CHANGING BC'S SALES TAX MODEL - MOVING BEYOND THE PST (2013- RENEWED 2016)

BC's tax competitiveness has been seriously undermined by the public's rejection of the Harmonized Sales Tax (HST). This has been compounded by the fact that the HST has been replaced with essentially an unchanged Provincial Sales Tax (PST). As a small, open trading jurisdiction this cannot be left unaddressed if BC wishes to remain competitive as a jurisdiction.

Background

The move to a HST was greeted with wide support from the business community and virtually unanimous support from academics. This support was based on a recognition that the HST would result in increased competitiveness; increased productivity; harmonisation with most of the Canadian and global economy; stable government revenue and a reduction in paperwork for business.

Of these positive aspects of the HST the two that are most important to our ongoing economic prosperity are competitiveness and productivity.

The Competitiveness Challenge

Since 2001 the Provincial Government have undertaken a sustained program of tax reductions for both individuals and business.

Table 1 - Interprovincial Comparisons of Business Tax Rates

	B.C.	AB	Sask	Man	Ont	Queb	New Brunswick	Nova Scotia	PE I	Nfl
General Rate	10[a]	10	12	12	11.5	11.9	10	16	16	14
Manufacturing	10	10	10	12	10	11.9	10	16	16	14
Small Business	2.5	3	2	0	4.5	8	4.5	4	1	4
SmallBus. Threshold (000s)	500	500	500	400	500	500	500	400	500	500
Corp. Capital										
- Financial	Nil	Nil	.7/3.25	3	Nil	.25	3	4	5	4
Sales tax[b]	7	Nil	5	7	8	9.5	8	10	10	8

a BC's Corporate tax was 10% prior to the 2013 Provincial Election. Depending on which party forms government this rate will increase to 11% under the BC Liberals and 12% under the BC NDP.

b ON April 1, 2013 BC joined Saskatchewan and Manitoba as the only provinces who levy sales tax on business that is not offset by tax credits

As shown in table 1 BC is now highly competitive in a Canadian context across a range of key business tax rates. It must be noted however that these rates are focused on established businesses generating revenue or making sales (with the exception of sales tax which in BC, Manitoba and Saskatchewan is paid on business inputs). BC's economic future will depend upon our ability to attract investment and new economic activity. If investment and new economic activity are the goal BC's tax picture looks very different. To review BC's tax picture as it relates to new investment it is necessary to review BC's Marginal Effective Tax Rate (METR)[1].

Table 2 - METR Rates by Province 2012 & 2014[2]		
	2012	2014
BC	17.4	27.7
Canada	16.8	19.9
Alberta	16.5	17.9
Ontario	17.6	19.8
Quebec	14.5	16.9
Saskatchewan	24.0	25.2
Manitoba	26.0	27.1
Nfld	9.6	11.2
Nova Scotia	5.2	7.7
New Brunswick	1.5	4.6
PEI	27.7	10.8

As we can see from table 2, in 2012 under the HST BC was placed as the 6th most competitive jurisdiction in Canada and well placed against our western neighbours and in relation to Ontario and Canada – in short against our competing jurisdictions. By contrast in 2014 we see BC move to be the bottom of the Canadian ranking, this shift can be traced to the fact that the "*provincial sales tax effectively raised METRs by over 9, 10 and 14 percentage points, respectively, for Saskatchewan, British Columbia and Manitoba*[3]*.*"

It must be noted, the METR calculations do not capture the full impact of the PST on BC competitiveness. They take into account only the PST on capital investment. The PST also applies to non-capital inputs that are used in business operations. In fact, the PST paid on non-capital inputs is four to five times the amount levied on capital inputs.

The other aspect of competitiveness is in regards to BC's critical export industries. As a jurisdiction BC has a smaller export base than most other provinces, as such it is critical that attention is paid to any tax changes that will negatively impact BC's exporters ability to compete in other markets. The PST is a significant impediment in this regard.

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1 METR is a measure used to compare the total tax burden on new investment by industry, type of investment, and size of firm. To do this METR includes the effect of corporate tax rates, sales tax on business inputs, investment tax credits and other incentives, capital cost allowances, capital taxes and the ability to deduct interest costs.

2 2012 Annual Global Tax Competitiveness Ranking, Duanjie Chen and Jack Mintz, pages 15 & 16. http://www.policyschool.ucalgary.ca/sites/default/files/research/tax-competitiveness-2012.pdf

3 ibid, page 16

As a small, open trading jurisdiction BC exporters compete with producers from across the globe, the majority of who do not have a sales tax structure that embeds costs at every stage of production as does the PST. Indeed, if we look at jurisdictions that levy a PST system we see that BC stands relatively alone as one of only 3 jurisdictions in Canada, and the exception to the more than 130 countries worldwide, that do not have a value-added sales tax in place. As such these producers have a significant competitive advantage over BC producers who struggle to remain competitive when building these costs into their price (HST also made BC producers more competitive against foreign competition when selling in domestic market for the same reason).

This is also an issue for BC's resource industries, the foundation of economy prosperity for communities across the province. Commodity based exporters are price-takers in the global context. PST represents a significant cost for the extraction and production of resources and reduces profits and therefore the ability of these companies to invest in innovation and job creation.

The Productivity Imperative

The single biggest determinant of our per capita income and our ability to raise wages and living standards is our productivity – in short how efficient we are as an economy. Countries that are innovative and able to adapt to shifts in the global economy will see high productivity and thus a superior standard of living.

In this regard Canada and BC have not fared well against competing jurisdictions. Between 1997 and 2011 the output of BC's business sector was on average only 92% of Canada's.[4] From 1981 to 2007 non-residential business investment in BC was 74.4% of the Canadian average. In the same period the capital employed per worker fell from 113.5% to 88.9% of the Canadian average. It is not surprising that during the same period BC's share of Canadian GDP fell from 13.1% to 12.4%.[5]

While there are a variety of factors that contribute to enhancing productivity it is recognised that improvements will require investment in equipment and technology, particularly investments in information and computer technology.

While BC's productivity performance is reason enough to look to government to find ways to boost investment in technology and equipment the Chamber believes the coming demographic shift must make this the highest of priorities for government.

We already know that the baby boomer generation is on the verge of retiring. While work continues to encourage older workers to remain in the workforce we can anticipate that through to 2019 we will see 676,000 workers leave the workforce through retirement. During that time BC can expect to create 450,000 new job openings through economic growth while graduating

4 Stats Canada table 383-0011
5 Investment in BC: Current Realities and the Way Forwards, Centre for the Study of Living Standards

only 650,000 students through the K12 system[6]. That represents a shortfall of over 450,000 positions with no workers to fill them.

To ensure this challenge does not profoundly damage the BC economy we must ensure that we improve significantly on our productivity levels.

The Importance to Small Business

While many of the arguments in favour of the HST focus on its broad provincial impact it is worth noting that this is an issue of particular importance for small business given BC's reliance on small and medium sized businesses for our economic prosperity.

Further to this BC's small business sector is critical to wealth generation and our capacity to grow and innovate. Responsible for employing over one million British Columbians small business is responsible for 57% of all private sector employment in the province, an increase of 2.6 per cent over 2006[7].

While the concentration of small businesses largely reflects the economy at large with a significant focus on service sector industries small businesses are significant economic generators. Small businesses were responsible for shipping approximately $16.9 billion worth of merchandise to international destinations in 2010, comprising almost 55 per cent of the total value of goods exported from the province.

In addition small businesses drive BC's innovation industries with 8,462 small businesses in British Columbia's high tech sector in 2011, which represents about 97 per cent of all high technology businesses[8].

This placed small business as one of the key beneficiaries of the HST and will see them significantly impacted by the return to the PST. In fact one of BC's largest productivity challenges is the difficulty small businesses face in accessing capital to invest in innovation or productivity enhancements. As such the return to the PST will have a disproportionate impact on these small businesses compared to larger firms in terms of addressing productivity.

The Solution

The competitive and productivity issues that we have outlined above were an issue before the introduction of the HST. Indeed, the HST was supported by so many business organizations specifically because of its ability to address many of these issues.

Despite the obvious benefits of a HST the Chamber recognises that the public has spoken through the referendum: there is no appetite either publicly or politically for a harmonised sales tax.

However, reform is needed. As we have demonstrated the return to the PST will have a significant impact on BC's competitiveness and productivity. The Chamber realises that

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6 http://www.workbc.ca/Statistics/BC-Economy/Pages/BC-Economy.aspx
7 2012 Small Business Profile, BC Stats
8 ibid

following the HST and the referendum there is little appetite of significant reform to our sales tax system and little appetite for a redistribution of the current tax which reduces the fiscal flexibility open to government.

The Chamber believes that the most damaging aspect of the return to the PST and the aspect that therefore requires the most immediate attention is that the PST will be levied on investment in machinery and equipment. This is not to suggest that the PST will see an increase in cost on all machinery and equipment. The PST already exempts certain machinery and processing equipment used in manufacturing and agriculture. Reform needs to widen these scope of sectors that can access these savings to reduce complexity but also to reduce BC's METR. Indeed, the Expert Panel on Tax estimates that offering an Input Tax Credit on the acquisition of machinery and equipment would cut BC's METR to 19%, significantly improving BC position in the Canadian context[9]

The Chamber recognises that this is not a measure that can be introduced immediately. The Expert panel on Tax estimates that this measure alone would result in a reduction in revenue to government in the order of $489 million in 2014/15 rising to $511 million in 2015/16 and to $534 million in 2016/17[10]

Long term – over the long term government must engage in a meaningful consultation with British Columbians on our competitiveness and productivity and the role taxation plays, a key component of this dialogue must be the role taxation plays in enhancing our competitiveness and productivity.

While the return to the PST represents the largest tax increase on business in BC's history representing an increase in cost of $1.5 billion BC business are facing rising costs on a number of additional fronts. Business is also facing higher Employment Insurance and WorkSafeBC premiums, a carbon tax that is the highest in North America, escalating electricity rates, substantial increases in the minimum wage, and uncompetitive municipal property taxes. This direct hit on companies revenue is amplified by the ongoing permitting issues that continue to impede investment in our critical resource sector and the ongoing regulatory impediments facing business at every level.

THE CHAMBER RECOMMENDS

That the Provincial Government:

1. provide a fully refundable investment tax credit claimed on businesses' income tax returns equal to the PST paid on all acquisitions of machinery and equipment (including computers and software) but excluding buildings and structures with a capital cost allowance rate of 5 per cent or less;

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9 Expert Panel on Tax Report, Table 7

10 The Panel does estimates that this would be offset by higher economic growth that would increase revenue by $12, $50 and $115 million in the period 2014-2017

2. continue to work with the chamber of commerce and others to find ways to reduce the administrative burden of the PST; and

3. commit to a dialogue with British Columbians on the development of a made-in-BC Value Added Sales Tax system to enhance BC’s competitiveness and productivity.

Submitted by the Policy Development Committee