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## Canada's Tax Regime: Complexity Undermines Competitiveness – PwC's Total Tax Contribution Survey

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This article discusses the results of a recent survey by PricewaterhouseCoopers examining the tax contributions of large Canadian corporations. The survey, called Total Tax Contribution, collected information on all business taxes borne and collected, other payments to government and tax compliance costs. The survey results reveal that:

- corporate income tax is only one aspect of the business tax burden;
- large enterprises make significant tax contributions; and
- the Canadian tax system is complex and costly for businesses.

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# Canada's Tax Regime: Complexity Undermines Competitiveness – PwC's Total Tax Contribution Survey

In a recent survey conducted by the authors' firm, Canadian CEOs ranked "tax regime" as their first priority for government reform. While corporate income taxes are important for competitiveness, they write, it is all business taxes and the complexity of the business tax regime that matter for the global competitiveness of Canada's investment climate.

Large enterprises play a significant role in the socioeconomic fabric of Canada and are crucial to the country's long-term economic prosperity. They have the capital to fund significant research and development, innovation and new technologies that enhance productivity. In addition, large enterprises, particularly multinationals, integrate Canada with the global economy by allowing for economic gains through knowledge sharing and economies of scale. Finally, large enterprises invest in Canada by providing quality employment opportunities and helping Canada build its infrastructure.

It is crucial that Canada's system of taxes be internationally competitive for all businesses, taking into consideration all taxes that they pay. PricewaterhouseCoopers has developed a methodology called "Total Tax Contribution" which collects data on all business tax contributions, not just income taxes. The aim of the survey is to stimulate an informed debate regarding the tax contribution made by businesses, function as a point of reference to frame future tax policy discussions, and help the public appreciate the total amount of tax paid by large enterprises.

Recent corporate tax rate reductions have produced savings for many Canadian corporations. However, the inaugural Canadian Total Tax Contribution survey suggests that the complexity of Canada's business tax regime may continue to hinder the international competitiveness of Canadian businesses. The high number of taxes and taxing points that result from a multi-jurisdictional tax environment, combined with the high compliance burden, detracts valuable organizational resources from productivity-enhancing activities. This article describes some of the more important findings of the survey. Based on international comparisons, it also provides suggestions for a more competitive tax regime.

## **The Total Tax Contribution framework**

The demands of global capital markets and the ease with which capital can be shifted around the world have made investment increasingly responsive to changes in a country's tax regime. Recognizing the need for competitiveness, the Canadian government has committed to lowering corporate income tax rates. Furthermore, Canadian CEOs ranked "tax regime" as their first priority for government reform in a recent global PwC survey. While corporate income taxes are important for competitiveness, it is all business taxes and the complexity of the business tax regime that matter for the global competitiveness of Canada's investment climate.

Hence, PricewaterhouseCoopers' (PwC) proposition is that a company's contribution should be looked at from the point of view of all the taxes to which a company is subject, and not just corporate tax on its profits. This is called a company's 'Total Tax Contribution.' We consider the taxes to which a company is subject, in the context of their economic effects, and take a view on where they fit into a company's economic contribution in taxes. We draw a fundamental distinction between business taxes paid by the company and charged to the income statement, which we believe are the core of its Total Tax Contribution, and business taxes collected by the company on behalf of government, which we consider to be part of its wider economic impact in respect of taxes.

The PwC Total Tax Contribution framework collects four types of information:

- Business taxes borne – taxes that affect the income statement;
- Business taxes collected – taxes collected from customers and employees that are remitted to government;
- Other payments to government – compulsory payments such as levies, rents and royalties; and
- Tax compliance costs – amounts incurred to prepare, compute and remit taxes borne and taxes collected.

The Total Tax Contribution framework is intended to function as a broad and consistent framework which companies can use to calculate and communicate their Total Tax Contribution. The Total Tax Contribution framework is not an economic model. The framework does not address economic questions such as whether businesses or consumers ultimately bear the burden of taxes imposed. By focusing on the cash payments that large businesses make, it provides a measure of what they contribute to government revenue, as an alternative to the measure in a company's financial statements (i.e., corporate income tax expense). We believe that it would be helpful to have greater transparency about the types of taxes, as well as the amount of tax, paid by companies and that a common language or framework for this would be useful.

While PwC recognizes that greater transparency can have some drawbacks, not least the amount of work involved in collecting data and reporting on business taxes paid, and that it may lead to greater scrutiny, we believe that the advantages outweigh the disadvantages. We suggest that the Total Tax Contribution concept could provide a framework for companies to satisfy the desire of stakeholders for more information on taxes and to promote a greater understanding of the taxes companies pay among analysts, investors, financial journalists and employees as well as governments, politicians and tax authorities.

#### *Survey participation*

In 2007, the Canadian Council of Chief Executives (CCCE) commissioned PwC to examine the contributions that large enterprises are making to Canada's competitiveness and prosperity. The resulting survey population included 39 participants constituting a significant proportion of large business in Canada. The participants listed on the TSX have a market capitalization of over \$700 billion. In addition, the survey participants include 20 (33%) of the S&P/TSX 60, comprising 61% of the market capitalization of the index. Survey participants reported revenue from under \$500 million up to \$17 billion, with an average of \$4.8 billion.

#### *Uses of the Total Tax Contribution framework*

The data provided by the Total Tax Contribution framework is useful in two domains:

#### **For the business community, governments and other external stakeholders**

The Total Tax Contribution methodology puts information regarding the tax contributions of large businesses into the public domain. This information will inform the tax policy debate by providing useful and empirical data about the composition and amount of taxes paid. International comparisons can be used to gauge the competitiveness of the Canadian tax regime. In addition, future industry and provincial comparisons will help to shape policy regarding industry-specific incentives and help provincial governments to measure and assess their domestic competitiveness.

#### **For the individual participants**

The Total Tax Contribution framework will enable businesses to collect and report total tax information in a consistent manner, to meet the needs of stakeholders and improve transparency. In particular, financial accounts rarely include information on business taxes other than corporate income tax. The Total Tax Contribution framework can provide valuable insights to participants. The information gathered by the survey provides a more comprehensive picture of their tax positions, which can be used to:

1. Benchmark tax contributions against other participants;
2. Improve tax risk management and controls;
3. Better allocate tax resources; and/or
4. Communicate total tax contributions to external stakeholders.

#### *Key messages from the 2007 Total Tax Contribution survey*

- I. Corporate income tax is only one aspect of the business tax burden.
- II. Large enterprises make significant tax contributions.
- III. The Canadian tax system is complex and costly for businesses.

## **I. Corporate income tax is only one aspect of the business tax burden**

“Taxes” is often synonymous with “income taxes”. However, corporate income tax is only one aspect of the business tax burden.

Businesses in Canada could bear or collect 49 taxes, excluding municipal or city taxes but including property taxes. Also, taking into account all of the taxing jurisdictions, a business operating in every province and territory could be subject to over 200 “taxing points” or compliance obligations.

This statistic indicates that there is considerable scope for simplifying and consolidating the business tax environment across all levels of governments – requiring a reversal of the trend of jurisdictions to levy their own taxes, such the City of Toronto’s land transfer tax.

The sheer number of these “taxing points” highlights the significant compliance obligation facing large enterprises and contributes to the complexity of the Canadian taxation system. The overall competitiveness of a country’s business tax environment hinges on an effective interrelationship between the tax systems of often competing jurisdictions. As each province, municipality and city endeavors to attract investment and raise revenues, the number of jurisdiction- or industry-specific incentives and taxes increase, adding to the complexity of Canada’s tax system.

The business tax landscape is made more complex by the lack of uniformity of rules and jurisdictional overlap of many provincial and/or municipal taxes. Similar provincial taxes are levied based on different legislation in each province; moreover, each province regularly amends its rules. This adds significantly to the number of potential taxing points for a business operating across the country and the complexity and compliance risk in meeting these obligations. Property tax, for example, is levied under a different set of rules in each city or municipality using different tax bases, thresholds and rates. In addition, some municipalities are introducing a variety of user fees for services.

The number of taxing points also affects the ability of businesses to manage compliance risk. The complexity of Canada’s business tax landscape, especially taxes and levies beyond corporate income tax and GST, is seen as being particularly problematic for Canadian businesses.

## **II. Large enterprises make significant tax contributions**

### **Taxes borne**

- Taxes borne by survey participants totaled \$10.5 billion in 2006.
- The most significant taxes were corporate income taxes, property taxes and employment taxes.
- For every dollar of corporate income tax paid, businesses paid a further 82 cents in other business taxes.
- Of the 34 taxes borne reported by participants, half generated only 8% of the taxes borne.

The survey results highlight Canada’s reliance on business tax by government to generate significant taxation revenue. These taxes are used to provide funding for healthcare, social programs, and other services that benefit all Canadians.

International comparisons looking at marginal effective tax rates may not show the full picture of a company’s tax burden; particularly if a country’s tax revenues are heavily reliant on labour or property taxes. The Total Tax Contribution methodology incorporates all taxes borne by a company, potentially leading to higher comparability among countries.

### **Taxes collected**

In addition to taxes borne directly, business makes a further significant contribution to government revenue through their obligation to collect a range of taxes from their customers and employees on behalf of the various governments. These payments are considered part of a company’s Total Tax Contribution since they are effectively generated through the activities of the company; for example, through employment of people or sale of goods.

Taxes collected by survey participants totaled \$19.8 billion in 2006. The major taxes collected in Canada were personal income taxes, fuel duties, GST and excise duties. For every dollar of corporate income tax paid, taxes collected were \$3.41.

Survey participants also paid \$3.9 billion in other payments to government in 2006. The highest other payments included:

- production royalties on oil and gas extraction of \$2.8 billion;
- royalties paid by mine operators of \$0.5 billion; and
- rentals paid to government on Crown land of \$0.2 billion.

Overall, for every dollar of corporate income tax paid, the survey population paid an additional 67 cents in other payments to government. However, among the 12 participants that reported other payments, an average of \$2.14 in other payments was reported for each dollar of corporate income tax paid. For companies which are subject to these non-tax payment regimes, this forms a significant cost of doing business which is not apparent from the financial statements of the company.

### **III. The Canadian tax system is complex and costly for businesses**

A complex tax system can divert scarce resources from productivity-enhancing investment. To obtain a measure of the complexity of the Canadian tax system, survey participants were asked to estimate tax compliance costs and time relating to income tax and other business taxes. Tax compliance includes gathering data to comply, making payments, corresponding with the Canada Revenue Agency and provincial Ministries and analyzing legislation. The cost includes both internal and external payments related to tax compliance.

Survey participants spent between \$100,000 and \$11 million on tax compliance and an average of 2,483 days on compliance in 2006. This is equivalent to 11 full-time employees dealing solely with Canadian tax compliance.

An annual World Bank and PricewaterhouseCoopers study, *Paying Taxes 1*, also examines the time needed to comply with taxes and the number of tax payments per year for a mid-size private company, comparing 178 economies around the world in the 2008 study. Of the 4 top successful tax reforms introduced by economies over the past 3 years, 3 related to simplifying the administrative burden for companies:

- Introduction of online filing
- Combination of taxes

While most federal and provincial tax payments can be made online, reforms by Canada can still be made in the area of combining taxes and simplifying tax administration.

Where more than one tax is levied on the same base (i.e. profits, property or labour) consideration should be given to combining these taxes into one taxing point. In addition, tax administration can be made simpler by reducing legislative complexity and ambiguity. This goal is difficult to balance with ensuring that the tax system is fair for all stakeholders.

## **International Comparisons**

### **The Total Tax Contribution of UK and Australian businesses**

PwC research into the Total Tax Contribution of businesses in the United Kingdom and Australia provide useful benchmarks for the Canadian results, bearing in mind the differences in economies and tax systems of the three countries.

The consistent methodology used in all PwC Total Tax Contribution studies enables participants to compare their tax data with that of not only with peers in their home country, but also of their overseas counterparts.

## United Kingdom

In 2005, PwC in the UK first conducted a detailed survey of the business taxes borne and collected by the members of "The Hundred Group," whose members broadly equate to the FTSE 100, a cross-industry grouping more or less representing the top 100 businesses on the London Stock Exchange FTSE index. The survey set out to determine the total tax contribution of businesses in The Hundred Group. The survey was repeated in 2006 and 2007. In the UK, businesses pay 21 taxes in addition to corporate income tax.

In addition to The Hundred Group surveys, PwC UK recently carried out a Total Tax Contribution survey for the insurance industry, collecting data on the UK taxes borne and collected by the members of the Association of British Insurers. In addition, a survey is currently underway for the oil and gas sector in the United Kingdom (OGUK). The Total Tax Contribution methodology is also being used in a global survey of the world's largest mining businesses, with results to be published in PwC's upcoming *mine*\* publication.

## Australia

A survey was undertaken by PwC in Australia in 2006 for the Business Council of Australia and the Corporate Tax Association, who have a combined membership of 170 of Australia's largest business entities. A second survey was performed by PwC in 2007. The 2007 survey results from the 63 participating entities revealed that 55 taxes are potentially payable by businesses in Australia; some have different rules and separate filing obligations in the various states, constituting a total of 169 "taxing points". The study also highlighted the fact that the reduction, abolition or consolidation of the multiplicity of territory and local taxes would have a relatively small effect on the total amount of tax collected.

## Further international comparisons

In addition to the Australian and UK studies, similar surveys are underway in Belgium, France, Germany, India, Ireland, The Netherlands, South Africa, Switzerland and the United States. Further international comparisons will be possible when the results are made available through 2008 and onwards. In late fall of this year in Venice, PwC will be releasing a global comparison of the many countries that have conducted the Total Tax Contribution survey.

Survey	Canada (Canadian dollars)	U.K. (UK pounds)	Australia (Australian dollars)
Sponsoring business association	Canadian Council of Chief Executives	The Hundred Group	
Number of survey participants	39	74	63
Survey year	2006	2007	2007
<b>Size and shape of tax system</b>			
Number of taxes borne and collected	50	22	55
Number of taxing points	> 200	-	169
Corporate income tax as a percentage of government revenues*	16.0% <sup>1</sup>	9.1%	18.4%
<b>Taxes borne and collected</b>			
Ratio of corporate income tax to other business taxes	\$1 : \$0.82	£1 : £0.79	\$1 : \$0.50
Corporate income taxes as a percentage of taxes borne	55%	56%	68%
Average Total Tax Rate	<b>2005:</b> 36.4%	<b>2005:</b> -	<b>2005:</b> 32.5% <sup>2</sup>
	<b>2006:</b> 29.5%	<b>2006:</b> 40.5%	<b>2006:</b> 33.1%
	<b>2007:</b> -	<b>2007:</b> 36.2%	<b>2007:</b> 32.8%
Ratio of taxes borne to taxes collected	\$1 : \$1.89	£1 : £1.83	\$1 : \$1.19
<b>Other key measures</b>			
Average taxes borne and collected to revenue	26.3%	17.9%	14.7%
Average employment taxes per employee	\$37,309	£16,820	\$25,173
Average compliance costs	\$2.1 million	£1.3 million	\$2.0 million

\* Source: Latest published government revenue statistics

1. Data for Canada is based on actual federal corporate income tax revenues to total federal government revenues for 2006-2007 taken from the 2008 budget.

2. Represents the median tax rate.

## *Looking forward*

### **Looking forward: an improved Canadian tax system**

The Total Tax Contribution survey grew out of a need to better understand the tax environment in which businesses operate, and to communicate that understanding to all stakeholders. The need arose in the context of:

- increased focus on tax regime reforms by CEOs and governments;
- concerns about international competitiveness;
- intensifying regulations; and
- the linking of tax contributions with corporate social responsibility.

The survey, administered by PwC and the CCCE, contributes to the bank of available data on the Canadian tax environment. The results of the survey have been organized under three key messages:

- I. Corporate income tax is only one aspect of the business tax burden.
- II. Large enterprises make significant tax contributions.
- III. The Canadian tax system is complex and costly for businesses.

The survey's empirical data is intended to inform the debate on tax policy, with a view to helping Canada develop a tax regime that is both competitive internationally and effective domestically. In particular, it draws attention to the need to consider the full array of business taxes, including the formidable administrative burden they impose on business. The substantial tax revenue contribution of large enterprises is also highlighted.

PwC has discussed the results with many interested stakeholders, including federal and provincial governments and trade organizations. Looking ahead, the Total Tax Contribution methodology will be used in further international and domestic comparisons.

### **Looking forward: improved tax management and disclosures**

One of the aims of the Total Tax Contribution framework is to improve transparency in the reporting of all business taxes and to provide better, more consistent information for the management of tax through analysis and benchmarking.

The 2007 Total Tax Contribution report focused on measures most relevant for the business community, governments and other external stakeholders. However, individual survey participants will benefit from having more robust data on the amount and type of taxes they are paying and collecting. The data will be helpful in improving the manner in which they report tax information, whether internally (for management purposes) or externally, in financial or corporate responsibility reports. Finally, the data can be used to benchmark their company against other survey participants.

In writing this paper it is our aim to bring the concepts to, and to share the PwC Total Tax Contribution framework with, a wider group of interested stakeholders who have an interest in the future of tax policy in Canada and in increasing transparency over the contribution of large business in taxes.

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