

SALES TAX HARMONIZATION

Summary of Issue:

The federal government has been strongly encouraging provinces that have not harmonized their sales taxes with the federal Goods and Services Tax (GST) to do so to enhance competitiveness and productivity.

The issue of combining the provincial sales tax (PST) with the federal GST into a harmonized sales tax (HST) is often raised and supported by many businesses and business associations, including Chambers of Commerce. Some business sectors, such as the restaurant industry, strongly oppose it.

While harmonization would remove tax from business inputs, reduce compliance costs for business and potentially enhance competitiveness and productivity of BC business, it would also result in individual consumers paying tax on goods and services that are currently exempt from PST.

Proposed BC Objective:

British Columbia recognizes the potential economic benefits of harmonization but continues to have concerns.

Position of Other Jurisdictions:

S.13, S.16

KEY POINTS

- BC recognizes the potential economic benefits of harmonizing with the GST. However, harmonization continues to present very real challenges including a loss of provincial tax policy flexibility, the real and perceived shift in tax burden from business to individuals, a lack of support from some business sectors, the need to protect low income individuals and families from tax increases, and the need to ensure adequate provincial revenues.

First Ministers' Meeting
January 16, 2009, Ottawa

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- Government will continue to monitor the provincial tax system to ensure British Columbians in all areas of the province have a fair and competitive tax system to support our economy and create jobs.

Background and Analysis

- Harmonization means repealing the PST and adding a provincial tax rate to the 5% federal GST. To be revenue neutral for the Province this would require, depending on various policy decisions taken, roughly a 7% provincial tax rate on top of the GST. The combined tax rate would be applied to the current GST base (i.e., tax on virtually all goods and services except basic groceries and prescription drugs).
- Harmonized sales taxes are now in place in Newfoundland and Labrador, Nova Scotia and New Brunswick. Those provinces impose 8% provincial tax rates for combined HST rates of 13%. Quebec also has a modified version of HST, where a Quebec sales tax (QST) of 7.5% is applied on top of the GST for a combined effective rate of 12.875%. With the exception of Alberta which has no provincial sales tax, all other Canadian provinces have retail sales taxes.
- HST is a multi-stage value-added sales tax levied and collected at all stages of the production and distribution chain as goods move from primary producers to wholesalers, to retailers, and finally to consumers. All businesses and final consumers are required to pay the HST but, under the multi-stage sales tax, businesses claim a credit, called an input tax credit, for any tax paid on their business inputs. Thus, businesses effectively recover all tax paid on purchases for business use.
- Retail sales taxes like the B.C. social service tax are single stage taxes imposed primarily on sales of goods to final consumers at the time of purchase. Businesses may purchase goods for resale or lease exempt of tax but must pay tax on all items purchased for their own business use as they are the final consumers. Thus, under a retail sales tax, businesses pay tax on business inputs. In British Columbia, even with the exemption for production machinery and equipment, businesses pay about 48% of the total provincial sales tax paid in the province (i.e., about \$2.5 billion in 2008/09).
- Harmonizing the PST in B.C. with the GST would have the following implications:
 - The elimination of most PST exemptions. For example, the following items would no longer be exempt from tax: residential fuel, magazines and newspapers, children's clothing and footwear, restaurant meals, candies, snack foods, school supplies, basic cable TV and residential telephone.

prescribed safety equipment, and patent medicines.

- Imposition of the PST on most services that are not currently taxed. All services which are currently subject to GST would be subject to the combined HST rate. A few examples of these services are: accounting services, architectural services, services of a general contractor, consulting services, tourism services (ski lift tickets, golf fees etc.) and personal care services (e.g., beauticians and hairdressers).
 - B.C.'s ability to make unilateral changes to the provincial tax base in support of specific provincial social or economic policy objectives would be reduced if the tax were administered by the federal government. Relieving measures would still be possible although at potentially high administrative cost (e.g., NB provides a refund of the 8% provincial portion of the HST on energy purchased for residential use). Provincial administration would provide more flexibility but would also increase complexity and significantly increase costs for both business and government. Also, the federal government is unlikely to agree to provincial administration of the GST.
 - There would be a shift in the tax burden from businesses to individuals because businesses would receive input tax credits to recover tax paid on their business purchases while consumers would pay tax on virtually all goods and services, including most that are currently exempt from PST or not taxable. This shift would likely be perceived as being larger than it actually is because individuals are already indirectly paying some of the sales tax that they would pay directly under an HST (i.e. a portion of sales tax paid by business is imbedded in product costs and passed on to consumers). However, the imbedded sales tax is not visible and the HST is very visible, so individuals will perceive that there has been a larger tax shift than has actually occurred.
 - The fiscal implications of harmonizing are dependent on multiple policy decisions that would have to be made such as; the level of rebates, if any, for municipalities, universities, schools and hospitals, new housing and the level of low-income tax credit to help offset the impact of the broader tax base. However, it has been estimated that, depending on rebate decisions taken, a shift to a harmonized sales tax would be roughly revenue neutral for the province at 7%.
- The potential advantages of harmonization include:
 - Improved competitiveness and productivity of B.C. business by removing tax on business inputs.
 - Simplified compliance and reduced compliance costs for business.

Armstrong, Glen E FIN:EX

From: Louise.Levonian@fin.gc.ca
Sent: Tuesday, January 27, 2009 1:49 PM
To: rconstantine@gov.nl.ca; ndburns@gov.pe.ca; codye@gov.ns.ca; James.Turgeon@gnb.ca; Brian.Girard@finances.gouv.qc.ca; steve.orsini@ontario.ca; Heather.Wood@gov.mb.ca; kmcgregor@finance.gov.sk.ca; nancy.cuelenaere@gov.ab.ca; Armstrong, Glen E FIN:EX; ptumilty@gov.nu.ca; John_Monroe@gov.nt.ca; Clarke.LaPrairie@gov.yk.ca
Cc: jgriffin@gov.nl.ca; decostem@gov.ns.ca; George.McAllister@gnb.ca; Eric.Ducharme@finances.gouv.qc.ca; eric.fournier@finances.gouv.qc.ca; kostas.plainos@fin.gov.on.ca; Stephen.Watson@gov.mb.ca; asrinivas@finance.gov.sk.ca; Flanagan, Paul FIN:EX; Gerry.Gagnon@gov.yk.ca; Baxter.Williams@fin.gc.ca; Nancy.Horsman@fin.gc.ca; Brian.Ernewein@fin.gc.ca; Paul.Berg-Dick@fin.gc.ca; Mireille.Ethler@fin.gc.ca; Deanne.Field@fin.gc.ca; Lise.Potvin@fin.gc.ca; Gerard.Lalonde@fin.gc.ca; Kei.Moray@fin.gc.ca
Subject: 2009 Budget

As you know, the Government tabled the 2009 Budget today. I would like to bring to your attention three areas that may be of particular interest to you.

First, the Budget announces an enhancement to the Working Income Tax Benefit starting in 2009, the design of which is not specified. An illustrative example is included, however, to provide the opportunity to consult with provinces and territories. A working level meeting will be called in the coming weeks to start the process. For further information, please contact Baxter Williams at 613-996-8267. Page 112...

The Budget also describes the Government's intention to consult on the feasibility of an Arrivals Duty Free program at international airports in Canada. We will follow up with you on this initiative in the coming weeks. For further information, please contact Lise Potvin at 613-992-6298. Page 329.

Finally, there is a section in the Budget that talks about the Government's encouragement to provinces and territories to reduce their corporate income tax rates to 10 per cent and move Canada towards the goal of a 25-per-cent combined federal-provincial-territorial statutory tax rate by 2012.

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I would be happy to discuss these or any other tax measures outlined in the Budget should you wish to do so.

Louise Levonian

A/Assistant Deputy Minister | Sous-ministre adjoint par intérim

Tax Policy Branch | Direction de la politique de l'impôt

Department of Finance Canada | Ministère des Finances Canada

Ottawa, Canada K1A 0G5

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Ministry of Finance
BRIEFING DOCUMENT

To: Honourable Colin Hansen
Minister of Finance
Date Requested: March 2, 2009
Date Required:

Initiated by: Glen Armstrong, A/ADM
Strategic and Corporate
Policy Division
Date Prepared: March 12, 2009

Ministry Contact: Glen Armstrong, A/ADM
Strategic and Corporate
Policy Division
Phone Number: 250 387-9011
Email: Glen.Armstrong@gov.bc.ca

184733

TITLE: Sales Tax Harmonization

PURPOSE:

INFORMATION / ISSUE OVERVIEW

COMMENTS:

Ontario Premier Dalton McGuinty has been indicating publicly that Ontario is taking a serious look at sales tax harmonization and may announce something in its budget on March 26.

There is a strong possibility that the British Columbia government will be asked in the next couple of weeks about its position on harmonization.

DATE PREPARED: March 12, 2009

TITLE: Sales Tax Harmonization

ISSUE:

Ontario Premier Dalton McGuinty has indicated that Ontario is seriously looking at harmonization and there is a possibility that Ontario will announce within the next couple of weeks that it will harmonize its sales tax with the federal GST.

Even if this does not occur, it is very likely that the Government of British Columbia will be asked about its position on harmonization.

BACKGROUND:

The federal government is strongly encouraging provinces to harmonize their sales taxes with the federal goods and services tax (GST) and is emphasizing the benefits and importance of harmonization. S.16

Harmonization means repealing the provincial sales tax (PST) and adding a provincial tax rate to the 5% federal GST. The combined harmonized sales tax (HST) would be a value added sales tax applied to the current GST base (i.e., tax on virtually all goods and services except basic groceries and prescription drugs).

The current HST has four common elements:

- A common HST rate of 13% (5% GST plus a provincial component of 8%);
- A common tax base (the same base as the GST, with a point-of-sale rebate of the 8% provincial portion for books);
- Common legislation (the federal *Excise Tax Act*); and
- Common federal administration (CRA administers the HST at no cost to provinces; payments are made to provinces based on a formula). As the first province to partially harmonize with the GST in 1991, Quebec was allowed to administer both its tax and the federal GST within Quebec. The federal government does not currently offer provincial administration as an option.

Under the HST provinces are able to provide certain public sector bodies with rebates of varying percentages (municipalities, universities, schools, hospitals, charities and non-profits). There are also partial rebates for new housing. There is considerable variation in the rebates provided by current HST provinces.

The attached appendices provide a technical overview of sales tax harmonization (appendix 1) S.16, S.13

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Ontario recently indicated that it is taking a "long, hard look" at harmonization.

- Previously (as recently as November 2008), Ontario Premier Dalton McGuinty stated that the province had no desire to harmonize and would only entertain the idea if substantial federal funding were provided.
- In January 2009, McGuinty indicated that Ontario was looking at harmonization and that Ottawa could help seal the deal if it provided financial support, similar to that provided to other provinces in the past. McGuinty also said that he had raised the issue with Prime Minister Stephen Harper and hopes talks continue.
- In February 2009, McGuinty indicated that Ontario is looking at harmonization so seriously that a change may come in Ontario's Budget on March 26. McGuinty said that there seems to be an emerging consensus around harmonization and he reiterated that financial support from Ottawa would be required (likely \$ billions).

DISCUSSION:

In light of Ontario's recent public statements regarding harmonization (with the possibility of a more substantive announcement within the next few weeks), the British Columbia government will likely be asked about its position on harmonization. Government may wish to consider how to respond to these questions.

Economic Impacts of Harmonization

There is a considerable amount of economic literature which suggests that, in the medium and long term, there are positive economic benefits to harmonization. Potential advantages of harmonization include:

- Improved economic competitiveness and productivity of British Columbia business due to the removal of taxes on most business inputs (i.e., those used to provide taxable sales);
- Improved international and interprovincial competitiveness (no sales tax embedded in exports);
- Reduced economic distortion (an HST would tax most goods and services equally);
- Increased investment and job creation; and
- Simplified compliance and reduced compliance costs for business.

Studies have shown a significant increase in investment in the harmonized provinces following sales tax reform. Studies have also shown that the savings from reducing tax on business inputs were passed along to consumers.

However, while there are many studies showing the positive long-term economic benefits of harmonization, there are also studies showing potential short-term economic costs. Given current economic conditions, this could be a concern.

For example, a recent study by the C.D. Howe Institute suggests that, while the long-term economic gain from harmonization is relatively clear, harmonization will cause a short-term loss in GDP and unemployment. Part of the reason is that the negative effect of higher consumption taxes occurs faster than the positive effect of lower taxes on investment goods and exports. The study suggests that it may take five or more years before the impact on GDP is positive and even longer for real wages and job numbers to recover.

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The C.D. Howe study also suggests that harmonization has a positive impact on federal government revenues, creating an opportunity for compensation from the federal to provincial governments.

Distributional Impact

Harmonization would result in a real shift of the tax burden from businesses to individuals, and an even larger perceived shift.

- Businesses currently pay PST on business inputs but under the HST businesses making taxable sales would receive input tax credits (ITCs) to recover tax paid on their business purchases. Businesses making exempt sales (e.g., residential rents and financial services) would pay tax on their purchases but would be unable to claim ITCs because businesses can only claim ITCs to the extent that the inputs are used in making taxable supplies (i.e., sales which are subject to HST).
- Consumers would pay tax on virtually all goods and services, including most that are currently exempt from PST or not taxable (e.g., residential fuel, magazines and newspapers, children's clothing and footwear, restaurant meals, etc.).
- Individuals are already indirectly paying some of the sales tax that they would pay directly under an HST (i.e., a portion of PST paid by business is imbedded in product costs and passed on to consumers). However, the imbedded sales tax is not visible and the HST is very visible, so individuals would perceive that there has been a larger tax shift than has actually occurred.

- About 48% of the total PST paid in British Columbia is paid by business, 48% by consumers and 4% by the public sector. For comparison, 87% of GST paid in British Columbia is paid by consumers, 11% by business and 2% by the public sector.

The issue of harmonization is often raised and supported by many businesses and business associations, including Chambers of Commerce. However, some business sectors, such as the restaurant industry which currently enjoys PST exemptions that would be lost under an HST, strongly oppose it.

Fiscal Impact

The fiscal implications of harmonization are dependent on multiple provincial policy decisions that would have to be made such as the level of low-income tax credit to help offset the impact of the broader tax base and the level of rebates, if any, for municipalities, universities, schools, hospitals, and new housing.

Depending on the various policy decisions taken, harmonization would require roughly a 7% provincial tax rate on top of the GST to be revenue neutral for the province.

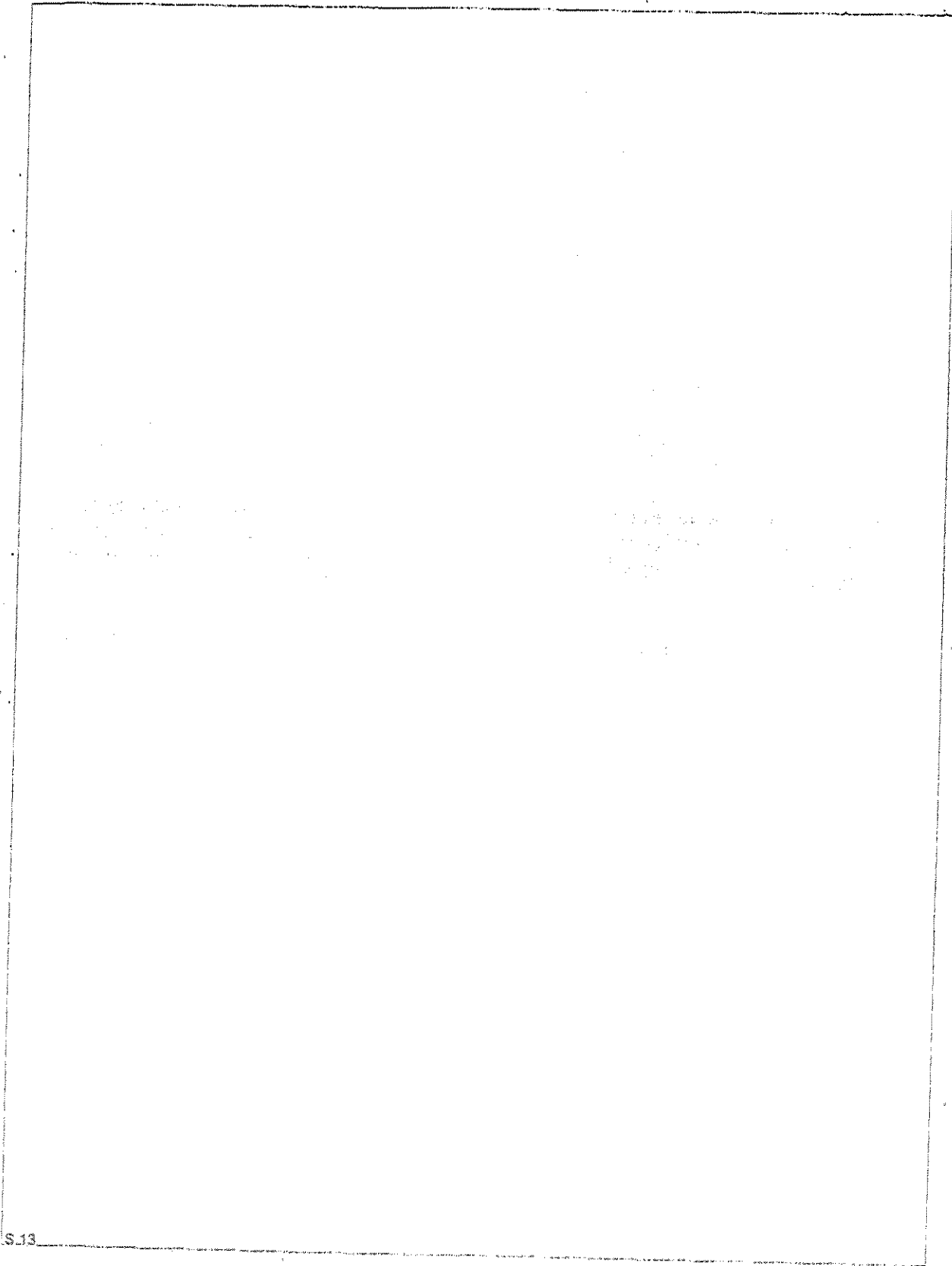
However, while harmonization would probably be revenue neutral at 7%, entering into an HST at a higher rate (e.g., 8%) could provide opportunities to further enhance the competitiveness of the provincial tax system by generating additional revenue that could be used to reduce other taxes.

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OPTIONS:



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Cole, Elizabeth FIN:EX

From: Cole, Elizabeth FIN:EX
Sent: Wednesday, March 25, 2009 9:44 AM
To: Armstrong, Glen E FIN:EX; Kendall-Craden, Rena PAB:EX
Cc: Flanagan, Paul FIN:EX; Andrew, Marc FIN:EX
Subject: RE: Globe and mail: ont to harmonize?

Yes, this is the final draft.

-----Original Message-----

From: Armstrong, Glen E FIN:EX
Sent: Wednesday, March 25, 2009 8:37 AM
To: Kendall-Craden, Rena PAB:EX
Cc: Cole, Elizabeth FIN:EX; Flanagan, Paul FIN:EX; Andrew, Marc FIN:EX
Subject: RE: Globe and mail: ont to harmonize?

The minister has a new BN from last week. S.13

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BN attached (I believe it is the final draft - Beth can confirm when she gets in)

-----Original Message-----

From: Kendall-Craden, Rena PAB:EX
Sent: Wednesday, March 25, 2009 8:19 AM
To: Armstrong, Glen E FIN:EX; Flanagan, Paul FIN:EX
Cc: Keast, Gordon PAB:EX
Subject: RE: Globe and mail: ont to harmonize?

Hey there: is this up to date? RKC

-----Original Message-----

From: Armstrong, Glen E FIN:EX
Sent: Wednesday, March 25, 2009 8:00 AM
To: Kendall-Craden, Rena PAB:EX; Flanagan, Paul FIN:EX
Subject: Re: Globe and mail: ont to harmonize?

Minister has a BN. I've given CT, GW and marc a heads' up

Cheers

----- Original Message -----

From: Kendall-Craden, Rena PAB:EX
To: Armstrong, Glen E FIN:EX; Flanagan, Paul FIN:EX
Cc: Patterson, Sherri PAB:EX; Keast, Gordon PAB:EX
Sent: Wed Mar 25 07:56:39 2009
Subject: FW: Globe and mail: ont to harmonize?

Hello and good morning.

Is there a possibility we will get questions on harmonizing tax in BC? RKC

McGuinty risks consumer backlash with move to harmonize sales tax Globe and Mail Wednesday, March 25, 2009 Page A01 By Karen Howlett TORONTO BLENDING THE TAX \$46,676

Armstrong, Glen E FIN:EX

From: Louise.Levonlan@fin.gc.ca
Sent: Thursday, March 28, 2009 5:10 PM
To: Armstrong, Glen E FIN:EX
Subject: RE: Ontario Budget

S.13_S.16

Louise Levonlan
A/Assistant Deputy Minister | Sous-ministre adjoint par intérim
Tax Policy Branch | Direction de la politique de l'impôt
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Government of Canada | Gouvernement du Canada



Department of Finance Canada | Ministère des Finances Canada

Canada

From: Armstrong, Glen E FIN:EX [mailto:Glen.Armstrong@gov.bc.ca]
Sent: March 26, 2009 7:10 PM
To: Levonlan, Louise
Subject: RE: Ontario Budget

Thanks, Louise. S.13_S.16

S.13_S.16

Many thanks.

From: Louise.Levonlan@fin.gc.ca [mailto:Louise.Levonlan@fin.gc.ca]
Sent: Thursday, March 26, 2009 3:17 PM
To: ndburns@gov.pe.ca; heather.wood@gov.mb.ca; kmcgregor@finance.gov.sk.ca; Armstrong, Glen E FIN:EX
Cc: Stephen.Watson@gov.mb.ca; asrinivas@finance.gov.sk.ca; Flanagan, Paul FIN:EX; Nancy.Horsman@fin.gc.ca; Brian.Ernewein@fin.gc.ca; Lise.Potvin@fin.gc.ca; Kei.Moray@fin.gc.ca; Francine.Noftle@fin.gc.ca; Billi.Chandler@fin.gc.ca; Peter.Turner@fin.gc.ca
Subject: Ontario Budget

As you may be aware, the Ontario Budget tabled today includes an announcement of the province's intent to eliminate its retail sales tax and join a modernized harmonized sales tax framework. For your information, I am attaching a copy of the Memorandum of Agreement between Canada and Ontario in this regard. I am available to discuss.

<<Final Signed MOA.pdf>> <<Final Signed MOA (français).pdf>>

Louise Levonlan

A/Assistant Deputy Minister | Sous-ministre adjoint par intérim

Tax Policy Branch | Direction de la politique de l'impôt

Cole, Elizabeth FIN:EX

From: Cole, Elizabeth FIN:EX
Sent: Friday, March 27, 2009 12:49 PM
To: Andrew, Marc FIN:EX
Cc: Chambers, Art B FIN:EX
Subject: FW: Apparently Ontario has confirmed and provided some details
Attachments: 184733 - Harmonization BN.doc; Appendix 1.doc; S.16, S.13; S.13; Not Responsive
Not Responsive

Hi Marc,

I've attached the harmonization BN (plus 3 appendices) and Not Responsive
Not Responsive

From: Armstrong, Glen E FIN:EX
Sent: Friday, March 27, 2009 12:17 PM
To: Cole, Elizabeth FIN:EX
Cc: Andrew, Marc FIN:EX
Subject: FW: Apparently Ontario has confirmed and provided some details

Beth, please email the harmonization note and Not Responsive to marc.

Thanks

From: Andrew, Marc FIN:EX
Sent: Friday, March 27, 2009 10:50 AM
To: Armstrong, Glen E FIN:EX
Subject: RE: Apparently Ontario has confirmed and provided some details

Glen - do you have an electronic version of this BN handy?

From: Armstrong, Glen E FIN:EX
Sent: Thursday, March 26, 2009 3:12 AM
To: Andrew, Marc FIN:EX
Subject: Fw: Apparently Ontario has confirmed and provided some details
Importance: High

Marc: S.13

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From: Cole, Elizabeth FIN:EX
To: Armstrong, Glen E FIN:EX
Sent: Wed Mar 25 19:13:27 2009
Subject: Apparently Ontario has confirmed and provided some details

<http://www.theglobeandmail.com/servlet/story/RTGAM.20090325.wPOLontbudget0325/BNStory/politics/home>

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Armstrong, Glen E FIN:EX

From: Louise.Levonian@fin.gc.ca
Sent: Monday, May 11, 2009 10:13 AM
To: Armstrong, Glen E FIN:EX
Cc: Llse.Potvin@fin.gc.ca
Subject: RE: HST Question

S.13_S.16

Louise Levonian
Assistant Deputy Minister | Sous-ministre adjoint
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Government of Canada | Gouvernement du Canada



Department of Finance
Canada

Ministère des Finances
Canada

Canada

From: Armstrong, Glen E FIN:EX [<mailto:Glen.Armstrong@gov.bc.ca>]
Sent: May 11, 2009 12:45 PM
To: Levonian, Louise
Subject: HST Question

Ont may change rate after 2 years. Am I correct in assuming a province could now start at a rate other than 8%? That is, that the legislation will be amended by July 1, 2010 to let a prov harmonize at a rate other than 8%?

Thanks