

Encouraging the Provinces to Replace their Retail Sales Taxes with a Value-Added Tax (VAT)

In its 2009 budget, the government of Ontario proposed that, starting July 1, 2010, Ontario's Retail Sales Tax (RST) will be converted to a value-added tax structure and combined with the federal Goods and Services Tax (GST) to create a federally administered single sales tax. The single sales tax will have a combined tax rate of 13 percent. The provincial portion would be eight per cent and the federal portion five percent.

The federal government will provide Ontario with \$4.3 billion in cash transfer payments – \$3 billion upon implementation of the combined sales tax on July 1, 2010 and \$1.3 billion on July 1, 2011 – to support the transition to the new value-added tax.

British Columbia has also announced that starting July 1, 2010, its provincial RST will be combined with the GST to create a federally administered single sales tax of 12 percent. The federal government will provide British Columbia \$1.6 billion to support the transition to a value-added tax.

Businesses pay RST on many inputs, including capital goods, related to the production of goods and services. The prices consumers pay reflect these embedded taxes. In contrast, businesses are able to recover VAT on the materials and services that they buy to make further goods or services directly or indirectly sold to end-users; thus, they are able to price their products, including those that are exported, more competitively.

RSTs in British Columbia, Saskatchewan, Manitoba, Ontario and Prince Edward Island significantly increase their respective marginal effective tax rates (METRs) on new business investment. In Budget 2009, the federal government stated: "If all five provinces currently imposing an RST were to adopt harmonized value-added taxes, the METR for Canada on new business investment would be reduced by more than 7 percentage points." A reduction of this magnitude would have a significant positive impact on the competitiveness of Canadian businesses.

Harmonization would also simplify the tax system. It would reduce compliance and administrative costs on businesses by combining paperwork and related efforts into one system instead of two.

The timing to harmonize could not be more right. It will help Canadian businesses weather the economic downturn and ensure that they emerge in a stronger and more competitive position.

With a harmonized sales tax, consumers could face paying tax on certain goods and services that are currently exempt from RSTs but are subject to the GST. If provinces decide to mitigate the impact on consumers by reducing the provincial component of the harmonized sales tax, provincial government revenues will be reduced. Some provinces could see reduced government revenues by switching from an RST tax base to the GST tax base, while keeping their RST rates the same.

The federal government could provide the provinces funding to compensate them for the fiscal costs of harmonization. Alternatively, it could provide funding to compensate the provinces for lowering the provincial component of the harmonized sales tax. Lastly,

it could provide relief directly to individuals – a tax rebate to lower-income individuals similar to the GST rebate to ensure that they were not adversely impacted by the change to a more broadly-based tax.

The Canadian Chamber strongly urges the federal government to redouble its efforts to persuade the other provinces that levy retail sales taxes (RSTs) – Saskatchewan, Manitoba and Prince Edward Island – to harmonize these taxes with the federal tax base – i.e. to adopt a value-added tax (VAT) akin to the Goods and Services Tax (GST). Harmonization would serve to increase the competitiveness of businesses both in the domestic and international markets, now and in the future.

Recommendations

That the federal government:

1. Redouble its efforts to persuade the provinces that currently levy retail sales taxes (RSTs) to switch to a value-added tax (VAT).
2. Provide transitional financial assistance to convince the provinces to switch to a VAT.