

## The HST: Smart Tax Policy

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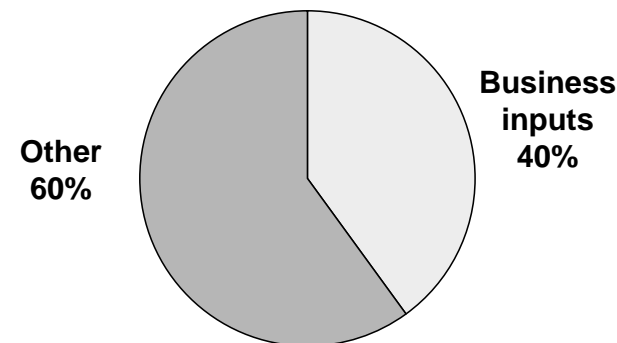
## Value-Added Consumption Taxes

- Definition:
  - » "... a broad-based tax levied at multiple stages of production, with – crucially – taxes on inputs credited against taxes on outputs" (OECD)
- Key features of a VAT regime:
  - » final base of tax is consumption
  - » full crediting of taxes paid on inputs by businesses
  - » revenue secured by being collected throughout the production process
- Expansion in use of VAT
  - » "the most important development in taxation over the last half century" (OECD)
  - » used by fewer than 10 countries in the late 1960s
  - » today 140 countries, including 29 of 30 OECD members, maintain value-added taxes of some kind

## HST – The Basics

- A single harmonized value-added tax that will replace the Goods and Services Tax (5%) and the existing BC Provincial Sales Tax (7%) effective July 1, 2010
- HST is a pure consumption tax; PST is a 'hybrid'
  - » PST taxes paid on most capital inputs; HST removes this burden
- Definition of the HST tax base largely follows the GST definition: almost all goods and services will be taxed
  - » much broader sales tax base
- BC will no longer collect sales tax – Canada Revenue Agency takes on this role for us
  - » remits provincial portion back to Victoria
- HST recognizes shift in consumption patterns
- Tourism and home building adversely impacted

## Provincial Sales Tax (PST) Revenues, 2008-09



Of \$4.96 billion in PST revenue collected in 2008-09, tax on business inputs represented \$1.98 billion.

## HST – The Benefits

- Reduces business costs
  - » removes sales tax on most business inputs
  - » lowers the cost of investing in machinery, equipment, structures, technology, etc.
- Decreased compliance costs – single tax system
  - » lower administrative costs for businesses (\$200 million)
  - » \$30 million savings for provincial gov't
- More efficient tax
  - » avoids cascading tax effect of PST
- Improves BC's competitive position
- BC gets \$1.6 billion in "transition" funding from Ottawa
- More tax on consumers partly offset by lower prices

## Marginal Effective Tax Rates on New Business Investment

<b>BC Current</b>	<b>26.4%</b>
<b>BC with HST</b>	<b>15.7%</b>
Ontario with HST	16.2%
Alberta	16.3%
Quebec	14.8%
US	34.3%
OECD avg	22%

The **Marginal Effective Tax Rate (METR)** is a comprehensive measure of the impact of business taxes on investments. It captures all taxes which impact the net return on capital employed – e.g., corporate income tax, capital taxes, sales taxes, and capital cost allowances. METR excludes R&D tax credits and property taxes.

## HST: Experience in Atlantic Canada

- 1997 HST tax reform resulted in tax savings being passed on to consumers
  - » study found with few exceptions (shelter, clothing) consumer prices fell
  - » estimates suggest 0.8%-0.9% decline in consumer products and services
- With HST, annual investment in machinery and equipment rose 12.2% above trend levels
- Similar outcomes in Quebec, which has its own value-added sales tax linked to the GST

Source: Michael Smart and Richard Bird, "The Impact on Investment of Replacing a Retail Sales Tax by a Value-Added Tax: Evidence from Canadian Experience," March 2009; and Michael Smart and Richard Bird, "The Economic Incidence of Replacing a Retail Sales Tax by a Value-Added Tax: Evidence from Canadian Experience" (June 2008)

## HST: Expected Economic Impacts Over the Long Term

- Increased business investment in productive assets (plant, equipment, technology, structures... )
- Higher productivity (output per worker rises because investment in capital increases)
- Higher average real wages (higher productivity lays the foundation for increased real wages for workers)
- More exports – PST adds to the cost of producing goods/services in BC for export, the HST will remove these costs
- Stronger economic and job growth over time as the distortions associated with the PST are eliminated
- Enhanced competitiveness, globally and within Canada, for BC business and industry

## HST – Some Details

- No item currently exempt from the GST will be subject to HST; entities making exempt ‘supplies’ cannot claim input tax credits to recover HST paid on inputs
  - » examples: health services, financial services, educational services
- Any business that pays more HST on inputs than it collects may claim a refund
- Zero rating – tax applied is zero, though input credits are still given
  - » exports are zero rated
- A low-income HST tax credit will shield low-income households from the new tax
- BC will establish ‘point of sale’ rebates for the provincial portion of the HST for a few items (adding up to about 5% of the tax base)

## Long-Run Economic Impact from ‘Revenue Neutral’\* Tax Reductions

Tax	% change in GDP for a tax reduction amounting to 1% of GDP
<b>Sales tax on capital inputs</b>	<b>3.1</b>
Capital tax	3.6
Corporate income tax	1.9
Average personal income tax	1.3
Wage / payroll tax	0.7
Consumption tax	0.2
Capital cost allowance	4.4

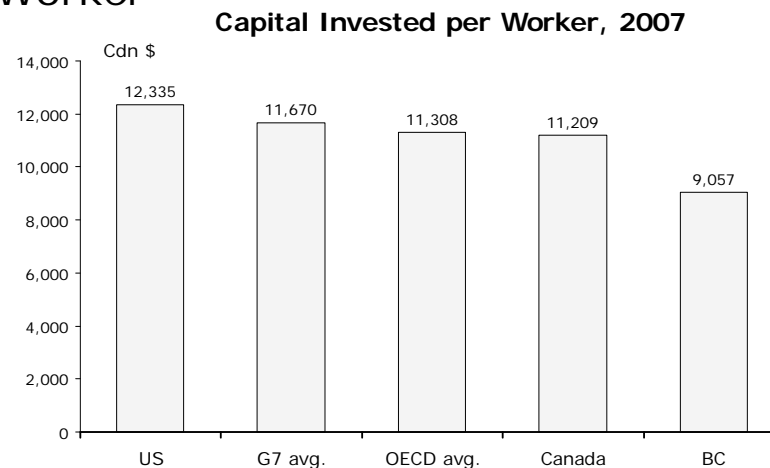
\* Revenue loss is assumed to be recovered by lump-sum taxation

Source: M. Baylor and J. Beausejour, “Taxation and Economic Efficiency: Results from a Canadian CGE Model,” Department of Finance Working Paper 2004-10:

## BC’s Fundamental Economic Challenges

- Insufficient investment, outdated capital stock in some sectors
- Low level of productivity, coupled with a pattern of sluggish productivity growth
  - » hard to ‘fix,’ partly reflects industry mix, but important to address nonetheless
- Weak export base and feeble export growth over time
  - » highlights the need to develop stronger ‘traded clusters’ – industries capable of producing goods and services of value to customers outside of local markets

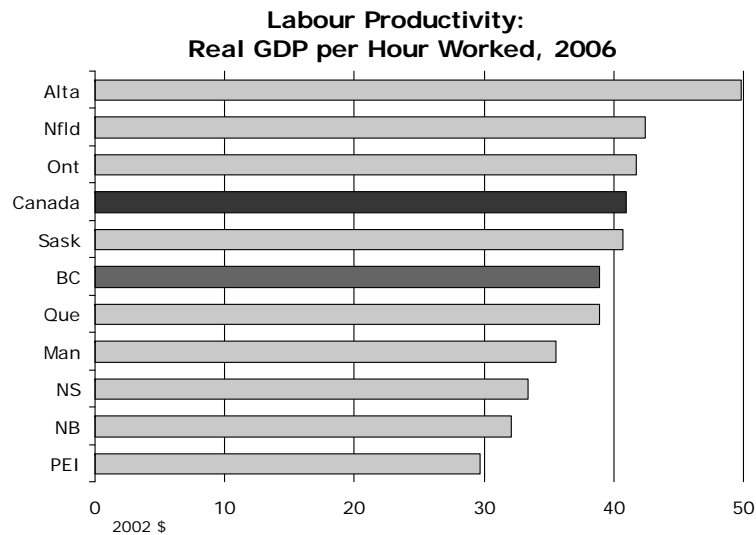
## BC Lags in Capital Investment per Worker



The typical worker in BC had \$9,057 in new capital investment in 2007, well below investment per worker in Canada, the US and the OECD.

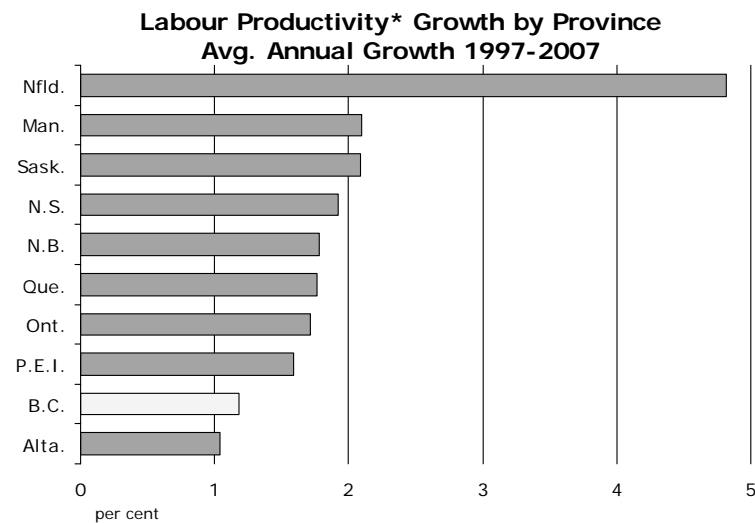
Source: CD Howe Institute.

# BC Productivity Level Below Canadian Benchmark



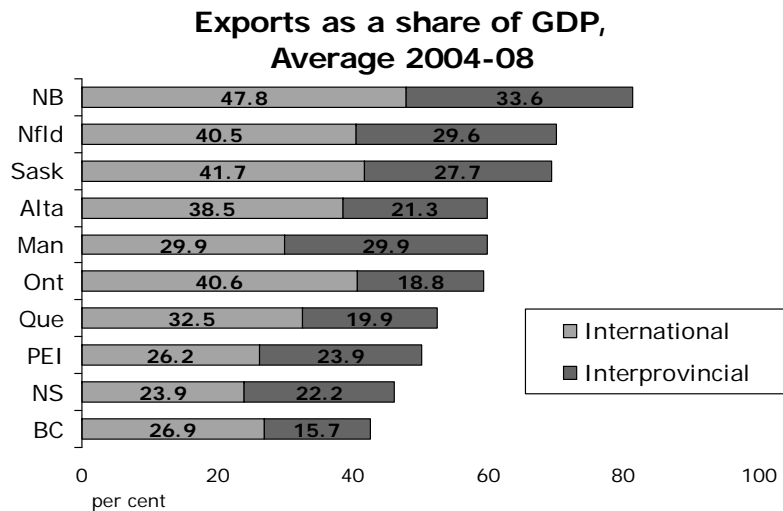
Source: Centre for the Study of Living Standards.

# BC Lags in Productivity Growth



Source: Centre for the Study of Living Standards. \* real GDP per hour worked

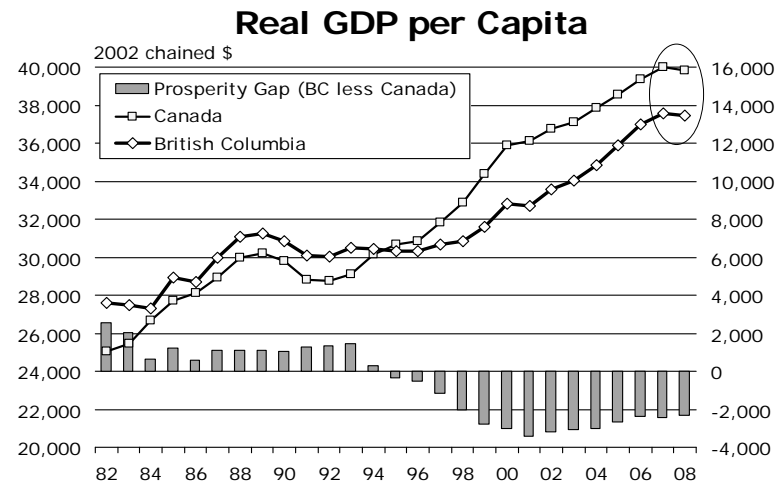
# Export Intensity



Sources: Statistics Canada, Provincial Economic Accounts.

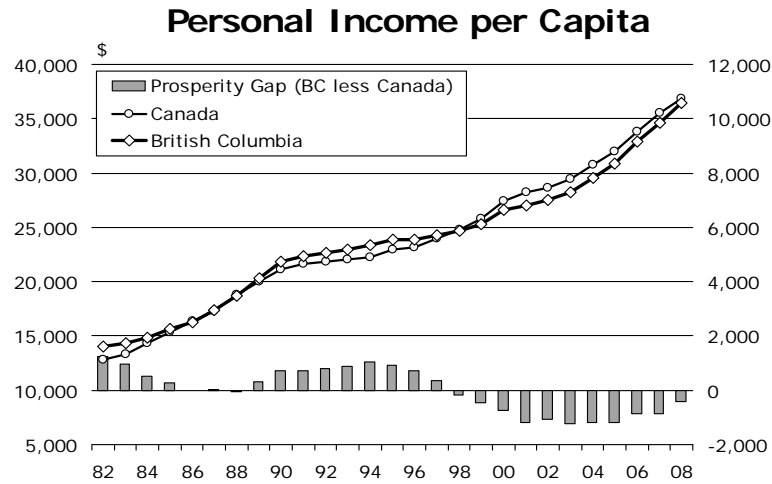
measured in current dollars

# Prosperity Gap Remains



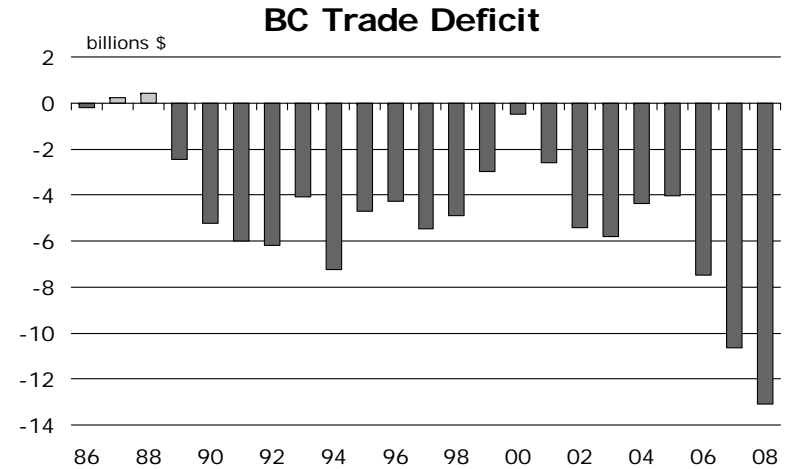
Source: Statistics Canada, Provincial Economic Accounts.

## Average Incomes Still Lower in BC



Source: Statistics Canada, Provincial Economic Accounts.

## A Widening Trade Deficit



Source: Statistics Canada, Provincial Economic Accounts.

## HST: New Housing

- Rebate for new housing to ensure that, on average, purchasers of new homes up to \$400,000 pay no more in tax due to harmonization than currently (the PST embedded in new homes adds 2% to the price)
- Purchasers of new homes > \$400,000 eligible for rebate, calculated at 71.4% of the provincial portion of HST, up to a maximum of \$20,000
- Tax-inclusive price of new homes above approx. \$550,000 will be higher
- Government is under pressure to...
  - » boost the threshold beyond \$400,000
  - » remove property transfer tax from new homes

## Total Sales Tax Payable on New Homes

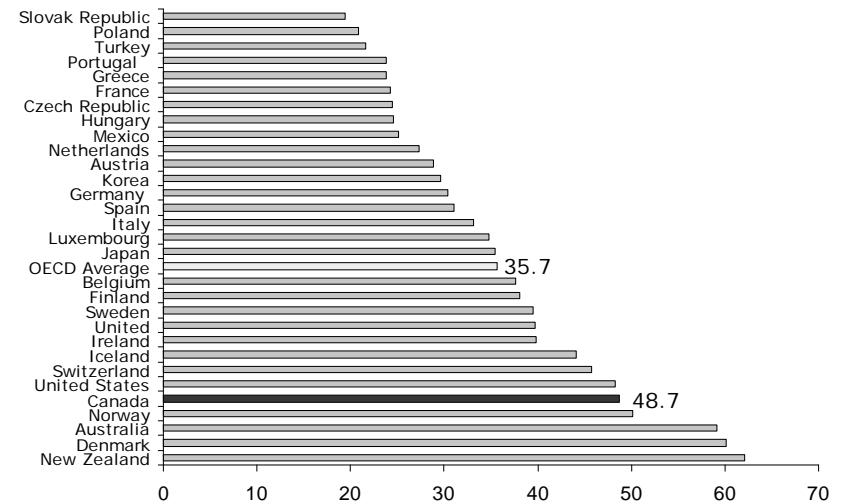
Purchase price	Current embedded PST of 2%	After Harmonization	
\$250,000	\$5,000	BC HST (7%)	\$17,500
		Less new housing rebate	(12,500)
		Net provincial HST	\$5,000
		Less embedded PST	(5,000)
		<b>Net impact on home buyer</b>	<b>\$0</b>
\$400,000	\$8,000	BC HST (7%)	\$28,000
		Less new housing rebate	(20,000)
		Net provincial HST	\$8,000
		Less embedded PST	(8,000)
		<b>Net impact on home buyer</b>	<b>\$0</b>
\$650,000	\$13,000	BC HST (7%)	\$45,500
		Less new housing rebate	(20,000)
		Net provincial HST	\$25,500
		Less embedded PST	(13,000)
		<b>Net impact on home buyer</b>	<b>\$12,500</b>

Source: September Budget Update – 2009/10 to 2011/12.

## HST: Tourism and Hospitality

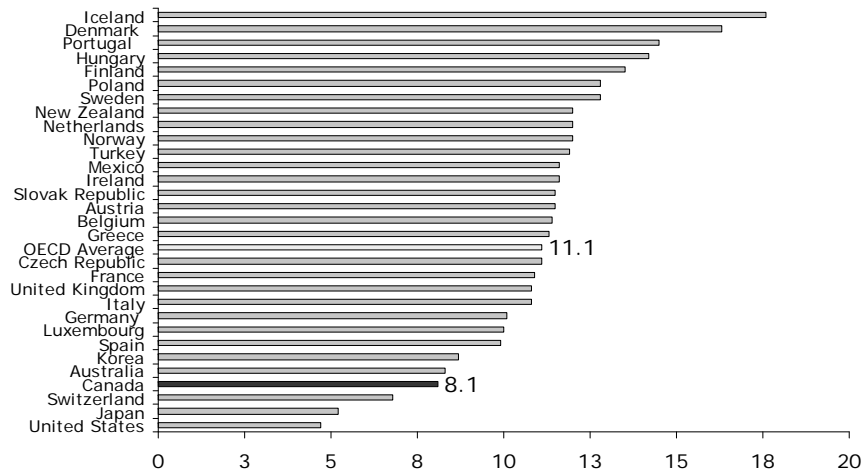
- Made up of several quite distinct sectors
- A big export industry for BC
- Concern of 'sticker shock' effect from HST...
  - » input tax credits small due to high labour intensity
  - » so limited cost saving from removing PST for many tourism related businesses
  - » some estimates point to a 3.0-4.6% average 'price' increase on tourism related products and service sold in BC
- Hard to determine the shape of demand curves for many tourism products/services
- Government is looking at mitigation options, but few obvious answers – other than making sure foreign visitor rebates are set at 12% under the Foreign Convention and Tour Incentive Program

## Income and Profit Taxes as % of Total Taxation, 2006



Source: OECD Revenue Statistics (2008).

## Goods and Services Taxes as % of Total Taxation, 2006



Source: OECD Revenue Statistics (2008).

## BC Tax Competitiveness Improving

- Corporate income tax rate slated to fall to 10% by 2011 (versus 16.5% in 2000)
- Small business income tax rate is now 2.5%, dropping to zero in 2012
- Elimination of capital tax
- Significant reductions in personal income taxes
- HST
- Carbon tax a step backward

## Summary

- Value added taxes widely used around the world
- Move to HST will significantly improve BC's competitive position and investment climate
- A net saving to business, most of which will be passed on to local consumers
- Experience from other jurisdictions is positive and consistent with economic theory
- Some sectors adversely impacted
  
- Bottom line – HST is smart tax policy

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