax credit for companies taking steps to develop their export business;
    - A mechanism to finance salaries for new positions created specifically to develop international markets;
    - The creation of a government-backed fund aimed specifically at financing the export projects of low- and medium-technology SMEs;
    - Participation in the financing of sector-based consortiums of companies and government organizations focused on international business.

**The Board of Trade of Metropolitan Montreal has more than 7 000 members. Its mission is to be the leading group representing the interests of the Greater Montreal business community. Its objectives are to maintain, at all times, relevance to its membership, credibility towards the media and influence towards government and decision-makers.**

## Introduction

Concerned about the major competitiveness issues in Greater Montreal, the Board of Trade of Metropolitan Montreal has examined the budget choices that the Canadian government is preparing to make. In the current context of trade globalization and international competition between urban agglomerations, the key role of cities as engines of growth and innovation is now clearly recognized. The fact that Canadian cities account for a large share of the GDP in their respective provinces – Montreal, for example, accounts for 50% of Quebec's GDP – attests to the important role they play in ensuring the country's prosperity.

It is therefore clear that the strength and vitality of Quebec and Canada hinge greatly on the competitiveness of their major urban agglomerations and their resident companies. A consensus prevails in this regard among the organizations that recently studied the issue of cities, notably, the C5 group, which comprises the five largest Canadian urban agglomerations (Calgary, Montreal, Toronto, Vancouver, and Winnipeg), the chambers of commerce of these five cities, the Federation of Canadian Municipalities and the TD Bank.

In the past decade, in an effort to balance the public purse, the higher levels of government have limited municipal investment even as devolving new responsibilities to these same municipalities. In a context of expanding urbanization, where four out of five Canadians now live in an urban setting, municipal administrations are called upon to respond to increasingly pressing needs. For example, all the infrastructure studies show that substantial funds are required to make the necessary improvements. With their limited, flat revenue base, cities simply do not have the means to simultaneously provide services to citizens, see to their economic development and renew their infrastructures.

Canada's cities are thus being especially hard hit by their dependence on their key source of revenue, property tax. In this regard, at 88%, Montreal heads the list of North American cities with the highest percentage of fiscal revenues generated from property taxes. Because property tax is determined by property value and not directly tied to economic activity, it does not allow cities to enjoy the benefits of the economic growth they may experience and encourage. In order to be able to assume their many responsibilities and create a stimulating and competitive environment, urban agglomerations need to diversify their revenue sources and be able to rely on adequate financing. The solutions required therefore call for both immediate adjustments, which will allow cities to meet their needs in the short term, and lasting measures that will support their long-term development plans.

Concrete and lasting initiatives are essential if we hope to remedy the situation depicted in the recent diagnosis published by the Montreal Metropolitan Community[1]. Despite the period of growth currently enjoyed by the Montreal region – growth characterized by a significant progression in exports in the past decade – its per capita GDP is still the lowest among the North American agglomerations of similar size. This poor performance in terms of standards of living underscores the need for further improvement and greater efforts in the areas of business competitiveness and exports.

1. Montreal Metropolitan Community, *Vision stratégique : Document déclencheur (préliminaire)*, tome 1 -Diagnostic, October 2002

In light of the foregoing, the Board of Trade of Metropolitan Montreal has identified **city financing** and **business competitiveness** as critical issues on which the Government of Canada must take action in its next budget.

In this regard, the fact that the federal government is focusing on urban issues, as the interim report of the Prime Minister's Caucus Task Force on Urban Issues attests, indicates that the government shares the concerns of many Canadians regarding the viability of our large cities. As well, the Board of Trade hopes that the creation of the Canadian Strategic Infrastructure Fund and the investments announced in the recent Speech from the Throne reflect the government's will to act strictly within the limits of its area of jurisdiction.

In this vein, the Board of Trade of Metropolitan Montreal would like to suggest the implementation of concrete, immediate and easily applicable measures to help the municipalities and bolster business productivity and competitiveness. Through these measures, the Board of Trade of Metropolitan Montreal is offering the Government of Canada possible solutions that can be deployed right away, in order to begin making the investments everyone considers essential to the vitality of the Montreal region and to Canada as a whole.

It goes without saying that, while the proposed measures are required and meet pressing needs, they will not alone ensure sustainable and optimal economic development for Metropolitan Montreal. As well, the Board of Trade would like to point out that beyond this budget year, it is important to move towards greater financial autonomy for the urban agglomerations and the acquisition of the necessary powers and means for them to meet their increasing responsibilities.

## 1. Municipal financing

Compared with other jurisdictions, chiefly in the United States and Europe, municipal taxation in Canada is considered relatively static in that Canadian cities rely heavily on property taxes for their revenue, a source of income that is not directly tied to economic activity. This high dependence on property tax, whose rate is already quite high, limits revenues while imposing a heavy burden on citizens. For the Board of Trade, the answer is not to add new taxes but instead to find ways to more equitably share the tax base and allow the municipalities to diversify their revenue sources so that they can directly reap the economic benefits of their investments.

The Board of Trade acknowledges that such major changes will not materialize as quickly as one would hope. As well, to the extent that the City of Montreal, like other Canadian cities, does not have any flexibility in the management of its finances, it is critical to reduce pressure on the municipal administration by rapidly giving it access to expanded financial resources. To this end, the Board of trade would like to present to the Government of Canada, measures that, while addressing the need to increase the financial resources of our cities, can be achieved in the very short term.

### 1.1 Full reimbursement of the GST

With respect to the Goods and Services Tax (GST), the status of the municipal administrations is both unusual and surprising. The upper levels of government cannot charge each other sales taxes; in fact, they are exempt, thus reducing the cost of the goods and services purchased for their operations and for the delivery of services to citizens.

Municipalities, however, do not enjoy such an exemption: they must pay the GST on every purchase. Yet the vast majority of the goods and services purchased by the City of Montreal are used to provide citizens with services on which GST cannot be charged. As such, rather than the consumer assuming the tax burden at the time of purchase, as the GST theory would have it, the City assumes the bill.

To ensure that municipalities do not assume the full burden of the GST, the government partially reimburses them, i.e., 57.14% of the GST paid. The resulting net payment of 3% is in fact an overpayment of funds to Ottawa's benefit. This three percent, consisting of the tax contributions of Montreal citizens that should be used to make purchases for the provision of municipal services end up in Ottawa's coffers, coffers which these very same citizens already help fill through income tax and GST levies on purchases.

Thus, exempting the municipalities from the GST or reimbursing them in full would be in keeping with the spirit of this tax while making it more equitable and significantly reducing the real cost of municipal investments. Canadian municipalities contribute some $425 million in GST payments to the Canadian government every year.[2] In 2001, the City of Montreal paid $61.2 million in GST and received a refund of $35 million. There is no doubt that a full reimbursement of the GST would considerably improve the financial means of the municipalities in the Montreal region.

**Recommendation: That the provincial government, as of the next budget year, exempt municipalities from GST or fully reimburse them in this regard.**

### 1.2 Compensations in lieu of taxes

Property tax, based on property evaluations, has for some time been the method of choice of municipalities to finance the services they deliver to their citizens. In this respect, the Government of Canada, unlike private property owners, has enjoyed a special status that exempts it from the obligation to pay the full property tax, and as a result, the cost of the municipal services its buildings nevertheless enjoy. Even if the federal government is required to pay the rates and service charges incurred for services consumed directly by its public buildings, in most cases, these charges are not enough to cover all the costs of the municipal services. Compensation intended to address this shortfall is referred to as "compensation in lieu of taxes."

In 1998, according to the report of the Quebec *Commission nationale sur les finances et la fiscalité locales*, the Government of Canada paid Quebec municipalities a compensation in lieu of taxes in the order of $104 million, i.e., the equivalent of 73% of the property taxes it would pay on the basis of property evaluations.

The compensations in lieu of taxes paid by the federal government do not equal 100% of the property tax value essentially for two reasons: first, because the compensations are based on agreed valuations rather than the assessment roll; second, because these compensations do not cover rental taxes (for example, business taxes). In 2002, the compensations in lieu of taxes paid by federal government departments to the City of Montreal amounted to $22 million, of which $15 million were for Dorval airport. To these are added the compensations normally paid by Crown corporations for buildings they own and manage, namely, Via Rail, the Canada Mortgage and Housing Corporation, Canada Post, CBC and Port of Montreal. It is interesting to note that the last two corporations have cases pending with the City of Montreal and that the arrears, dating back to 1999, could amount to $5 million in each case.

In the interest of tax equity, the Board of Trade of Metropolitan Montreal supports the conclusion of the Quebec *Commission nationale sur les finances et la fiscalité locales* recommending that the Government of Canada pay compensations in lieu of taxes equivalent to 100% of the local taxes on the property value

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2. TD Bank Financial Group, *The Greater Toronto Area (GTA): Canada's Primary Economic Locomotive in Need of Repairs,* May 22, 2002

of its buildings. This measure would simplify the compensation in lieu of taxes plan and increase municipal revenues.

**Recommendation: That the compensation in lieu of taxes paid by the federal government to Crown corporations equal 100% of the local taxes on the property value of all the buildings it owns as of the next budget year.**

## 2. Corporate taxation

### 2.1 Large corporations tax (*capital tax*)

Aimed at large corporations and financial institutions, the federal capital tax – referred to as the large corporations tax (LCT) – is levied on equity capital, debt capital and capital reserves. It therefore applies on capital expenditures made by companies, such as plant construction and equipment and material purchases. Not only do corporations pay this tax at the time of the initial expenditure, they must continue to pay it for the entire life of the goods. Capital tax therefore constitutes an additional fixed cost, increasing the real cost of investments and hence reducing the capital available for other investments.

Canada is just about the only country in the world that levies a substantial tax on capital at both the provincial and federal levels. The LCT is 0.225% for companies and 1.25% for financial institutions. In 1999, companies provided Ottawa with $1.4 billion in revenue, while financial institutions contributed an estimated $143 million[3].

Because it constitutes an additional fixed expense for businesses, capital tax stifles investment and productivity gains. It is also recognized in the business community that this additional expense dissuades innovation and the acquisition of new technologies. As well, because it increases production costs, Canadian companies find themselves at a disadvantage both on the international and domestic markets vis-à-vis foreign companies unfettered by the need to add the cost of capital tax to the price of their goods and services.

The LCT imposes a disproportionate burden on highly capitalized companies such as those operating in the manufacturing, natural resources, financial and high tech sectors. Companies that invest heavily in new projects must pay the capital tax before the investment even begins to pay dividends, which could take years. Lastly, this tax is levied without any regard to profitability and can therefore destabilize companies during periods of low earnings or losses.

Unlike machines and plants that require long-term investments, and are difficult to move, capital is a mobile production factor that is typically rapidly moved to those locations that offer the best conditions for profitability. The LCT therefore has a direct impact on investments, driving it to other jurisdictions where a higher rate of return can be obtained. Consequently, investment opportunities in Canada are rendered less attractive for foreign investors, who compare the business tax environment between countries.

In the opinion of the Board of Trade of Metropolitan Montreal, levying capital taxes is contrary to the federal government's objective of ensuring an internationally competitive tax system for Canadian business. Indeed, capital taxes discourage investment in new technologies and stifle innovation, the exact two activities the government is trying to stimulate. Eliminating the LCT would place Canada on and equal footing with most of its international competitors, which impose no such tax — among OECD

3. Conference Board of Canada, *The Case Against Capital Taxes*, 2001.

members, only Japan and Germany levy a capital tax[4] — and make the country a more attractive place to invest.

Some provincial administrations have already recognized the negative impact of capital tax and have either completely abolished or announced measures to eliminate it. Alberta and British Columbia no longer levy a corporate capital tax and Ontario is in the process of reducing it. Quebec has also announced a gradual reduction, but the 0.30% target rate for 2007 is the same as the Ontario rate today.

The Board of Trade believes that the elimination of the LCT would encourage companies to invest and ultimately lead to productivity gains. The resulting increase in local and foreign investments should boost GDP, helping, in the medium term, to offset the loss in revenue currently generated by this tax.

**Recommendation : Since the large corporations tax, or capital tax, is considered a tax measure that is highly detrimental to business productivity, the Board of Trade recommends that the federal government immediately abolish this tax.**

### 2.2 Measures to support exports

Greater Montreal has over 5,000 exporting companies and is home to 70% of all Quebec exporters. The vitality of the export sector plays a major role in Canada's economic growth. However, in the past few months a negative trend has emerged in this industry, particularly in Quebec. The Institut de la statistique du Quebec reported a 2.5% drop in the volume of merchandise exports in Quebec for the first 8 months of 2002. The data published in November by Export Development Canada (EDC) point in the same direction: Quebec exports in 2002 should decrease 2% over 2001. While the EDC expects a return to growth for 2003, Quebec's performance will be significantly lower than the Canadian average: 3% compared to 6%. In fact, the Board of Trade believes that the need to bolster export development is so pressing that an appeal to joint and complementary action on the part of both levels of government is in order.

Given their importance, it is essential to find creative ways to support exporting companies and hence contribute to the growth of the Quebec economy. This support is all the more necessary given that typically, major investments and efforts are required to develop new markets before yielding results. In this regard, the economic slowdown south of the border has certainly driven home the importance of diversifying our export markets.

The Board of Trade shares the concerns already expressed by the Canadian government regarding our productivity, innovation and accessibility to the U.S. market. Still, the Board of Trade would like to reiterate the importance it places on the development of Canadian exports. Indeed, insofar as the prosperity of Canadian businesses increasingly hinges on their ability to export and develop new markets, supporting their efforts in this regard is just as relevant as supporting innovation and productivity. Because doing business on the international scene motivates Canadian companies to become more competitive and hence increase productivity, we consider it most relevant to encourage them, particularly SMEs, to increase their exports, by supporting them in a targeted way.

During the past year, the Board of Trade has made suggestions to the Canadian Minister of Finance on how to support the efforts of Canadian exporters in the short term. Given that this support remains necessary, the Board of Trade is taking advantage of this pre-budget analysis to present them once again:

4. Jason Clemens, Joe Emes and Rodger Scott, "The Corporate Capital Tax: Canada's Most Damaging Tax", *Public Policy Sources*, The Fraser Institute, Number 56, May 14, 2002.

### 2.2.1 Export tax credit

The first measure proposed by the Board of Trade to rapidly stimulate the development of Canadian exports is to offer a tax credit to companies taking preliminary steps to develop their export business. These steps would include, among others:

- preparing an export business plan;
- training personnel in international trade;
- participating in a trade mission;
- participating in a trade show.

The purpose of such a measure is to encourage companies to develop their exports in a systematic, organized manner. The Board of Trade considers that facilitating access to such steps greatly enhances the chances of success.

### 2.2.2 Financing new jobs dedicated to exports

The exporting process is a long one, and in order to be successful, foreign market development should be approached as a separate task. Unfortunately, it is difficult for companies to free up an employee or create a position expressly for this task because typically, the financial rewards of his work and initiatives will only materialize after a time.

In this context, the Board of Trade believes it is relevant to implement a mechanism to finance salaries for new positions created specifically to develop international markets. With a view to encouraging the immediate use of this measure, rather than offering partial financing over several years (as is the case, for example, with the Quebec government's refundable tax credit for a portion of the salary of an employee working for a company in E-Commerce Place), the government assistance could cover the entire salary but be limited to the first year of work. As well, this assistance could be made available only for a newly created position, thus contributing to the creation of promising jobs, especially for young people.

### 2.2.3 Government-backed fund

The Board of Trade recommends the creation of a government-backed fund to specifically finance foreign market development projects for low- and medium-technology SMEs with an export business plan.

The advantage of such a fund is that it fulfills a real need for a private source of financing for low- and medium-technology companies seeking to develop foreign markets. By guaranteeing a portion (20% for example) of the potential losses of a private financial institution, the government acts as a facilitator, making available to SMEs as much as five times the financing typically accessible to them. In fact, the first benefit of such a guarantee is that it significantly limits the risk incurred by the financial institution, which should make financing more accessible and cheaper for small and medium borrowers.

### 2.2.4 Financing the start-up of sector based consortiums

Canadian SMEs generally run into formidable and savvy competition on the international markets, so much so that one of the only ways for them to be competitive is to pool their resources and expertise.

To this reality is the added fact that a wealth of Canadian expertise is found within the ranks of the public sector. As such, be it at the municipal, provincial or federal level, there often exists exportable public expertise that oftentimes complements the know-how found in the private sector but that no one thought to market outside our borders. As such, in addition to encouraging export companies to pool their talents, the Canadian government through its regional development agencies such as CED should ensure that these groups include, when relevant, participants from the public sector.

As such, in order to launch sector-based initiatives (such as trade missions on different markets or aimed at multi-lateral development banks) and promote the competitiveness of Canada's offering abroad, the Board of Trade suggests that the Canadian government examine the possibility of financially contributing to the formation of sector-based consortiums of companies and government organizations dedicated to international trade.

**Recommendation: That the government adopt the following export support measures in the next budget:**

- **A tax credit for companies taking preliminary steps to develop their exports;**
- **A mechanism to finance salaries for new positions created specifically to develop international markets;**
- **The creation of a government-backed fund to specifically finance the export projects of low- and medium-technology companies;**
- **Participate in the financing of sector-based consortiums of companies and government organizations dedicated to international trade.**

## Conclusion

As economic engines and the main sites for the creation of wealth in the country, Canada's major urban agglomerations must have political, economic and tax powers and tools befitting their size and heightened economic responsibilities. The Board of Trade believes that Canadian and Montreal companies must operate within a fair legislative and fiscal framework that favours innovation, productivity and competitiveness. The recommendations formulated by the Board of Trade as the Government of Canada prepares its next budget point in this direction. They are pragmatic solutions that can be swiftly translated into action. The Board of Trade expects the Canadian government to begin fulfilling its commitment to give us "The Canada We Want"[5] without delay, by launching concrete initiatives to optimize sustainable economic development for the Montreal region and, by extension, for all of Canada.

5. *The Canada We Want* (Speech from the Throne delivered on September 30, 2002).