City of Saskatoon

BUSINESS PROPERTY TAXATION BY CITIES

WHAT WE KNOW, WHAT WE DON'T, AND WHAT WE SHOULD

A DISCUSSION PAPER

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1. INTRODUCTION

1.1 Background

Perhaps no city in Canada has placed more focus on the relationship between residential and non-residential (i.e., business) property tax rates than Saskatoon. Almost two decades ago, in 1998, Saskatoon City Council adopted a resolution to set the non-residential property tax rate at 1.75 times higher than the residential property tax rate. At that time, the non-residential to residential property tax ratio was 2.11:1. This meant that on a property of equal value, for every one dollar paid in property taxes from residential property owners, over two dollars was paid by non-residential property owners.

The Council resolution was the result of a recommendation from Saskatoon's Tax Review Committee (1997).[1] The Committee was concerned by the tax rate differential and believed that:

- Property taxes are an important variable on business location decisions;
- The existing business property tax rate could have an adverse effect on the location of businesses in the city, especially small and medium sized businesses; and
- Higher property tax rates on business properties are not justified on the basis of equity.[2]

In fact, the equity issue, combined with the ability for non-residential property owners to deduct property taxes from their corporate income tax requirements resonated with the Committee. This formed the basis for their recommendation of a targeted (or pegged) non-residential to residential tax ratio:

> *The target effective tax rate we recommend…was determined taking into account the benefit that most small medium sized businesses receive from the deductibility of property taxes in the determination of income for income tax purposes…this suggests an income tax rate of greater than 40%. We believe the effective income tax rate in Saskatoon on the majority of businesses in much less than this.*
> (Saskatoon Tax Review Committee, 1997).

The Committee's rationale was further influenced by a paper from local public finance economists, (Gilchrist and St. Louis, 1997) commissioned and sponsored by Saskatoon Business Groups. They concluded that Saskatoon's business property taxes: (a) could be more transparent with explicitly stated mill rates; (b) are high relative to other prairie cities; and (c) violate standards of fairness in taxation policy.

Thus, in 2001, the City of Saskatoon (City) took steps to reduce the non-residential property tax rate differential until it reached 1.75:1 in 2010, resulting in one of the lowest tax ratios among major Canadian cities. However, the issue did not end there.

About two years after the property tax ratio reached the 1.75 target, local business groups began advocating to Saskatoon City Council for a further reduction in the property tax ratio, this time arguing for a ratio of 1.43:1 by 2020 (Greater Saskatoon Chamber of Commerce 2012).[3]

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[1] The Tax Review Committee was appointed by the City in 1996 and was required to submit recommendations to City Council by December 1997. It reported to City Council in December 1997, making 19 recommendations on property assessment and tax policy. The 1.75 ratio was a result of the calculations on property tax deductions that businesses are entitled to under the *Income Tax Act*, for Corporate Income Tax purposes, which at that time was roughly 43 percent.

[2] More precisely, it relates to the concept of horizontal equity, which means treating equal taxpayers equally. This concept is addressed in more detail in Section 2 of this paper.

[3] It is the author's understanding that the 1.43 ratio came from a report by the Canada West Foundation, called "A Tax Framework for Saskatchewan's Continuing Prosperity." The authors state: The reform is also complimentary to other recent tax changes,

This new position was based on the principle advanced by the Tax Review Committee of equity and income tax deductibility, and spurred by various federal and provincial corporate income tax changes and rate reductions. In 2013, the City Council of the day, however, deferred the matter until after the 2017 property reassessment.

This issue sat dormant until it was revived three years later during Saskatoon's 2016 civic election campaign. Again, local business groups were advocating for the ratio between the non-residential property tax rate and the residential tax rate be reduced to 1.43 from 1.75. (MacPherson-a, September 29, 2016). They argue that a lower tax ratio will create more employment opportunities, attract new businesses, allow firms to reinvest in existing properties, and ultimately, make local business more competitive (MacPherson-b, October 31, 2016).

By contrast, opponents to a lower tax ratio argue that the City already has one of the most competitiveness business property tax regimes in Canada and that a further reduction in the ratio would increase the tax burden on residential property owners (CBC News, Saskatoon October 22, 2013). Part of their argument was strongly supported by a December 2016 report by the C.D. Howe Institute, concluding that Saskatoon had the most competitive business tax environment when comparing the largest city in each province (Found and Tomlinson, 2016).[4]

In 2017, Saskatoon City Council passed a resolution to reduce the non-residential municipal property tax ratio to 1.59 to 1. That is, the municipal property tax rate on commercial and industrial properties would be 1.59 times higher than that for residential properties.

Given this outcome, a fundamental question becomes: If Saskatoon already has the most competitive business tax regime for capital investment, then should the City's non-residential to residential tax ratio be lowered further? Does the original principle of (horizontal) equity and tax deductibility still resonate? If the answer is yes, then: (a) What is the appropriate ratio? and (b) Is there evidence to suggest that a lower tax ratio is a catalyst to additional business investment? If the answer is no, then (a) Is there a "better" alternative? and (b) Will maintaining or even increasing the tax ratio result in reduced commercial and industrial investment?

1.2 Focus and Purpose of Paper

This paper attempts to address the questions posed at the end of subsection 1.1 and other fundamental issues relating to business property taxation by city governments. It does so by integrating theoretical frameworks in the economic literature with practical analysis of how selected cities approach the issue of business property taxation. The motivation for this paper is to advance various property tax policy issues (and options) so that the reader has a more complete understanding of how property taxes—especially business property taxes—work and why high taxation of business properties can be harmful to capital investment.

particularly the cuts in the corporate income tax rate from 17% to 12%, and the earlier elimination of the general corporate capital tax.

[4] The analysis was based on a measure called the Marginal Effective Tax Rate (METR). In this particular analysis, the METR was limited to capital investment and is defined as "the effective tax rate on the revenue generated by the last unit of capital invested." Stated another way, it measures the percentage increase in the rate of return an investor needs to cover the cost of taxes.

1.3 Scope of Paper

While the primary focus of this paper is on municipal business property taxation, the analysis also integrates the impact on municipal residential property taxes where necessary. The inclusion is needed because the two are very closely linked when it comes to local tax policy.

Although the research and topics addressed in this paper attempt to be as comprehensive as possible, there are several tax policy issues that go beyond the scope of this analysis. For example, this paper does not address in any detail:

- Property tax exemptions, rebates, and abatements;
- Education property taxes;
- Evaluation of other types of taxes, such as income, consumption or excise taxes;
- Evaluation of alternative financing mechanisms, such as user fees, tolls, and tax increment financing; and
- Local expenditures or service levels.

1.4 Key Findings of the Paper

Based on the principles of tax theory, the economic literature, and the practical applications of local tax policy, the research reveals that:

- Property taxes on business align with the "capital tax view," meaning that the tax is borne by the owners of capital;
- High business property taxes can have an impact on capital investment and location decisions, but there is no definition of what "high" is;
- Saskatoon is the only city of those included in the research with a targeted tax ratio between residential and non-residential properties. Others use a "tax share" approach.
- The literature does not reach a consensus or advance an optimum tax ratio;
- Saskatoon's existing tax ratio is among the lowest in Canada, however, there is no concrete proof to suggest that this is the cause for increases in business investment.
- Business property owners in Saskatoon face the second lowest municipal property tax burden among all cities, and the most competitive marginal tax rate in Canada.

1.5 Organization of Paper

The remainder of this paper is organized as follows:

- Section 2 presents generally accepted public finance criteria to help provide an evaluation framework to apply to the various options for the subsequent analysis.
- Section 3 provides an overview of the property tax, and briefly addresses its key features, good and bad. It also distinguishes between residential and business property taxes and investigates the economic incidence of the tax (meaning who pays it).
- Section 4 addresses whether business property taxes have an impact on business competitiveness, location decisions, and investment.
- Section 5 offers three policy options or approaches for consideration. These options, or variants of them, are used by the cities to distribute the property tax burden. This section also evaluates the options by using the criteria set out in Section 3.
- Section 6 summarizes the findings of this work and offers some concluding observations and issues that should be explored further as they concern business property taxation in Saskatoon.

2. What Makes a Good Property Tax? Criteria to Consider

2.1 Introduction

The purpose of this section is to provide an overview of key criteria or principles for evaluating taxes. The central objective is to identify and explain generally accepted criteria that are fundamental to the implementation and operation of a good tax system. While it may be impossible for any tax system to meet all of the criteria in establishing a good tax system, it is important to have some standard of measure so that a determination can be made on the efficacy of various property tax options that are advanced later in this paper.

2.2 Equity

The concept of "equity" is a fundamental principle of taxation. For taxation purposes, it implies that the burden of a tax should be shared fairly among individuals so that there is an equitable distribution of the cost of government to society. Since taxes are essentially the cost of government, "any measure of the equity or fairness of the tax system obviously involves weighing the burden borne by one taxpayer against the burden borne by another" (Boadway and Kitchen, 1999). There are two fundamental principles of equity: (1) the benefits principle, and (2) the ability to pay principle. The paper addresses each concept below.

2.2.1 The Benefits Principle

The benefits principle holds that the tax burden should be distributed in accordance with the benefits that taxpayers receive from a particular service. In other words, proponents of this principle argue that the financing of government goods or services should be linked to the benefits that individual or business taxpayers receive from the service. However, the benefits principle is not applicable to situations where government provides a public good, such as parks and sidewalks, or where the distribution of income or wealth is desired (Rosen et.al, 2003).

2.2.2 The Ability to Pay Principle

In contrast to the benefits principle, the ability to pay principle maintains that taxes should be distributed according to some measure of a taxpayer's ability to pay. Ability to pay can be measured by income, consumption, and wealth to determine a taxpayer's well-being. Taxes based on an ability to pay are appropriate in circumstances where collective benefits are provided to taxpayers. That is, they are appropriate where no clear link exists between the benefit received and the taxes paid. The ability to pay principle has two important dimensions: horizontal equity and vertical equity.

2.2.2.1 Horizontal Equity

Horizontal equity is simply the equal treatment of equals. In other words, a tax is said to be horizontally equitable if taxpayers who have the same level of well-being before the tax is imposed have the same level of well-being after it is imposed (Rosen et.al, 2003). With respect to property taxes, horizontal equity can be achieved when taxpayers with similar types of properties are treated equally; that is, the same tax rates are applied to all properties in the residential and non-residential property classes.

2.2.2.2 Vertical Equity[5]

Vertical equity, on the other hand, refers to the unequal treatment of unequal taxpayers. In other words, it determines the treatment of individuals with different levels of well-being. Vertical equity is thus achieved when taxpayers who have unequal economic abilities pay annual taxes that differ to achieve some collective notion of fairness (Hyman & Strick, 2001). Simply, a tax that achieves vertical equity is generally a progressive tax (e.g., federal personal income tax).

2.3 Efficiency/Neutrality

Taxes are said to be efficient or neutral when they do not require firms or individuals to alter their production, consumption, work, or savings patterns in order to comply with the tax. In other words, an efficient tax does not distort the economic decisions of firms or individuals (Boadway and Kitchen, 1999). Thus, it is desirable to impose high taxes on markets that do not respond significantly to price changes, since the imposition of the tax will be reflected in market prices. Taxes also play an important role on the level of economic growth in an economy by either impeding investment or enhancing investment.

2.4 Ease of Administration

Compliance costs are imposed on firms and individuals in order to ensure that they comply with the tax system. Similarly, administrative costs are imposed on the public sector in administering the tax system. Obviously, the more complicated the tax or tax system, the more costly to administer. A major objective of any tax or tax system, therefore, is to ensure that compliance and administrative costs are kept to a minimum.

2.5 Accountability/Transparency/Simplicity

A transparent and simple tax system provides taxpayers with the ability to determine if they are receiving appropriate levels of public services for the amount of taxes they pay, which will improve accountability. In addition, a transparent tax system is more difficult to evade than a more convoluted one. Transparent and visible taxes offer fewer incentives for taxpayers to avoid paying taxes, thereby reducing the administrative and compliance costs associated with the tax system (Boadway and Kitchen, 1999).

Accountability is also affected by how much of tax is exported to other jurisdictions. In other words, the greater ability to export taxes to other jurisdictions, the local tax becomes less accountable (Kitchen and Slack, 2014).[6]

[5] Vertical equity also classifies taxes as regressive, proportional and regressive. This paper addresses these issues briefly in Section 2.

[6] This paper address tax exporting in the context of business property taxation in Section 4.

2.6 Stability & Predictability

A good tax, or tax system, should provide stable and predictable revenues to help governments pay for the demand of public services and meet the ongoing costs of delivering those services. For taxpayers, it means that the tax should not result in unanticipated changes over time. Thus, stable and predictable taxes are important for ratepayers in planning their finances, and for cities in planning their budgets.

So how do the above criteria apply to the property tax? According to the economic literature (Kitchen and Slack 2012; Bird and Slack, 2004; and Bird and Bahl, 2008), the best local taxes are those that have the following characteristics:

- They are based on an immobile tax base, and therefore, borne primarily by local residents (not exported);
- They do not create problems with harmonization or harmful competition between local governments or local governments and other orders of government;
- They generate sufficient, stable and predictable revenues;
- They are visible to ensure accountability and transparency; and
- They are perceived to be fair and they are easy to administer at the local level.

The residential property tax meets the above criteria better than any other tax. The non-residential property tax, conversely, does not (Kitchen and Tassonyi, 2012). The next section of this paper will address the reasons why.

3. AN OVERVIEW OF PROPERTY TAXATION

3.1 Introduction

The purpose of this section is to provide an overview of the property tax. In particular, it addresses the objective of the property tax, how it works, what types exist, and the incidence, or who bears the burden of the property tax. This section concludes by addressing some criticisms of the property tax and attempts to determine if they can be justified.

3.2 The Objectives of the Property Tax

Local governments use property taxation as a primary source of funding for services that have been requested by their taxpayers. They are the backbone of local finance and play a vital role in funding the services citizens and businesses receive from local governments. The goal is to ensure that the amount of tax paid reflects the cost of services received by the property owner and that municipal governments' service-level decisions reflect that object.

Thus, the major objective of the property tax is to raise revenues to help finance services provided by local governments. While the property tax is used to fund local services, public perception is that there is a direct linkage between the amount of property taxes paid and services received. Although this is true, it is important to distinguish between what types of services are funded by the property tax.

If structured correctly, the property tax should pay for those services that provide collective benefits for the residents and businesses of the community, meaning, police and fire protection, maintenance and repair of roadways and public parks, and social services. It also should help to subsidize those services that provide benefits to the individual user and collective benefits to the community, such as public transit and recreation. However, it should not fund those services that provide direct benefits to a consumer of a service (Kitchen, 2015).

3.3 The Mechanics of the Property Tax

The property tax is an ad valorem ("according to value") tax that is levied on the value of real property (including both land and structures). Because the property tax is essentially a local tax in Canada, and since local governments are under the control of the provinces, the definition of real property, the valuation process, and taxing ability varies from province to province.[7]

The value of real property is determined by the property assessment process. While property assessment and taxation are two distinct processes, they have an important relationship. Assessment is the process of estimating a dollar value on a property for taxation purposes so that the property tax burden can be distributed equitably. Taxation is the process of applying a tax rate to a property's assessed value to determine the taxes payable by the owner of that property.

In Canada, the property tax is levied on properties that are subject to taxation.[8] Although it is different in various provinces, properties not subject to taxation are typically federal, provincial and municipal government owned properties (buildings), places of worship, and education and higher education institutes. In lieu of paying property taxes, federal and provincial governments

[7] In Canada, a property tax is also levied at the provincial level in order to fund education. See Section 5 of this paper for an overview of the differences among provinces and cities.
[8] Provincial legislation will allow certain types of properties to be exempt from taxation. Typically, these are provincially and federally owned properties, churches, and universities.

will provide a municipality with a “payment in lieu of taxes,” which is considered to be tax revenue, just not “property tax revenue.” Almost all properties that are exempt from taxation are non-residential properties, which, in turn, reduces the non-residential tax base.

3.4 Criticisms of the Property Tax

Despite its usefulness as a primary funding source for local governments, it is likely that no tax receives as much criticism as the property tax (especially the residential property tax).[9] The criticisms are largely levelled in the following ways (Slack 2001):

- The property tax is regressive because it is perceived as affecting lower income property owners more adversely than higher income property owners (this point is addressed in more detail in subsection 3.7).
- The property tax is unfair because it is levied against capital (stock) as opposed to income or consumption (flows).
- The property tax is inadequate because it does not provide enough revenues to finance local government activities.
- The property tax does not grow with the economy, like income or sales taxes.
- The property tax is considered to be too high because it is billed in one single instalment, instead of being deducted at the source, like income tax. Its highly salient (or visible) nature has made the property tax an unpopular revenue source for financing local government activities.
- The way properties are valued, or assessed, for tax purposes has led to the criticism that market value assessment discourages property improvements and leads to unpredictable tax burdens in volatile property markets. The perception is, therefore, that an increase in the assessed value of the property leads to an automatic increase in the property tax burden for the property owner.[10]

Nonetheless, the obvious question becomes: are the criticisms of the property tax justified and factual? The general consensus is no, but it depends on the type of the property tax.

With respect to the residential property tax, economists and policy analysts generally agree that it is a good revenue source to fund local government services. As one economist puts it, “the property tax is…a good local tax. It is far from perfect, but perfection in taxation is not of this world…relative to other tax bases available to local government…the property tax gets high marks” (Oates, 2001). However, a distinction needs to me made between residential and non-residential property taxes.

3.5 The Two Sides of the Property Tax Coin: Residential and Non-Residential

In the study of local public finance, much attention is paid to how the property tax affects households or people. Moreover, local governments generally communicate property tax increases in terms of their impact on a household with an average or median assessed value, and the amount more per month that such households may pay.

This is to be expected, given that the residential properties (single-family homes and condominiums) comprise over 70 percent of the assessment base and 90 percent of the total

[9] Perhaps the Canadian Goods and Services Tax (GST) is more hated, but it is interesting to note that the most salient (visible) taxes are also the most hated. For more see Cabral & Hoxby, 2012.

[10] An increase in property taxes does not automatically stem from the assessment process, but the budgetary and service delivery decisions of a City (or municipal) Council. The assessment process is used to simply distribute, or redistribute in the case of reassessment, the local tax burden among property owners.

amount of properties in most Canadian cities.[11] The consensus in the economic literature is that the residential property tax is a good local tax (OECD, 2010; Slack, 2011; Dahlby, 2012; and Norregaard, 2013).

Among the reasons for this conclusion are: (a) the connection between the types of services funded at the local level and the benefit to property values[12]; and (b) residential property cannot be moved or hidden to avoid paying the tax. However, property taxes on residential properties only tell part of the local property tax story.

The other part of the property tax story concerns the treatment of non-residential properties (e.g., commercial and industrial) or more succinctly, “business” properties. In Canada, the United States and in most of the world, business properties face higher property tax rates than residential properties (Bird and Slack, 2004) although they receive less benefits from services.[13] There are several reasons for this, but one of the most commonly cited is that residential property owners vote (Bird, Slack, and Tassonyi, 2012).

Non-residential property taxes are levied on commercial (a retail store or office building) and industrial (manufacturing plant) properties. Unlike the Corporate Income Tax (CIT), business property taxes are paid regardless if the business turned a profit or not. However, non-residential property owners, or businesses, can deduct property taxes from their CIT filings, something that residential property owners cannot do. This sometimes justifies higher non-residential property tax rates by way of achieving horizontal equity in tax policy.

Nonetheless, the prevailing view in the literature is that that business property taxes are not good local taxes because (a) there is a poor link to benefits received; (b) business properties are more mobile; and thus, business investment is more responsive to tax increases; and (c) the tax can be exported to owners of capital and consumers who live in other jurisdictions (Slack, 2011; Kitchen and Slack, 2012).

As several recent studies have concluded, property taxes on commercial and industrial property increase the marginal effective tax rate on capital, discouraging investment in structures, and reducing the competitiveness of the business sector (Dahlby, 2012; Found, 2014; Found and Tomlinson 2016).

3.6 Who Pays the Property Tax?

There is a widely held perception that the property tax is a regressive tax (Calgary Sun, December 4, 2013). The allegation is that the property tax takes a greater percentage of income from low-income earners than high-income earners. However, as one study has noted, “despite a series of books and papers stretching over a period of nearly 50 years, there is nothing approaching a consensus on this issue” (Fischel, Oates, and Youngman, 2011).

This lack of consensus stems from the fact that there are three different views or theories about how the property tax interacts in the economy, or what the economic incidence of the property

[11] In Saskatoon, residential properties make up about 80 percent of the total taxable property assessment base, while non-residential properties account for 20 percent in 2016. This share has been relatively consistent over the last 20 years. Based on the 2017 preliminary assessment data, residential properties in Saskatoon represent slightly above 96 percent of total taxable properties.
[12] For example, residential property owners benefit from the access to roads and transit, parks or green spaces, etc; thus, it can be argued that he benefits of local programs are reflected in local property values.
[13] See Section 4 for more on this topic.

tax is. In other words, who bears the burden of the property tax is fundamental to its understanding. There are two prevailing theories about the incidence of the property tax.[14]

One view, or theory, the so called “benefit view” surmises that the property tax is simply “the payment that households make for the bundle of local public services that they have chosen to consume (Fischel, 2001; Zodrow, 2007). In this case, the incidence of the property tax is irrelevant, because the tax is equivalent to a user fee for public services. This view may be applicable to residential properties, but not for business properties (Found 2014). Empirically, businesses seem to react little to business property taxes, which supports the “benefit tax view” (Smart, 2013).

Another theory, the so called “capital tax view” (or new view) argues that the property tax is predominantly shifted to the owners of capital in the economy. It considers real estate property as an input factor for the business and calls for taxation in line with other input factors to avoid a misallocation of input factors. In this view, business property taxation falls on capital, thus disincentivizing investment and creating location distortions; it is a distortionary tax that has an impact on capital investment (Gilchrist and St. Louis 1997; Dahlby, 2012; Found 2014). As such, this view holds that the property tax is a progressive tax because the economic incidence falls on consumers of capital. This lends support to claims that business property owners are sensitive to higher property taxes.

[14] A third theory, called the “traditional view,” which no longer holds much merit, claims that the property tax is an excise tax that falls on both land and structures (Fischel, Oates, and Youngman, 2011). The tax burden is borne by local housing consumers in the form of higher housing prices. According to this view then, the property tax is considered to be regressive because housing constitutes a relatively larger share of consumption for poorer individuals. This view relies on partial equilibrium model whereby capital is assumed to be immobile (meaning non-responsive to tax changes) and it assumes that the property tax has no connection to benefits local taxpayers receive.

4. BUSINESS PROPERTY TAXES and COMPETITIVENESS

4.1 Introduction

The objective of this section is to address the issues pertaining to business property taxes and their impact on competitiveness.[15] More specifically this section will address the following question: do business property taxes impact the ability of a city to attract or retain investment, improve economic activity (including employment opportunities) and ultimately, influence business location decisions? But before it does, it reviews whether business properties are overtaxed relative to the benefits they receive from municipal services.

4.2 Business Property Taxes and Benefits Equity

As described in Section 3, one way to measure equity is through the benefits principle, meaning that the cost burden should be linked to the benefits that taxpayers receive from the delivery of local services. Benefits equity is generally covered by charging user fees for the service, but there is a residual cost for the remaining bundle of city services that is financed by property taxes (residential and non-residential).

Over the years, studies have attempted to quantify the amount of services that businesses receive from the municipality relative to residential property owners. Their intent is to determine if businesses are overtaxed relative to the benefits they receive.

The bulk of the studies have been conducted in the United States, but a few have been done in the provinces of British Columbia and Ontario. They generally conclude that the residential sector receives proportionately more benefits from local government services than the non-residential sector. For example, and as summarized in (Kitchen and Slack, 2012):

- A review of property taxes and municipal expenditures in eight municipalities in Ontario in 1990 concluded that non-residential property taxes ranged from 28 to 51 percent of total local property taxes but accounted for only 31 to 40 percent of municipal expenditures (Kitchen & Slack, 1993).
- A study in the City of Vancouver (MMK Consulting, 2007) compared the consumption of services to taxes paid by the different property classes and concluded that the non-residential sector paid $2.42 in taxes for each $1 of benefit received, while the residential sector paid $0.56 for each $1 of benefit. The study also concluded that the non-residential share of services consumed was 24 percent of the total; the residential share was 76 percent.
- In C.D. Howe Institute Commentary (Mintz and Roberts, 2006), the authors concluded that the non-residential sector is over-taxed relative to the residential sector when compared with the benefits that each of these sectors receives.

In addition to these studies, analysis conducted by Gilchrist and St.Louis (1997) in the Saskatoon context concluded that non-residential property taxes exceed the benefits that non-residential properties receive.

Looking at the statutory tax rates in Canada and elsewhere, there is no denying that business properties are taxed at higher rates than residential properties. Higher property taxation of commercial and industrial properties is generally done in one of three ways: (1) through

[15] For the purpose of this section, "competitiveness" refers to the ability to make a jurisdiction more attractive to create wealth and enhance economic prosperity.

assessing business properties at higher values than residential properties with the same tax rate applied to both property types (see Winnipeg); (2) through the application of higher tax rates on business properties (see Calgary and Edmonton); and (3) or both (see Saskatoon and Regina). So, is this justified?

In theory, higher taxation of business properties creates efficiency and equity concerns. Efficiency in municipal service levels will not be achieved if revenues collected from property taxes on business properties are used to subsidize services consumed by the residential sector. Equity is violated because those benefiting from the services are not paying their full costs (Kitchen & Slack, 2012).

4.3 Business Property Taxes and Competitiveness

Over the last two decades, the issues of competitiveness and business property taxes have generated a significant amount of interest from business group advocates and economists through the literature. Business group advocates have placed their focus squarely on the difference in tax rates—or the tax ratio—that cities levy on residential and non-residential properties. Their aim, naturally, focuses on reducing the tax rate differential between the two property classes, and thus, the overall tax burden for business properties.

The focus of the economic literature is broader and has generally tried to investigate whether or not local business property taxes affect competitiveness, investment and location decisions and whether or not higher business property rates are equitable (Smart, 2012; Kitchen & Slack, 2012; Found 2014). The consensus is that high business property taxes can affect competitiveness, but the literature does not define what "high" is.

For example, the tax ratio between commercial properties and residential properties in Vancouver is 4.23 to 1 and for industrial properties it is 21.7 to 1 (based on 2016 general levy rates).[16] A November 2016 report by B.C.'s Commission on Tax Competitiveness found that, "the overall level of business property taxation in B.C…does not represent a competitiveness issue or a significant impediment to economic performance."[17] They do caution however, that high property tax rates on industrial properties can have "devastating effects on unprofitable plants."

That said, there have been very few studies on the relationship (or influence) of non-residential property taxes on competitiveness. The conclusion is that the impact of non-residential business investment depends on several factors: (1) the business cycle (e.g., economic expansion vs recession); (2) the business decision (e.g., investment vs operations); (3) the nature of the business (small vs. large multi-national); (4) access to skilled labour; and (5) access to infrastructure (Kitchen and Slack, 2012). In jurisdictions that have higher statutory property tax rates than Saskatoon, such as Calgary, capital investment flow and firms locate there. According to one report, Calgary was the number one destination for inflows of foreign capital investment into Canadian cities (Calgary Financial Task Force, 2020).

[16] Rates obtained from http://vancouver.ca/home-property-development/tax-rates.aspx and compares the "general purpose tax levy only.

[17] See Commission on Tax Competitiveness, "Improving British Columbia's Business Tax Competitiveness," November 15, 2016, pg 5. Obtained from https://engage.gov.bc.ca/app/uploads/sites/76/2016/11/4637_CommissionOnTaxCompetitiveness_Final_Report_Nov-2016.pdf

Some studies use the marginal effective tax rate (METR)[18] to measure tax competitiveness. For example, the C.D. Howe Institute publishes annually a review of the METR for a several business-related taxes. In their most recent review, they showed that Saskatoon had the lowest METR at 36.4 on general corporate capital investment in Canada, compared to the largest city in each province (CD Howe, April 2020). When it comes to municipal business tax burdens, “they are highest in Montreal, Halifax and St. John’s, while near the group average (17.3 percent) in Calgary, Charlottetown and Moncton. Vancouver showcases the most competitive municipal business tax environment, followed by Saskatoon, Toronto and Winnipeg.”

4.4 Business Property Taxes and Location Decisions

Businesses generally locate where they can maximize profits, so in theory, property taxes can influence a firm’s location decision in the same way as any other cost of production. As noted elsewhere in this paper, property taxes on business properties increase the marginal effective tax rate on capital, thereby discouraging investment on structures and reducing the competitiveness of the business sector (Dahlby 2012; Found 2014). However, according to Slack and Kitchen (2014) there is no general agreement about the importance of property taxes in location decisions.

The available evidence—largely drawn from the United States—suggests that property tax differentials are relatively unimportant in inter-municipal or inter-regional location decisions but do play a role in intra-municipal or intra-regional location decisions (Kitchen and Slack, 2012). In other words, differences in property taxes are unlikely to play a significant role in a firm’s decision whether to locate in the metropolitan areas of Vancouver, Calgary, or Toronto. They are likely to play a role, however, once a firm or business decides to locate in a certain region such as the Greater Toronto Area, Metro Vancouver or the region around Montreal.

More recently, a very technical and comprehensive study by Found (2014), in the context of Ontario, reveals that capital investment in commercial structures and commercial property values are highly sensitive to the property tax and builds on the growing consensus that property taxes on business impose a substantial economic cost. This cost then can influence a firm’s decision to locate in a particular jurisdiction. However, as Kitchen and Slack (2014) report, “stakeholders in Halifax told us that there is no concrete evidence that the tax differential between commercial and residential properties is having much impact on business location… :” In other words, economic models do indicate that business property taxes can influence location decisions, however, practical or empirical analysis may suggest otherwise.

[18] The METR measures the percentage of the gross-of-tax return needed to pay business taxes on the marginal investment. For example, if the minimum acceptable rate of return on investment net-of-tax is 6 percent, and if investors need a gross-of-tax return of 10 percent to pay taxes and leave shareholders with a 6 percent return, net-of-tax, the METR would be (10 – 6) / 10 = 40 percent

4.5 Business Property Taxes and Exporting the Burden

As this paper notes in Section 2, the ability to export a tax that is levied in one jurisdiction and paid for by taxpayers in another jurisdiction weaken accountability of the tax and may reduce equity. A good explanation of tax exporting is provided in (Kitchen and Slack, 2012): "Tax exporting refers to situations in which some portion of the local tax burden is borne by people who live elsewhere either through a change in relative commodity prices or a change in the net return to non-locally owned factors of production." The ability of businesses to export the property tax depends on what the price elasticity (meaning sensitivity to price) of the demand for the product(s) is. However, according to (Kitchen and Slack 2012) there is very little evidence of tax exporting in Canada.

5. BUSINESS PROPERTY TAX POLICY OPTIONS FOR CONSIDERATION

5.1 Introduction

The purpose of this section is to provide an overview of three general policy approaches (or options) that may be considered for implementation in Saskatoon. These three approaches are as follows: (1) targeted tax ratio approach; (2) revenue neutral approach; and (3) tax share or (budget based) approach. To some degree, each of these options exist in Canadian cities.

5.2 Options & Approaches

Option 1: The Targeted Tax Ratio Approach:

This option is the City of Saskatoon's approach of having a targeted (or pegged) non-residential to residential property tax ratio. The City's existing ratio, as described earlier in the report, is set at 1 59 to 1, meaning the non-residential property tax rate is 1.59 times higher than the residential property tax rate. Only a few cities use this approach (including Toronto).

Advantages:

- Maintains a long-established existing policy that is easy to administer.
- Sends clear signal and certainty to investors about the tax rate.
- Tax rate is simple and transparent.
- Depending on the ratio, may not distort market decisions.
- Depending on the ratio, could achieve horizontal equity.

Disadvantages:

- Depending on the ratio, could increase tax burden on non-residential properties relative to previous year.
- Depending on the size of the ratio, may result in lower investment/profitability for some business properties.
- Holding a tax ratio consistent reduces ability to distribute tax revenue equally from all classes of property.

Option 2: Revenue Neutral Approach

This option proposes to let market forces dictate the tax ratio. More precisely, it lets the assessment valuation changes determine the tax ratio, so that the tax change is revenue neutral. This is largely the approach Regina uses.

Under this option, the only tax increase to either property class would result from the budget process. A primary challenge with this option is to maintain the revenue neutral ratio in non-reassessment years, as property values do not change in non-assessment years, other than with the growth in inventory.

Advantages:

- Maintains the property tax burden for both property classes.
- Achieves reasonable sense of equity, in that no additional burden is placed on either property class through the assessment process.
- Market forces determine the tax ratio, so tax policy limits distortions.

Disadvantages:

- Results in change to existing policy (assuming the existing policy is the appropriate one).
- Does not provide certainty to investors about the potential tax rate as revenue neutrality is a function of inventory growth and market value changes.
- Does not reduce residential tax burden.

Option 3: The Tax Shares (or Budget) Approach

This option lets the budget process to determine the tax implications for non-residential and residential properties. This option follows the approaches used in Edmonton and Calgary and works optimally under a system that has more frequent property assessments.

In this case, the tax ratio would be the result of three factors: market values, inventory growth, and budgetary requirements. For this option to work, the City of Saskatoon would need to establish how much of the property tax is allocated to residential properties and non-residential properties for budgetary purposes.

To illustrate, let's assume that the City needs to collect an additional $10 million in property taxes to balance its operating budget. Let's also assume that the City wants to fill that gap by requiring the residential sector to pay $5 million and the non-residential sector to pay $5 million. In other words, the annual property tax budget requirement is split equally between the residential and non-residential property classes.

The tax ratio is then the outcome of this process. Over a period of time, the tax mix differential between the residential and non-residential properties would become more evenly split, instead of the close to 70/30 split that currently exists in Saskatoon.

Advantages:

- Reduces the property tax burden for residential properties.
- Distributes tax burden equally among all property classes.
- Easy to administer.
- Provides stable and predictable revenues.

Disadvantages:

- Results in change to existing policy (assuming the existing policy is the appropriate one).
- Violates equity as it increases the non-residential tax burden over time and has no relationship to its share of taxable assessment.
- May reduce accountability and transparency of tax policy, especially with respect to business properties.

5.4 Evaluation of Options/Approaches

The previous subsection offered three general tax policy approaches that are used by various cities in Western Canada. At one end of the spectrum is a targeted tax ratio approach and at the other end is targeted tax share approach. In the middle is the revenue neutral approach. The revenue neutral approach, as used by Regina, is essentially a hybrid of revenue neutral tax policy and a targeted tax share approach. Despite its use in Regina, the revenue neutral approach is not covered in the literature, but the tax ratio approach and the tax share approach are. As such, this section dismisses the revenue neutral approach and reviews some conclusions in the literature on the other two approaches.

5.4.1 Tax Share Approach

In 2014, the City of Vancouver's Property Tax Policy Review Commission (City of Vancouver, 2014) released a report that, among things, addressed the debate over the tax ratio approach and the tax share approach. At the time, the City of Vancouver used—and still uses—the tax share approach to allocate its municipal tax burden among property classes.[19] This is the same approach used in Calgary and Edmonton.

In distributing the City's local tax burden, Vancouver implements equal tax increases to residential and business tax classes. Moreover, Vancouver's business to residential tax ratio at that time was 4.32:1. However, the Commission had no major concerns over this approach and stated that, "the Commission does not believe that there is a compelling case for a further shift in the municipal tax burden from Class 6 (business) to Class 1 (residential) at this point in time." (City of Vancouver, 2014). At the time, the total tax share from business properties was 43 percent and residential properties was 57 percent.[20]

Nonetheless, on the tax ratio approach, the Commission states that it is: "one of the legitimate ways to view equity and to allocate the tax burden across types of property…the share of taxes collected from each class of property will change in response to market changes in property assessments." The tax ratio approach is often cited as a key factor in influencing business location decisions and capital investment (Saskatoon Chamber of Commerce, 2012).

However, despite Vancouver's high business to residential tax rate ratio—at least relative to Saskatoon's—the Commission concluded that it "finds no evidence of an increasing business tax differential, or of business investment leaving to other municipalities in Metro. Accordingly, the Commission recommends that the City leave the tax shares unchanged at this time" (City of Vancouver, 2014).

However, an earlier report seems to contradict the conclusion reached by the Vancouver Commission. In a 1997 report for Saskatoon business groups, Gilchrist and St. Louis conclude the tax share approach violates equity and is contrary to competitiveness and efficiency goals. As they state: "to predetermine a business share, or to insist on the continuation of an historical share, is indefensible on equity grounds. It insists on a levy that is insensitive to the relative size of the business sector." (Gilchrist and St. Louis, 1997 page 26).

[19] This approach is actually used by most BC municipalities.
[20] The Commission also did not recommend an appropriate share of taxes from each sector. But if the goal is an equal allocation of the tax burden, over time, the total tax share would equal 50/50.

5.4.2 Tax Ratio Approach

As noted in Section 5, the tax ratio approach is used in Saskatoon, but in no other cities in Western Canada. However, there is evidence of provincial jurisdictions mandating a tax ratio approach:

- In Ontario, all municipalities must adopt a bylaw that sets the tax ratios for each class of property. All property tax rates are compared to the residential tax rate. The Province has set "allowable ranges of fairness" for tax ratios.
- In New Brunswick, municipalities set a rate on residential property and the rate on non-residential property must be 1.5 times the rate on residential property.
- In Alberta, the province's *Municipal Government Act* sets the non-residential to residential tax ratio at 5:1. This means the non-residential tax rate cannot be more than five times higher than the residential rate.

As the above points illustrate, the tax ratio approaches used, or proposed, in various jurisdictions have large variations. In fact, other than the Saskatoon Chamber of Commerce (2012) and the Canada West Foundation (2010), the literature does not recommend a specific tax ratio between non-residential and residential properties.

For example, in a 2014 report on Nova Scotia's property tax and assessment system, Kitchen and Slack (page 69) state: "Unfortunately, there is no single means of determining the appropriate tax rate ratio for business relative to residential properties." They make two additional points worth mentioning: (1) they were not able to obtain empirical evidence of businesses leaving the province because of property taxes; and (2) they are unable to make a recommendation on the appropriate ratio because the setting of tax rates and ratios requires judgement by decision makers.

Kitchen and Slack's arguments were bolstered recently by a report from the B.C. Commission on Tax Competitiveness (November 2016). Even though tax ratios for some property classes (e.g., industrial) are 20 times higher than residential properties, the Commission could not recommend a specific tax ratio. They concluded that a specific tax ratio substantially reduces the fiscal flexibility of local governments.[21]

It appears that the tax share approach is used in those jurisdictions that have more frequent—meaning annual—property assessments (e.g., Edmonton, Calgary, and Vancouver). The tax ratio approach appears to be used in jurisdictions that have less frequent assessment cycles (e.g., Saskatoon and Toronto) although New Brunswick is an outlier.

Nonetheless, the major benefit to the tax ratio approach is that it does provide certainty to investors about what the potential tax implications will be for new investments. However, there is no optimal tax ratio. On the other hand, the tax ratio approach can reduce a city's fiscal flexibility.

[21] They did caution, however, that excessive property taxes on major industrial and/or utilities properties creates investment uncertainty and competitiveness concerns about what the future level of property tax will be.

5.5 Implications of Options/Approaches

The options and approaches described in subsection 6.3 can have various tax policy implications for residential and non-residential properties. Table 9 shows the implications that four different tax ratio options would produce both in terms of their impacts on residential and non-residential properties and the City of Saskatoon's non-residential and residential property tax mix. It also shows what the implications would be for revenue neutral approach and the tax share approach.

At this point, it may be useful to explore Saskatoon's approach in more detail. The original intent of the City of Saskatoon's property tax ratio policy was to achieve (horizontal) equity among residential and non-residential properties of similar assessed values (Saskatoon Tax Policy Review Committee, 1997). This was achieved by estimating the amount of property taxes that a business could deduct for income tax purposes. Canada's *Income Tax Act* allows businesses to deduct property taxes as an expense for the purposes of filing their corporate income tax (CIT) returns each year.

In Canada, CIT's are levied by both federal and provincial governments on the net profits (before taxes) of a business. The federal and provincial governments each establish their own CIT rates and different rates are applied to different types of business. In Saskatchewan, for example, a small business (meaning income up to $600,000 per year) would face a combined federal and provincial tax rate of 9 percent (9 percent federal rate and 0 percent provincial rate) in 2020.[22] However, larger corporations (income thresholds above $600,000 per year) in Saskatchewan face a higher combined income tax rate of 27 percent in 2020 (15 percent federal rate and 12 percent provincial rate).[23] Manufacturing and processing firms see a statutory tax rate of 10 percent in Saskatchewan.

Since 1997, federal and provincial governments have taken steps to reduce CITs.[24] For example the combined general corporate income tax rate in Saskatchewan was approximately 43 percent in 1997. In 2010, it was 30 percent and, as noted, in 2017 it was 27 percent. It remains at 27 in 2020. Lower CIT rates also reduce the amount of property tax expenses that businesses can deduct for income tax purposes.

[22] Saskatchewan temporarily reduced its small business income tax rate to 0 in 2020. https://www.saskatchewan.ca/business/taxes-licensing-and-reporting/provincial-taxes-policies-and-bulletins/corporation-income-tax.
[23] This is known as the "General Corporation" Income Tax rate applied to active business income. It is the rate that has been used by Saskatoon's Tax Policy Review Committee in recommending the 1.75 property tax ratio and further advance by the Canada West Foundation and Saskatoon Business Groups to arrive at the 1.43 property tax ratio. (Canada West Foundation, 2010).
[24] Economic research concludes that higher CIT's (and raining CIT rates) are harmful to the economy because capital investment is highly mobile. See, (BC Tax Competitiveness Commission, 2016).

The table below illustrates how the CIT rate changes affect the business property tax liability and thus, can influence property tax equity. It suggests that business property taxes should be levied at a higher rate than residential properties. According to this approach, the municipal property ratio in 2020 would be equivalent to 1.37 to 1.

Property Tax Equity and Corporate Income Tax Deduction

	2020		2017		2010		1997	
	Residential	**Non-Residential**	**Residential**	**Non-Residential**	**Residential**	**Non-Residential**	**Residential**	**Non-Residential**
Taxable Property Value	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000
Property Tax Liability	**$1,500**	$2,055	$1,500	$2,055	$1,500	$2,143	$1,500	$2,632
CIT Deduction Allowance (%)	**0**	**27%**	0	27%	0	30%	0	43%
CIT Deduction	**0**	$554.85	0	$554.85	0	$643	0	$1,132
Net Tax Liability	**$1,500**	$1,500	$1,500	$1,500	$1,500	$1,500	$1,500	$1,500
Property Tax Ratio	**1**	**1.37**	**1**	**1.37**	**1**	**1.43**	**1**	**1.75**

6. SUMMARY AND CONCLUDING OBSERVATIONS

The primary focus of this paper is to provide a comprehensive overview of business property taxation issues in selected Canadian cities. Given that context, a secondary objective is to help educate and inform decision makers about the complex issues on business property taxation. It does so by integrating theoretical frameworks in the economic literature with practical analysis of how selected cities approach the issue of business property taxation.

As section one of this paper details, Saskatoon has a storied history with respect to business property taxation. It is one of the only cities in Canada with a targeted non-residential to residential tax ratio. Section one also revealed that Saskatoon's tax ratio approach was the result of integrating income tax deductibility and (horizontal) equity. The tax ratio, now at 1.59 to 1, was credited as helping to reduce Saskatoon's marginal effective tax rate on commercial and industrial investment, although no empirical evidence supports this.

Hence, a fundamental question that emerges is: if Saskatoon already has the most competitive business tax regime for capital investment, then should the City's non-residential to residential tax ratio be lowered further? If the answer is yes, then: (a) What is the appropriate ratio? (b) Is there evidence to suggest that a lower tax ratio is a catalyst to additional business investment? If the answer is no, then (a) Is there a "better" alternative? and (b) Will maintaining or even increasing the tax ratio result in reduced commercial and industrial investment? Moreover, does the original principle of (horizontal) equity and tax deductibility still resonate? Should Saskatoon City Council continue to uphold this principle?

In attempting to answer these questions, this paper had to first set the stage by reviewing some fundamental criteria with respect to evaluating tax policies. As section two reveals, while it may be impossible for any tax system to meet all of the criteria in establishing a good tax system, it is important to have some standard of measure so that a determination can be made on the efficacy of various property tax policy options that can be implemented.

In section three, the paper provides a review of the property taxation, including how it works, what types exist, the criticism (and adulation) of it, and the incidence, or who pays the burden of the property tax. On the last point, we fundamentally agree that the residential property tax is generally consistent with the "benefit view" and the non-residential property tax is consistent with the "capital view", indicating that the tax burden is generally borne by owners of capital.

In section four, the paper turns to focus more exclusively on business property taxation. In this section the objective is to determine the nature and extent to which the business property taxes help or hinder competitiveness. The section reveals:

- On the basis of benefits received, the empirical evidence in Canada suggests that the non-residential sector is overtaxed relative to the residential sector. This over-taxation is potentially harmful if it reduces the level of economic activity;
- Studies suggest that the impact of property taxes on business competitiveness depends on a number of factors – the nature of the business decision (investment in new facilities, on-going operations, etc.), the business in question, plus other factors. More specifically, property taxes on business properties are not a concern unless the firm is in financial distress and the tax is a large component of its fixed cost.

- The literature, almost all of it based on U.S. studies, suggests that property tax differentials are relatively unimportant in inter-municipal or inter-regional location decisions but do play a role in intra-municipal or intra-regional location decisions. Two Canadian studies on tax competition find no evidence of harmful competition for capital and that neighboring jurisdictions show more similarity in their tax policies than non-neighboring jurisdictions.

Section reviews and evaluates three policy options or approaches that are typically used to for tax rate policy: (1) targeted tax ratio approach; (2) revenue neutral approach; and (3) tax share (or budget) approach. As a result, two possible approaches emerge: the tax ratio approach and the tax share approach.

In some ways, the two approaches are inversely related. Under the tax ratio approach, the tax share is the outcome. Under the tax share approach the tax ratio is the outcome. So the question is, what is more important?

Well, the evidence suggests that equity can be achieved under both approaches. It can be argued that the tax ratio approach provides transparency, accountability to business investors as the tax rate is essentially fixed, while the tax share approach provides more fiscal flexibility and generally limits the tax impact to residential property owners.

However, as Kitchen and Slack (2014) argue:

> *Ultimately, the task of setting tax rates and ratios requires judgement on the part of decision-makers. Local governments should monitor tax changes in their municipality and neighbouring municipalities as well as the attractiveness of their municipality for business investment. This information should help to determine whether tax ratios need to be changed, keeping in mind that a lower commercial tax rate will be borne by higher residential tax rates".*

Ultimately, the issue comes down to managing trade-offs that emerge in tax policy. The size of the tax pie is determined through the budget process, but the distribution of that pie is determined via tax policy and thus, the political process. As the research in this paper has explained, there is no right balance or optimal level, but the outcomes are largely a reflection of local values.

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