Incentivizing Business and Young Families to Put Down Roots in NL

EMPLOYERS' COUNCIL
NEWFOUNDLAND & LABRADOR

Employers' Council Submission to
NL Tax Review

6/25/18

Who We Are

EMPLOYERS' COUNCIL
NEWFOUNDLAND & LABRADOR

Advocating to enhance the ability of employers to contribute to the economic growth and prosperity of Newfoundland & Labrador.

Established in 1982, the NL Employers' Council enables employers to present a strong collective voice on issues impacting business.

Our membership consists of the province's largest and most economically significant employers, including companies from all major economic sectors. Collectively, they are responsible for the majority of all non-government jobs in Newfoundland & Labrador (NL). Our members are Newfoundland & Labrador citizens who have invested in this province and employ tens of thousands of people. Many of them have children and grandchildren that live here. They care about the future of Newfoundland & Labrador.

The Employers' Council works to develop responsible and well researched positions on issues of importance not just to the business community but to the economic success and prosperity of all Newfoundlanders and Labradorians. We are a vocal advocate for competitive taxes, competitive regulations, and fiscally responsible government budgets. We advocate for big picture, but specific, policy change on root issues that will remove barriers to doing business in this province and unlock opportunity. The Employers' Council takes great pride in ensuring our positions benefit the collective economic prosperity of NL, and does not represent individual business or sectoral interests unless they align with our mission, values, and key objectives.

Currently, the organization's key advocacy objective is to:

Affect public policy change that will make Newfoundland Labrador one of the most competitive jurisdictions in which to do business, by 2020.

In order to grow our economy and ensure the quality of life for all citizens continues to improve, we must create a competitive business environment that encourages outside investment, and motivates local business to grow and expand. NL is presented with some unique challenges due to our remote geographic location and ageing population, therefore, we need to work harder to differentiate ourselves in a global marketplace.

The entire province benefits from policy that encourages economic growth. Successful private sector businesses operating in NL are responsible for that growth. Policy that creates a globally competitive business environment is the only known way to grow our economy and ensure prosperity for all Newfoundlanders & Labradorians, now, and for future generations.

Review of the Provincial Tax System must focus on Economic Growth

The Employers' Council was pleased that in the announcement for this review, Finance Minister Osborne and review committee Chair Mr. Steve Jerrett both emphasized the need for a competitive tax system to ensure long-term fiscal stability, attract investment, and provide an "incentive for young families and businesses to put down roots in the province." Given the current economic situation in the province, it is essential that a review of our tax system be rooted in achieving these goals.

While Hebron will help spur some economic growth next year, outside the oil industry GDP is expected to decline past 2020. According to recent statistics released by the Conference Board of Canada (Arcand & Bernard, June 2018), there has been more than a 20% drop in investment in both 2017 and 2018 and there has been no job creation in NL since 2014. In 2019 employment levels are expected to be the lowest they've been in 10 years. Only 220,000 NLers will be employed, versus a peak of more than 240,000 in 2013. The provincial unemployment rate is nearly 14%, up from just over 11% in 2013.

Wage increases are also deteriorating. In 2017 wages increased 5%. In 2018 and 2019 wage increases will be approximately 1% - less than inflation. Household disposable incomes have also declined since 2016, due to the lack of job creation and 2016 tax increases. After an average increase of 4% annually from 2008-2015, household income will drop more than 1% each year this year and next year.

Given these statistics it should come as no surprise that after a few years of net in-migration, the population in NL is in decline once again.

Why a competitive tax regime is important

The key to long term economic success in NL is to create a competitive business environment that will diversify our economy, attract increased investment and allow local businesses to thrive. True competitiveness of a jurisdiction is measured by productivity. Increasing productivity does not mean working harder or longer hours, as many assume. It means generating more output per hour worked by making better use of machinery and equipment (investing in capital); by changing the organizational structure or developing new methods of production or products (innovation); or by having a skilled and knowledgeable workforce (human capital). The policy environment in which businesses operate plays a significant role in their ability to improve productivity.

In 2015 the Employers' Council commissioned the Conference Board of Canada to benchmark the business and economic environment in NL against peer jurisdictions. They graded NL against nine national and international competitor jurisdictions. They determined that jurisdictions such as Alberta, Saskatchewan and North Dakota are our biggest competitors given they are direct export competitors with similar economies, business environments and challenges (Palladini, 2015). Such jurisdictions should be used in evaluating our competitiveness in public policy areas. While Atlantic Canadian targets are politically realistic, when evaluating NL's tax competitiveness in this review, the committee should also consider who our true competitors are. We do not compete with Prince Edward Island for exports or labour, and our economic and business environments are vastly different.

The study, Achieving Sustainable Prosperity, found that NL has room to improve our competitive position. They graded NL in the areas of innovation, investment, education and skill level, labour market and the business and policy environment. They found that NL's competitiveness is weak compared to our direct competitors. In fact, out of 32 benchmarking indicators used, NL ranked in the bottom half on 21.

While some indicators, such as high transportation costs, structural reliance on employment insurance, or the relatively low skill level of our adult population are complex political and societal issues difficult for government to address; taxation is a policy area government can easily utilize to improve our competitive environment. A competitive and efficient tax regime is an essential component of a more competitive and productive economy. The tax burden is a key factor affecting both the cost of doing business and the cost of living. Tax competitiveness is increasingly important given the mobility of both financial and human capital in our globalized economy. Tax burdens influence firms' decisions about where to invest and/or continue to operate, and they affect individuals' decisions about where to live.

The Employers' Council recommends a focus on growing the pie versus fighting over how it is allocated. Improving tax competitiveness would not decimate government revenues. Generally, lowering tax rates and broadening the tax base is more successful in increasing government tax revenue than increasing tax rates (Johansson, Heady, Arnold, Brys, & Vartia, 2008). The province should remove barriers to productivity and innovation and incentivize the most productive sectors, businesses and citizens to increase their output to the benefit of all residents. It is important not to overburden them with regulation, inefficiently allocate resources within our economy through distortive tax measures, or provide disincentives through uncompetitive taxation and fees.

The Employers' Council encourages the tax review committee to make recommendations that improve the province's tax competitiveness. This would:

- Grow our economy by increasing our attractiveness to internal and external investment,
- Grow our population and improve our ability to recruit and retain a skilled and educated workforce, and
- Combat our fiscal capacity challenges created by an aging and shrinking population.

The Impact of Budget 2016

Like most Newfoundlanders & Labradorians, Employers' Council members were alarmed by the magnitude of the tax increases imposed in the 2016 provincial budget. To address the provincial deficit, Budget 2016 increased a wide array of taxes and fees and took approximately $900 M out of the economy. The HST went from 13 per cent to 15 per cent, new tax brackets were introduced for earnings over $125,000 and $175,000, and marginal rates were increased for all tax brackets in 2016 and 2017. Furthermore, a deficit reduction levy of up to $900 was applied to individuals, tobacco and gas taxes rose, the corporate income tax rate increased by 1 percentage point (to 15 per cent), the financial corporations tax rate increased by 2 percentage points over two years, and a variety of smaller taxes and fees were increased or introduced.

Our organization has serious concerns about the long term implications of the creation of such a high tax environment in NL. In a 2017 survey of Employers' Council member CEOs, who represent some of the largest and most economically significant businesses in NL, 97% said the tax increases from the 2016 budget have negatively impacted their business. One hundred percent said they were concerned the tax increases will have a long term negative impact on their business. And twenty-five percent said they had considered relocating all or part of their business out of the province due to the tax increases.

The Employers' Council also commissioned Corporate Research Associates to conduct a poll of Newfoundlanders & Labradorians in June 2017. When asked, "Have you, or has anyone in your family, considered leaving the province due to tax levels since the announcement of the 2016 budget?":

- 49% of NL's who earn $75,000 or more have said they or someone in their family has considered leaving the province due to tax increases
- 43% of NL residents who graduated post-secondary said the same.
- 43% of those 18-34 said they have *personally* considering leaving the province.

These tax increases are having the unintended consequence of driving away the people and businesses that the province needs for future success and prosperity. Most concerning is that our highest income earners, our most educated, and our young people are the most likely to leave. If this happens it will be exceptionally impactful on our future productivity and competitiveness, and to the tax base that government will be able to draw revenues from.

We Have a Spending Problem, not a Revenue Problem

Given our contracting economy and the impact of high taxation, competitiveness on taxation should not be traded for increased revenue in this review. It is important that a review of our tax system not be restricted to being revenue neutral, or be tasked to increase revenue. The Premier, Finance Minister, and other government officials have all publicly stated that we have a spending problem not a revenue problem. The NL provincial government obtains more money in revenue on a per person basis than any other province in Canada - but we also have the highest program spending per person in the country. We spend 27.1% more than the average of the other Atlantic Provinces—a difference of $2,942 per person. In spite of all this spending, our outcomes in health, education, the labour market, and infrastructure investment underperformed in comparison to the rest of the country.

There are serious concerns from many think tanks, economists, and organizations (including the Employers' Council) that government's current plan does not go far enough to address our spending problem and our growing debt. We currently spend more on servicing our debt than we do on education. Government's ability to weather global events such as another drop in oil prices or a rise in interest rates is also heavily impacted by our massively accumulating debt. If action is not taken now by government to implement long term reforms to improve program delivery, drastic action may have to be taken in an emergency situation – which is in no one's best interest.

While government has some spending reductions in their long term plan, they are minimal. In order to achieve competitive tax rates further reductions would be needed, but this should not be a problem. Last fall the Employers' Council commissioned the Conference Board of Canada to do research into our tax system to determine if it is possible to make a more competitive tax regime a reality given our current fiscal situation. This work resulted in suggestions for adjustments to government's plan that we entitled "Another Way Forward". They found that NL could reduce program spending by $1.1 B and still have the highest per person spending in Atlantic Canada. Another Way Forward used research from the Conference Board of Canada to illustrate a variety of areas where government currently overspends significantly as compared to other provinces. Addressing some of the suggested measures would allow government to continue to be able to eliminate the deficit by 2022, while also bringing the province more line with other provinces in Atlantic Canada on taxation.

There is room to reform how we deliver programs and services in NL to reduce cost and improve outcomes, and the review committee is encouraged to consider this in their recommendations.

Analysis of our Tax Competitiveness

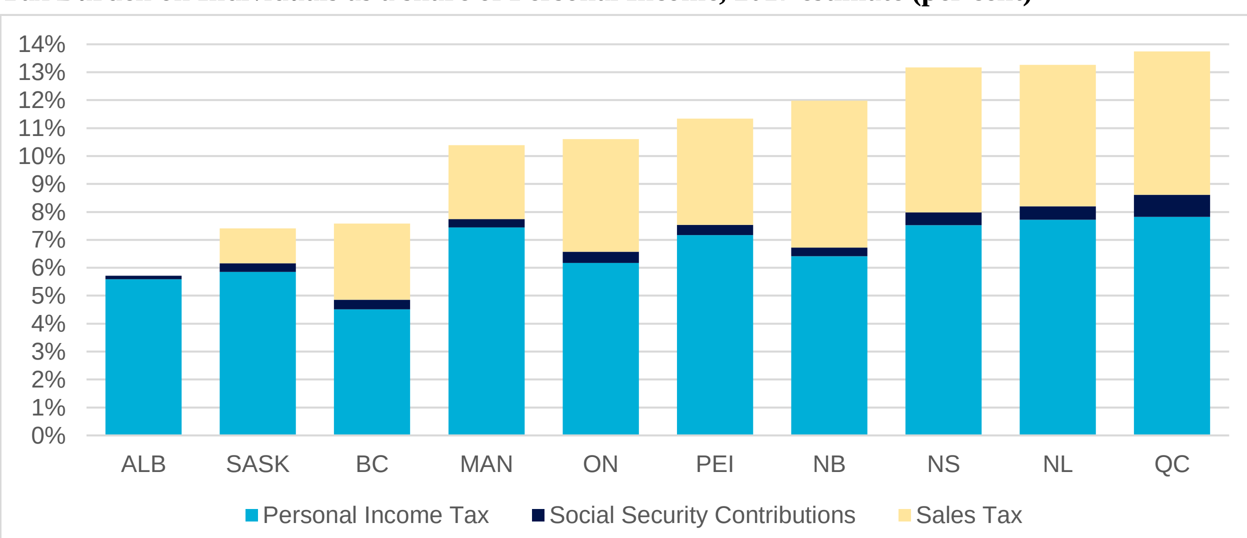
The Conference Board of Canada also compared NLs personal and business tax burden with other provinces in Canada and made suggestions for improvements that would help foster economic growth.

Personal Taxes

In determining tax competitiveness it is important to consider the total tax burden paid and not just stated tax rates. It is widely accepted by economists that comparing the total tax burden, after deductions, as a share of personal income is the best comparison to determine the competitiveness of tax regimes. The reason is simple. No matter what a tax is called – income tax, gas tax, or deficit reduction levy - it all comes from the same wallet. Following the tax increases of Budget 2016 NL citizens are paying substantially more to the provincial government than they would if they lived elsewhere in Canada. The Conference Board found that in 2017, the burden of provincial income, social security and sales taxes on individuals in Newfoundland and Labrador was the second-highest level in the country, at 13.3 per cent of personal income (see Chart 1.) This is just behind the highest taxed province of Quebec at 13.7 per cent.

Chart 1

Tax Burden on Individuals as a share of Personal Income, 2017 estimate (per cent)



Sources: The Conference Board of Canada; Statistics Canada

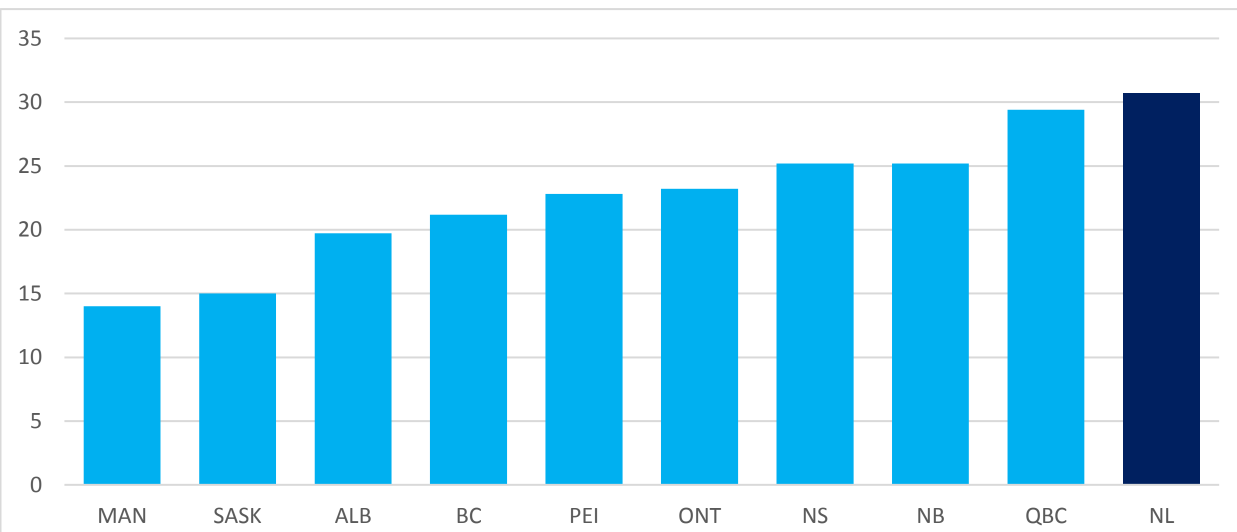
A significant component of the overall personal tax burden in Newfoundland and Labrador comes from the sales tax rate, which, at 15 per cent, is tied for the highest in the country. This includes the 15% retail sales tax on insurance premiums reintroduced in Budget 2016, and a 1% increase in retail sales tax on used vehicles. It also includes the provincial sales tax that in NL is calculated on top of gasoline tax, which would have increased with the temporary surcharge.

While sales tax in NL is high, sales, or consumption, taxes are some of the least distortive taxes in terms of their impact on GDP. Consumption taxes have much less of a negative impact on the economy than personal income taxes or corporate income taxes. There are two specific consumption taxes in NL, however, that the Conference Board found are particularly problematic in NL in terms of competitiveness.

Gasoline Tax

NL has the highest gas tax in the country. At its peak NLers paid 12 cents per litter more than the Canadian average on gas tax. In a province that is very reliant on driving, with very little in the way of public transit, this has been highly impactful on the cost of living. Since this analysis government has made reductions to the gas tax. NLers now pay 20.5 cents tax per litre, compared to 24.5 cents in June of 2017, and 33 cents per litre prior to that. Gas tax is still 4 cents per litre more than the 16.5 cents of tax paid prior to the 2016 budget, and it remains the highest in the country (see Chart 2). This is partially due to the calculation of HST on top of the gasoline tax, which is something that not every province does.

Chart 2
Gasoline Tax (2018) After HST/PST (c/litre)



Sources: The Conference Board of Canada; BC Budget 2017 interprovincial comparison table.

Government has committed that as the carbon tax is phased in during 2018, the remaining gas tax increase will be phased out. Government has not yet released plans for a carbon tax in this province, but the projected revenue from “gas tax” in the 2018-19 budget included carbon tax revenue, and is only approximately $13 M less than what was generated from gas tax in 2017-18.

Tax on Insurance

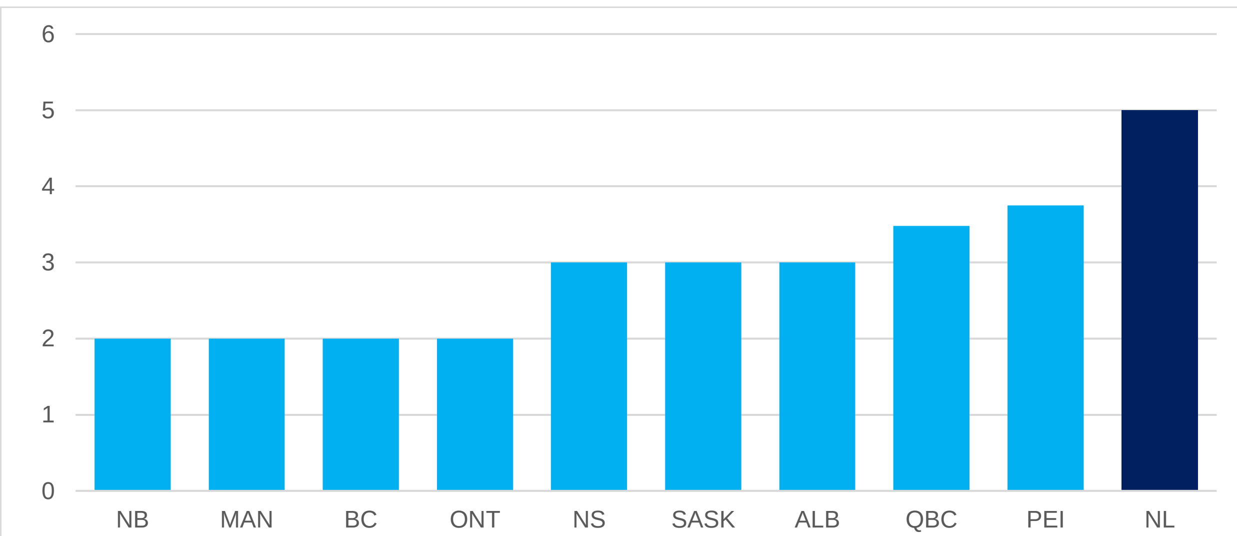
In addition to reintroducing sales tax on insurance premiums in Budget 2016, government also increased Insurance Companies Tax by from 4% to 5%, making it the highest in Canada - more than double New Brunswick (see Chart 3). These changes drove up insurance cost in NL for both individuals and businesses.

According to the Insurance Bureau of Canada, auto premiums in Newfoundland and Labrador are the highest in the Atlantic region. Due to the combination of gasoline tax and insurance premiums tax NL has been called the "most expensive place in the country to drive a vehicle." In a province with already high transportation costs, this is problematic for both citizens and businesses.

In Budget 2018 government made a commitment to reduce the Retail Sales Tax on automobile insurance a minimum of five per cent over four years, from 15% to 10%. On Jan 1, 2019 tax will be reduced by two percent with one percent reductions in 2020, 2021 and 2022. This will not apply to other types of insurance premiums.

Chart 3

Insurance Companies Tax, 2018 (per cent)



Sources: The Conference Board of Canada; BC Budget 2017 interprovincial comparison table.

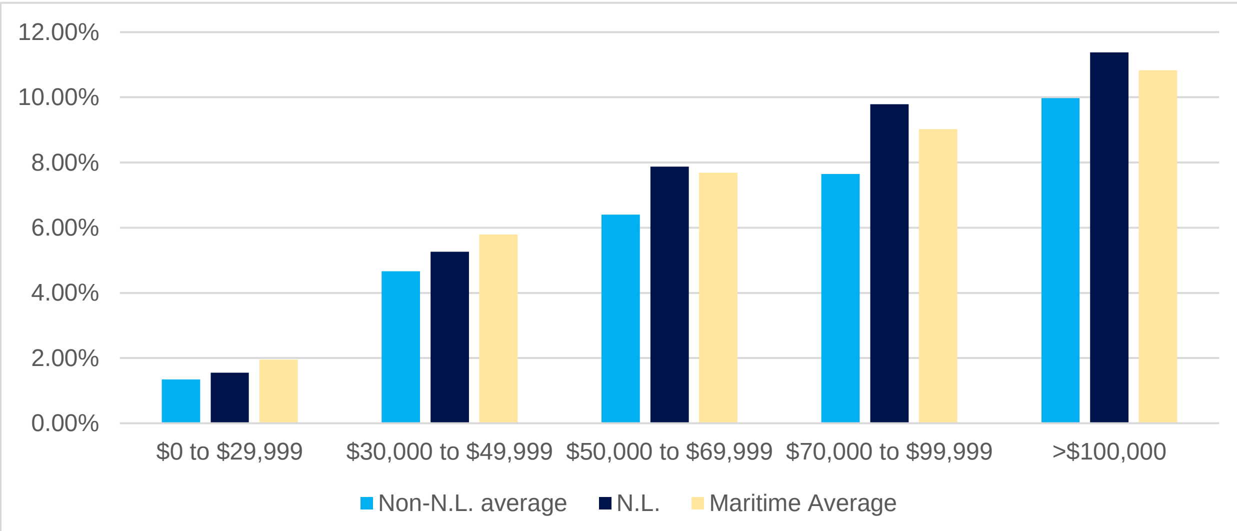
Personal Income Tax & the Deficit Reduction Levy

When looked at in terms of total tax burden (after refunds and deductions are considered) our personal income tax system is vertically progressive and is competitive in the lower income brackets. The province has, however, one of the highest personal income tax rates for individuals earning more than $50,000 per year in the country (see Chart 4). Put another way, in NL if you earn $50,000 or more, you are paying a greater share of your personal income than if you lived anywhere else in Atlantic Canada and substantially more than the Canadian Average. This includes the deficit reduction levy, which according to government will be in place until the end of the 2019 taxation year. This is not the case for those earning under $50,000 a year, whose tax burden is actually substantially less than it would be in the other Atlantic Canadian provinces.

Being uncompetitive on personal taxation seriously impacts the cost of living, making NL unattractive as a place to live and work. As indicated from the public opinion polling, our highest income earners, most educated and are youth are those most at risk of leaving the province due to high taxation. People in these categories are highly mobile. High tax rates encourage tax avoidance and mobile individuals will shift income to other jurisdictions, or simply leave the province for jurisdictions with a lower cost of living.

Chart 4

Comparison of Effective Personal Income Tax Rates as a Proportion of Total Income, 2017 estimate (per cent)



Sources: The Conference Board of Canada; Canada Revenue Agency.

There are some who believe that to have a truly fair and progressive tax system the "rich" should pay more than they currently do. Even if tax rates on the highest income brackets were increased dramatically, the reality is, there are not enough high income earners in NL to generate sufficient revenue. Only 12% of tax filers in NL make over $80,000. They already pay 54% of all personal income taxes. Twelve per cent of taxpayers pay more than half of all provincial income tax, about $829 million dollars per year (Cochrane, 2016). As evidenced in Chart 5 the $70-99,000 tax bracket in NL has the largest gap between the percentage of their earnings they pay in taxation here versus if they lived in the rest of the country. This tax bracket consists of many young professionals, entrepreneurs, and hard-working families. These group is bearing much of the tax burden, but would hardly be considered "rich." In a global economy, the expectation that this segment of the population would "put down roots" in NL while saddled with such a hefty burden is unrealistic. It is essential to economic and population growth that the tax burden imposed on middle to higher income brackets also be competitive.

High tax rates also impact our ability to attract new residents. Since 2016, we have heard from many employers who are having difficulty attracting needed skilled workers to NL from outside the province due to the high taxation and high cost of living. We have an aging population, and low adult skill levels in this province. We need every incentive to attract and retain young, skilled and educated workers in order to improve productivity. Due to our remote location, climate, and other factors beyond our control, attracting skilled workers from the US, Europe, and other parts of Canada to NL has always been challenging - but tax levels have made it even more difficult. One employer in the oil and gas industry commented that the only workers they are able to entice to move here are those from war-torn or highly violent countries. At a time when we should be looking to build both our economy and our young, educated population, this is a serious concern. If we are to remain productive and grow our economy in a global environment, this segment of the workforce must be given incentive to live here. Not only are we not providing this incentive – right now they are being deterred.

While a progressive tax system is fair and reasonable, there are limits to how much a government can tax the highest income brackets before these taxes have negative implications. Only 4,000 people make more than $250,000 in NL. This less than 1% of all tax filers pays 11% of taxes (Cochrane, 2016). Combined with federal tax the highest income earners already give more than 51% of all earnings to government through income tax. Based on 2018-19 personal income tax estimates, even if tax rates on these individuals were doubled, only about $160M in revenue would be generated – that is if any of them remained in the province.

High top marginal rates of personal income tax are also known to reduce productivity growth by reducing entrepreneurial activity. Research shows that cutting marginal tax rates raises productivity in industries with potentially high rates of enterprise creation and could also possibly increase the share of industries with high rates of enterprise creation (Johansson et al., 2008). If it is government's desire to foster an economy that encourages innovation, entrepreneurial wealth creation and the upgrading of education and skills across the working-age population, then high top marginal tax rates are counterproductive (Clemens, Emes & Scott, 2003).

US Tax Reform

When evaluating changes to NL's personal incomes tax regime, it is important to consider the tax reform agenda of our closest neighbour. With tax burdens of over 50% on the highest income earners in seven provinces, Canada imposes one of the highest income tax burdens on highly skilled people of any advanced economy (Finlayson & Peacock, 2017). The Fraser Institute (Murphy & Palacio's, 2017) found that among the 10 provinces and 50 American states, seven of the eight highest personal income tax rates are found in Canadian jurisdictions. Top income tax rates in Canada also start at lower income thresholds than they do in the United States. This study was completed prior to any U.S. tax reforms. Reforms will see some U.S. income tax rates drop below Canadian combined federal-provincial rates, in particular in states like Washington, Texas and Nevada, which have no state-level personal income taxes (Finlayson & Peacock, 2017). This will have implications on our ability to compete for the most talented and ambitious segments of the population, who are highly mobile. There could also be pressure on Canadian companies to shift some of their highest-value corporate jobs, some of which are located in NL, to the United States.

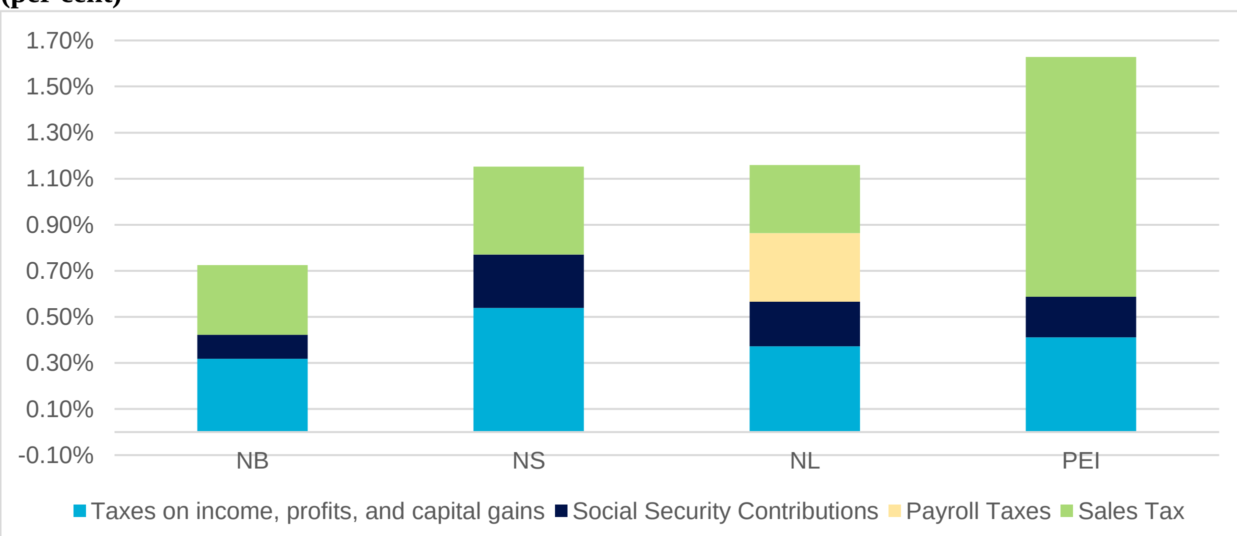
Business Taxes

Competitive business taxes play an even more important role in economic growth, job creation, and productivity. Corporate taxes are widely found to be the most harmful tax for economic growth followed by personal income taxes, and then consumption taxes. Since 2000, Canadian federal and provincial governments have gradually reduced business taxes to attract investment. Despite rate reductions, corporate-tax revenues increased, and the ratio of corporate taxable income to gross domestic product (GDP) remained stable. This effective strategy for improving economic growth and tax revenue has also been used by many other OECD countries (O'Riordan, 2018). Lower corporate and labour taxes encourage inbound foreign direct investment, which in turn is found to increase the productivity of local firms (Johansson et al., 2008).

It is extremely important that a tax review takes a holistic view of our overall business competitiveness and that no tax measure is looked at in isolation. Tax policy interacts with a number of other areas to impact the province's overall productivity and competitiveness. For example, transportation costs, utility costs, and labour cost in NL are among the highest in Canada (Palladini, 2015). Worker's Compensation premiums in NL are the 3rd highest of any other province in Canada. If the goal is to attract business investment, improve productivity and grow our economy, recommendations surrounding business tax policy and their impact must consider these and other business costs.

As with personal taxes, to determine competitiveness they also must be compared by evaluating total tax burden paid and not just compare stated tax rates. When making investment decisions businesses are concerned about the total tax that is paid, not published rates.

Chart 5
Provincial Tax Burden on Businesses as a Share of Gross Output in the Business Sector, 2017 (per cent)



Sources: The Conference Board of Canada; Canada Revenue Agency.

When you add up all the different taxes businesses pay as a share of revenue after deductions and incentives, NL has the second highest business tax burden in Atlantic Canada. The Conference Board found that the total business tax burden as a share of gross output in the business sector in 2017 was 1.2 per cent in Newfoundland and Labrador. That is about average compared with other Canadian provinces, but much higher than New Brunswick's nation-leading 0.7 per cent (See Chart 6). Having a low business tax burden relative to competitors is essential to attracting investment, improving productivity, and growing the economy.

When it comes to business taxes, the tax mix is exceptionally important to economic growth. Revenues from business taxes are split between direct taxes (including corporate income tax, capital tax), sales taxes, payroll taxes, and social security contributions. The province is among the provincial leaders in the share of tax revenue generated from social security contributions. Sales taxes contribute a very low share of total business taxation likely because businesses are largely buying goods from outside the province.

There are three specific concerns about the business tax mix in NL.

Payroll Tax

The biggest concern is that NL is the only province in Atlantic Canada with a payroll tax (see Chart 5). In fact, the province obtains more of its total business tax revenues from payroll taxes than any other province in the country, with the exception of Quebec. Payroll taxes are regarded as “killers of jobs or killers of wages – pick your poison” (Gunderson, 2012). NL’s Health & Post-Secondary Education Tax (HAPSET) is a direct tax on payroll – the more people a business hires and the higher wages they pay the more they get taxed. Taxes on labour can have adverse effects on labour utilization by affecting both labour supply and labour demand. Lower taxes bring down labour costs and firms respond by increasing labour demand (Johansson et al., 2008).

Especially when combined with workers’ compensation rates that are the third highest in the country, there is a significant disincentive for employers to grow employment levels or increase wages. Most jurisdictions have recognized the negative consequences of taxing payroll and have chosen to remove or stay away from such a tax altogether. Government has recognized that this tax is counterintuitive to employment and wage growth and has been increasing the threshold since 1992. In Budget 2018 government announced an increase in the exemption threshold for payroll tax from $1.2 m to $1.3 m effective Jan 1, 2019. This change will remove 50 companies from having to pay this tax, and the remaining 1200 companies will pay up to $2000 less each. However, this tax is still a massive impediment to NL’s competitiveness by negatively impacting labour productivity, employment, and wages.

Corporate Capital Tax

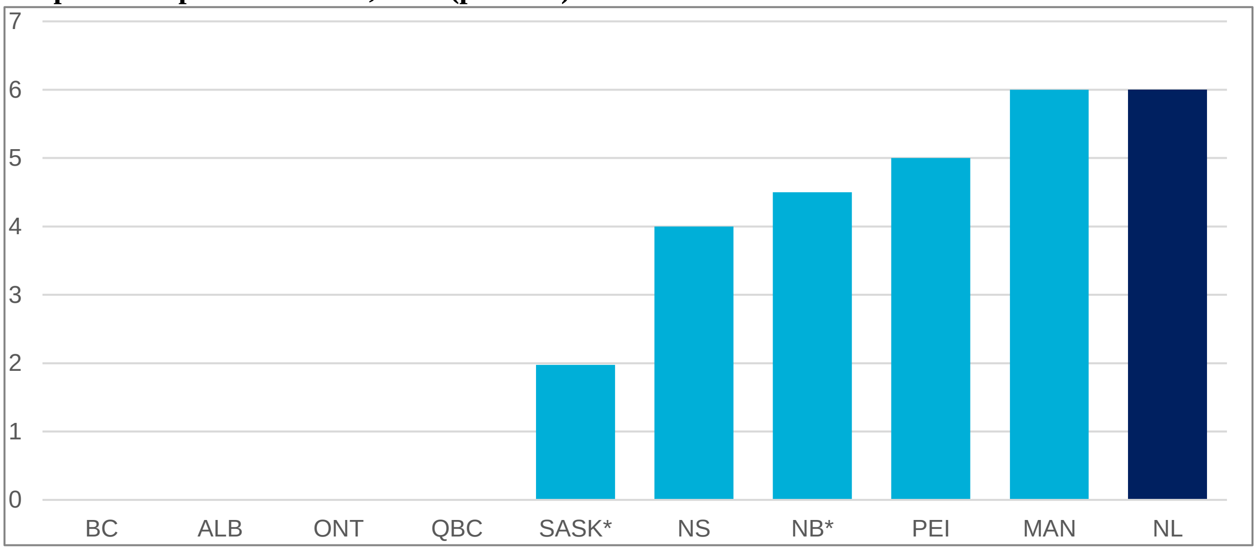
The Conference Board also expressed major concerns about NL’s Corporate Capital Tax, which is the highest in the country (see Chart 6). Taxes on financial and capital transactions are known to be highly distortionary – the most economically damaging of any tax (Johansson et al., 2008). They are essentially a tax on investment in this province. Canada is one of only six of 30 Organisation for Economic Co-operation and Development (OECD) countries that levies such a tax at some level and it has been called “the most destructive and growth-inhibiting tax imposed by Canadian governments” (Clemens, Emes & Scott, 2002). All customers of financial institutions and particularly borrowing customers bear the cost of the financial institutions corporate capital tax (Clemens et al., 2002). The Federal government has eliminated its Corporate Capital Tax and the majority of provinces are also eliminating it.

This tax was increased 1% in Budget 2016. This change seems counterintuitive given the government’s goal of increasing investment and growing our economy. This tax does not generate significant revenue in NL, but “its presence is extremely damaging due to its rarity internationally” (Clemens et al., 2002).

Elimination or phasing out of this tax would send a message to investors that NL is welcoming to investment and serious about growing our economy.

Chart 6

Corporate Capital Tax Rates, 2017 (per cent)



Sources: The Conference Board of Canada; BC Budget 2017 interprovincial comparison table.

Corporate Income Tax, Incentives & Credits

Budget 2016 also increased Corporate Income Tax (CIT) rates. At 15% the published Corporate Income Tax rate in NL is quite high – the second highest in the country. Raising CIT just one percentage point would give us the highest published Corporate Tax rate in the country. The US is also making changes on the corporate tax front. The average combined federal/state corporate rate in the United States is now 26 per cent, below the average combined Canadian federal/provincial rate of 26.7 per cent (O'Riordan, 2018). A published corporate tax rate in NL that is higher than other provinces and US states would make it difficult to attract investment and would not be in the best interest of our economy, nor would it likely result in increased revenue. In 2016 government increased the corporate tax rate by 1 percentage point and collected $135.6 million LESS than the year before. Corporate profit is at a 15 year low in our province, and efforts should be made to boost output not dampen it.

The Employers' Council does not support "labour based incentives" as was identified as a specific consideration for the review by government. These types of incentives may or may not make our tax code more competitive or be effective or efficient at improving employment or labour productivity.

Investors are attracted by tax systems that are stable and predictable, and are administered in an efficient and transparent manner. In Achieving Sustainable Prosperity (2015), the Conference Board of Canada found that while NL has competitive business taxes once deductions and credits are taken into account, they are achieved in a very inefficient way. NL's business tax system was called "one of the most distortive tax systems in Canada" and "rife with tax credits giving preferential treatment to certain sectors." OECD research cited in the report found that removing targeted sector-specific tax relief (with the exception of R&D credits) and levelling the tax rates across sectors increases investment: by providing greater certainty and predictability for firms; by leaving more money available for firms to purchase productive-enhancing machinery and equipment; and by attracting inbound foreign direct investment (FDI). Attracting inbound FDI has also been found to increase the productivity of local firms, by increasing competition and innovation.

While at that time the biggest concern in this province was the Manufacturing and Processing Profits Tax Credit, eliminated in Budget 2016, the same premise would apply to other tax incentives and programs. It is generally accepted by economic literature that a larger tax base that is taxed at a lower overall rate is better for economic growth than a smaller tax base with targeted tax relief for certain industries or sectors. Not only are the administration and compliance costs more efficient since the same rate applies to every sector but, more importantly, a broader tax base lessens economic distortions because firms will invest in the most productive areas of the economy.

Government should not be in the business of picking “winners” and “losers.” Our recommendation is that instead of exploring additional incentives government level the playing field by creating an equitable and efficient tax system. This means broadening the tax base by reducing preferential tax treatment for certain sectors of the economy and then using these additional revenues to reduce the overall CIT rate and/or other business taxes such as payroll tax.

If government is intent on exploring tax incentives, then current programs should be evaluated based on measurable, outcome based performance indicators to determine if they have been successful. Any new programs must also be evaluated based on results that are measured and reported against stated outcome based performance targets.

Another Way Forward - Making our tax mix more competitive

Following the Conference Board’s analysis, they recommended a combination of tax cuts and spending reductions that would improve the province’s competitiveness while also enabling the government to balance its books by 2021–22. These recommendations were suggested by the Employers’ Council in Another Way Forward. Our vision in this plan was to recommended changes to personal and business taxes that would make Newfoundland & Labrador the most attractive place to live, work and do business in Atlantic Canada. The plan would address the following issues:

1. Reduce cost of living
2. Stop people from leaving the province
3. Provide an incentive for people to move here
4. Make us attractive for business investment
5. Create jobs and increase wages
6. Grow our economy
7. Resolve our fiscal situation

In this plan, the Conference Board suggested complete removal of the temporary deficit reduction levy and gasoline tax surcharge; reducing personal income tax and the insurance tax to the most attractive in Atlantic Canada; and eliminating the payroll and capital tax due to their impact on business competitiveness. They found the total cost to the treasury of these measures would be just $591 (annually) once fully implemented, on a more than $8B budget (see Table 1).

Table 1
Another Way Forward Proposed Tax Changes, Revenue Impact & Current Status

Item	Annual Cost once fully implemented (as estimated in Fall 2017)	Current Status
Remove Temporary Deficit Levy	$126 million	Will be removed “at the end of the 2019 taxation year”
Remove temporary gasoline levy	$143 million	Reduced by 8.5 cents/ litre in June 2017, 4 cents/ litre in Dec 2017. 4 cents/ litre of surcharge will remain through 2018 to be replaced by some form of Carbon Tax.
Lower PIT rates to lowest in Atlantic	$78 million	
Remove payroll tax	$177 million	Threshold increased from $1.2M to $1.3M, effective Jan 1, 2019.
Remove capital tax	$34 million	
Reduce insurance tax	$33 million	HST on automobile insurance premiums only will be reduced from 15% to 10% from 2019-2022. No change to Insurance Companies Tax.
Total	$591 million	

Sources: The Conference Board of Canada, NL Employers’ Council.

These changes do not amount to an excessive amount of revenue. Given the magnitude of government spending, these reforms are very reasonable and achievable. Some of these changes have been addressed by government since the release of Another Way Forward, although none in their entirety. The Employers’ Council would like to see further action on improving the competitiveness of our tax system, in order to foster economic growth. We encourage the review committee to make such recommendations.

We need a plan that makes NL’s young people, our most skilled and educated, and our job creating business owners choose to stay and, as Minister Osborne put it “put down roots in this province.” Our tax system can play an important role in that plan.

Summary of Recommendations:

Thematic Recommendations:

1) It is essential that a review of our tax system be designed to encourage economic and population growth. A competitive personal and business tax regime is key to achieving these objectives.
2) Competitiveness on taxation should not be traded for increases in government revenue. Our fiscal situation is rooted in a spending problem, not a revenue generation problem.
3) There is room to reform how we deliver programs and services in NL to reduce cost and improve outcomes. The review committee is encouraged to consider this in their recommendations.

Tax Recommendations:

1) Eliminate the Deficit Reduction Levy prior to planned timeline of end of 2019.
2) Reduce personal income tax for citizens earning $50,000 or more to the most competitive in Atlantic Canada in order to attract and retain skilled workers, young families, and entrepreneurs.
3) Eliminate the payroll tax, HAPSET, as it is a job and wage killer.
4) Maintain corporate income tax rates, or eliminate incentive programs and use revenue to broaden and reduce the overall CIT rate.
5) Eliminate corporate capital tax.
6) Reduce taxes on insurance.
7) “Labour based incentives” are not recommended as they are not productive or efficient.

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