BRIEF TO THE NOVA SCOTIA TAX AND REGULATORY REVIEW

From

NOVA SCOTIANS FOR TAX FAIRNESS

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I. Introduction

The Tax and Regulatory review is a valuable initiative. The Ivany Report has called for bold action to turn the economy around. It refers to the Scandinavian countries as one model for the direction we can take. Northern European countries have higher taxes, better public services and stronger economies than we have in NS.

We recommend broad, innovative changes to our tax system. Tinkering will make little difference. We propose bold action to increase taxation and to make it more progressive. Those Nova Scotians who benefit most from society`s wealth must shoulder a larger share of the cost of providing public services. Fairness should be the primary goal among the four elements of the Minister`s Vision for the Tax Review. Countries that are successful economically and socially have demonstrated this approach can be a foundation for economic success.

For those who argue that we must cut taxes in order to increase competitiveness the experience of other jurisdictions does not support this claim, the US State of Kansas being only the most recent[1]. But what is more compelling is that the 2014 "Competitive Alternatives" report, KPMG's Guide to Business Location Costs ranks Halifax the 5th lowest cost of 89 cities in the US and Canada. Smaller NS communities are ranked high on the low cost list. The Tax Primer circulated by the Tax and Regulatory Review also shows NS already has low corporate taxes comparatively. There is no need to cut taxes to increase competitiveness. In fact excessive tax cutting would lead to big problems for NS' economy and for local businesses, as Kansas` experience so vividly shows.

N.S. Department of Finance's Thomas Korring got it right in the Tax Primer when he wrote ``determinations of investment location and production activities are made by businesses and private sector financiers based on business cases while the tax system plays a minimal role``.

Government and private industry are co-creators of economic wealth. A better balance between the two that is closer to the North European model will be more successful. An increasing body of research supports this approach as well as the practical examples established in Denmark, Norway, Sweden, Finland and Germany.

It is pointless to talk about the tax system without also discussing the value taxes create in terms of the public services they fund and their contribution to social stability and economic stimulus. In this submission, we try to do both.

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[1] Paul Krugman, Charlatans, Cranks and Kansas, New York Times, June 29, 2014
http://www.nytimes.com/2014/06/30/opinion/paul-krugman-charlatans-cranks-and-kansas.html?_r=0

II. Primer on the Nova Scotia Tax System

A - Comment on the Tax Review's Vision

Make Fairness the priority among the four elements of the Vision

Changes to the tax system are about choices. The criteria established by the Minister are good but at times they compete with each other – e.g. some measures intended to increase simplicity or competitiveness substantially reduce fairness. While it is important to have a clear set of criteria to use when considering changes, it is also important to have a clear set of priorities among those criteria. When they are in conflict, which will take precedence?

The only statement in the initial descriptions of the 4 criteria that is qualified by its potential effect on another criteria is under fairness - "The tax system should allocate a disproportionate burden to those tax filers (whether household or business) that have more favourable economic circumstances, but without leading to substantial reductions in labour supply or investment." This suggests that reducing inequality takes a back seat to other considerations.

Measures to increase competitiveness and simplicity should certainly be considered but they should not undermine measures to reduce inequality. Reducing inequality must take priority. The evidence shows that this will pay off both socially and economically in the long run.[2] Poverty reduction and broader social supports have been repeatedly shown to result, not just in health and justice system savings but also increased tax revenues in personal income taxes from people re-integrated into the labour market. Given the state of the empirical evidence, we really are at a point where it is incumbent on cash-strapped jurisdictions such as Nova Scotia to justify why they are not leveraging the tax system to move aggressively toward poverty alleviation and broader social supports. Stated simply, we cannot afford *not* to commit to serious social investments toward greater equality.

Reducing inequality supports the growth in labour supply, an underpinning of economic growth as the Ivany Report pointed out. Increasing the incomes of low and moderate people generates more local spending than increasing the incomes of higher income people, bringing greater benefit to local businesses. The experience of the last 3 decades demonstrates that an overemphasis on simplicity and competitiveness does not create "a rising tide that lifts all boats" as the prevailing economic theory predicted.

Increasing the economic pie is important but only when great care is taken to promote equality at the same time. It is not necessary to choose one over the other - some policies do both while others undermine equality in the false name of increasing prosperity.

Brazil and north European countries have demonstrated that economic prosperity and an emphasis on equality are possible while the US has demonstrated that increasing productivity and wealth is not enough - the "rising tide' theory is false.

[2] See Richard Wilkinson and Kate Pickett, "The Spirit Level – Why Equality is Better for Everyone", 2010; and Thomas Piketty, "Capital in the Twenty-First Century", 2014

B - Comment on the view of taxable personal income

Treat taxable personal income more fairly

The Tax System Primer states that "As the common tax bases are determined by Federal legislation, Provincially-determined policies are limited to: tax rates, tax brackets, small business threshold, tax credits and sales tax rebates." The common tax base is derived by taking a person's total income and reducing this by a number of deductions. This statement implies there is no room for changing "taxable income", the income that is left after deductions.

We disagree. As the Primer notes, the province has the power to apply tax credits. The province can replace tax deductions with tax credits by making small changes to Nova Scotia's provincial tax return, Form 428. [3] It can use total income in calculating taxes and reduce the taxes owing by tax credits instead of reducing income by tax deductions. This would be much more equitable.

The unequal impact of tax deductions: A tax deduction of $5,000 is worth $2,500 in reduced federal and provincial tax savings to someone earning $200,000 but it is worth nothing to a single parent with one dependent earning $20,000 and only $1,190 to someone earning $38,000. The provincial portion of these savings is $1,050 for the high income earner and only $440 for the person earning $38,000. The incentives for low and modest income Nova Scotians to save for retirement and the compensation for the costs of child care and other employment related expenses should be equal to the incentives for higher income Nova Scotians.

Capital gains tax exemption: A CEO who receives stock options worth $500,000 and then sells them for $1 million makes $500,000 on the sale. $250,000 of this income from the capital gain is tax free. Only $250,000 of such income is taxed. All of a salary or hourly wages is taxed. This is fundamentally unfair and deprives the public sector of the resources needed to sustain health care, child care, reasonably priced higher education and other essential public programs.

Authority to change deductions to credits: The NS government has argued that the province has no authority to pursue these recommendations. Ontario didn't agree with this view when it threatened to change capital gains taxation unilaterally in 1999. It didn't follow through because the federal government decided to make the changes it sought. The Province of Quebec has this authority written into the governing legislation, which establishes the precedent. Nova Scotia has the power to define its own tax credits. Deductions can be removed in one line and new tax credits based on the same personal expenses can replace those deductions. Simple changes to the NS tax from would implement recommendations detailed below to treat taxable income much more equitably

C – Comment on the Indicators

The indicator on fairness shows how progressive Nova Scotia's income tax system is compared with other provinces. The common view is that because Nova Scotia's marginal tax rate on the top income earners is slightly higher than in other provinces, our tax rates play a negative role in influencing where people choose to live. However the Share of Total Income comparative chart shows that the top 20% of earners pay less than the Canadian average as a share of total income. There is room for additional taxation at that highest level and still remain well within the normal range in Canada.

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[3] CCPA Alternative Budget 2013, page 20.

We recommend that an additional indicator be used, **showing the % of personal income that each quintile pays for all taxes – income, property and sales taxes**. This is a more accurate representation of how progressive and fair our whole tax system is.

III. Priorities for changing the tax system to achieve a better mix of fairness, simplicity, sustainability, competitiveness

The Tax Review requested recommendations for our 5 top priorities to achieve the 4 interlocking elements of the Minister's vision for changes to the tax system. We are submitting 10 recommendations. We could easily recommend more. Our top 5 are #s 1, 3, 4, 5 and 7. Note that #10 is not about tax changes but about raising sufficient taxes to support new programs that will help with economic development. It is not possible to talk about taxes without talking about what they fund. Higher taxes combined with strategic government investments designed to save money and to spur social and economic development are the elements of a bold, effective approach to taxes.

Make the total tax system more progressive

1. **Keep the 5th tax bracket and add 5 more tax brackets**. The top 20% of NS taxpayers pay a lower percent of total income than in other provinces as illustrated in the Tax Primer`s Share of Total Income chart. Here are the new brackets and rates that we recommend:

NS rates:

17.67% from $75,000 to $93,000	(**a new bracket** 1% above the current rate)
19% from $93,001 to $120,000	(1.5% above the current rate)
20% from $120,001 to $150,000	(**a new bracket** 2.5% above the current rate)
24%from $150,001 to $375,000	(3% above the current rate)
26% from $375,001 to $500,000	(**a new bracket** 5% above the current rate)
28% from $500,001 upwards	(**a new bracket** 7% above the current rate)

2. **Keep the Affordable Living Tax Credit & the Poverty Reduction Tax Credit**. These credits have created the greatest improvement in the economic position of the lowest income Nova Scotians in recent years.

3. **Equalize the tax value of personal expenditures on child care, retirement savings and other deductible expenses.** This can be accomplished by changing tax deductions to refundable tax credits with the same tax credit rate for everyone. This is much more equitable than the current system. Existing tax credits are a recognition of this fundamental principle of fairness. Converting tax deductions to credits expands this principle to all personal expenditures that warrant reductions in taxes. Converting non refundable credits to refundable credits expands the principle further. A few tax credits like the federal Child Care Tax Benefit and the Nova Scotia Affordable Living Tax Credit are already refundable. These changes will mean that low and moderate income Nova Scotians will receive the same tax benefit as higher income Canadians for RRSP/Pension contributions, child care or disability or employment expenses.

4. **Remove the 50% deduction for capital gains & stock options.** There is no valid reason to tax 100% of a person's earned salary but leave 50% of unearned capital gains tax free. This is fundamentally unfair treatment of income. All of the income from capital gains should be taxable as well – with a few exemptions such as primary residences or farms and other active businesses being transferred to children.

5. **Replace 50% of property taxes by income taxes.** Property taxes do not reflect ability to pay. Northern European countries use a blend of property tax and income tax to fund municipal services. This is a more equitable approach than relying solely on property taxes.

Create incentives to reduce climate change

6. Replace the Your Energy Rebate Program (YERP) with a Universal Service Program (USP). The YERP sends the wrong economic signal to households about their energy use. It makes energy cheaper, encouraging greater use. However, it is a recognition that home energy use is a necessity. The people who suffer the most from rising home energy costs are low and moderate income Nova Scotians. A Universal Service Program ensures low income households will continue to be able to pay for essential energy services by tying their energy costs to their income. It also ties higher energy users directly to intensive efficiency services to minimize the rate relief required.[4]

7. Remove incentives for carbon based industries. Carbon fuels should be economically viable without subsidies or they should not be used. They should be required to reduce their CO2 emissions in keeping with the province's goal that "greenhouse gas emissions are, by 2020, at least 10 per cent below the levels that were emitted in 1990" as spelled out in the Environmental Goals and Sustainable Prosperity Act[5]. Nova Scotians should not subsidize their Greenhouse Gas emissions through tax incentives and grants.

8. **Retain incentives for expanded renewables and efficiency**. The tax incentives under the CEDIF system should be retained for projects that are not subject to feed in tariffs. A feed in tariff should make a renewable project financially viable on its own. The substantial tax benefits created by CEDIF's to spur local development should be available to renewable and efficiency businesses.

Encourage economic and social development

9. **Expand the tax base sufficiently to fund labour force expansion measures.** These would include targeted a universal child care program; labour force development in 1st nations and African Canadian communities; immigrant settlement. The Ivany Commission identified the declining working age population as a long term problem in terms of economic drivers for Nova Scotia's economy. The Commission recommended increased efforts to expand immigration and to increase labour force participation in the First Nations and African Nova Scotian communities.

Another important source for expanding the working age population is by increasing the number of women in the workforce. Quebec created a highly popular universal, affordable child care program to increase women's participation in the workforce. "In 2008 it is estimated that the subsidized daycare programme increased the number of women in the labour force by 70,000."[6]

The tax system must generate sufficient taxes to pay for a universal child care program and measures to increase labour force participation in African Canadian and First Nations communities as well as settlement programs for new immigrants will require tax funding to pay

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[4] See Brian Gifford, "Solving Nova Scotia's Electricity Pricing Problem: Energy Affordability vs Rising Electricity Prices", Ecology Action Centre, 2013, pages 8-10.

[5]NS Environmental Goals and Sustainable Prosperity Act, page 3

[6] Pierre Fortin, Garderies: pourquoi tout le monde y gagne Le petit Fortin, Les Editions Rogers Limitee, Montreal, 2013, pp. 94-5.

for them. As with the payroll rebate, these programs would generate more tax revenue than they cost while expanding economic activity. An analysis of the Quebec child care program showed that [it] "generated a total of $5.1 billion additional revenue which contributed $1.9 billion in additional taxes: $1.3 billion to Quebec, $600 million to Ottawa. The new daycare programme cost the Quebec government $1 billion more than the previous programme, hence there was a net gain of $300 million to the Quebec government."[7]

ADDITIONAL POINTS

IV. Tax Cuts Won't Spur the Economy

We are very concerned that the chorus of calls for tax cuts will be heeded. Many media commentators and the business representatives at the March 20 consultation promote this idea.

We have been very pleased to hear the government's recognition that tax revenues cannot be heavily cut due to the impact this will have on valuable public services. Ms. Broten said at the consultation that reducing red tape was a higher priority than reducing taxes. We are encouraged by this. As the Primer on taxation states, taxes play a minor role in business location decisions. Other fundamentals of a business case are more significant.

There is evidence that cutting taxes is not an effective way to attract new industry.

> The KPMG report on competitiveness which ranks Halifax, Truro and other NS municipalities close to the top among municipalities across North America in terms of low costs. There is no need to reduce costs further by cutting taxes.
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> The Tax Primer prepared for the Tax and Regulatory Review shows that NS has the lowest marginal effective tax rates in the country for manufacturing but this has not translated into success in attracting manufacturers. We already have the 2nd lowest corporate income tax rates for all sectors so there is no need to reduce corporate taxes further.
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> Substantial cuts in federal corporate taxes led to limited investment and instead created large pools of unutilized capital (the "dead money" problem identified by the former Governor of the Bank of Canada Mark Carney) and higher profits for corporations. They may have contributed to the exponential growth in salaries for top corporate officers as well.
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> The US state of Kansas applied the tax cut mantra two years ago resulting in the largest drop in taxes in one year in any US state ever. A predicted boost in economic activity turned in reality into a large government debt, a debt rating downgrade and higher interest. But the most important result was slower economic growth than in neighbouring states and in the US as a whole.[8]
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> The effect of reduced revenues from lower taxes would reduce the attractiveness of NS for businesses through reduced public services and/or higher debt levels.

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[7] ditto

[8] See footnote 1

V. Economic impact of taxation

It is dishonest to talk about taxes without talking about public services. Supplying public services paid for by taxation has a positive impact on economic activity in several ways:

- by supplying more and better services required by industry for success
- by lowering the cost of doing business by reducing the cost of benefits like health care
- by increasing local demand and
- by directly funding employment

Those promoting lower taxes focus only on the added cost of doing business without considering all the positive impacts of the services paid for by taxation.

VI. Co-creators of economic wealth

Many suggest only private business creates wealth and all that governments do is spend it. This is a narrow, false view of the role governments play in wealth creation. Nova Scotia cannot have successful economic growth without government investment in people, infrastructure and the many services that are required for businesses to operate successfully. The legal and regulatory systems create a predictable environment in which business can operate. The public health system reduces benefit costs for industry. Transportation, water and sewer systems and public safety services are all required for businesses to operate successfully. The reality is that governments create the framework that allows business to function successfully. In this sense, governments and businesses are co-creators of economic wealth.

Many higher taxed jurisdictions are very successful both economically and socially as the Ivany report points out, with the northern European countries providing the best examples, demonstrating vividly how governments and businesses are co-creators of economic wealth.

VII. Tax Havens

Higher income households and large corporations are able to hire expensive tax lawyers and accountants to devise schemes to reduce their taxes. Some of those tax avoidance devices have nothing to do with the original intent of the tax regime that they take advantage of. Some corporations and individuals hide money and artificially shift profits to tax havens. This leads to unfair competition and reduces the tax base unfairly, undercutting federal and provincial resources for public services. We recommend that NS take a strong stand against such tax avoidance and evasion and press the federal government to follow the most aggressive anti tax avoidance recommendations available. There are 7 proposals advanced by the Tax Justice Network and Canadians for Tax Fairness which Canada should adopt. While there has been some progress in this area in recent years Canada lags behind other countries in taking effective action. NS should lead an effort to have the Council of the Federation demand an effective coordinated plan to reduce the loss of billions of dollars from tax avoidance and evasion.

VIII. Conclusion

Nova Scotians for Tax Fairness look to the NS Tax and Regulatory Review to recommend bold actions to make Nova Scotia's tax system more progressive and to ensure sufficient taxes for the NS government to provide the services its people and businesses need for economic and social success.