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Corporate Income Taxes, Profit, and Employment Performance of Canada's Largest Companies

By David Macdonald

Introduction

Corporate income tax cuts have become a defining issue separating the Conservatives from the opposition parties. The Conservatives vow to continue their ongoing corporate tax cuts that have slashed the federal corporate income tax rate from 21% in 2006 to 15% in 2012.

It isn't hard to see why the opposition parties have latched on to the corporate income tax cuts when Canada is facing large deficits: they are incredibly costly. The government estimated that by 2011–12 the cuts from 2006 would be costing more than $10 billion a year,[1] a tremendous amount given the large deficits that otherwise appear to pre-occupy the Conservatives.

Unlike other government programs of comparable expense, there is great debate over the relative effectiveness of corporate income tax cuts as an efficient means of creating jobs. The government's own stimulus multipliers show that corporate income tax cuts are the least effective means at the government's disposal of creating economic growth and jobs in the short run.[2] Instead, social housing and infrastructure investments top the list, creating 10 times as many jobs per public dollar spent.

A recent study by University of Calgary business professor Jack Mintz extolled the benefits of corporate tax cuts but conceded that it would take seven years for the full effects to be felt.[3] In essence, Canadians need to pay big bucks now and hope they'll see the benefits almost a decade later.

It's no wonder that, without tangible short-term effects, the value of corporate tax cuts is being questioned. Giving more money to Canada's most profitable companies seems counter intuitive to most Canadians.

However, the argument is being made, by people like Finance Minister Flaherty, that you can lower the tax rate on corporations and still take in more money because they will expand their activities and pay more tax. The claim that you can charge corporations a lower tax rate yet take in more tax revenue seems to strain credibility for most Canadians.

However, the claim is that by lowering corporate income tax rates, companies will have more money to invest in their machines, technology, and employees. The argument goes: these investments will help to spur Canada's chronically low productivity growth, driving long term economic growth while creating employment and wealth in the process.

This report takes a look at Canada's biggest companies, household names like the big banks, Research In Motion and Canadian Tire and tracks them as a group over the past decade to see how much their tax bill has changed, how much their profits have changed, and to determine how many jobs they created.

Falling Statutory Corporate Tax Rates

Tax cut proponents advocate lowering taxes for Canada's most profitable corporations with the promise of prosperity in the long run. Thankfully, we don't have to wait 10 years to know if that promise holds true because corporate tax rates have been cut throughout the last decade. The Conservative corporate tax cuts beginning in 2006 were actually the second big wave of corporate cuts. A similar package was introduced by the 2000 Liberal government under Jean Chretien. 2001 marked the start of Canada's falling federal income tax rate so we don't have to wait a decade for results, we should be able to see them already.

The 2000 Federal Budget decreased CIT rates from 28% to 21% between 2001 and 2004. The 2006 Federal Budget further decreased them from 21% to 18% by 2010. They dropped again to 16.5% on January 1st, 2011 and are scheduled to drop one last time to 15% at the start of 2012. Between 2000 and 2012, the rate that profitable corporations pay in income taxes will have been almost halved. This is a dramatic change in corporate tax policy in Canada.

However, Figure 1 excludes the myriad of other changes that affected corporate income taxes during this period. Corporations don't just pay income tax to the federal government, there is also a provincial component. The provincial rates are generally lower than the federal one, and depending on the province, they may have also declined.

The industry that corporations operate in also affects the rate they pay. In 2000 for instance, manufacturers already paid 21% instead of the 28% that was paid by companies in other industries. A corporate surtax that existed prior to 2008 also altered the taxes paid for highly profitable companies. Less profitable companies (making under $500,000) also pay a lower rate. Given the various tax rules and exemptions over the 2000s, it is a complex task to estimate the effect of changing corporate tax rates on what Canada's most profitable corporations pay.

To further muddy the waters, corporations only pay corporate income tax on their profits, not on their revenues. Individuals pay income tax on their gross income, not on what they have left after they pay rent, car payments, gas and electric bills. Corporations only pay tax on what they have left over after paying employee wages, rent, energy costs, etc.

Figure 1: Falling Federal Corporate Income Tax Rates

Year	Statutory Federal Corporate Income Tax Rate
2000	28%
2001	27%
2002	25%
2003	23%
2004	21%
2005	21%
2006	21%
2007	21%
2008	19.5%
2009	19%
2010	18%
2011	16.5%
2012	15%

If a company is just breaking even and doesn't have any money left over, the tax rate could be 0%. No profits means no taxes paid. Alternatively, the more profit a corporation makes, the bigger their gain from corporate tax cuts. The most profitable companies in Canada get the biggest benefit from corporate tax cuts.

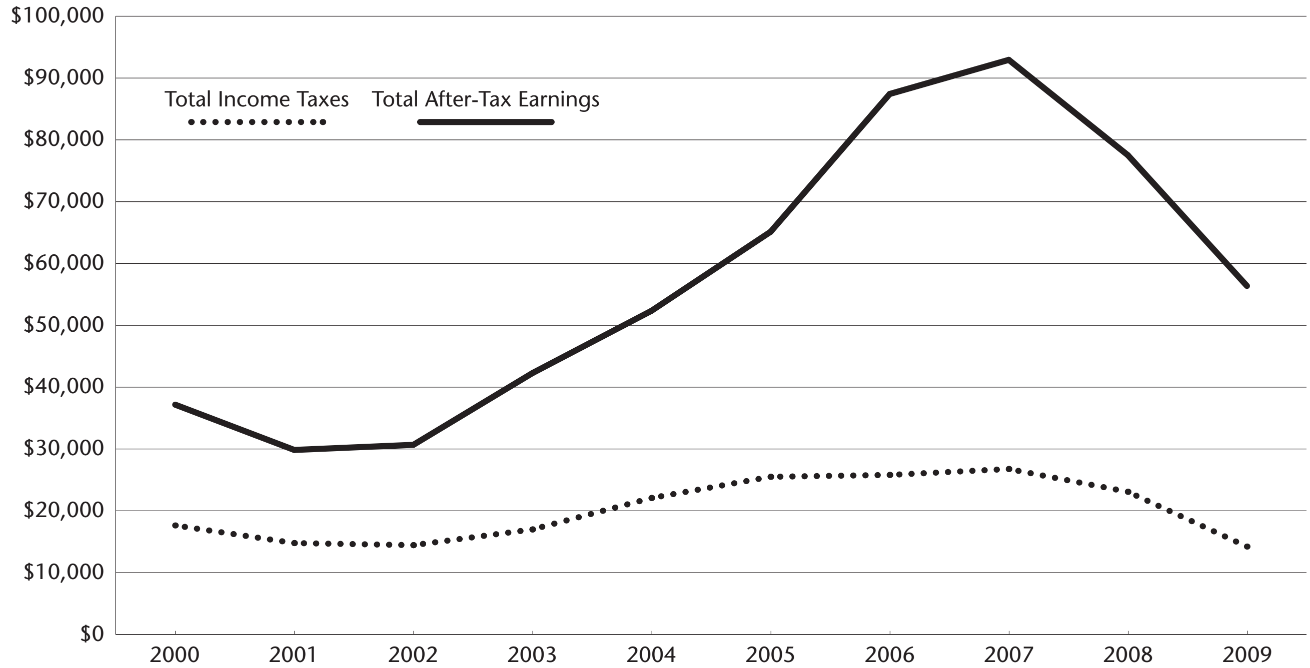
The tax cut theory of Mr. Mintz, Mr. Flaherty and others argues that the more corporate taxes are cut, the more jobs and economic activity will be created. As well, those that benefit the most from corporate tax cuts, large profitable corporations, should be paying the biggest dividends in job creation.

Examining Canada's Biggest Companies

Canada's 245 biggest publicly traded companies are represented by the S&P/TSX Composite (ranked by market capitalization).[4] Many of these companies are quintessentially Canadian. The composite has corporate names like the big five banks, Rogers, Sunlife, Telus and Bombardier. This study narrows in on those 198 companies for which financial data from 2000 to 2009 is publicly available to see how they fared.

Unfortunately, companies do not disaggregate provincial from federal income taxes. As such, rates in

Figure 2: Corporate Tax Boon ($mil)[5]



Source: Globeinvestor.com and authors calculations

this study are combined federal and provincial rates. Nonetheless, the findings should still be relevant to declining federal rates, which would obviously impact the combined rate.

Figure 2 shows the aggregate amounts that our 198 S&P/TSX composite members made in profits and paid in income taxes. The total income taxes represent the amount paid in both federal and provincial corporate income taxes. The most recent complete year of data is 2009.

What is perhaps most striking about Figure 2 is how little governments collected in additional income taxes in the boom years from 2004 through 2007. Profits for Canada's biggest companies soared and governments saw very little additional revenue. When the recession hit in 2008, company profits dropped but didn't return to anywhere near their 2000 starting point. On the other hand, income taxes collected fell below their starting point in 2000.

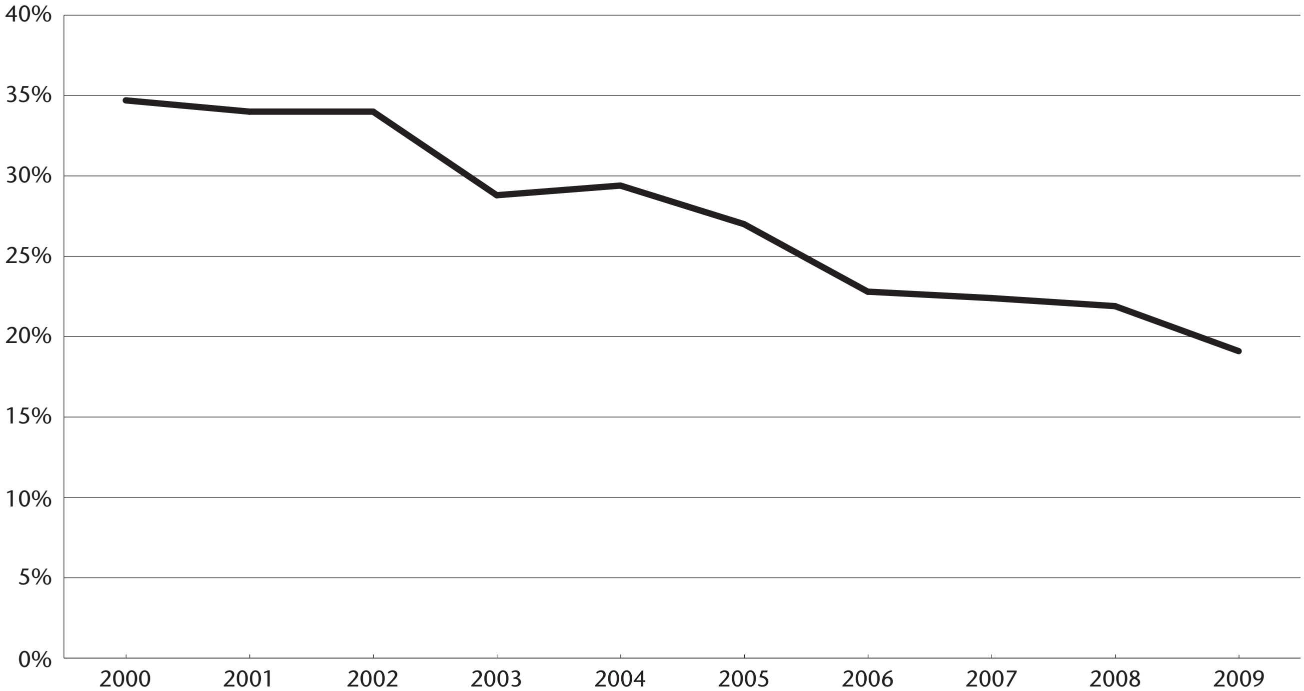
Profits are up 52% from their 2000 base, despite their steep drop in 2009. Even with the recessionary pressures, Canada's biggest companies still managed to increase their profits from the start of the decade. In fact they were much higher in 2007, peaking at 151% above their 2000 level that year.

However, while corporations made 52% more profit in 2009 than in 2000, they are paying almost 20% less in federal/provincial income tax.

Figure 3 shows how governments managed to collect far less in income taxes on huge profits in the mid-2000s. The effective tax rate (combined federal/provincial) has dropped significantly over the study period. It started at an effective rate of almost 35% and dropped to 19% by 2009, about half its original value. This fall is not due to the recession, it happened throughout one of the strongest boom periods in recent memory.

It is hard to overstate the dramatic transformation of corporate taxation over the last decade. These 200 or so Canadian giants now pay essentially half the rate they paid only 10 years ago. On top of that, corporate tax rates continue to drop after the study period. The federal corporate tax rate alone is scheduled to fall another 4 percentage points between 2009 and 2012.

Figure 3: Effective Provincial/Federal Corporate Income Tax Rate



Source: Author's Calculations

With such a large drop in corporate rates, there ought to be some clear effects on the companies that benefit the most, i.e. the companies of the S&P/TSX Composite. It is difficult to argue that halving of the effective income tax rate isn't enough to see an effect.

Promises, Promises: Employment and Taxes Paid

The first promise of cutting corporate tax rates is that governments won't actually see a decline in revenue. Instead, companies will work harder, make more and pay more in taxes. It follows that the most profitable companies in Canada that receive the biggest breaks from rate cuts will show the biggest benefit. Corporate tax rates have declined dramatically for Canada's biggest companies as shown in Figure 3.

If, in 2009, these S&P/TSX Composite companies paid the same rate as they had in 2000, federal and provincial governments would have collected an additional $12 billion a year in revenue. Remember, that this is only from the 198 companies in the study. The loss in revenue from all Canadian corporations would be larger still. This amount alone is roughly equivalent to a Canada-wide $10 a day child care program or a national pharmacare program.

The second promise of cutting corporate taxes is that it will create jobs. Company employment data is not as readily available as financial data, as such only an examination of the effects of the second round of tax cuts starting in 2006 is possible. There were 198 TSX/S&P Composite companies that had publicly available employment figures in both 2005 and 2010. Those companies are the ones used in Figure 4.

From 2005 to 2010 the number of employed Canadians in the economy overall rose from just over 16 million to just over 17 million, for a growth rate of 6% over the five year period. That's not bad considering the worldwide recession that hit in 2008. That 6% growth in the number of people employed represents the average across all sectors of the Canadian economy.

What's interesting is that our S&P/TSX Composite companies show employment growth of only 5% over the five year period, from 2.0 million to 2.1 million employees. It should be noted that these figures

Figure 4: Employment Growth (millions)[6]

Year	S&P/TSX Composite Company Employment	Total Economy (Dec. of year)
2005	2.035	16.238
2010	2.131	17.145
% Change 2005–10	5%	6%

Source: Report on Business Top 1000, Labour Force Survey

also include jobs these companies created in their operations outside of Canada. So the actual number of jobs created in Canada is in fact less.

Despite a massive tax savings, the S&P/TSX Composite members did not keep up with the average number of jobs created in the Canadian economy. These companies saw the largest benefit from corporate tax cuts, worth over $12 billion dollars a year and counting, yet they are actually pulling the employment growth average down.

There was a major recession between 2005 and 2010, with unemployment shooting up from 6% to 8% and 'Canadians Employed' taking a significant hit. Despite that, the companies that benefited the most from corporate tax cuts still didn't keep up with the average growth in employment.

The only noticeable result from the decade-long corporate tax cut experiment is that Canada's largest companies have larger profits. For such a spectacular and ongoing tab, those are pretty slim pickings.

Conclusion

As deficit pressures put both federal and provincial government spending under increased scrutiny, it's hard to find so expensive a program with so few tangible benefits as corporate tax cuts. Canadian governments are now losing $12 billion a year to 200 of Canada's strongest companies, who are making 50% more in profit while paying 20% less in income tax; all while creating proportionally fewer jobs than the economy-wide average. The revenue that Canadian governments are losing from all corporations would be much larger still, although that amount is outside of the scope of this study.

The bargain that Canadian governments made to provide Canada's largest companies with massive tax breaks in return for the promise of jobs and prosperity has not materialized. These companies are the ones that should be showing the best job creation results from corporate tax cuts because they get the biggest benefit. Instead, the most tangible result of those cuts is that corporate profits are up, government deficits are also up and Canada's biggest companies are laughing all the way to the bank.

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Notes

1. Federal Budget 2009, pg. 255.

2. Federal Budget 2009, pg. 240.

3. Chen Duanjie and Mintz Jack, Federal-Provincial Business Tax Reforms: A Growth Agenda with Competitive Rates and a Neutral Treatment of Business Activities, SPP Research Papers, January 2011

4. This index does not include privately held companies, however, it is much more difficult to obtain reliable information on private companies and the S&P/TSX represents a fair cross section of Canada's biggest companies. The S&P/TSX Composite members are based on their market capitalization as of January 2011.

5. See Appendix 1 for the full breakdown of figures behind Figure 2

6. The job numbers in Figure 4 are net jobs created. Some S&P/TSX Composite companies shed jobs.

Appendix 1: S&P/TSX Composite Figures

Year	Total Sales	Total Before Tax Earnings	Total Taxes	Total After-tax Earnings	Effective Tax Rate
2000	438,753.11	50,858.88	17,632.95	37,168.34	34.7%
2001	468,676.47	43,492.81	14,780.71	29,843.69	34.0%
2002	475,728.82	42,470.33	14,444.87	30,671.39	34.0%
2003	498,771.32	59,020.78	16,988.35	42,275.53	28.8%
2004	555,429.21	75,092.98	22,073.57	52,356.63	29.4%
2005	637,640.53	94,279.04	25,500.68	65,135.25	27.0%
2006	708,035.34	113,226.65	25,803.24	87,421.15	22.8%
2007	775,274.13	119,518.20	26,758.91	92,941.47	22.4%
2008	839,703.99	105,218.96	23,078.20	77,520.30	21.9%
2009	771,325.58	74,522.32	14,217.27	56,372.23	19.1%
% Change 2005–09	76%	47%	-19%	52%	

Source: GlobeInvestor.com & Author's Calculations

Includes only 198 of the 245 companies in the S&P/TSX Composite of January 2011. Companies having annual financial information from 2000 through 2009 are included all others are excluded.