# Harmonized tax badly needed and likely revenue-neutral

By Ben Dachis and Alexandre Laurin, Special to the Sun August 11, 2009

British Columbia has taken a step towards greater prosperity for its citizens with plans to harmonize its seven per cent provincial sales tax (PST) with the federal goods and services tax (GST), creating a single harmonized sales tax (HST) of 12 per cent.

This proposal is primarily an attempt to build a more efficient tax system, and not to increase sales tax revenues. Following Ontario's lead, this reform is now needed for B.C.'s economy to remain competitive. The PST -- which raises business costs and discourages investment by taxing inputs, often many times before a final sale -- is an antiquated tax in today's world of complex supply chains, and has been abandoned by most economies throughout the world.

GST-type sales taxes are the most efficient way to tax consumption because such taxes effectively strike only once, when something is purchased for final use. The PST, on the other hand, embeds tax at arbitrary rates, depending on how often inputs change hands -- about 40 per cent of PST revenue comes from taxing business inputs.

Understandably, the proposal has drawn the ire of those whose products are exempted from the PST but would be subject to HST. But the PST is applied on inputs at multiple stages of production, leading to a cascading -- and arbitrary -- tax bite hidden in higher consumer prices, including on currently exempted products, such as new houses or restaurant meals. On many products, such as clothing, consumer appliances, automobiles and computers, the effective tax rate is higher than the seven-per-cent PST paid at the cash register. The implementation of the GST itself, and harmonization in the eastern provinces, demonstrated that those prices will fall after the change.

A C.D. Howe Institute study examined the revenue impacts of creating an HST that exactly copied the GST and showed that such a plan would increase provincial revenues. However, there are major differences between what the B.C. government has proposed and the GST. Looking at the details of the B.C. plan shows that harmonization may be very close to revenue-neutral.

First, like the PST, the HST would not apply to gasoline or diesel whereas the GST does. By our estimates, the province left approximately $300 to $400 million per year in the pockets of drivers by maintaining this exemption.

Second, the province is providing a more generous exemption on new housing than the federal government. The GST is partly rebated on the value of new homes below $350,000. Homes above that not only have to pay GST on the value above $350,000 but also have to pay back the rebate on the value of the house below this amount. When Ontario announced it was harmonizing, it initially proposed a similarly awkward new housing rebate.

This created a firestorm of opposition from developers, and Ontario went back to the drawing board.

The new Ontario proposal responded to the concerns raised and now includes the same rebate as B.C. is proposing. Homes below $400,000 would receive a rebate compensating for the HST, and -- unlike the GST -- the rebate would not be recaptured. Based on estimates for Ontario, we expect this more generous rebate to reduce B.C. HST revenues by about $400 to $500 million per year.

Whether these changes make harmonization exactly revenue neutral depends on how fast, and in what sectors, the economy grows.

But these rebates go most of the way in reducing the tax bite of harmonization.

The HST will significantly lower the cost of investing in B.C., making businesses more competitive, nationally and internationally.

Evidence from numerous studies shows that harmonization raises business investment and that PST-type taxes slow down provincial growth.

Sales tax harmonization is crucial for B.C to maintain its economic competitiveness with Ontario and the rest of the world without significantly increasing taxes.

Ben Dachis and Alexandre Laurin are policy analysts at the C.D. Howe Institute.