Business Council of British Columbia

Submission to the Expert Panel on Business Taxation

June 21, 2012

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British Columbia

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SUBMISSION TO THE EXPERT PANEL ON BUSINESS TAXATION

The Business Council of British Columbia is pleased to share our views with the Expert Panel on tax measures that could be implemented to strengthen BC's economy and competitive position as the province shifts from the HST back to the dual PST/GST system. The Panel is familiar with the benefits of the HST, and the many reasons why economists and public finance scholars almost universally see value-added taxes like the HST as an important and useful element in the revenue mix for governments.

The key feature of the HST that improves BC's competitiveness and lowers production costs for most businesses in the province is the removal of sales taxes from virtually all business inputs. Taxes on inputs are a significant factor shaping the economic environment for firms, particularly in industry sectors engaged in international/interprovincial trade. Although the PST was commonly viewed as a "consumption" tax, the reality was (and will soon be again) that it applied to both domestic consumption and many production activities. According to one estimate, as much as 48% of all PST revenue was derived from business inputs, amounting to about \$2.5 billion annually.[1] Adoption of the HST removed \$1.9 billion from the tax-inclusive cost of business inputs – that is, from the cost of producing goods and services in British Columbia.

While the PST on inputs was paid initially by businesses, to a significant extent it ultimately became embedded in the cost of locally-produced goods and services. The return to the PST/GST system will see the provincial sales tax again levied on a wide range

[1] Jonathan Kesselman, "Consumer Impacts of BC's Harmonized Sales Tax" (January 2011), p.4. Prepared for the Business Council of BC; available at www.bcbc.com.

of business inputs.[2] When the reversion takes place next April, it will be the largest business tax increase in the province's history. And as with any other expense, most businesses will build the cost into their pricing and attempt to pass it on to customers.

As we see it, the central question before the Expert Panel is what policy changes can be made to lessen the impact of the tax increase on BC businesses that will ensue once the PST is re-instituted. Near-term fiscal constraints mean there may be only limited room to consider significant tax reductions or other measures that would have an immediate net revenue cost to government. It is also clear, from public statements by the Minister of Finance, that the government intends to re-instate the PST largely as it existed prior to July 2010, suggesting there is not a great deal of scope to address the erosion of the province's competitive position by altering the PST base and/or expanding the range of exemptions for business inputs. That said, the Business Council believes the Panel should be looking at additional and more broadly applied exemptions for business inputs, and at an overall restructuring of the PST regime, as key medium-term steps to re-capture some of the soon-to-be-lost economic benefits delivered by the HST. In this regard, future changes to the PST regime should be focused primarily on capital investment and providing exemptions to support export-oriented industry sectors that are unable to pass government-imposed tax and regulatory costs on to their international customers.

We do, however, view broadening PST exemptions only as a partial measure and hopefully only an interim step. **To improve tax policy and BC's competitive position, the longer-term objective should be to move toward a "made-in-BC value added tax."** Such a tax would be similar to the HST in overall structure and operation, but BC would retain administrative control and be free to determine the tax base, if desired, and to establish different tax rates for different categories of goods/services.

[2] The remaining $600 million (the difference between $2.5 billion and $1.9 billion) is due to HST exemptions on items such as financial services and rental accommodation. While HST is not applied to these services, companies selling them are not eligible for input tax credits, so in practice they end up paying HST on their business inputs (and passing the cost on to consumers).

The remainder of this submission is structured as follows. The next section deals briefly with the increase in business costs and the erosion of BC's competitive position that will occur when the PST returns next April. We then consider proposed tax measures to help offset the damaging impact of the shift back to the PST. In some cases there are changes that can be implemented in the short-term, but most of the measures discussed in this submission are medium- or longer-term recommendations.

The Business Council of BC is a cross-sectoral association representing approximately 260 large and medium-sized enterprises active in British Columbia. Our members are drawn from all major sectors of the provincial economy, including forest products, mining, manufacturing, transportation, agri-food, telecommunications, information technology, financial services, energy, utilities, tourism, retail, construction, life sciences, engineering, healthcare, post-secondary education and the professions. As a province-wide organization, our main interest is in developing an attractive investment climate that supports the economic well-being of businesses and individuals throughout the province.

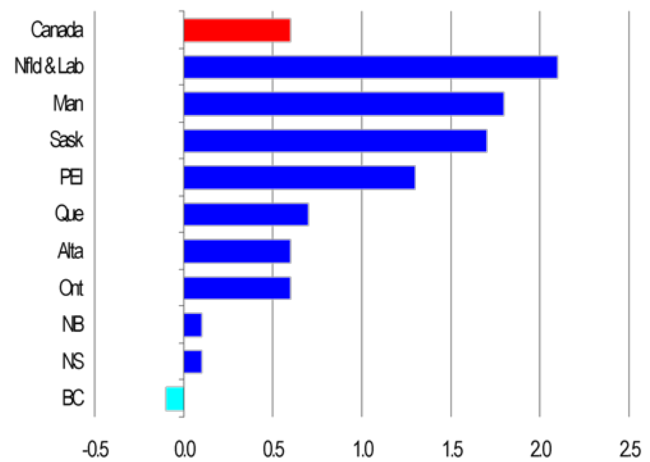
1. Re-Cap: Why Eliminating the HST Will Hurt BC's Competitive Position

The debate over the merits of the HST has passed, and the public has voted to reinstate the PST. As such there is little point in reviewing in detail the reasons why the HST is a better system of consumption taxation. However, it is worth recapping some of the economically relevant attributes of value-added taxes such as the HST.

While there is a long list of reasons the HST is a better tax – it is more efficient, simpler to administer, treats most sectors equally, has a broader and more stable tax base, and does not become embedded in prices and cascade through the production process, to name a few – from the Business Council's perspective three benefits stand out in the current context: it eliminates sales tax on all capital equipment and most other business inputs that sustain and improve enterprise productivity and efficiency; it supports the development and growth of "traded industries"[3]; and since it is harmonized with the federal GST, it represents a simpler, more streamlined and less costly-to-administer sales tax system.

No Overall Productivity Gains for BC

Change in GDP per Hour Worked, Business Sector Average 2003-2008



Source: Statistics Canada.

One of the most welcome aspects of the HST is the removal of sales tax on business purchases of all forms of capital equipment. Lowering the cost of capital means firms can invest more in productivity-augmenting equipment and technologies, and in some instances proceed with projects they otherwise would not pursue. BC's poor productivity record is well documented, and the HST was a key option available to government to support economy-wide capital investment aimed at boosting productivity and raising real wages over time.[4] A paper prepared for the BC Progress Board by Dr. Andrew Sharpe and his colleagues in 2008 concluded that "[h]armonizing the PST with the federal GST would do more to stimulate investment in the province than the complete abolition of the [provincial] corporate income tax…"[5] Of interest, in 2011/12 BC's corporate income tax generated just over $2 billion in revenue for the government, similar to the revenue derived from levying the PST on business inputs prior to 2010. The HST, however, has the added benefit, relative to a lower corporate income tax, of directly reducing the cost of investment in "capital goods" (e.g., machinery and equipment, technology products, vehicles, and the construction of physical plant).

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[3] Traded industries consist of export-oriented industries as well as domestic industries that compete with imports in local markets. See Institute for Competitiveness and Prosperity, Tenth Annual Report (November 2011), pp. 19-20.

[4] Andrew Sharpe, Jean-Francois Arsenault and Peter Harrison, "Investment in British Columbia: Current Realities and the Way Forward," BC Progress Board (December 12, 2008).

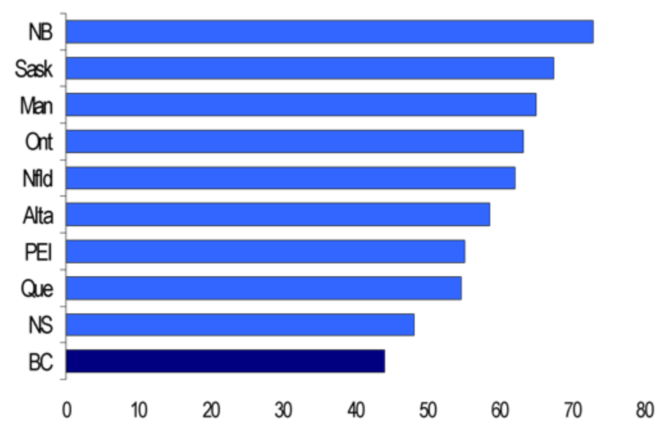
[5] Ibid., p.30.

The scale of the deterrent to investment linked to restoring the PST can be proxied by considering the impact on the marginal effective tax rate (METR) on new investment. The METR gauges the total tax burden on an additional dollar of investment; it differs from the statutory business tax rate because, in addition to combined federal-provincial corporate income taxes, it captures the effects of capital taxes, sales taxes on inputs, investment tax credits, and depreciation rules (capital cost allowances), among other factors, all of which influence the actual returns on investments. Recent estimates show that with the HST in place, the METR on capital in BC stands at 18.5%, which is a bit below the national average and also slightly less than in Ontario.[6] When the HST is replaced by the PST/GST, the average METR will jump to 27.7%, leaving BC with the highest rate among all provinces.[7] As the nine percentage point increase suggests, the PST alone will account (on average) for nearly one-third of the overall METR on private sector capital investment. To the extent possible, the Business Council recommends that future tax changes to improve the province's competitive position in the post-HST context be directed at reducing the cost of capital for businesses operating in British Columbia.

A second key advantage of the HST is that it makes it more attractive to operate export-oriented businesses in BC. [By the same logic, it also helps non-exporters operating in the local market to compete with

Weak Export Base

Provincial Exports as a Share of GDP, avg % 2005-2009



based on chained 2002 dollars, includes international and interprovincial exports.

Source: Statistics Canada, Provincial Economic Accounts.

[6] Duanje Chen and Jack Mintz, "2012 Tax Competitiveness Report," forthcoming publication from the School of Public Policy, University of Calgary. The 18.5% figure cited is an average for all industries. METRs differ across sectors.

[7] Ibid. It is unclear whether this estimate fully captures the effect of restoring all of the PST exemptions in place prior to the HST's adoption in 2010. As discussed below, the BC government has stated that these exemptions will be re-established when the PST is re-instituted next year.

imports.] While most industries and businesses are better off with the HST, in general the cost savings from the HST have less of an impact for businesses producing solely for domestic consumption. This is because in a competitive marketplace, most of the cost savings attributable to the removal of the sales tax on inputs under the HST are passed on to consumers in the form of lower prices. When the province re-establishes the PST, the reverse process will occur: the additional costs from businesses again having to pay sales tax on many of their inputs will be shifted onto BC consumers, in the same manner that price reductions were passed on in the wake of the implementation of the HST.[8] British Columbia-based exporters, on the other hand, typically are competing with producers located in different jurisdictions with an entirely different set of circumstances. The lower production costs resulting from the HST give our exporters an advantage they did not enjoy under the former PST. The same logic applies to BC businesses that compete in the domestic market with imports whose production elsewhere does not attract provincial sales tax.

In a paper prepared for the Business Council, Simon Fraser University public finance scholar Jonathan Kesselman points to the positive impact of the HST on trade-exposed industries. He argues that BC exporters are among the main beneficiaries of the elimination of the PST. With reduced input costs, BC-based companies are better positioned to succeed in the global marketplace; lower input costs also help local producers compete with imported goods. Commodity-based exporters whose prices are set in world markets benefit from higher profits. In this connection, Professor Kesselman notes that the resulting tax saving should not be viewed as a "gift" to exporters, because companies involved in export businesses will put profits back into their operations by way of investment and additional jobs. Any changes contemplated by the government to ease

[8] In the months after the HST was introduced, Professor Kesselman found strong evidence that cost savings were passed on to consumers, as reflected in an estimated 0.5% reduction in BC's consumer price index in the months following the HST's adoption. See Jonathan R. Kesselman, "Consumer Price Impacts of BC's Harmonized Sales Tax (February 2011). Available at:
http://www.bcbc.com/Documents/EC_20110216_Kesselman_ConsumerImpactsofBCHST.pdf

the sales tax burden on exporting (and import-competing) industries following the re-establishment of the PST should be viewed through the same analytical lens.

The loss of the economic benefits of the HST for export industries is especially unfortunate because in a small jurisdiction like BC, exports play a fundamental role in driving productivity and prosperity. **For this reason the Expert Panel is advised to pay particular attention to the economic situation of export industries when considering changes to taxation and other government policies intended to offset the negative impact of re-instituting the PST.** It is these industries that are most at risk of being damaged by the elimination of the HST. That BC has a comparatively small export base compared to other provinces is a further reason why policymakers should be looking to support the growth and competitiveness of the export sector.

Both the telecommunications and transportation industries should also be on the Expert Panel's radar as it examines the tax mix and how to improve the province's competitiveness. While this focus should not be to the exclusion of other sectors, the transportation and telecommunications industries are central to a broader competitiveness strategy because they are capital-intensive and play important roles in enabling and facilitating trade and other aspects of commercial activity for the broader business community and the economy as a whole. Given their capital-intensive nature, both sectors will face significantly higher costs for inputs when the PST is reinstated.

Finally, it is well understood that the HST also lowered the cost of sales tax compliance for the provincial government and for BC companies, because it merged two pre-existing tax regimes – the federal GST and the former provincial PST – into a single system with a (largely) common tax base and one bureaucracy to administer and collect the tax. This economic benefit will disappear as the province shifts back to the PST and compliance and collection costs inevitably rise. The associated cost impact is estimated to fall in the range of $200 million per year – a pure dead-weight loss to our economy.

2. Options for Improving BC's Business Tax Competitiveness

PST Administration

A major advantage of the HST is that it is easier and less costly to administer than the former PST. We recognize and applaud the provincial government for its willingness to simplify the PST administration and remittance process. As the province has indicated, businesses will be able to file on-line, and although they will still have to remit PST statements monthly, the process will be aligned with GST's end-of-month dates to simplify matters for tax filers. Businesses will also be able to register using their federal business number. These are positive steps.

PST Exemptions

The PST is being reinstated largely in its original form, which presumably means the complex array of exemptions that previously existed will be put back in place. On the provincial government's PST website[9] there are 134 bulletins covering exemptions and clarifying the application of the PST for various industries and business operations. Importantly, production machinery and equipment for the manufacturing, oil and gas, mining, logging and agricultural industries will again be exempt from the PST.

However, determining what capital expenses are exempt is often confusing, cumbersome and somewhat arbitrary. For example, parts and materials for machinery and equipment used in the oil and gas industry will be exempted. Yet materials for self-manufacture of equipment are not. Software is exempt, but only if it is an "integral" part of processing machinery. For manufacturers, any equipment used in the manufacturing process is eligible, including equipment used to transport products. It is only exempted from PST, however, up to the point of being moved to a "first storage area." So a forklift is eligible for the PST exemption if it is moving goods to an initial storage area within a manufacturing facility, but an identical forklift at the site would not be exempt if it

[9] The website for PST bulletins is http://www.sbr.gov.bc.ca/business/consumer_taxes/provincial_sales_tax/bulletins.htm.

transports and loads the same goods from the first storage area to a truck or loading area in a different location. Manufacturers may have to monitor usage of a forklift if it is used to transport goods to the first storage area, as well as to other locations, because the equipment is only eligible for the exemption if it is used more than 50% of the time to move goods to the first storage area. Transportation equipment used to transport raw materials to a manufacturing site, even though it is a necessary part of the manufacturing process, is also not exempt. Farm equipment will be PST exempt. Parts designed specifically to repair tax-exempt farm equipment are also exempt, but generic parts that could be used on other farm equipment are not. There are many of these kinds of examples in which most of the equipment for an industry is PST exempt, but some equipment, uses or parts thereof are not. These situations create unnecessary complications and compliance costs for what seems to be a very small amount of government revenue. As a matter of sound tax policy, it would be far better to exempt broad categories of equipment and other important business inputs from the PST, and to do so for all industries rather than only a few. **We urge the Expert Panel to embrace this as a medium-term goal.**

While we understand the requirement to put the PST back in place largely as it was in June 2010, the government can and should commit to simplifying the existing exemptions. A primary short-term objective here is to expand the equipment and repair exemptions so all parts and equipment related to similar production activity are exempt. For example, if most transportation equipment involved in manufacturing is eligible for the PST exemption, then make all related transportation equipment eligible. As such an expansion would have only modest revenue implications, it is something the government could consider in the near-term.

Software and IT-development costs for systems used within business, unless they are directly related to production activity, are not considered to fall within the definition of production machinery and equipment, and thus will not initially qualify for any PST exemption. Software and related systems are an increasingly important part of business operations and, for many companies, the use of up-to-date software and IT systems is integral to realizing productivity gains (or even staying in business). Additional government-imposed costs which discourage investment spending in this area make no sense and should be removed as quickly as possible. In the short-term, a broader PST exemption for software and IT development costs could be applied to industries that are already eligible for production and machinery exemptions; over time, this policy should be extended to all businesses.

More generally, the Business Council recommends that PST exemptions should be broadened to different industries and more categories of capital inputs over time as fiscal circumstances permit. As suggested earlier, the transportation and telecommunications sectors should be at the top of the list. The major railways operating in BC are looking to invest close to $3 billion in the province over the next few years to enhance service and efficiency. Telus recently announced plans to invest $3 billion in the BC over the next three years. Exempting capital equipment for the transportation and telecommunications sectors would lower the after-tax cost of capital and spur additional investment in these key infrastructure industries. It is odd that hydro-electricity producers are deemed to be manufacturers for the purposes of the PST exemption, but telecommunications providers are not.

We encourage the government to closely examine the implications of returning to the PST for the LNG industry. While we anticipate that much of the capital investment required for the industry will be PST exempt, the province should simplify the application of sales taxes and reduce the tax burden on as many inputs for the industry as possible. A network of new pipelines will be required to establish an LNG industry. Our understanding is that pipelines and compressors, valves and related items do not qualify for the production machinery and equipment exemption.[10] Building a globally competitive LNG industry will result in billions of dollars in construction activity and tens of thousands of jobs in BC, while also having a very positive impact on provincial revenues

[10] Ministry of Finance Tax Bulletin SST 126, Oil and Gas Service Providers and Contractors.

far beyond any potential foregone PST tied to exempting capital inputs used by the industry. In support of developing the LNG industry, the province should consider expanding the PST exemptions to include pipelines and related equipment.

Corporate Income Tax

A relatively low corporate income tax rate is an important component of a business tax regime geared to promoting investment, enterprise growth, and job creation. On this front, we urge the Panel to recommend that the government keep the provincial corporate income tax rate at 10%. We recognize that the 2012 budget references a "provisional" increase in the CIT to 11%, if this is deemed necessary to balance the budget by 2013/14. However, given prudent and cautious forecasting assumptions, we believe the government will be able to meet its budget target without having to resort to a higher CIT rate. We encourage the province to rescind the provisional increase as soon as possible and, over the medium-term, to consider reducing the corporate income tax rate from its current level of 10% to mitigate the economic damage that will be done by re-establishing the PST. The good news is that BC's corporate income tax rate is relatively low on a North American basis. Reducing it further would have the effect of lowering the METR and improving BC's competitive position, at a time when the METRs for most export and import-competing industries will be pushed higher by the restoration of PST. Statutory corporate income tax rates are readily identifiable by entrepreneurs, corporate executives, site selectors and professional advisors to management, and they have become a widely used yardstick for inter-jurisdictional comparisons. Keeping BC's corporate income tax rates low and predictable would send a positive signal that the province remains open for business, despite the difficulties caused by moving back to an antiquated retail sales tax.

Property Taxes

Panel members are likely aware that property taxes are an area of concern for many businesses operating in British Columbia. The Business Council believes reform of the property tax regime as it applies to municipal and regional governments is overdue and can help to bolster BC's overall competitive position in a post-HST world. High rates of property tax, marked variations in the rates levied on business properties in different municipal jurisdictions, and large discrepancies between business property tax rates (especially as applied to utilities and heavy industry) and residential rates have evolved in some municipalities. The roots of the problem can be traced back to 1984, when municipalities were given authority by the province to freely adjust tax rates among different property classes. This unfettered ability to set tax rates, coupled with an unusually large number (nine) of property classes in BC, has led to an excessive property tax burden being imposed on some property classes in a number of municipal jurisdictions. As Professor Robert Bish noted in his landmark paper on the property tax system, British Columbia municipalities "have more discretion to set different property tax rates on different classes of property than any other jurisdiction in Canada."[11] The existing system has also resulted in significant differences in property taxes paid by similar facilities (e.g., pulp and paper mills) located in different municipalities across the province.

Academic research highlights the concern that high rates of property taxes on major industry, railways, and utilities can deter investment.[12] In its 2006 report, the BC Competition Council stated that to ensure consistency and establish a competitive level of property tax for major industry, "municipalities must reduce the tax burden on the major industry sector particularly where the ratio of industry versus residential rates is high."[13] The Competition Council's final report saw a need for BC to "[a]ddress the disincentive to investment as a result of high municipal property taxation rates for the major industry property class … in some municipalities."

[11] Robert Bish, "Property Taxes on Business and Industrial Property in British Columbia: Comparisons and Business Climate Observations" (October 2003).
[12] Bish (2003).
[13] BC Competition Council, 'Enhancing the Competitiveness of British Columbia" (June 2006 summary report).

The evolution of port property taxes provides a good case study of the issue. Prior to 1984, under provincial law class 4 industrial property tax rates, which included port properties, were limited to a ratio of 3.5 to 1 as compared to residential rates. After the restriction was removed, the tax rate soared to $38 per $1,000 of assessed value, or a ratio of 11 to 1, by the mid 1990s. Because of the strategic importance of port facilities to British Columbia's gateway economy, the government wisely enacted the 2004 Ports Property Tax Act to restrict the amount a municipality could charge for port-designated property to $27.50 per $1,000 assessed value for existing facilities, and $22.50 for new investment. Under the Act the province also compensated affected municipalities. In its February 2012 budget the government made the cap on tax for port properties permanent. The Business Council fully supports this decision.

In some circles there is a perception that property taxes are not an important part of overall operating costs for large industrial facilities, and that property tax rates therefore do not have a material impact on operations or investment decisions. This is incorrect. High property tax rates – and the virtual absence of any restrictions on the ability of BC municipalities to shift the tax burden away from residential on to other property classes – can be a significant factor in business decisions relating to continuing operations, to new investments in greenfield operations, or to expand/extend the life of existing facilities. There are now 16 municipalities in BC charging property rates in excess of 5% on major industry (that is just the municipal portion; in 30 communities the total property tax bill for major industry is in excess of 5%).[14]

In a 2010 submission to the District of North Vancouver, the North Shore Waterfront Industrial Association provided a numerical example of two businesses to highlight the impact of local property taxes. The two hypothetical businesses both operate in North Vancouver, and each has an assessed value of $5 million and 100 employees. However, one is in the class 4 or heavy industry category and pays municipal property tax rate of 4.59% while the other is assumed to be a class 6 property, where the tax rate is 0.86%.

[14] Ministry of Community, Sport and Cultural Development, Local Government Department, 2011 tax rates.

Hypothetical Example of Impact of Different Property Tax Rates		
Assessed value	**Business Class 6**	**Heavy Industry Class 4**
Earnings before municipal and income taxes	$400,000	$400,000
Municipal property tax rate	0.86%	4.59%
Other property tax rate	0.88%	1.24%
Municipal taxes	$44,998	$229,280
Other property taxes	$44,180	$61,750
Earnings before income tax	$312,822	$108,970
Income tax rate	15.5%	15.5%
Income taxes paid	$48,487	$16,890
Net Income	$264,334	$92,080
Return on assessed value	5.29%	1.84%
Employees	100	100
Earnings before tax per employee	$4,000	$4,000
Earnings after tax per employee	$2,643	$921

In this example, the higher property tax rate has a dramatic effect on the bottom line. Despite having the same property assessments, one business pays more than five times more than the other, which seems out of line. Note that in this particular situation North Vancouver class 6 property taxes are relatively low. While class 6 rates are generally lower than class 4 rates, in many BC municipalities the class 6 rates themselves are also quite high.

The utility property class rate is also very high in some municipalities, resulting in an excessive tax burden for telecommunications service providers, railways and others operating in this property class. As with the PST on capital inputs, high property taxes for these companies erode BC's competiveness because the cost is passed on to the price of services delivered to other businesses in the province.

In our view, a comprehensive resolution of the property tax problem in BC must involve the province taking action to restrict the multiple or ratio of business property taxes to residential rates at the municipal level, similar to what has been done in some other North American jurisdictions (and as BC itself required prior to the early 1980s). The province can start by prohibiting further increases in the ratios between residential tax rates and the rates charged to the various business classes. Once new provincial maximum ratios (or fairness ranges) have been legislated, municipalities that currently have ratios above these maximums (or fairness ranges) would be required to reduce their business/residential ratios over a specified period of time.

Carbon Tax

Most Business Council members support the concept of putting a "price" on carbon emissions as part of a long-term strategy to shift to a lower-carbon economy and to address legitimate concerns about climate change. Indeed, British Columbia was the first jurisdiction in Canada to legislate a broadly-based carbon levy, which came into effect in 2008. To date, BC is the only province/state in North America to have taken this step. The carbon tax is "revenue-neutral" to the government, because it was accompanied by a commitment to reduce personal and business income taxes such as to keep the amount of net revenue collected by the provincial government essentially unchanged. Many of these compensating tax cuts accrued to households rather than to businesses, although the carbon tax did allow for a modest cut in business income tax rates.

The carbon tax raises the cost of all forms of fossil fuel energy for both businesses and households. As such, it encourages the use of lower-carbon energy sources. But at the same time, the BC carbon tax negatively affects the competitiveness of many of the province's key export industries, in part by increasing their energy costs, but also by raising the costs associated with shipping goods to market. The industries most vulnerable to the negative consequences of the made-in-BC carbon tax are those that are energy-intensive in their operations; that sell into global markets; and/or that compete against imports in the domestic market (recognizing that imported goods are not subject to the BC carbon tax when they are produced abroad).

It is important to put BC's carbon tax in context. The tax has steadily increased since 2008, and is set to rise again to $30 per ton of C02 equivalent emissions on July 1, 2012. To our knowledge, BC currently maintains among the highest policy-prescribed carbon charges of any jurisdiction in the world. In its 2012 budget, the provincial government announced that it is reviewing the future of the carbon tax. Over the summer the Business Council will be developing a submission to the BC Ministry of Finance on this matter. For now, we encourage the Expert Panel to take note of the carbon tax as an issue of particular concern for energy-intensive and trade-exposed businesses, and for the transportation industry. As it happens, these sectors are among the industries whose competitive position will be most challenged as the province returns to the PST next year.

Other tax policy measures

British Columbia currently has several tax measures in place that support particular industry sectors or types of business activity. Examples include research and experimental development tax credits intended to stimulate business innovation, which are linked to similar credits that exist at the federal level; tax credits to encourage film production and digital media activity in BC; and the various incentives available under the International Financial Activities Act. We make no recommendations here to modify any of these incentive programs. However, we do encourage the government to review current industry- and activity-specific tax incentives to determine whether they should be maintained in their present form once the province has transitioned back to the PST.

During the research and consultations to develop this submission, the issues of housing affordability and the need to encourage urban densification arose. Although these topics are only tangentially related to BC's competitiveness, they are important in their own right. Over time, the province should explore policy changes to lower the cost of housing, such as reducing the property transfer tax and incenting municipalities to contain the growth of development cost charges. In the Greater Vancouver context, the province should work with local governments to create economic development zones around transit nodes in order to spur densification and provide additional revenues for the regional transportation authority, TransLink.

As a final comment in this section of the submission, we urge the Panel to explicitly recognize the <u>cumulative burden</u> of all tax increases, with particular sensitivity to the economic circumstances of trade-exposed industries. As just noted, the carbon tax is slated to rise again. Although it is revenue neutral in aggregate, it imposes a disproportionate and substantial net tax burden on energy-intensive industries operating in the province. Returning to the PST will increase production costs for businesses. Major industrial operators are looking at sizable cost increases for electricity as they will no longer benefit from input tax credits on energy inputs when the PST comes into effect – and this at a time when the cost of power is climbing for other reasons. In the federal domain, companies are facing rising premiums for employment insurance. We are also concerned that in a fiscally constrained environment, the provincial government may be tempted to introduce industry or sector specific taxes or levies. And, notwithstanding our suggestion, there is a chance the provincial CIT will be notched up. **The Business Council strongly encourages the Panel to embrace the notion that all changes to BC taxes, levies, fees and other government-imposed costs should be evaluated in a holistic manner and tracked on an ongoing basis.**

3. A More Comprehensive Solution: A BC Value Added Tax

As a longer-term strategy, we believe the provincial government should consider moving toward a "made-in-BC" value-added tax. Such a tax would operate in a manner broadly similar to the HST, and therefore deliver many of the same economic benefits – in particular reducing or removing sales tax on most business inputs. But unlike the HST, a made-in-BC value-added tax would not be "harmonized" with the GST or administered by the Canada Revenue Agency. And importantly, the province would retain control over the relevant tax base.

A BC-designed and -operated VAT would afford the government the flexibility to set the tax rate and define the tax base in a manner that takes account of public concerns and the province's evolving economic and social needs. A provincial VAT could have a different rate for services generally, or it could apply different rates to particular kinds of services. In the short to medium-term, the government could move toward an eventual VAT regime by providing more PST exemptions for business inputs, as discussed above, and potentially by expanding the tax base to encompass a larger proportion of the overall consumption basket. Over time, this would lead to a more equitable treatment of services, rather than the arbitrary application of PST to just some services that prevailed before the HST, and also provide additional revenue to fund an expanded array of business input exemptions.

When reinstated next year, the PST will again apply to a number of services. As was the case prior to the HST, the PST will be charged on:

- legal services (with a number of exemptions, such as negotiating a collective agreement, acting as an arbitrator, or providing immigration or emigration counsel);
- telephone services;
- internet and email access services; and,
- television (specialty channels and satellite, but not basic cable).

The PST will also apply to any service provided to install, dismantle, assemble, refinish or maintain personal tangible property. Examples include:

- furniture repair and re-upholstering;
- television, stereo and computer repairs;
- repairs to business equipment such as photocopiers;
- automobile maintenance and repairs;
- setting up displays at fairs and trade shows;
- maintenance of plants (such as pruning);
- alterations and repairs for linens, bedding and other non-clothing items;
- uniform and formal wear rentals; and,
- photography and video services – PST is paid on videos and photographs and all services related to their production.

While we do not at this point have firm recommendations relating to which services the PST should cover, we do wish to draw the Expert Panel's attention to the essentially arbitrary nature of the above list of PST-taxable services. Why legal services are taxable while accounting, advertising and home cleaning/maintenance services are not, is difficult to understand and cannot be justified on the basis of any known set of tax policy principles. If more services were included within ambit of the PST tax base, it would be possible to set the tax at a lower rate. Economists generally agree that the best way to structure any major tax is to combine low rates with a broad tax base.

Another reason for broadening the PST tax base to include more consumption spending is that doing so would provide a stronger and more stable revenue base. In the final analysis, the main reason taxes exist is to pay for the public goods and services that citizens want. At the outset, we noted that value-added taxes are recognized around the world as a beneficial element of the revenue mix for governments. One reason value-added taxes make sense is that spending on services accounts for a large and growing share of consumption in all advanced economies. Back in 1981, for every dollar they spent on goods British Columbians spent 91 cents on services; by 2010, for every dollar spent on goods, BC consumers shelled out $1.61 for services. Over the past decade, consumer spending on goods (in nominal dollars) increased by 39%, while outlays for services jumped 72%. As it seeks to meet demands for government-provided/funded services, the province may want to ponder whether it is wise to exclude many of the fastest growing components of consumer expenditure from what, in the end, is supposed to be a "consumption tax."

With respect to fairness and long-term stability of the provincial tax base, it is also worth noting that another reason economists support broadly-based consumption taxes over most other forms of taxation is that they are difficult to avoid. In any market society the very wealthy often have the means and ability to legitimately shelter income from taxation. On the other hand, consumption taxes are more difficult to avoid, and affluent households typically spend much more on services. For those at the other end of the income scale, legitimate concerns about the regressive nature of consumption taxes can be addressed though appropriate low income tax credits.

A point that was seldom mentioned during the heated debates over the HST is that the provincial government actually has relatively few policy levers available to attract investment, foster the growth of high-paying jobs, and strengthen the ability of BC firms to compete and succeed in global markets. The design of the consumption tax regime is one area where the province does have the capacity to shape the economic environment in a positive way. Most economists agree that the HST was the single most important measure the province could have implemented to make BC exporters more competitive and to stimulate capital investment. It also had the advantage of providing a significant and stable revenue source for government.

As the Expert Panel looks at what can be done to build a competitive tax regime for BC businesses, for the reasons noted above we believe the Panel should recommend that the government undertake a comprehensive review of the PST 18 months after it is re-established. Such a review would examine technical and administrative issues around the restoration and re-implementation of the PST, how the tax is affecting small businesses, the impact on the province's competitiveness, and the steps necessary to move further in the direction of a made-in-BC value added consumption tax.

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