




CAPC
Fiscal & Investment Work Group
 May 2005

Initiative	Action Plan Item	Owner	Timing	Status
SUPPORT FOR INVESTMENT	(1) Investment Programs: Expand, better coordinate, improve flexibility and transparency of Automotive Investment Incentive Programs	FED	ST	Y
		PROV - ONT	ST	G

 Addressed / Implementation underway and on-time.
 Fed - Federal Government
 Prov - Provincial Government
 Auto - Auto Manufacturers, Suppliers
Data as of: 04/05/05

 Plans, commitments and timelines not clear - attention needed.

 Immediate Attention

Timing
 MT - Medium Term
 ST - Short Term

Much of the public dialogue in Canada over the need for a new automotive policy framework has been sparked by the current practice of several competing jurisdictions, especially the states in the U.S. southeast, to provide major financial incentives for new automotive investments. In most recent greenfield investments in the U.S. southeast, the reported value of these incentives has accounted for one-third or more of their fixed capital cost. For major brownfield investments in traditional U.S. auto-producing areas, incentives typically offset an average of one-fifth of the capital cost. A vigorous discussion has naturally sprung up in Canada regarding whether or not our governments need to, or should try to, compete with those incentives in order to protect our share of new automotive investment spending.


Our policies should aim to enhance the broad attractiveness of Canada as a site for all new automotive investment, and not solely to recruit particular high-profile greenfield investments (although those are also important to the future of our industry). Automotive policies should reflect and respect the particular Canadian circumstances of industrial development, including issues of federal-provincial jurisdiction, and the need to design investment-friendly policies that fit within the existing program envelopes and budget authorities of government agencies. Active measures to promote new automotive investments fall within several broad categories of government activity, include policies to stimulate more training, infrastructure, technology, environmental protection and capital investment.


We are asking Canadian governments to act positively to enhance the attractiveness of new automotive investments in Canada, to be prepared to add significant value (in many forms, and through legitimate government programs) to potential projects so that Canada can win a healthy share of future investment, and preserve and enhance our existing share of automotive production and jobs.


We recognize that investors will continue to engage governments at all levels in important discussions regarding the precise terms and conditions of individual potential investments, and governments will need to be constructive and flexible in those discussions. It has always been the case that major investments in this industry in Canada – both greenfield plants and critical investments to regenerate and revitalize brownfield facilities – have been supported with proactive policy measures from all levels of government. This cooperation between investors and governments needs to continue. In addition, investors also need to be confident that the overall fiscal and economic context for their potential investments in Canada is amenable and attractive. The measures that are proposed in this submission would help to achieve that goal, and would put Canada back on the map for new auto investment spending, with a set of transparent, consistent, and fair policies which would add value to future investment projects.

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Initiative	Action Plan Item	Owner	Timing	Status
SUPPORT FOR INVESTMENT	(1) Investment Programs: Expand, better coordinate, improve flexibility and transparency of Automotive Investment Incentive Programs (Cont'd)	FED	ST	Y
		PROV - ONT	ST	G

 Addressed / Implementation underway and on-time.
 Fed - Federal Government
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To this end, the members of the Canadian Automotive Partnership Council have identified a number of guiding principles which should ensure that our automotive policy framework supports new investment in a transparent, fair, and efficient manner. These principles should provide a useful framework for governments as they work to design a new set of automotive policies:

- A new automotive policy for Canada must be fairly accessible and equally beneficial to all companies in the industry that undertake new investment spending in Canada.



- In the auto industry, which is both labour and capital intensive, investments must be renewed every five to eight years to ensure continued jobs and economic spin-offs. Therefore, it is important that any government initiatives are available equally to renewed investments in existing facilities as to greenfield investments.


oWithin the bounds of Canada’s international obligations, governments should put in place strategies that encourage and make it advantageous for companies that sell here to invest here.


- Transparency and certainty is important for all investors, and it is critical that all levels of government work constructively together to attract business investment and jobs. In this regard, government policies must be complementary – between government ministries and between federal, provincial and municipal levels of government. (Duplication and conflicting regulatory requirements can add a severe burden of red tape negatively impacting the overall competitiveness of the jurisdiction).


- The auto industry functions as a complex system, and all elements need to be healthy for the system to function effectively as a whole. Accordingly, the work of each of the major CAPC policy work groups is equally important. This includes strategies to address investment, human resources development, regulatory harmonization, trade infrastructure, innovation and climate change. In addition, we need to ensure that we enhance the competitiveness and performance of all elements of the value chain in Canada, from raw material suppliers through parts producers and service providers, assemblers, dealers, retailers and the aftermarket.

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Initiative	Action Plan Item	Owner	Timing	Status
SUPPORT FOR INVESTMENT	(2) Taxes:	FED	MT	
	a) Establish Investment Tax Credit for New Machinery & Equipment	PROV - QUE	MT	

 Addressed / Implementation underway and on-time.
 Fed - Federal Government
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Canada established an Investment Tax Credit (ITC) program to encourage investments in machinery and equipment in 1975. While it was originally slated to last for a period of 2 years, its success was such that the ITC rates were increased several times, its base was broadened and its geographic area of application as well as measures permitting the transfer of ITC were introduced to make it a more powerful economic policy tool. When in the late 1980's tax reform measures were introduced that saw general corporate tax rates reduced and the base broadened, one of the victims of this important taxation policy realignment was the end of the ITC program as it applied to manufacturing and processing investments in Canada. However, CAPC believes that the ITC program for machinery and equipment was a very effective model that produced significant economic results. **CAPC recommends that the federal and provincial governments establish an Investment Tax Credit of 20% to encourage investment in new manufacturing machinery and equipment to be effective immediately, as well as increase the CCA rate on new equipment used in M&P.**

CAPC recommends that the new ITC program should apply to the cost of new machinery and equipment acquired for the use in Canada primarily in manufacturing and processing activities.

A taxpayer would be able to deduct 20% of his investment in qualified property from his federal income tax liability. In other words, the cost of the asset to the taxpayer would be reduced by these ITC's.

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Initiative	Action Plan Item	Owner	Timing	Status
SUPPORT FOR INVESTMENT	(2) Taxes:			
	b) Eliminate Provincial Capital Tax	PROV - ONT	MT	G
	c) Eliminate Federal Large Corporation Tax (LCT)	FED	MT	Y

<p>G Addressed / Implementation underway and on-time.</p> <p>Fed - Federal Government Prov - Provincial Government Auto - Auto Manufacturers, Suppliers</p> <p>Data as of: 04/05/05</p>	<p>Y Plans, commitments and timelines not clear - attention needed.</p>	<p>R Immediate Attention</p> <p>Timing MT - Medium Term ST - Short Term</p>
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The link between investment, long-term output and job growth has been well established in economic literature. Capital taxes are an inhibitor to investment and are damaging Canada's economy. They discourage investment in plant, equipment and technology, which are essential for long-term growth and job creation. At this juncture, the auto industry, which includes assemblers and a growing Canadian supplier base, needs every reason to make significant capital investments in order to preserve existing jobs and to create new ones in this industry that has been a mainstay of Canada's economy.

Capital taxes are a clear impediment to reaching an investment decision. It is an annual tax on investment and therefore accumulates each and every year of the investment's life. The auto sector is capital and labour intensive and invests for the long term. Accordingly the industry bears a disproportionate burden of capital taxes due to this capital intensity and the long-term commitments that it makes.

Historically the manufacturing sector has been accorded a lower corporate tax rate in recognition of its role in the Canadian economy and the need to remain competitive internationally. The move to bring the federal and provincial general corporate income tax rates in line with the preferential rate for the manufacturing sector is a positive step toward making Canada more competitive in general terms. However, leaving capital taxes in place while leveling the corporate income tax rates is increasing the relative tax burden on manufacturers. Additionally, although not isolated to the manufacturing sector or to the auto industry specifically, capital taxes are profit insensitive.




Capital taxes are a significant drag on economic output. A study conducted by the Department of Finance Canada, and published in the Organization for Economic Co-operation and Development's 1996-1997 Economic Survey of Canada, compared the cost to the economy of the various tax measures being used in Canada. The results of the study indicated that every dollar of tax collected through corporate taxes (both income and capital) results in a loss of \$1.55 in output. Indications are that the loss inflicted by capital taxes alone is significantly larger and could be as much as \$7.00 for every dollar of revenue raised.


Capital taxes are an inefficient and expensive system for raising government revenues. The costs associated with reducing profitability, investment, and productivity often falls upon the labour force, giving capital taxes the reputation of "job killer" (4). Labour suffers not only because of reduced employment but also through reduced wages. Capital is more mobile than labour so market forces can be expected to shift a part of the capital tax burden onto labour, the less mobile factor, in the form of reduced wages.


Making progress in innovation and research and development must become the cornerstone of Canada's policy agenda in order to enhance our productivity and standard of living. While it is recognized that achieving this involves a well-integrated policy framework, an essential element is the creation of a business environment that is conducive to investment. At a time when Canada is challenged with increasing its productivity and closing the standard of living gap with the United States, capital taxes are a significant investment barrier that needs to be removed if we are to meet this challenge.


The auto-sector is disproportionately and negatively impacted by capital taxes. CAPC recommends the expedited elimination of the federal Large Corporation Tax and provincial capital taxes to remove a key impediment to automotive investment in this country.

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Initiative	Action Plan Item	Owner	Timing	Status
SUPPORT FOR INVESTMENT	(2) Taxes:			
	d) Reduce Corporate Tax Rates	FED	MT	
		PROV - ONT	MT	
		PROV - QUE	MT	

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Canada's prosperity and its ability to create the necessary wealth to sustain the lifestyle demanded by its citizens will continue to rely heavily on its ability to export high value-added goods, primarily to the U.S. The economic growth required to achieve this prosperity and wealth creation depends on the cost competitiveness of Canadian businesses in international markets. Also, given the openness of the Canadian economy, a business taxation system that does not inhibit continued strong export performance is critical to maintaining jobs within the Canadian border. A business that finds that its costs, of which tax is one, are higher in Canada than in other countries will shift production elsewhere or lose market share.


During the nineties, as other countries continued to reduce the total tax burden on business enterprises at the industry or sector level, Canada began to, and must continue to, respond accordingly or risk eroding its overall competitiveness, resulting in less internationally competitive exports and reduced ability to attract and maintain its stock of capital investment.


There is increasing evidence that Canada's corporate effective tax burden on investment is above international norms, particularly compared to the U.S. Multinational or Trans-national businesses with Canadian operations are less willing to allocate income-producing investment or to source income-producing product from Canada and instead are more willing to repatriate Canadian-sourced income by shifting/allocating costs to Canada in various forms, for example, interest, royalties and management fees.


The resulting loss in corporate tax revenues will require federal and provincial governments to seek other sources of revenue, e.g. capital and payroll taxes, to maintain public expenditures, further exacerbating the inefficiency and uncompetitiveness of the Canadian business tax structure and eroding the overall tax base. Over time there will be less business investment and activity to generate tax revenues.

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Initiative	Action Plan Item	Owner	Timing	Status
SUPPORT FOR INVESTMENT	(2) Taxes:			
	e) Expand Manufacturers & Processors Tax Deduction	FED - PROV	MT	

 Addressed / Implementation underway and on-time.
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Any Canadian manufacturing and processing success can only be sustained by new capital investment in production capacity, processes and technologies which means being successful in attracting a meaningful share of the limited global capital investment pool.

Since investments in manufacturing and processing operations typically require high fixed capital investment, compared to service industry investments, the business will seek out the highest return alternative to minimize the economic risks inherent with commitments of relatively immobile capital.

Due to this risk associated with capital-intensive fixed investment, to win a siting or sourcing decision the Canadian operation of a multinational enterprise must demonstrate a return that is meaningfully better than the next best alternative (generally, a U.S. or Mexican location). When there is only an advantage at the margin, the U.S. location will be favoured for trade, political, market mass or other reasons. Proximity to the largest consumer market in the world and the destination for the majority of Canada's production is both a blessing and a curse. Similarly, Mexico has a significant labour cost advantage, comparable quality, and has preferential access to the European and Latin American markets through various trade agreements. Unfortunately, capital investment in Canada has been declining over the past decade in contrast to the significant increase in the real value of the capital stock in the U.S.

This is, in large part, due to the uncompetitive Canadian business tax system, compared primarily to the U.S. as U.S.-based multinationals have made investments increasingly in the home market and Mexico.

Historically, Canada recognized that where its general corporate tax rate was not competitive, to continue to be able to attract high multiplier/high export value manufacturing investment, it needed to put in place a Manufacturing and Processing deduction. While Canada has taken a positive step forward in reducing its general corporate tax rate, manufacturing investment remains at a competitive corporate tax disadvantage. The continuation and expansion of a Manufacturing and Processing deduction for Canadian M&P operations would make an obvious and compelling reduction in the resulting effective tax rate to favour a Canadian investment alternative, either a new investment or maintaining existing investment. It would immediately reverse the trend of decapitalizing the Canadian manufacturing industry and sustain and enhance this highest value-added part of the Canadian economic fabric.

To encourage investment in new manufacturing and processing facilities in Canada, CAPC recommends that the federal and provincial governments continue and expand the M& P deduction to reduce the federal rate to 17% and the provincial rates to 8%.

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Initiative	Action Plan Item	Owner	Timing	Status
SUPPORT FOR INVESTMENT	(3) Vehicle Leasing: Eliminate Vicarious Liability	PROV -ONT	ST	R

G Addressed / Implementation underway and on-time.
 Fed - Federal Government
 Prov - Provincial Government
 Auto - Auto Manufacturers, Suppliers
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Under provincial vicarious liability legislation, finance leasing companies are often deemed the "owners" of motor vehicles in civil proceedings against their customers (lessors). The definition of owner stated within the Highway Traffic Act (HTA) – Part XI (Civil Proceedings), Section 192. (1), results in many cases where the vehicle finance leasing companies are unfairly deemed liable for the loss or damage sustained due to actions of drivers, even though vehicle finance companies have no control over the use or operation of the vehicle. An inequity exists between vehicle financiers, such as banks and credit unions that are not held vicariously liable when the vehicles they finance are in motor vehicle accidents, versus non-bank financiers that are held vicariously liable.

The Canadian automotive industry is approximately 1.6 million vehicles per year. Ontario represents approximately 40% of all of Canada's vehicle sales. Leasing has become a popular instrument in making vehicles affordable to Canadians, as it often offers consumers with a lower monthly payment option versus other methods. In fact, more than 40% of new vehicles were leased in 2003.

In New York State, a jurisdiction with similar vicarious liability laws as Ontario, Ford, GM, and DCX have pulled out of vehicle leasing. Honda (halted July 2003 and resumed March 2004) and Toyota continue to offer leasing, however both companies have had to raise leasing fees in order to minimize the risk of vicarious liability (by US\$500 and US\$650 respectively). Automotive manufacturer finance leasing companies in Canada estimate that they are currently facing a total of over \$1 billion in outstanding vicarious liability claims filed in Canadian courts.

The continuance of vicarious liability on finance leasing companies in civil proceedings against lessors, will result in negative impacts on consumers, automotive dealers and the government. In Ontario, consumers will incur an impact on their vehicle affordability and accessibility if companies pull out of vehicle leasing. It could become more difficult for Ontario residents to be able to have personal access to a new vehicle with the latest, most environmentally friendly technologies. Dealers will experience lost vehicle sales as fewer consumers will be able to afford the monthly vehicle payment, resulting in less economic benefits to Ontario's economy. The government is also negatively impacted, as sales tax revenue normally received in leasing contracts, will be foregone.

To eliminate the risk that vehicle leasing will cease to be an available affordable choice to Ontario consumers, CAPC recommends that an amendment of the Ontario HTA should be pursued.