

Intelligence MEMOS



From: William B.P. Robson
To: Beleaguered Taxpayers
Date: March 21, 2024
Re: **A CHEER FOR NOVA SCOTIA'S NEW INFLATION INDEXING**

Nova Scotia's budgets do not always make national headlines, but the [one](#) recently delivered by Minister of Finance and Treasury Board Allan MacMaster got some well-deserved attention.

It indexed the province's personal income tax to inflation. Starting next January, the thresholds for all Nova Scotia's tax brackets and its non-refundable credits for spouses and dependents will rise with the consumer price index each year.

As Alexandre Laurin and I argued in a [recent C.D. Howe Institute report](#), this move is long overdue. Price surges during the pandemic reminded everyone that inflation and taxes are a toxic combination. Governments that tax nominal amounts even when inflation is eroding money's purchasing power dodge accountability by increasing tax burdens in ways that are hard to see. If they want to raise taxes, they should do so out in the open, not by inflation stealth.

Granted, some interactions of inflation and taxes are hard to address except by keeping inflation low. Interest payments that do no more than compensate savers for inflation's erosion of their principal get taxed, yielding negative real returns. Capital gains that simply reflect generally higher prices get taxed, leaving asset holders with real losses. Profits that reflect only the falling real value of a business's capital and inventories get taxed, costing it the real resources it needs to reinvest.

Others are easier to address, notably tax thresholds, deductions and credits that are fixed dollar amounts. Unindexed thresholds and credits mean that people whose wages or spending have simply risen in line with prices – that is, are stagnant in real terms – get exposed to higher tax rates. Many tax thresholds in Canada are indexed, including (giving credit where it is due) federal income-tax brackets. But others, including (casting blame where it is due) many other federal thresholds, are not.

Recent inflation makes some examples stand out. The GST/HST New Housing Rebate, which refunds part of the tax on new or extensively refurbished houses, phases out between \$350,000 and \$450,000. Established when the GST was introduced in 1991, the goal of the \$450,000 threshold was to relieve all but the most expensive homes from the tax. Now, nearly all homes are above it. The limit for the Child Care Expense Deduction was \$7,000 a quarter-century ago. If it had risen with the CPI, it would now be \$12,000 – half again above its current \$8,000.

Many other nominal markers – such as the small-supplier threshold for charging GST, the \$1,000 exemption from capital gains tax for personal property, the exemption for foreign employees in the Canada-US tax treaty, and amounts that returning travellers can bring into Canada duty-free – have not changed for decades. All these non-indexed provisions hit Canadians with higher taxes year after year, simply because they do not rise with inflation.

Nova Scotia was not alone in imposing these invisible tax increases. Alberta paused indexation of its personal income tax thresholds in 2020 and 2021. Prince Edward Island still indexes none of its thresholds. Ontario does not index its top two thresholds – \$150,000 and \$220,000 – even though their real value has fallen more than a fifth since they were established a decade ago. The federal thresholds related to housing, childcare, GST, capital gains and duty-free imports remain unindexed.

Inflation is down from its 2022 peak, but even if it returns to the Bank of Canada's target of 2 percent next year, as the Bank projects, the purchasing power of a dollar will still be some 15 percent lower than it was before the post-COVID surge in prices. Taxes have magnified that loss for wage and salary earners, people who depend on income from their savings, and everyone who owns, works for, or buys from businesses whose tax burdens rose with inflation – in fact, all Canadians. It is high time all governments addressed their tax provisions that bite harder when prices rise.

The indexing of personal income tax thresholds in Nova Scotia's budget therefore deserves attention, praise and – most of all – imitation.

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A version of this Memo first [appeared](#) in the Financial Post.