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ANALYSIS: Proposed Changes to HST

Prepared by the B.C. Federation of Labour - June 22, 2011

Summary

BC's sales tax has been a stable, predictable source of revenue for the province for more than 62 years. Over the last 15 years the provincial sales tax annually provided an average of 15.8 percent of BC's Consolidated Revenue Fund receipts. Far from being "damaging," as Kevin Falcon has suggested, a return to the PST after the referendum would be positive for BC's finances.

The Harmonized Sales Tax (HST) was initially expected to generate tax savings of \$2 billion annually to businesses in BC. But, instead of being "revenue neutral" as the Liberals originally claimed, the HST generates annual average revenues of about \$767 million higher than the old sales tax.

In a scramble to salvage the HST and sell it to the general public before the referendum and a general election, the Liberals announced BC businesses would temporarily pay \$400 million more in taxes through the introduction of two measures: a temporary increase in the corporate income tax rate from 10 percent to 12 percent on January 1, 2012 and postponing the elimination of the 2.5 percent small business corporate tax.

Even with these two changes the annual tax savings to business is \$1.6 billion in a single fiscal year. (It is reasonable to expect that after the HST referendum and a snap general election, the BC Liberals will restore their corporate tax cuts and businesses again will enjoy the full \$2 billion in savings.)

The proposed one percent reduction in the HST rate (from 12 to 11 percent) will cost the provincial treasury about \$881 million in the next fiscal year, 2012/13. The net loss, taking into account HST receipts of \$767 million, will be about \$114 million in the next fiscal year alone. That cost will balloon in 2014/15, when the HST rate is further cut from 11 to 10 percent. The annual loss of revenue then will be about \$1.2 billion.

By 2014/15, the shift of \$2.0 billion in sales taxes from corporations to families and individuals will be complete. It is most likely, therefore, that the BC Liberals will address their \$1.2 billion gap in 2014/15 — and in the years thereafter — by cutting government spending through the elimination of services and programs.

1. PST — Retail Sales Tax — Social Service Tax

Increasingly, the BC Liberals are attacking the PST. The referendum question is:

“Are you in favour of extinguishing the HST (harmonized sales tax) and **reinstating the PST (provincial sales tax)** in conjunction with the GST (goods and services tax)?”

On May 25th in the Legislature, Kevin Falcon made the following assertions:

“... the NDP’s preferred option is to go back to a 12 percent PST plus GST and knowing full well that that has an over \$3 billion hit to the fiscal plan negatively just within this three-year period. That’s the NDP opposition plan.”

“... an improved HST — even marching it down to 10 percent, even with the transition payments that will be going out to families with children and low- and modest-income seniors — is still financially much more responsible, much more sound than going back to the NDP’s preferred option of a 12 percent PST and GST.”

“... the NDP, so let’s recap their option. Go back to a 12 percent PST plus GST. **Reimposing the PST is one of the most damaging things that you can do to the business community.**”

British Columbia’s PST was in place from 1948 through to 2010. During that time, BC’s population grew from 1.1 million to 4.5 million — an increase of 310 percent.

Over the same time frame, Canada’s population grew from 12.9 million to 34.1 million — an increase of 164 percent. BC, in other words, grew nearly twice as fast as Canada while our province had the PST.

(Alberta, with no sales tax, grew from 846,000 to 3.7 million — an increase of 337 percent, slightly higher than BC’s growth rate. Contrary to Falcon’s assertion, it does not appear that a sales tax has much of an impact on economic growth — or lack thereof.)

The correct (official) name for BC’s original sales tax wasn’t the PST or even the RST (Retail Sales Tax). It was called the **Social Service Tax**.

It was enacted in 1948, just three years after the end of the Second World War, because the province was committed to expanding the size and scope of government services — notably the introduction of **Hospital Insurance** in 1949.

In other words, the BC sales tax — which Kevin Falcon now describes as ruinous to BC’s economic and fiscal health — was introduced specifically to pay for health care. Its name, the Social Service Tax, reflected that commitment.

For more than 60 years BC’s sales tax was a stable, predictable source of revenue for the province.

<i>Fiscal Year</i>	<i>CRF Revenues (\$millions)</i>	<i>Sales Tax Revs (\$millions)</i>	<i>Sales Tax as % of CRF</i>
1995/96	\$19,698	\$2,999	15.2
1996/97	20,126	3,076	15.3
1997/98	20,216	3,243	16.0
1998/99	20,312	3,209	15.8
1999/00	21,836	3,338	15.3
2000/01	23,727	3,626	15.3
2001/02	22,701	3,552	15.6
2002/03	21,995	3,794	17.2
2003/04	23,175	4,024	17.4
2004/05	27,295	4,156	15.2
2005/06	29,460	4,367	14.8
2006/07	31,206	4,714	15.1
2007/08	31,982	5,072	15.9
2008/09	30,471	4,958	16.3
2009/10	28,570	4,765	16.7

Over the last 15 years of its existence, the Social Service (Sales) Tax annually provided an average of 15.8 percent of BC’s Consolidated Revenue Fund receipts.

Are HST revenues stable and predictable? To date, the BC Liberals have been consistent only in constantly changing their HST revenue projections. And the Dinning Panel revealed that far from being “revenue neutral,” the HST “will continue raising

more revenue [than expected] ...because it taxes a broader base of goods and services.”

The fact is that Christy Clark, Kevin Falcon and the BC Liberals have not been honest with British Columbians as to how much revenue will be generated by the HST.

2. Corporate savings from the HST

The BC Liberals brought in a post-election budget on September 1, 2009. In contrast to their pre-election budget — which forecast a deficit of no more than \$495 million — the post-election fiscal plan had a \$2.775 billion shortfall.

In fact, the BC Liberals couldn't even correctly guess that latter figure. The deficit for the year ended up at \$1.779 billion.

Now we're supposed to trust Christy Clark, Kevin Falcon and the BC Liberals when they make wild assertions about the HST?

There was an interesting HST backgrounder released with the September 1, 2009 post-election budget. It outlined the annual savings their corporate backers could expect from abolition of BC's historic Social Service (Sales) Tax, and introduction of the Harmonized Sales Tax.

Below are the pertinent sections of that backgrounder:

*It is estimated **the HST will remove approximately \$2 billion in costs** for job-supporting BC businesses, helping enhance competitiveness, increase investment and productivity and promote job growth.*

Collecting, accounting for, remitting and administering PST is a costly and complicated process for both the business owner and the provincial government. The proposed HST eliminates the current duplication of meeting separate requirements for PST and GST.

*BC's businesses are **expected to save \$150 million annually in administrative costs** under the new streamlined HST tax system.*

To summarize, the HST was expected to save BC corporations \$2 billion annually, as follows:

<u>INDUSTRY</u>	<u>HST SAVINGS (\$millions)</u>
Construction	\$880
Transportation	210
Manufacturing	140
Forestry	140
Mining, Oil and Gas	80
<i>Sub-total</i>	<i>\$1,450</i>
<u>Administrative</u>	<u>150</u>
TOTAL	\$1,600

This table shows corporate savings of \$1.6 billion — \$400 million short of the \$2 billion figure touted by the BC Liberals. The difference is because many industries and businesses will save amounts under the \$80 million enjoyed by mining, and oil and gas, and are not shown on the table.

On May 25, 2011, Kevin Falcon announced the corporate sector would be paying higher taxes to help balance the provincial budget. Two measures were announced:

1. **The corporate income tax rate** — which the BC Liberals have lowered from 16.5 percent in 2001, to 10 percent in 2011 — will be raised to 12 percent on January 1, 2012.
2. **The small business corporate tax rate** will stay at 2.5 percent, instead of falling to zero (0.0 percent) on April 1, 2012.

It is important to note that the first measure is **TEMPORARY**. That is, after the HST referendum and another provincial general election, the BC Liberals may again be expected to cut the corporate income tax rate to 10 percent.

Moreover, the second measure only **POSTPONES** the reduction of the small business income tax rate to zero. Again, the BC Liberals are certain to slash the small business rate after the HST referendum and a general election.

More importantly, both measures will generate very small revenues for the province. Put another way, while businesses will enjoy a \$2 billion annual reduction in their tax bills from the HST, the changes Falcon announced yesterday will be at most about \$400 million.

The following table shows BC's corporate income tax revenues (with large corporations and small businesses combined) over the last 15 years, plus projections from the Budget for 2011/12.

<u>Fiscal</u> <u>Year</u>	<u>Corporate Income Tax</u> <u>Revenues (\$millions)</u>	<u>Corporate Income</u> <u>Tax Rate (%)</u>
1995/96	\$1,225	16.5
1996/97	1,347	16.5
1997/98	1,138	16.5
1998/99	1,098	16.5
1999/00	939	16.5
2000/01	1,054	16.5
2001/02	1,522	16.5
2002/03	612	13.5
2003/04	775	13.5
2004/05	1,255	12.0
2005/06	1,426	12.0
2006/07	1,538	12.0
2007/08	2,250	11.0
2008/09	2,038	11.0
2009/10	1,317	10.5
BUDGETED		
2010/11	\$1,638	10.0
2011/12	1,571	10.0
2012/13	1,872	10.0

BUDGETED

2011/12	\$1,571	10.0
2012/13	2,246	12.0

The *temporary* increase in the corporate income tax rate by 20 percent (from 10 percent to 12 percent) may be expected to generate an additional \$374.4 million. To account for the *postponement* of the small business cut, we might round that number up to \$400 million.

To sum up, the BC Liberals have stated that corporations will save \$2 billion annually from the elimination of the Social Service Tax, and introduction of the HST. To help sell the HST to the general public before the referendum and a general election, BC businesses will take a temporary \$400 million hit — which will reduce their annual savings (temporarily) to \$1.6 billion.

<u>ITEM</u>	<u>\$billions</u>
Corporate savings from the HST	\$2.0
<u>New tax costs from Falcon's announcement</u>	<u>0.4</u>
TOTAL SAVINGS	1.6

We are left with a fundamental question with regards to the HST: if corporations are going to save \$2 billion annually in their tax bills (temporarily reduced to \$1.6 billion in 2012/13), who will pay the difference?

There only can be two answers:

1. Consumers will have to pay more at the cash register; or
2. British Columbians will receive fewer services and programs from their government.

3. Impact of reducing HST from 12 percent to 10 percent

As stated in Section 1, BC's provincial sales tax (PST -- officially called the Social Service Tax) was a stable, predictable source of revenue. The table in that section showed PST revenues as a percentage of Consolidated Revenue Fund total revenues.

The tables below show:

(A) PST revenues as a percentage of GAAP total revenues from 2001/02 to 2009/10, the last full-year of the PST before it was repealed;

(B) Total PST and HST revenues as a percentage of GAAP in the transition year, 2010/11; and

(C) Estimated HST revenues as a percentage of GAAP over the three-year period outlined in the most-recent provincial budget.

(A) HISTORIC PST

<i>Fiscal Year</i>	<i>GAAP Revenues (\$millions)</i>	<i>Sales Tax Revs (\$millions)</i>	<i>Sales Tax as % of GAAP</i>
2000/01	\$29,689	\$3,626	12.2
2001/02	28,169	3,552	12.6
2002/03	27,775	3,794	13.7
2003/04	29,155	4,024	13.8
2004/05	33,355	4,156	12.5
2005/06	35,946	4,367	12.1
2006/07	38,448	4,714	12.3
2007/08	39,772	5,072	12.8
2008/09	38,302	4,958	12.9
2009/10	37,521	4,765	12.7
<i>Totals</i>	<i>\$338,132</i>	<i>\$43,028</i>	<i>--</i>
<i>Averages</i>	<i>\$33,813</i>	<i>\$4,302</i>	<i>12.7</i>

(B) UPDATE -- Transition year from PST to HST

2010/11	\$39,893	\$5,570	14.0
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(C) BUDGET FORECAST – HST

2011/12	\$41,337	\$5,820	14.1
2012/13	42,446	6,164	14.5
2013/14	44,091	6,516	14.8
<i>Totals</i>	<i>127,874</i>	<i>18,500</i>	<i>--</i>
<i>Averages</i>	<i>42,625</i>	<i>6,167</i>	<i>14.5</i>

A number of observations are readily apparent.

1. To reiterate a point made earlier, the PST was a remarkably stable and predictable source of revenue. Over the 10-year period from 2001/02 to 2009/10, the PST generated an average of 12.7 percent of total GAAP revenues.
2. The fiscal year 2010/11 — which ended 8 weeks ago, on March 31st — was a transition period between the PST and HST. The former generated revenues of \$1.399 billion, and the latter, \$4.171 billion, for a combined total of \$5.570 billion.

Despite the BC Liberals' claim the HST was "revenue neutral," the combined PST/HST generated revenues equal to 14 percent of total GAAP receipts. That figure not only is higher than the recent 10-year average with the PST, it is higher than any single year of PST revenue in the last decade.

3. That the HST generates windfall revenues is even more evident when the three-year forecast from the current fiscal-year budget is examined. This year, HST revenues are 14.1 percent of total GAAP receipts; next year, 14.5 percent; and in 2013/14, 14.8 percent.

Not only does the HST generate higher revenues than the PST, it appears that HST revenues are increasing over time. A word of caution, however: the BC Liberals seem to have under-estimated total GAAP revenues in fiscal years 2012/13 and 2013/14, so it's likely that the HST proportion of GAAP receipts is over-stated.

4. Nonetheless, it is evident that the HST is not "revenue neutral" — it *does* generate additional, windfall revenues for the provincial treasury. To perform a crude calculation of the difference, let's merely subtract the average percentage differential between the PST average for the last 10 years and the HST average for the three-year budgetary period, thusly: $14.5\% - 12.7\% = 1.8\%$.

Then we'll multiply the three-year average of GAAP revenues by the difference:
 $\$42.625 \text{ billion} \times 1.8\% = \767 million .

In the near-term, then, we can expect the HST to generate an annual average of about \$767 million in excess of what would have been derived from the PST.

The above tables enable us to do a crude calculation of the cost of Falcon's reduction of the HST rate from 12 percent to 11 percent in 2012/13.

It must be remembered that the BC Liberals only can reduce the provincial portion of the federal-provincial HST. Therefore, the provincial treasury's revenues in the next fiscal year will be based on a reduction of the BC portion from 7 percent to 6 percent.

The move from 7 percent to 6 percent translates into a reduction in revenues of 14.3 percent. By multiplying the three-year budgeted average for HST revenues by that amount ($\$6.167 \text{ billion} \times 14.3\% = \881 million) we can calculate the cost of Falcon's HST rate reduction.

So, while the HST will produce windfall revenues of about \$767 million annually, it appears that Falcon's HST rate reduction will cost about \$881 million.

As a result — and these are very crude calculations based on annual averages — we may expect that Falcon's HST rate cut from 7 percent to 6 percent will cost about \$114 million in the next fiscal year, 2012/13. ($\$881 \text{ million} - \$767 \text{ million} = \$114 \text{ million.}$)

However, Falcon has pledged another HST rate cut in 2014/15. There are no estimates for either GAAP receipts or HST revenues in that fiscal year, but again we may make crude calculations.

A reduction from 6 percent to 5 percent translates into a reduction in revenues of 16.7 percent. (HST revenues will be 16.7 percent lower in 2014/15 than in the preceding fiscal period.)

However, the reduction from 7 percent to 5 percent results in a total loss of revenues equal to 28.6 percent. If we estimate that HST revenues before Falcon's cuts would have generated \$7 billion (of which about \$800 million was a windfall over the PST), the total amount lost is \$2 billion. ($\$7 \text{ billion} \times 28.6\% = \2.0 billion.)

The *net* loss in 2014/15, therefore, will be more than \$1.2 billion ($\$2,000 \text{ million} - \$800 \text{ million} = \$1,200 \text{ million.}$)

In Conclusion:

1. Far from being "revenue neutral," the HST generates annual average windfall revenues of about \$767 million higher than the old PST receipts.

2. Falcon's one percent reduction in the HST rate (from 12 to 11 percent) will cost the provincial treasury about \$881 million in the current fiscal year, 2011/12. However, the *net* loss, taking into account windfall HST receipts of \$767 million, will be about \$114 million.
3. That cost will balloon in 2014/15, when the HST rate is further cut from 11 to 10 percent. The annual loss of revenue then will be about \$2 billion.
4. Factoring in the windfall gains from the HST over the PST, the *net* cost to the provincial treasury in 2014/15 will exceed \$1.2 billion.
5. By 2014/15, the shift of \$2.0 billion in sales taxes from corporations to families and individuals will be complete. It is unlikely, therefore, that the BC Liberal government (if re-elected) will be able to impose an additional \$1.2 billion tax burden on beleaguered British Columbians, to make up for revenues lost through the HST rate cuts.

It is most likely, therefore, that the BC Liberals will address their \$1.2 billion gap in 2014/15 — and in the years thereafter — by cutting government spending through the elimination of services and programs.