Municipalities

Newfoundland and Labrador

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Taxation & Municipal Economic Development

A Community Development Project

An Operational Handbook and Workshop Guide

Taxation & Municipal Economic Development

A Municipalities Newfoundland and Labrador
Community Development Project

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Operational Handbook and Workshop Guide
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for

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Note: This Module can be used as an operational handbook or as a workshop guide for a facilitated session.

Operational Handbook

Introduction and Overview

The issue of municipal taxation has always had the ability to raise the ire of both residents and businesses alike in Newfoundland and Labrador. Unfortunately, it is also one of the most misunderstood aspects of municipal government. Too often taxes are seen as some kind of punishment or undue hardship placed on individuals or businesses by a council who is "out of control" or some other such nonsense. It is important to remember that a municipal government is just that, a level of government. And as a level of government it has the ability to levy taxes. The main purpose of municipal taxes is to provide the municipality the needed revenue to continue operations and provide the required services to residents. This idea is reflected in the current legislation under the Municipalities Act (1999) under Rate of Tax,

> Section 113. *The Rate of tax imposed under section 112 shall be*
>
> *(b) one that is estimated to be sufficient, together with the anticipated revenues from other sources, to cover the expenditures of the council to be made from current funds during the current financial year of the council.*

This section essentially indicates that when developing a budget, expenditures should be calculated first and then revenue sources should be identified to cover those expenses. That would include setting the tax rate at an appropriate rate. The common practice in Newfoundland and Labrador is to first calculate the revenues and then allocate the expenditures. Unfortunately this process leads to many unfunded activities, including economic development in some cases.

On a large scale at the national or perhaps even the provincial level it is sometimes argued that adjusting tax levels or providing tax incentives can provide the extra pull for large corporations to invest here as opposed to some other jurisdiction. The question for municipalities is whether or not that holds true at the local government level, and if it does are the benefits worth the possible loss in tax revenue.

Considerations

In small communities there are many considerations for economic development and taxation levels is but one tool that can be utilized. For further information on some of the other tools available refer to the accompanying modules on economic development. In addition to the other tools there are a great number of considerations impacting tax rates and economic development.

- Existing businesses: if you were to adjust tax rates in an effort to attract new business how would that impact existing businesses. Or conversely if you were to raise rates to take advantage of a new business.

- Location/neighbours: if you are in a remote location with a specific asset that could be of value, such as a deep-water port, ice free access, forest resources, etc that may mean that a tax incentive may not be required to attract business and an additional tool may be best suited to the objective. Similarly if you have close neighbours then perhaps you might want to confer with them to ensure a common approach in terms of taxation levels to avoid extreme competition with each other.
- Traditional/appropriate industries: attracting a new industry to an area that has been dominated by a traditional industry can be a challenge and tax incentives may be a good tool in that circumstance. Aiming tax incentives toward an industry that is unlikely to set up in your area may take some research but would help prevent unnecessary tax changes.
- Scale of operation: depending on the size of the industry some operators prefer to arrange for a grant in lieu of taxes. On the other hand an area that has many small businesses may want to consider a restructuring that could provide greater benefit over a broad spectrum of operators.
- Number of employees: some businesses are very labour intensive and can provide employment for many residents of a town, and therefore a tax incentive may be worthwhile.

All of these considerations should form part of the deliberations around any changes to the tax structure for a town for economic development purposes.

The Legislative Options

As municipalities are entities created by the provincial government, the obligations and the opportunities of municipalities are laid out in provincial legislation. The ability of municipalities to tax is no different and the majority of the taxation relevant legislation can be found in Part 5 of the Municipalities Act, 1999. While it is always the best idea to be familiar with the legislation in question, the following will provide an overview of the taxation abilities of a municipality.

Real Property Tax

Section 112 states that a council can impose an annual "real property tax" on the owners of property within the municipality as a percentage of the assessed value of the property. It also states that there can be one rate for residential property and a different rate for commercial property, and the council can impose a minimum tax level for each. While property tax is perhaps the most common form of taxation it is not utilized by all councils. Some councils have cited the cost of property assessment and the difficulty of residents to pay as rationale for not implementing a property tax.

If an existing or potential business owns a highly valued property and can afford a comparable tax rate then it may be an opportunity for revenue but may not be an especially attractive situation for new businesses.

Business Tax

In cases where there is no property tax or the business does not own or operate from any real property in the municipality then the council can implement a business tax that is to be calculated as a percentage of the gross revenue of the business. Again this can be a good opportunity for tax revenue but may be very attractive to the business community.

In the case where the council has imposed a real property tax then "it shall set the business tax as a percentage of the assessed value of the real property used by the business…" and the same approaches apply. With the imposition of a business tax comes the ability for council to vary the rate for different classes of business. It is common practice to impose much higher rates for businesses involved in the financial sector as opposed to the tourism sector. The council also has the ability to set minimum tax rates for the different classes of business. Again consider that tax rates can be seen as an incentive or an obstacle for both existing and potential businesses.

Under section 5 of the "Taxation of utilities and cable companies Act" a municipality may, by resolution, impose on a utility an annual business tax of no more then 2.5% on the gross revenue of the utility. While this may provide some revenue it is unlikely to play a significant role in economic development.

Direct Sellers Tax

The direct sellers tax is covered in Section 129 and refers to a person acting as a direct sales agent such as an Avon salesperson. This tax is to be imposed as a fixed amount and cannot be applied if the business tax has already been applied to the business. This tax is not greatly utilized, as it does not generally yield considerable revenue.

Water and Sewerage Tax

Implemented in municipalities that provide water and/or sewer services, this tax can have different rates for residential and commercial customers. Similar to the Business Tax, council may set different rates for different classes of buildings. Section 131 dictates the options for implementing the tax such as a flat, mill or metered rate. This tax is not usually a significant obstacle for economic development with the exception of businesses that require a significant water supply such as fish processing facilities.

Tax Incentives

The legislation is very specific as to the types and the process of commercial tax to be levied, including collections. It is however flexible in terms of the classes of businesses and the rates of some taxes. It is this flexibility that can provide the opportunity for a council to develop a tax strategy that is "business friendly" or maximizes tax revenue depending on their objectives.

In addition to the above-mentioned flexibility the council also has the ability to make special arrangements with individual businesses under Section 111 of the Municipalities Act, which states:

Exemption and remission

> 111. (1) *A person may apply to a council for, and the council may, by a vote of 2/3 of the councillors in office, grant an exemption, remission or deferment of taxes and interest on the taxes, either in whole or in part, for those periods of time that the council decides and the council may determine the evidence which it shall require to warrant the exemption, remission or deferment.*
>
> (2) *A council may, by a vote of 2/3 of the councillors in office, enter into tax agreements and offer tax incentives which vary existing rates of tax.*

This section provides council with the ability to make arrangements for special circumstances such as developing grant-in-lieu agreements for some major industrial businesses. In economic development terms this may create an additional concern that is addressed in the accompanying module "Small Towns and Big Industries."

Existing Businesses vs. New Business Attraction

When considering taxation as a tool in economic development it is important to remember that changes that you make to your tax structure can have impacts on your existing businesses as well. Unless there is a specific deal in place, such as a grant-in-lieu situation, then the impacts can be either positive or negative depending on the changes to the system as well as the nature and size of the business. Changes to any broadly applicable taxes, such as property tax or general business tax can have significant impact on already existing business.

Even if special tax incentive packages are being considered you must still consider the viewpoint of your existing business owners. How will they feel if your council offers an incentive package to a similar size or type of business for a new startup, if they have been in operation in your town for many years? Taxation is an issue where the perception of fairness comes into play. If the situation is seen as being unfair then the advantages must be seen as obvious and considerable. Remember that new business investment is good but usually not at the cost of existing businesses.

Developing a Tax Structure to Accomplish your Goals

With the taxation options available and the specific considerations identified how does a municipality determine what the best approach is for a taxation structure that might support economic development? To develop such a strategy a council must begin by considering the following questions.

- Is the structure fair to existing businesses?
- Is the structure appropriate to, or supportive of the approach in the region?

- Does the approach appropriately balance tax revenues with other benefits to the community?
- Are there alternative incentives possible, such as a grant-in-lieu of taxes?
- Are the rates and types appropriate for the nature of businesses?

Once all these have been considered then perhaps the most important questions can be addressed:

- What amount of tax incentive would be required to really attract new business? And would it be worth it?
- Is there an approach that might best benefit existing business or encourage expansion? And is it worth it?

Partner Opportunities

While each individual municipality implements changes to taxation, the repercussions can be felt throughout the region. In addition, tax changes to one small municipality may not be significant enough to instigate investment from outside businesses or boost existing business, and so it is always a good idea to, at minimum discuss the idea with surrounding councils. One of the options available to help facilitate that approach may be through your local Regional Economic Development Board (RED Board). For additional assistance on the regional approach to economic development refer to the accompanying module on "Regional Economic Development."

Conclusion and Follow Up

As with many aspects of economic development changes in tax structure can be undertaken without consultation with any partners but yet can have far reaching impacts. Adjusting tax structure can be a complicated scenario with multiple factors any many possible impacts, and as such it is often the best approach to understand the implications and impacts as best as possible before implementing any changes. One of the best ways to accomplish this is to speak to other municipalities that may have gone through the process and analyze their results. This approach should be undertaken with the long term picture in mind and should be included in any strategic plans such as you Integrated Community Sustainability Plan (ICSP).

In order to develop a sound and comprehensive tax strategy to assist in economic development many factors must be considered. From the impacts on existing business and the surrounding region, to the long-term implications and the question of real effectiveness of any changes, taxation adjustments can be a positive tool but it must be used wisely. Ensure you understand your business community, your region, your revenue needs, your business potential and the balance between benefits and costs of any possible tax incentive package.

Workshop Guide

Workshop Basics

Basic Concept:

To assist participants understand the connections between taxation and economic development.

Objectives

- Understand the basic relationship between tax rates and economic development
- Compare the existing tax options
- Understand the issues facing existing businesses as opposed to new business attraction
- Developing a tax structure to accomplish your goals

Materials

- Printed tables
- Flipchart and markers
- Printed sub-section introductions if desired
- Participants should bring a copy of their most recent budget and/or understand their current taxes and rates

Timeframe

This workshop contains 5 detailed exercises and a full day is required to meet the objectives and complete the tables. A short 5-minute break between exercises is recommended along with a meal break at approximately the midway through the workshop.

Suggestions

- Provide participants with the written sections at the beginning of the module.
- The introductions for each exercise can be read aloud, distributed to each group to read or discussed in general so long as the basic ideas presented are understood before the activity begins.
- Only distribute materials and handouts immediately prior to each individual exercise.

Groups

- For this workshop groups can be comprised of participants from the same municipalities.
- If this is not possible or not desired for some reason then groups should at least be comprised of participants from similar municipalities.

EXERCISE #1

Taking Stock of Existing Tax Rates

Time: 60 minutes
(30 minutes in small group and 30 minutes feedback)

Objective:
This exercise will initiate group participation early in the workshop. It is intended to allow participants to take stock of existing tax revenues.

Exercise:

- Break participants into small groups by municipality.
- Have them use the attached worksheet to collectively answer the following question
    - List the types of taxes your municipality collects that could potentially impact economic development
    - Indicate the rate
    - Indicate the approximate revenue collected last year for each tax
- Return to the entire group and collect some responses to each and collate on flip chart.
- Discuss common or outstanding results and any obvious missing opportunities.

Resources required:
Flipchart, markers, tape

Note to facilitator:
It will be useful to check back to the information gathered here at various points during the workshop

Type of Tax	Rate	Annual Revenue

EXERCISE #2

New Business

Potential Case Study

Time: 45 minutes
(30 minutes in small groups and 15 minute feedback)

Objective:
Understand the tax revenue potential for new businesses based on existing and potential tax structures

Exercise:

- Divide participants into same groups as first exercise, based on municipality.
- Provide each group with a copy of the attached case study and worksheet.
- Have each group complete the table based first on their current tax structure from exercise 1, and then on any possible new taxes or structure changes to calculate tax revenue for the sample new business. (30 mins)
- Bring all groups together and compare results.
- Note and discuss any significant changes groups have made to better take advantage of the new business.

Resources required:
Flipchart, markers, tape

Note for facilitator:
Encourage groups to be reasonable with new tax options for the potential Business.

Tax Revenue Case Study Worksheet

Congratulations! A new business is seriously considering opening in your municipality and you will have the opportunity to gain new tax revenue from its operation.

The characteristics of the new business are as follows:

- It will be a recreational vehicle sales and service business dealing with snowmobiles, ATVs and RVs.
- It would like to build a new building on an already serviced lot that would have a total value of $1,000,000.
- The business is estimating an annual gross revenue of $2,000,000 in its first year.
- The business will employ 10 persons with an average salary of $35,000 per year.
- At least 3 of the employees will require specific training that may require those people to be recruited from other areas and moved into the area.

Type of Tax	Rate	Annual Revenue
Existing taxes		
	Total:	
	Total:	
	Grand Total:	

EXERCISE #3

Increased Taxation Impacts
on Existing Businesses

Time: 45 minutes
(30 minutes in small group and 15 minutes feedback)

Objective:
Understand the tax revenue vs cost for existing businesses

Exercise:
- Divide participants into same groups as first exercise, based on municipality.
- Have each group complete the table and estimate based on their current tax structure recalling the information from exercise 1. (30 mins)
- Have each group estimate the ability for the existing businesses to deal with increased rates.
- Bring all groups together and compare results. (15 mins)
- Discuss the following question
    - What would be the impact of a significant tax increase on the existing business community?

Resources required:
Flipchart, markers, tape

Note to facilitator:
Encourage groups to compare results

Existing Businesses	Total Annual Tax paid to town	Can this business support a significant tax increase?

EXERCISE #4

The Balancing Act:

Tax Revenue vs. Development Opportunity

Time: 70 minutes
(50 minutes in small group and 20 minutes feedback)

Objective:
Understand the cost benefit approach to taxation changes to encourage economic development

Exercise:

- Divide participants into the same groups as in exercise 2
- Using the same case study information, the results of exercise 2 and the following new information answer the provided questions.
- Assumptions:
- Of the 10 positions created, 7 will bring current residents back into the workforce and 3 will bring people from outside the area.
- Because there are no available homes in the community 2 of the 3 will build new homes and 1 will commute from a nearby town.
- The business has pledged to create a new scholarship program at the high school for the student that shows mechanical aptitude and proceeds to post secondary training on the condition that its profits are sufficient.

Questions:

1. Use reasonable estimations to determine approximately how much additional money will come into the town besides direct taxation of the business. Include any information you feel is relevant. (20 mins)
2. What additional non-monetary benefits will come to the community from having the new business start up? (10 mins)
3. Based on a comparison of the direct taxation benefits as opposed to the monetary and non-monetary benefits coming from the new business would you: (20 mins)

   A) Tax as much as possible to get the maximum tax revenue from the business?

   B) Offer considerable incentives such that the town would not gain much taxation revenue?

   C) Develop your own answer and include reasons why you choose it.
4. Reconvene as a whole and compare and discuss the results from the groups. Focus especially on the rationale provided for the choices made in question 3. (20 mins)

Resources required: Flipchart, markers, tape

Note to Facilitator: Ensure that during the group session the participants write down and discuss the reasons or rationale for their choice for question number 3.

EXERCISE #5

Developing A
Comprehensive Tax Strategy

Time: 50 minutes
30 minutes in small group and 20 minutes feedback

Objective:
Understand approaches for maximizing benefit of economic development through the development of a comprehensive taxation strategy

Exercise:

- Divide participants into the same groups as exercise 4.
- Based on responses to the previous exercises answer the following questions: (30 Mins)
  1. Is your current tax structure fair to existing businesses?
  2. Do you currently use it as a toll in economic development?
  3. Are your tax rates similar to other municipalities in your area?
  4. Can you modify your current tax structure to attract new business?
  5. What type of business would you like to attract?
  6. Can a new tax structure help attract that business?
  7. What changes could you make to your existing structure in terms of types or rates or otherwise that might be able to help in economic development and why?
- Reconvene the entire group and compare and discuss the results. Especially focus on question 7 and highlight the similarities and rationales provided. (20 mins)

Resources required: Flipchart, markers, tape

Note to Facilitator: Draw out the participants to explore what possibilities exist and if they would be truly beneficial.

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