Independent Tax Review Committee
c/o Department of Finance
Tax and Fiscal Analysis Division
5 Mews Place
PO Box 8700
St. John's, NL, A1B 4J6
Submitted by email to: NLTaxReview@gov.nl.ca

September 25, 2018

Dear Chair and Committee Members,

Re: Common Front of Newfoundland and Labrador Tax Review Submission

Thank you for the opportunity to provide this written submission. And thanks once again for hearing our presentation earlier this year.

The Common Front of Newfoundland and Labrador is a broad-based coalition of labour, social justice, and community groups representing over 100,000 Newfoundlanders and Labradorians. We have been actively researching and participating in discussions of taxation and other fiscal issues in this province since our founding. Our member organizations have been active for many more years.

We bring a perspective that is underrepresented in mainstream discussions of tax issues. Such discussions tend to be dominated by the interests of big business and its spokespersons and fail to reflect the views of many Newfoundlanders and Labradorians.

We have spoken with residents of this great province since our founding. They feel that the tax system should help to bring this province toward an economy *rich in good jobs* with greater *fairness* and *sustainability* (see the Common Front NL report *A Better Future*). An economy that is *rich in good jobs* is one that supports families and communities in diverse sectors that can withstand resource sector price swings. A *fair economy* is one where inequality is low, nobody is forced into poverty, and all kids have a reasonable chance for a good life. A *sustainable* economy is one that carefully stewards the natural resources upon which it depends, achieves its climate change emissions goals and raises adequate revenues from sustainable sources.

These three pillars need to become core principles of our tax system, acting as a screen for any reforms. All aspects of the tax system should be examined for how they serve, or fail to serve, these three pillars. The attached submission maps the changes needed to meet the priorities we heard from citizens.

Submission to the Independent Tax Review Committee

Common Front of Newfoundland and Labrador

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Context of the tax review

The context of this tax review is a profoundly important set of social, economic, and environmental factors. The province is at a critical juncture. Current policy decisions will have serious implications for how those factors—and government policy—shape Newfoundland and Labrador long into the future. This review will need to carefully consider the implications of these factors for the tax system.[1]

Poverty and inequality

Newfoundland and Labrador has among the highest GDP per capita of Canada's provinces ($46,088 per person—higher than Ontario and even above Sweden and Denmark).[2] Yet, NL is tied for worst province in the country for poverty, and children born in poverty are more likely than the Canadian average to remain poor, and less likely to end up rich.[3] The province also has a high level of income inequality (ranking the worst in Atlantic Canada under the Gini Index), and scored a D minus for its gender wage gap—the worst in Canada.

There is clear consensus that both poverty and inequality impose costs not just on government budgets (e.g., higher health care costs), but also more broadly on society.[4] The TD Bank, International Monetary Fund (IMF), Conference Board of Canada, and Organization for Economic Cooperation and Development (OECD), have all warned that high levels of inequality are bad for economic growth.[5] This inequality effect has been

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[1] The Common Front of Newfoundland and Labrador thanks PolicyLink for research and analysis.

[2] Conference Board of Canada, "Provincial and Territorial Rankings, Income Per Capita," 2016, conferenceboard.ca/hcp/provincial/economy/income-per-capita.aspx.

[3] Harris Centre, Newfoundland and Labrador's Vital Signs 2017, mun.ca/harriscentre/vitalsigns/NL_Vital_Signs_2017.pdf.

[4] For references and costs by province, see Canada Without Poverty, "The Cost of Poverty," cwp-csp.ca/poverty/the-cost-of-poverty/. For the cost of the gender gap, see Pete Evans, "How much does gender inequality cost Canada? $150B," CBC News, June 21, 2017, cbc.ca/news/business/gender-equality-mckinsey-1.4169287. For the cost of inequality, see Oxfam Canada, "The cost of inequality," January 2013, oxfam.ca/our-work/publications/publications-and-reports/cost-of-inequality.

[5] C. Alexander and F. Fong, "The case for leaning against income inequality in Canada," TD Economics Special Report, 2014, td.com/document/PDF/economics/special/income_inequality.pdf. A.G. Berg and J.D. Ostry, "Inequality and Efficiency: Is there a trade-off between the two or do they go hand in hand?" International Monetary Fund, *Finance & Development* 48(3), 2011, imf.org/external/pubs/ft/fandd/2011/09/Berg.htm. Conference Board of Canada, "Canadian Income Inequality: Is Canada becoming more unequal?" April 2017, conferenceboard.ca/hcp/hot-topics/canInequality.aspx; Federico Cingano, "Trends in Income Inequality and its Impact on Economic Growth," OECD, 2014, oecd.org/newsroom/inequality-hurts-economic-growth.htm.

quantified: a 1 per cent increase in the Gini coefficient reduces GDP per capita by around 1.1 per cent over a five-year period; the long-run (cumulative) effect is larger and amounts to about -4.5 per cent.[6] Furthermore, inequality is associated with significantly worse outcomes on a range of measures, including child well-being, educational attainment, teen pregnancies, obesity, drug abuse, physical and mental health, trust and community life, social mobility, violence, and imprisonment levels. This is true in rich and poor jurisdictions alike.[7]

Poverty and inequality undermine well-being for everyone. Newfoundland and Labrador cannot afford to exclude any citizens from participation in the economy. And yet, we have an economy with a highly skewed income distribution, limiting the access of many to adequate education, good jobs, and entrepreneurship opportunities.

The tax system plays a key part in reversing inequality and poverty: by more equally distributing income and wealth; by ensuring there are adequate revenues to provide the necessary social and physical infrastructure; and by supporting a diverse, sustainable, jobs-rich economy.

There is more than enough wealth in the economy that nobody needs to be forced into poverty, and nobody needs to lack adequate health care, education, and other important services. Every child, even the poorest child, in Newfoundland and Labrador should have a realistic chance of a good life.

Unemployment and demographic challenges

The province is facing a crisis of unemployment; it is a genuine crisis, and it is highly relevant to public policy, including tax policy. The official unemployment rate (R4) is very high at over 14 per cent and has been rising even as Canada's overall rate drops. This number—as bad as it is—includes only those actively looking for work, and omits those who have given up. The more inclusive R8 rate is closer to 20 per cent—one in five.

In addition, the rise of precarious work, and the decline of quality jobs with pensions and benefits, are creating economic insecurity for workers, families, and communities.

[6] Markus Brückner and Daniel Lederman, "Effects of income inequality on economic growth," Centre for Economic and Policy Research, 2015, voxeu.org/article/effects-income-inequality-economic-growth.

[7] R.G. Wilkinson and K. Pickett, *The spirit level: Why more equal societies almost always do better,* London, UK: Allen Lane, 2009.

Our highly rural and aging population poses additional challenges. Newfoundland and Labrador is the most rural of the Atlantic provinces, with 60 per cent of its population living in rural areas.[8]

Many rural communities in this province are characterized by aging populations and youth out-migration that is not being balanced with in-migration.[9] A recent (2016) population projection model found that Labrador's population is expected to decrease by 8 per cent between 2015 and 2036,[10] and the province is facing a youth-retention crisis. In a recent ranking of youthful cities, St. John's placed last among large Canadian cities.[11]

The combination of population decline and an aging population means that the proportion of people past retirement age is growing, while the proportion of working-aged people is decreasing.

Overall, absent significant change in government approach, the demographic picture in NL is one of a declining labour force and aging population, out-migration by youth, movement from rural areas to urban centres, and overall population decline in most areas. This will put pressure on families, communities, and already-strained municipal tax bases. The tax review can focus on supporting sustainable rural communities, in-migration, and youth retention by being jobs- and education-focused, and supporting small, local businesses and regional business clusters.

Legacy of unsustainable tax cuts

By implementing large and regressive tax cuts, the previous provincial government took the treasury from surpluses to deficits, even when oil was priced at over $100 per barrel. As the current government has noted, those tax cuts created several billions of dollars of provincial debt.

Tax cuts since 2004 have disproportionately benefited the wealthy. By 2015, those tax cuts amounted to a give-away of $1.4 billion to those earning over $100,000.[12] This submission, in later sections on corporate taxes and personal income taxes, elaborates on these trends. The tax cuts were regressive in that the rates for the top income earners and large corporations were reduced at the same time as the reliance on consumption taxes was increased.

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[8] A. Simms and R. Greenwood, "Newfoundland and Labrador," in *State of Rural Canada Report* (2.10), 2015, http://sorc.crrf.ca/nl/

[9] Ibid., Simms and Greenwood.

[10] A. Simms and J. Ward, *Regional population projections for Labrador and the Northern Peninsula 2016-2036, 2016,* http://www.mun.ca/harriscentre/PopulationProject/LabradorPopulation_Report.pdf.

[11] Youthful Cities, "Canadian Index 2018," youthfulcities.com/canadian-urban-index.

[12] Robert Sweeny, "Taxes and Fairness, Part 2: Anti-Social Transfers," *The Independent*, May 7, 2018.

The province is still running a deficit, and while it is declining and expected to reach zero in a few years, the era of massive tax cuts is clearly over. This province needs a strong, progressive tax system that raises the revenues we need to create jobs, improve fairness, and ensure sustainability—now and into the future. This is about more than a technical discussion of optimal tax mixes and economic growth; it's about the type of society we want to live in.

Importance of government in the economy

There is a tendency among some commentators to suggest that private business is the sole creator of wealth, while all governments do is spend it. **This is not just misleading; it is factually incorrect**. Businesses and governments are co-creators of economic wealth.

Governments create the framework that allows businesses to function successfully, and are increasingly important direct creators of quality jobs and demand. Newfoundland and Labrador cannot have successful economic growth without:

- Government investment in people, infrastructure, and services that are required for businesses to operate successfully (transportation, water, wastewater management, and public safety, to mention only a few);
- Legal, regulatory, and security systems that create a predictable environment in which business can operate;
- Public health and education systems that reduce the costs to business of providing benefits and training; and
- Public employment and programs like EI that help to counter the boom-bust business cycle and commodity price fluctuations, and to stabilize employment and demand for private-sector outputs.

This may explain why many higher taxed jurisdictions are very successful, both economically and socially (e.g., Nordic countries).

The tax review needs to consider the critical role government plays in job and economic stimulus, economic sustainability and stability, and consumer confidence and local demand, particularly in the context of a changing economy.

Linkage of taxation and spending

Much of the advocacy for tax cuts omits the implications for spending and public services. However, tax cuts have many negative impacts. A tax cut means lost government revenue, leading to:

- Increased deficits;
- Lower spending on the infrastructure needed to support economic growth;
- Lower spending on health care, education, and other important program areas; and/or
- Lower spending on supports that alleviate poverty and inequality, including gender inequality (note also that women make up more than half of the public sector workforce, so layoffs in the public sector also have an impact on gender equity).

Government spending often has higher employment and GDP impacts than a tax cut, and the omission of these impacts makes the tax cuts rhetoric grossly misleading.[13]

Supplying public services has a positive impact on economic activity in several ways, by:

- Providing an educated workforce;
- Supplying services and infrastructure required by industry for success;
- Lowering the cost of doing business by reducing the cost of employee benefits like health care; and
- Increasing local demand through local purchasing of goods, and through public employment—employment that creates indirect and induced jobs in the private sector through multiplier effects. Local businesses in this province benefit greatly from the direct employment and indirect economic effects of government spending in terms of local demand.

Tax cuts are effectively a transfer of future resources from public to private control, resulting in reduced capacity to address increasingly urgent social, economic, and environmental challenges. Any assessment of a tax change needs to include full accounting for the government spending and service delivery implications in terms of jobs, fairness, and sustainability.

[13] Federal government budget analysis shows that direct spending by government on infrastructure and programs has a much higher impact that tax measures, see budget.gc.ca/2016/docs/plan/anx2-en.html. Data in a U.S. study showed that a corporate tax cut created one fifth the stimulus when substituted for government spending, see Dean Baker, "Spending Versus Tax Cuts: Who Pays the Cost of Political Compromise?" Centre for Economic and Policy Research, 2009, cepr.net/publications/reports/spending-versus-tax-cuts.

Other aims of taxation

Raising revenues is a core function of the tax system. Tax systems raise revenues needed to provide essential public goods and services—roads, policing, ambulances, fire trucks, health care, education, environmental protection, support for seniors, and more. Obviously, we couldn't all buy these things as individuals; taxes and government are the way we economize by cost sharing.

However, in addition to raising needed revenues, the tax system also influences decisions of individuals and corporations. For instance, tobacco taxes reduce smoking rates; a Georgetown University study for Health Canada concluded that of all smoking reduction strategies, "taxes had the largest effect."[14] Youth smoking rates in this province have declined by more than half since 1999, and thousands of premature deaths have been prevented. In terms of retirement savings, the RRSP deduction has encouraged (generally wealthier) Canadians to save hundreds of billions of dollars.

Also, the tax system reduces income inequality, through progressive income taxation and income supports for low income earners, and through spending programs if the benefits go more to lower and middle income individuals than higher income ones.

Clearly the tax system can have a big influence outside of raising revenues. This begs the question: What sorts of things should our provincial tax system aim to achieve?

Newfoundlander and Labradorian priorities: jobs-rich, fair, and sustainable

For more than three years, we've engaged with the people of this province—women and men; workers and the unemployed; parents, grandparents and students; business owners and social assistance recipients—to understand what people need, and to help them express those needs to the government.

What we learned from talking with Newfoundlanders and Labradorians is that this province needs an economy that creates good jobs, is fair, and is sustainable.[15] Reforms to the tax system are critical for advancing any of these three goals.

[14] D. Beeby, "Health Canada report calls for big tax hike on cigarettes," CBC News, November 21, 2017, cbc.ca/news/politics/cigarettes-vaping-packaging-tax-tobacco-smoking-target-health-canada-philpott-1.4410518.

[15] Common Front NL, *A Better Future: Building a jobs-rich, fair and sustainable economy for Newfoundland and Labrador*, December 2016, wearenl.ca/wp-content/uploads/2016/12/A-Better-Future-full-report-final-Dec-6-v3-2016.pdf.

After global oil prices crashed in 2015, government and big business were threatening austerity measures—deep public spending cuts that would hurt residents, throw public sector workers (and indirectly private sector workers) out of work, hurt local businesses, and send the economy into a tailspin. Newfoundlanders and Labradorians told the government to roll back the regressive Deficit Reduction Levy, repeal the book tax, and have the rich and large corporations pay a larger and fair share of taxes, among other things. There were notable successes in some those areas. The most important was the avoidance of extreme spending cuts.

However, building a jobs-rich, fair, and sustainable economy will require much more. A system-wide tax review provides an excellent opportunity. Members of the Tax Review Committee should be focusing on the following questions.

- What could a system-wide tax reform do to help build an economy rich in good jobs—jobs that support families and communities, in diverse sectors that can withstand resource sector price swings?
- What could tax reform do to make a fairer economy—one where nobody was forced into poverty, and all kids had a reasonable shot at a good life?
- What could tax reform do to help the province steward its resources, and achieve its climate change emissions goals?

This submission explores each of these issues, while considering the existing tax system in terms of progressivity, cost, tax mix, and simplicity (key metrics for the Committee). We propose changes that will put the province on the high road, making the best of the opportunity to build a more resilient, diversified, and stable economy that is less vulnerable to oil price shocks—to put the province on the road to a recovery that is built to last.

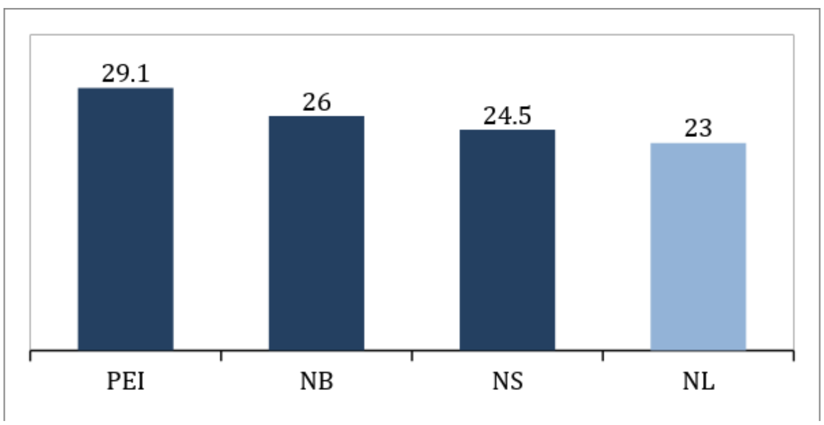
The government can choose that high road, building a future that is centred on NL citizens, rich in quality jobs, fairer, and more sustainable; or the government can choose a low road that is focused on serving outside business interests, with increasing inequality, more precarious work, higher unemployment, and continued vulnerability to external resource shocks. This tax review and the Committee's recommendations will be vitally important in determining which road the province will take.

Revenue options

This submission proposes a number of tax changes aimed at making a more jobs-rich, fair, and sustainable economy. There are proposals for reductions, and for increases.

It is important to note that there is room to move on increasing revenues. Contrary to panic stories of "out of control" public spending and revenues in this province and Canada, our spending and revenues are pretty average. NL is actually the lowest in Atlantic Canada for revenue as a share of the economy (see Figure 1), and Canada lags below the OECD average for revenue as a share of the economy (see Figure 2).[16] There is plenty of room to move.

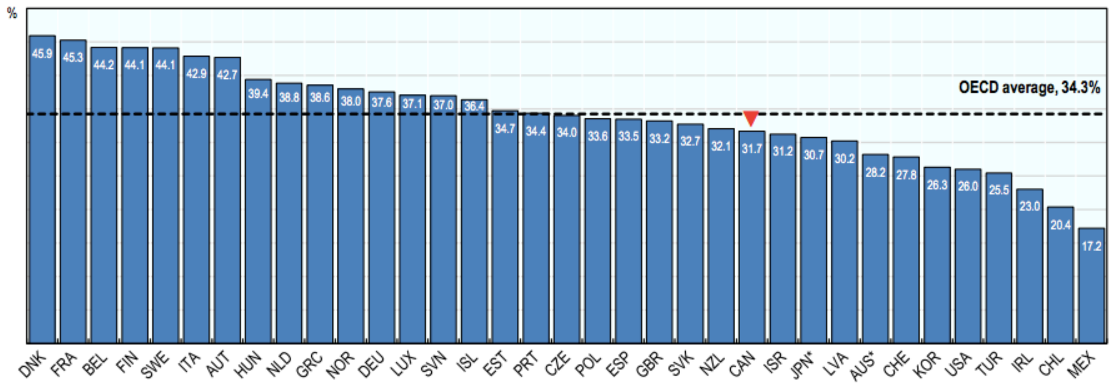
Figure 1: Provincial revenue as a percentage of GDP for Atlantic provinces 2016-17



Source: RBC Canadian Federal and Provincial Fiscal Tables, February 2018.[17]

[16] OECD, "Revenue Statistics 2017 – Canada," oecd.org/tax/revenue-statistics-canada.pdf
[17] www.rbc.com/economics/economic-reports/pdf/provincial-forecasts/prov_fiscal.pdf

Figure 2: Revenue as a share of GDP for OECD Countries



Corporate income tax

There is a loud and constant clamouring for corporate income tax cuts by representatives of big business and their allies. Without any context, one might get the impression corporations are taxed to death, and the provincial government must urgently slash the corporate income tax rate. A look at the facts tells a different story.

Canadian corporations have received the benefit of substantial tax cuts for decades. The federal basic rate for large corporations had been about 50 per cent through the 1960s, and was reduced to 46 per cent by the end of the 1970s, and to 38 per cent by the end of the 1980s.[18] A "tax abatement" of 10 per cent set in the 1960s takes the net rate down to 28 per cent, and a "general tax reduction" of 13 per cent set in the 2000s takes it down further to 15 per cent for large corporations.[19] And of course, the 15 per cent net rate is just theoretical; the actual rate paid by large corporations is often reduced through various tax deductions, credits, exemptions, and other special tax breaks.[20] A recent study found corporations listed on the Toronto Stock Exchange paying a little as 1.8 per cent.[21]

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[18] S. Cahill, "Corporate Income Tax Rate Database: Canada and the Provinces, 1960-2005" (Government of Canada, 2007), www5.agr.gc.ca/resources/prod/doc/pol/pub/itdat60-05/pdf/tax_e.pdf.

[19] Government of Canada, "Corporation tax rates," canada.ca/en/revenue-agency/services/tax/businesses/topics/corporations/corporation-tax-rates.html. The small business rate is 10 per cent.

[20] One could add loopholes to this list. Loopholes are often defined as a tax law provision that is being used to reduce taxes in a way not intended by the law. However, it is difficult to know the intention behind a law, as there are many legislators. And when a government is aware of a loophole usage, but does not introduce legislation to close it, there is an argument that the loophole is intended.

[21] D. Gibson, "Bay Street and Tax Havens" Canadians for Tax Fairness, 2017, taxfairness.ca/sites/taxfairness.ca/files/pdf/canadian_for_tax_fairness_-_tax_havens_2017_nov_15_for_release.pdf.

Another found that in an average year "the 102 biggest companies in Canada pay $10.5 billion less than they would if they paid tax at the official corporate tax rate."[22]

Furthermore, the corporate income tax is not a tax on income, like individuals pay; it is a tax on profits. The difference is important; many companies pay zero in taxes in a given year if they don't declare a profit, even if they have very high revenues. This motivates corporations to avoid taxes by declaring low or zero profits, for example by using transfer pricing through subsidiaries in tax havens. Canadians for Tax Fairness report that use of offshore tax havens by Canadian corporations is rampant; 58 of the top 60 companies listed on the Toronto Stock Exchange have subsidiaries and related companies—hundreds of them—in known tax havens.[23]

The combination of tax cuts and increasingly sophisticated and aggressive tax avoidance has boosted the share of the economic pie taken by corporations, as compared to individuals' income. A greater share of the province's GDP has been going to corporations than elsewhere in Canada—more than twice the Canadian average (see Figure 4).[24] However, median income is the second-lowest of all provinces, at 48 per cent.[25] The other Atlantic Canada provinces average over 70 per cent median income-to-GDP ratios.

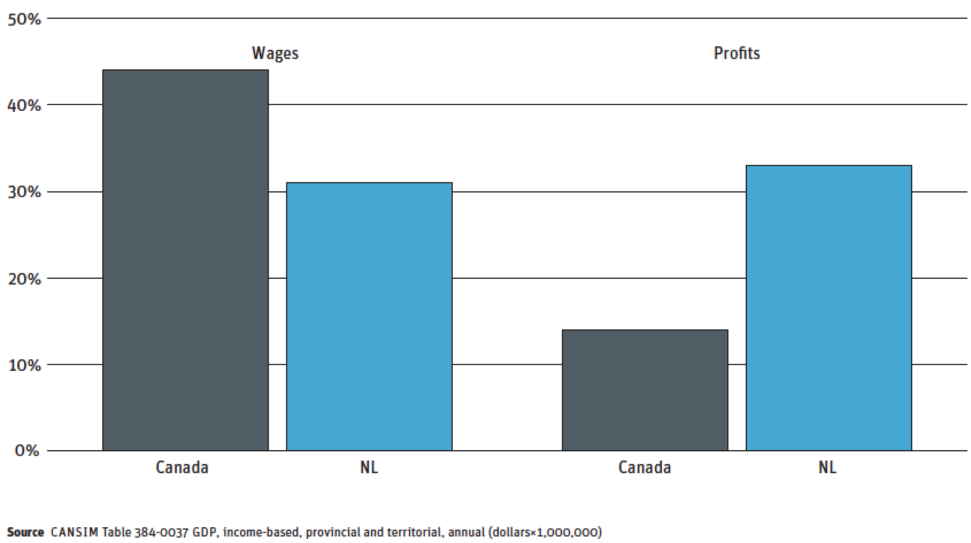
[22] M. Oved, T. Heaps and M. Yow, "The high cost of low corporate taxes," *Toronto Star*, December 2017, http://projects.thestar.com/canadas-corporations-pay-less-tax-than-you-think/.

[23] D. Gibson, supra note 19. For more on this topic, see Oved, Heaps and Yow, supra note 21.

[24] Diana Gibson and Greg Flanagan, *Options for a Strong Economy*, Canadian Centre for Policy Alternatives, 2014.

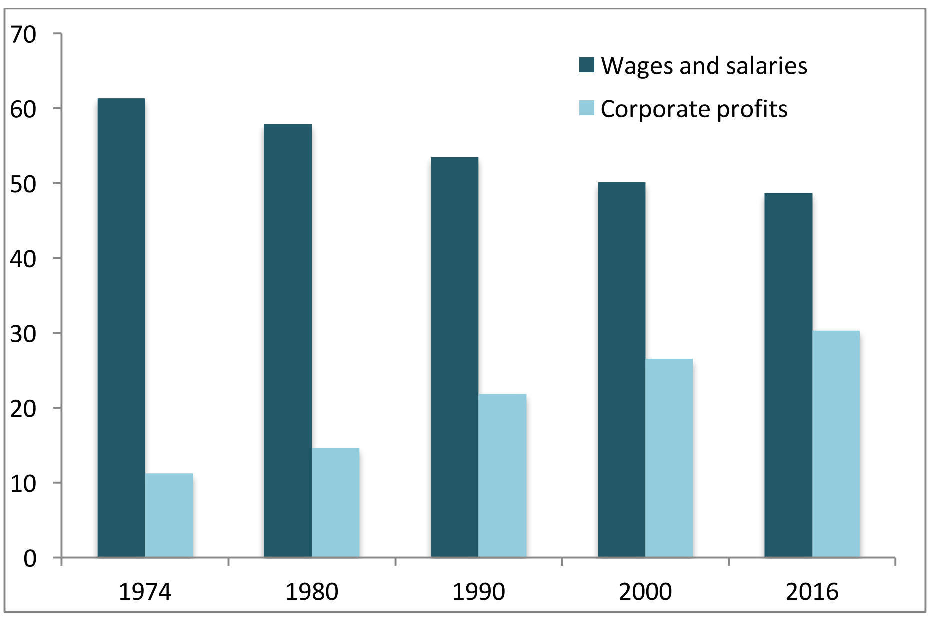
[25] Statistics Canada, "Neighbourhood income and demographics, tax filers and dependents with income by total income, sex and age group, annual (number unless otherwise noted) (CANSIM table 111-0008)," 2016, online, and Statistics Canada, "Gross domestic product, expenditure-based, by province and territory (CANSIM table 348-0038," 2015, online, and Statistics Canada, "Population by year, province and territory (number) (CANSIM table 051-0001), 2016, online.

Figure 4: Profits and wages as a share of GDP 2014, Canada and NL



The share of NL's GDP going to corporate profits has been increasing over time despite declining profitability in oil and gas due to price fluctuations (Figure 5).

Figure 5: Wages and profits as a share of GDP over time NL

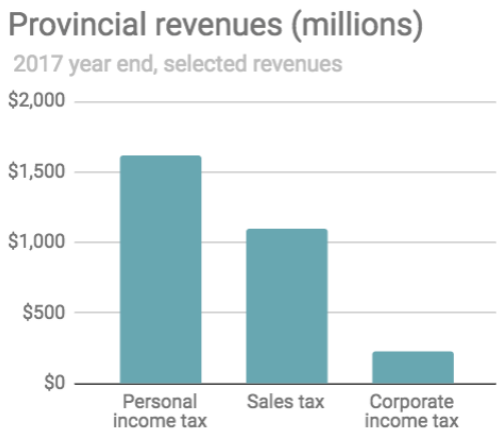


Sources: Historical Statistics of Newfoundland and Labrador[26]

[26] Historical Statistics of Newfoundland and Labrador, Table F-1 Provincial Income and Provincial Gross Domestic Product, NL 1961, 1965, 1970-1985, stats.gov.nl.ca/Publications/Historical/PDF/Historical_Statistics_of_Newfoundland_and_Labrador_V2_N5_1988.pdf and Statistics Canada CANSIM Table 36-10-0221-01 (formerly CANSIM 384-0037).

So, set against this context, how much does the provincial government actually receive from corporate income taxes? Provincial revenues from corporate income taxes are a small fraction of what individual Newfoundlanders and Labradorians contribute (see Figure 6).[27]

Figure 6: Newfoundland and Labrador provincial revenues



Jobs-rich, fair, and sustainable

Corporate taxes can be part of a growth strategy where those revenues are used to build a quality jobs economy. Direct government spending has many times the job multipliers of tax cuts.[28] Tax cuts reduce revenues and thus eliminate jobs in the public sector (and through the multiplier effect, jobs in the private sector).

As an example, small businesses can be encouraged to create jobs by targeting the lower tax rate for smaller businesses to companies that actually employ people, as Quebec has done. About half of Canadian firms that access the advantageous small business deduction don't employ anyone but the owner. Quebec changed the rules for access to the small business deduction to include those in the primary or manufacturing sector and those who employ more than three full time employees.[29]

Some argue that leaving more money in the hands of corporations should boost economic growth and thereby create jobs, as those corporations should spend that money on things

[27] Government of Newfoundland and Labrador, Annual Financial Report, 2016-2017 fin.gov.nl.ca/fin/publications/volI_2016-17.pdf.
[28] Common Front NL 2016, supra note 1; Gibson and Flanagan 2014, supra note 23.
[29] Revenue Quebec, "Corporate Income Tax Changes," https://www.revenuquebec.ca/en/press-room/tax-news/details/100337/

that grow their business. However, when corporations decide whether to spend revenues on creating future growth, or to just hang on to profits, a low tax rate on profits (i.e., a low CIT) tends to steer money toward profits rather than expenses. It reduces the incentive to investing in future growth. Profits often are hoarded within the company, or paid out to shareholders. Canadian corporations have hoarded hundreds of billions in cash reserves—"dead money" in the words of the Governor of the Bank of Canada.[30]

The recent US tax cut is an illustrative example. The Federal Reserve of Atlanta released results from a national survey of businesses on the impact of the recent tax cuts on capital spending in 2018: three quarters said there was no material change to capital spending after the US tax cut.[31]

A 60-nation panel study found that much of the increase in foreign direct investment (FDI) associated with reduced corporate tax rates was aimed at corporate mergers and acquisition rather than productive investment.[32] Despite the higher FDI, those tax cuts were associated with a decrease in annual GDP growth.

A recent Canadian study concluded that "there is no empirical or statistically significant relationship between the CIT regime and economic growth."[33] Canada's competitiveness ranking has fallen steeply despite the dramatic corporate tax cuts documented above—from second in 1960, to 12 in 1990, to 16th in 2015.[34] Newfoundland and Labrador's growth rate fell below that of other provinces after its tax cuts in 2007 (Figure 7).[35]

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[30] Gordon Isfeld, "Canadian corporate cash hoard rises to $630-billion in first quarter," *Financial Post*, August 27, 2014, business.financialpost.com/news/economy/canadian-corporate-cash-hoard-rises-to-630-billion-in-first-quarter . P. Power, "Free up 'dead money,' Carney exhorts corporate Canada," *Globe and Mail*, August 2012, theglobeandmail.com/report-on-business/economy/free-up-dead-money-carney-exhorts-corporate-canada/article4493091/.

[31] Federal Reserve of Atlanta, "What are Businesses Saying about Tax Reform Now?" *Macroblog*, March 23, 2018, macroblog.typepad.com/macroblog/2018/03/what-are-businesses-saying-about-tax-reform-now.html.

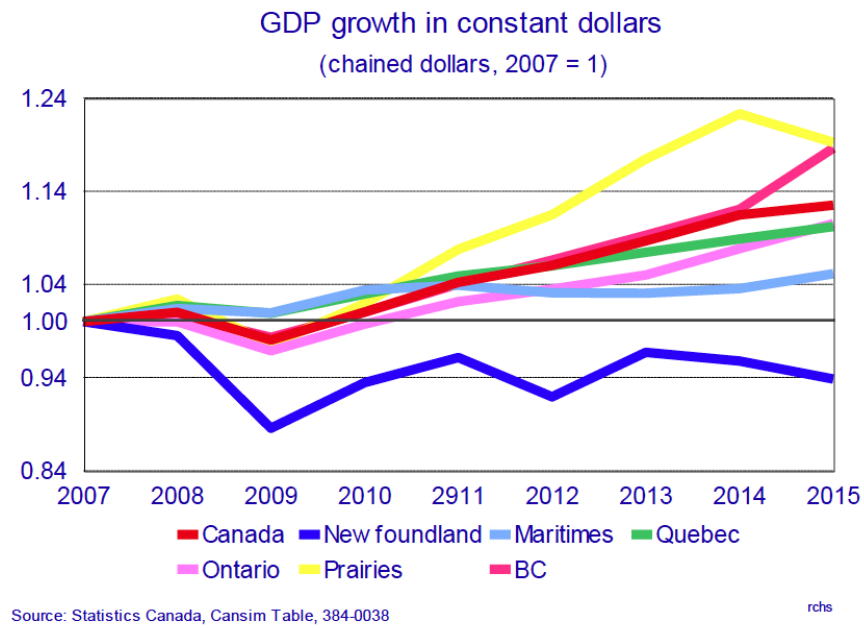
[32] N. Anguelov, "Lowering the Marginal Corporate Tax Rate: Why The Debate? The Negative Impact of Interstate Tax Competition," Public Policy Centre, University of Massachusetts, Working Paper No. PMG-2015-01, publicpolicycenter.org/wp/wp-content/uploads/2016/07/PPC-Working-Paper-No.-2-LOWERING-THE-MARGINAL-CORPORATE-TAX-RATE-WHY-THE-DEBATE.pdf.

[33] J. Brennan, "Do Corporate Income Tax Rate Reductions Accelerate Growth?," Canadian Centre for Policy Alternatives, 2015, policyalternatives.ca/sites/default/files/uploads/publications/National Office/2015/11/Do_Corporate_Income_Tax_Rate_Reductions.pdf.

[34] World Economic Forum, World Competitiveness Report, weforum.org/docs/WEF_GlobalCompetitivenessReport_2006-07.pdf and Gabriel Yiu, "Corporate Tax Cuts Have Made Canada a Poorer Country," *Huffington Post*, September 16, 2015.

[35] "The Challenges of an Equitable Fiscal Policy," Draft paper, Memorial University, 2017.

Figure 7: GDP growth by province



Another claim made by opponents of corporate taxation is that corporate taxes should cause corporations to flee from the jurisdiction, with associated job losses. However, high-tax jurisdictions like those in northern Europe have strong economies. This is because, among other reasons, taxes are only one small piece of a corporate location decision. As Nova Scotia Department of Finance Director Thomas Storring noted, "[d]eterminations 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."[36] Former federal Finance Deputy Minister Peter Nicholson remarked similarly: "corporate behaviour is generally driven more by opportunity and competition than by tax rates per se. … I don't think raising or lowering taxes has a hell of a lot of influence on where companies invest."[37]

In a resource economy this is even more the case; location decisions are made based on resource quality and access to markets much more than on a tax basis. With a high proportion of foreign ownership and profitable extractive industries, corporate taxes are key to capturing and redistributing those profits and preventing tax leakage out of the province. Lower corporate income tax rates mean more profit flows out to overseas shareholders, who do not pay taxes here.

Corporate tax cuts are particularly inefficient at job creation and economic growth compared to other tax and spending options—they directly increase inequality, and they

[36] Thomas Storring, "Primer on the Nova Scotia Tax System," *Briefing Note*, March 18, 2014, members-digitalnovascotia.wildapricot.org/Resources/Documents/Primer on Tax Reform in Nova Scotia-3.pdf.
[37] Oved, Heaps and Yow 2017, supra note 21.

reduce government revenues, with costs in terms of program or services cuts, and/or higher long-term deficit and debt loads and servicing.

Recommendations

The province should immediately raise corporate tax rates and broaden the base for capital taxes:[38]

- Raise the CIT rate to 16 per cent in the short term;
- Return the rate to the 1990s rate of 17 per cent in the medium term;
- Add further brackets to make corporate taxes more progressive in the longer term —including a reduced rate for micro businesses, and higher brackets for larger corporations;
- Target the small business tax rate to small and medium sized businesses that have at least a minimum number of employees, as Quebec did;
- Extend the 6 per cent capital tax currently levied on financial institutions[39] to all large corporations; and
- Close loopholes and change the law so that corporations (and individuals) cannot use tax havens to avoid paying taxes.[40]

Automation tax

Technological improvements have always been a part of our evolving economy, and they have always destroyed existing jobs and created new jobs. This has taken place in various industries over time.

Recently, however, analysts have noted that this existing pattern is being accelerated by high technology, automation, Internet-based transaction platforms, and artificial intelligence. Technological change will be taking place more quickly, across a range of industries at the same time, and affecting a wider range of occupations.

[38] See also discussion of payroll taxes and gross income taxes elsewhere in this submission.
[39] Government of Canada, "Newfoundland and Labrador capital tax on financial institutions," canada.ca/en/revenue-agency/services/tax/businesses/topics/corporations/provincial-territorial-corporation-tax/newfoundland-labrador-provincial-corporation-tax/newfoundland-labrador-capital-tax-on-financial-institutions.html.
[40] For more recommendations on tax havens, see D. Gibson 2017, supra note 19.

Jobs-rich, fair, and sustainable

Many are forecasting that 30 to 50 per cent of jobs will be affected in coming decades. The jobs most at risk are those that are repetitive (whether manual or cognitive), while those being most resilient will be those involving creativity and human interaction. “Smaller centres that are highly dependent on manufacturing, mining, agriculture and forestry will likely suffer the most.... By contrast, towns where hospitals, universities, or the government provide most of the jobs will feel the least impact.”[41] Workers will be laid off, or simply not hired, and they, their families, and their communities will pay the costs.

In addition to the above employment-related impacts, absent significant government policy change there will likely be many other impacts, including:

- An increased shift of GDP to corporate profits, especially for corporations that boost production or reduce payroll through automation;
- Decreased government revenues from payroll taxes, and from personal income taxes and consumption taxes paid by affected workers and families;
- Increased costs of social spending related to affected workers, families, and communities; and
- Widening inequality.

Recommendations

The government should work with the federal government to develop an automation taxation strategy to address the impacts on the tax base, and social spending costs. There are many options, for example:

- Excise taxes on sale or import of worker replacement technology, e.g., retail kiosks, industrial robots, self-driving vehicles;
- Surtaxes on profits arising from labour cost reductions associated with worker-replacement technology (e.g., a company pays a portion of the taxes that the replaced worker would have paid in personal income tax);
- A special capital tax, and/or a higher income tax rate for corporations that employ a high ratio of capital to labour; and
- Taxing capital gains at the same rate as earned income.

[41] E. Alini, "Here are the Canadian towns and cities that could lose the most jobs to robots," *Global News*, June 8, 2017, globalnews.ca/news/3511940/small-town-canada-robots-lost-jobs/.

In the longer term, taxes on capital and corporations will be need to be increased to address the loss of income distribution through wages and salaries, and to ensure balance in the economy.

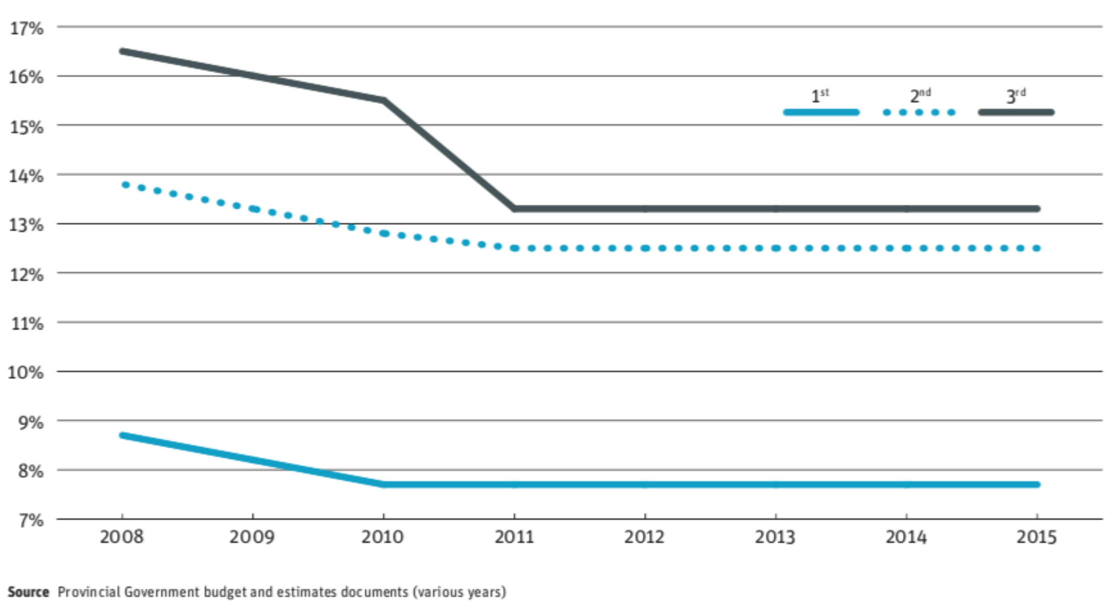
Personal income taxes

The personal income tax is important to the tax mix, as it is progressive, provides a counterbalance to the many regressive taxes in the overall tax system, and is more stable than resource extraction revenues.

Provincial PIT rates were cut significantly in recent decades. In the last few years, federal and provincial governments have returned a little progressivity to the income tax system by increasing marginal rates for top income brackets. However, the provincial government has fallen short of reinstating those cuts, and falls shorts on progressive taxes overall.

The PIT was cut and made less progressive with the highly regressive cuts introduced by the conservative government in 2007 and 2010. This disproportionately benefited those with higher incomes. Figure 8 shows the rate cuts in the three different marginal rate categories.

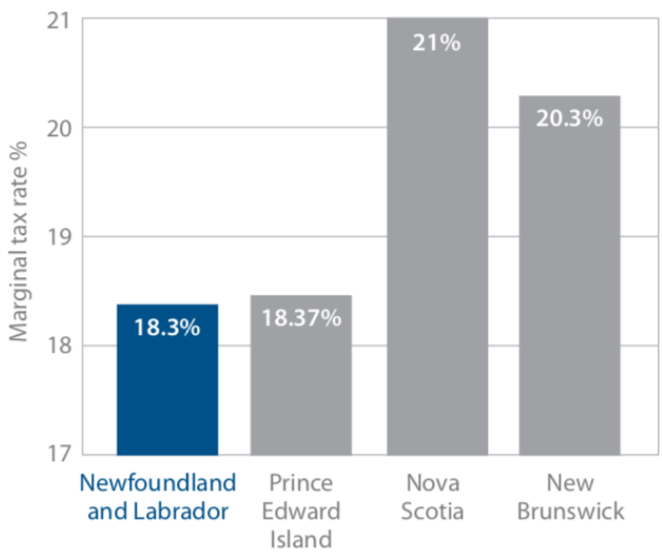
Figure 8: Rate cuts by marginal bracket NL



Source: Gibson and Flanagan 2014, supra note 23, p. 27.

The provincial tax rate for the top bracket is still the lowest in Atlantic Canada (see figure 9). Also, that top bracket often isn't paid: tax loopholes, tax havens, and creative accounting enable the wealthy to pay far less than the top marginal rate. And we don't have significant taxes on wealth.

Figure 9: Lowest top-bracket tax rate in Atlantic Canada[42]



Meanwhile, toward the bottom of the income scale, provincial tax rates kick in at lower levels than the Canadian average: the threshold for the lowest rate (income above the Basic Personal Exemption) is currently third-lowest of the provinces,[43] while the threshold to the next marginal rate is fourth-lowest.[44]

Jobs-rich, fair and sustainable

A more progressive income tax system means more equality, as well as economic and employment benefits. It results in more money in the hands of lower and middle-income people. Lower and middle-income people spend a greater proportion of increases in

[42] Figure: Newfoundland Federation of Labour, "Newfoundland and Labrador Budget 2018: Measuring What Matters," February 2018, nlfl.nf.ca/wp-content/uploads/2018/02/measuring-what-matters-NLFL-budget-indicators-report-Feb-2018-.pdf.

[43] KPMG, "Personal Tax Credits – Federal and Provincial Non-Refundable Tax Credit Rates and Amounts for 2018," https://home.kpmg.com/content/dam/kpmg/ca/pdf/2018/07/federal-and-provincial-non-refundable-tax-credit-rates-and-amounts-for-2018.pdf.

[44] KPMG, "Personal Tax Rates – Federal and Provincial Income Tax Rates and Brackets for 2018," https://home.kpmg.com/content/dam/kpmg/ca/pdf/2018/07/federal-and-provincial-income-tax-rates-and-brackets-for-2018.pdf.

income and more locally. This is in contrast to the rich, who tend to save increases in income, put it in offshore accounts, or spend it on imported goods.

Thus, a more progressive income tax system can provide greater stimulus to the local economy, helping to employ people locally and grow the tax base.

*******Text box:**

Millionaires and the myth of tax flight

Conservatives and lobbyists for the rich like to claim that any tax increases on the rich will simply cause them to flee to lower tax jurisdictions. However, the evidence does not support this claim.[45]

Interstate migration is actually more common among the US middle class than among millionaires, and almost twice as common among its poorest residents; most people move for much more vital reasons—in order to get jobs, not tax advantages.[46]

Only about 2.4 per cent of US-based millionaires change their state of residence in a given year, and 85 per cent of those moves have no net tax impact for the movers. Of the 15 per cent of migrations that have tax impact, most are moves to Florida, which also has beaches and nice weather. Other low-tax states like Texas, Tennessee and Nevada don't receive any net tax-migration. This suggests that there may be other motivations for the few moves that do result in tax benefits. Even billionaires don't stray far; 84 per cent live in their country of birth, and of the 16 per cent who moved, only one-third of those did so after they got rich.

****** End of text box**

Recommendations

Brackets and rates need to be changed to make the personal income tax system more progressive. Those least able to pay should be given a break, while those most able to pay should shoulder more of the burden:

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[45] C. Young, "If you tax the rich, they won't leave: US data contradicts millionaires' threats," *The Guardian*, November 20, 2017, theguardian.com/inequality/2017/nov/20/if-you-tax-the-rich-they-wont-leave-us-data-contradicts-millionaires-threats; C. Young, *The Myth of Millionaire Tax Flight: How Place Still Matters for the Rich*, 2017, Stanford University Press.

[46] For most individuals, any potential tax savings from moving to another province would be outweighed by a few return flights to visit home.

- **Enhance the low-income tax reduction program.** Raise the thresholds under which individuals and families are given tax exemptions and reductions.
- **Reduce the bottom-bracket rate.** Reduce the rate by 1 per cent on the first bracket, which is paid by everyone on his or her taxable income up to $35,851.
- **Leave middle brackets alone**. Do not change the rates for the 2nd and 3rd brackets (up to $128,010).
- **Increase the rate for the 4th bracket** ($128,010 to $179,214) by 1 per cent.
- **Increase the rate for the 5th bracket** (>$179,214) to 21 per cent—Nova Scotia's current top bracket rate.
- **Introduce a millionaire tax**. Create a new bracket for income above $1,000,000, with a rate of 30 per cent.
- Introduce a **"Buffet Rule"** requiring that those with gross incomes above $1,000,000 pay an average tax rate no less than that paid by those with a median income, regardless of deductions, credits, exemptions, and other special tax breaks.
- Work with the federal government to eliminate the special deal given to **capital gains income**—both the lifetime exemption of $800,000, and the free ride on 50 per cent of income above the exemption.

Sales taxes and user fees

In its 2016 budget, the provincial government increased the HST from 13 to 15 per cent, and instituted and increased a number of user fees and item-specific sales taxes ("excise taxes"). Sales taxes and user fees have a disproportionate impact on lower and middle-income people.

Jobs-rich, fair, and sustainable

Sales taxes are important, as they provide a significant proportion of overall revenues needed to support public services. However, like user fees, sales taxes can be regressive—requiring lower income people to pay a higher proportion in taxes. While the revenues from these sources are needed, their regressive impact should be mitigated by selective reductions and exemptions, and by coupling any increases to rebates and spending that help support lower income and middle-income people.

Recommendations

- The general HST rate should not be increased.
- The Newfoundland and Labrador income supplement and seniors benefit (paid along with the HST credit[47]) should be increased.
- User fees should be reviewed to determine which ones affect lower income or fixed income people the most, and these should be restructured, reduced, or eliminated.
- Revenues from tobacco, cannabis, and liquor should be set at rates that minimize consumption, while not enabling a strong black market. Revenue increases can go toward enforcement, health and addiction programs, and the income supplement and seniors benefit.

Carbon tax

Climate change is bringing a range of impacts, with disaster and insurance costs rising already, and far worse harm to come. This province has failed to meet its own climate change emission targets, and is on track to miss future targets unless it adopts much more aggressive policies, including economy-wide carbon pricing.

Jobs-rich, fair, and sustainable

Federal law will require the province to adopt a form of carbon pricing that ramps up to $50 per tonne by 2022. This translates to about ten cents per litre of gasoline—a fraction of annual market-induced price swings. Despite being a modest level of taxation, it will bring in over $400 million per year.

Alberta and BC both adopted carbon pricing several years ago, and their current structures provide rebates that make most lower-income and middle-income people financially better off than they were before the tax.

The provincial government can use a portion of the carbon tax revenues to enhance its programs for assisting lower to middle income residents to improve their home energy efficiency, thus reducing their costs of living, while reducing emissions and creating green jobs. Apart from the revenues, the carbon tax itself can help build the green economy,

[47] Government of Canada, "GST/HST Credit Including related provincial credits and benefits," https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/rc4210/gst-hst-credit.html#P414_18386.

which represents a tremendous opportunity[48] to add economic diversification and resilience—creating jobs and reducing our economic vulnerability to global oil price swings.

Recommendations

- The provincial government should establish an economy-wide carbon tax that covers not just consumers, but also industry, including the offshore.
- Revenues should be used to:
  - Make most lower to middle income people better off than they would have been without the tax, through supporting home energy efficiency improvements, and providing rebates based on income;
  - Support low-emissions electricity generation;[49] and,
  - Provide modest, production-based rebates to industries that have low climate impacts, and to individual businesses that have low climate impacts within their industries.
- The provincial government should commit to continuing the ramp-up of both the carbon tax, and the rebates and programs, after 2022 – thereby providing a greater financial benefits while also reducing greenhouse gas emissions more quickly.

Payroll tax

The payroll tax impacts workers by targeting wages and salaries. It is different from an income tax, which also covers income from investments, interest, dividends and capital gains.[50]

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[48] See Newfoundland and Labrador Federation of Labour, “Good Jobs, Green Jobs: Exploring Opportunities for Newfoundland and Labrador – Discussion Paper,” May 2009, nlfl.nf.ca/files/sharethewealth/NLFL_Green_Jobs_Discussion_Paper.pdf. See also: GEN, "Green Economy Network Platform: A Roadmap Toward 27,449 Jobs for Newfoundland and Labrador," greeneconomynet.ca/wp-content/uploads/sites/43/2017/05/Newfoundland-and-Labrador-long-EN.pdf; and Vancouver Economic Commission, "Green jobs boom continues in Vancouver: Green Economy Report," June 7, 2018, vancouvereconomic.com/blog/media/vancouver-green-economy-report-2018-launch/.

[49] Alberta, for example, is supporting growth of its wind and solar industries using carbon tax revenues. Part of NL’s carbon tax revenues could help offset some of the costs of Muskrat Falls. The government has indicated it will be mitigating rate increases due to Muskrat Falls, and the cost of doing so is expected to be on the order of $400 million per year.

[50] Note that EI and CPP, which are sometimes termed payroll taxes, are actually contributory benefit systems funded by paycheque deductions.

It disproportionately impacts businesses that employ people, compared to those that do not. It creates an incentive for companies to reduce their payroll, which can be done through:

- Laying off employees and contracting out;
- Replacing workers by automation; and
- Reducing salaries and wages.

Unemployment is already at crisis levels in this province, which places downward pressure on wages. This is not the time to be targeting workers, and of companies that employ workers.

Furthermore, the payroll tax is a flat tax, at 2 per cent of payroll; the rate is the same whether workers are paid minimum wage or a quarter million dollars a year, which means it is relatively regressive compared to personal income taxes.

The payroll tax base also is constrained by existing high unemployment levels, and could be shrunk further by increasing automation, as well as by the broader trend to precarious work relationships (e.g., contracting out and self-employment).

Jobs-rich, fair and sustainable

The payroll tax should play a smaller role in the overall tax mix. Reducing it, and backfilling the lost revenues with other sources, would provide an incentive to businesses to actually employ people.

While the payroll tax should be reduced, it should not be eliminated. The province needs a wide variety of tax instruments and a broad tax base. A payroll tax does have the advantage of getting at least *some* tax from corporations that otherwise might not pay corporate income tax, e.g., corporations that declare no profits by using tax havens, or otherwise evade or excessively avoid taxes.

However, there are other ways to ensure that corporations pay at least some tax on their revenues. The most direct way is to tax the actual revenues.

Recommendation

The payroll tax should be reduced by 50 per cent, and the foregone revenues should be replaced by revenues from a new tax on gross corporate revenues. Note that this is different from the "corporate income tax," which is actually a tax on profits (note that the proposal is not to replace CIT, nor HST,[51] but just payroll tax). Such a tax is used in many states in the United States, and in other countries, and is sometimes termed a gross revenues tax, or commerce tax.

This change would reduce the incentive to lay off employees, cut wages, or use precarious workers or automation to shrink payroll. It would ensure that corporations pay at least some tax on their revenues. It would broaden the tax base by covering corporations that employ nobody, and those that choose to declare no profits (e.g., by creative transfer pricing, hiding profits in tax havens, and other tax avoidance).

The gross revenue tax rate could have a lower rate for smaller businesses than for big businesses, and by maintaining an exemption threshold (the current $1.2 million threshold applied to payroll tax could be raised modestly for the gross revenues tax).

Other revenue enhancements

The government should develop options and consult the public on a number of other revenue enhancement opportunities.

- **Royalties**. The government should fund an independent, third party review of royalties collected on resource extraction, with the goal being to sell Newfoundlanders' and Labradorians' resources at the highest price the global market will bear.
- **Windfall profits tax**. The government should institute a windfall profits tax that would capture unearned revenues, as has been done in other jurisdictions.[52] While this tax would not be expected to bring in substantial revenues in times of low oil prices, it would ensure that excess profits do not escape the jurisdiction, and enable repayment of debt when prices are high.
- **Registration of deeds fee**. The fee for registration of deeds operates as a land transfer tax—a percentage tax on the price of a property transfer. Many land transfer taxes are progressive in nature, with lower rates for lower-cost properties, and higher rates for pricier properties, as well as exemptions for first time home buyers.[53] Newfoundland and Labrador's flat fee[54] should be increased for higher-priced property, making it progressive.

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[51] The argument that VATs are better due to avoiding tax pyramiding, vertical integration incentives, and distortions, is not applicable, as the proposal is to replace part of the payroll tax, not the HST.

[52] D. Gibson and G. Flanagan, *Prosperity for all: An alternative economic path for Newfoundland and Labrador*, Canadian Centre for Policy Alternatives, 2013, policyalternatives.ca/publications/reports/prosperity-all.

[53] Rates.ca. (n.d.). Land transfer tax in Toronto Ontario & Other Provinces: Provincial and municipal land transfer tax & tax rebate. *Retrieved from* https://rates.ca/land-transfer-tax.

- **Junk food tax**. Generally, the tax system should "tax bads, not goods." Revenues from a broad-based junk food tax could support healthy food programs for children, health care spending, active transportation infrastructure, etc., or could be used to forestall increases in other taxes.
- **Municipal revenues**. In order to help municipalities balance their books, and reduce future municipal demands on the provincial treasury, the provincial government should expand municipal options for raising revenues.[55]
- **Estate tax**. Canada is the only country in the Group of 7 advanced economies (G7) without an inheritance, gift, or estate tax.[56] The government should work with other provinces and the federal government to introduce a minimum inheritance rate of 45 per cent on estates valued above $5 million.

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[54] Government of Newfoundland and Labrador, Department of Government Services, Commercial Registrations Division. (2007). Schedule of fees prescribed by the Minister of Government Services Registry of Deeds. *Retrieved from* www.servicenl.gov.nl.ca/forms/files/fees_deed.pdf.

[55] See Common Front NL 2016, supra note 1.

[56] David Macdonald, "Born to Win: Wealth concentration in Canada since 1999," Canadian Centre for Policy Alternatives, July 31, 2018, policyalternatives.ca/publications/reports/born-win

Government objectives for the review

Our analysis above is organized around the priorities of building a jobs-rich, fair, and sustainable economy, but also addresses the government's four objectives for the review:

- Ensure the province's tax system is competitive and fair;
- Identify ways to simplify the tax system;
- Reduce costs for both government and taxpayers; and
- Consider whether the appropriate tax mix is applied to taxpayers and the progressivity of the tax system.

Below we briefly further address each of these objectives

1. Competitive and fair

Competitive

Being competitive is a means not an end and can mean many things. Below, we briefly explore some of the key elements of competitiveness: in what way, for whom, for what?

Competitive **in what way**? There are many competitive advantages in Canada's economy, including our universal health care and public education system. Research and development and infrastructure are other examples. Such policy advantages are often undermined by a focus exclusively on tax competition, which reduces revenues and means that fewer resources will be available for providing these advantages.
As an example of an opportunity for improvement, NL's education outcomes are below the OECD average.[57] NL has had some success in science and technology innovation but better-quality education is needed to build on that success. To be competitive in this area will take public investment.

Competitive **for whom**? Workers? Students? Businesses? Elderly? Women? If government shifts the tax burden from business to workers, is that going to send a signal to workers and young families to remain in NL? If we want to our tax system to support an economy that is competitive for workers, we need well-funded education, health care and quality jobs.

[57] K. Neil, (n.d.), NL employment paradox: Falling employment, labour shortages? *Talking Points Our Human Capital Strategy: Invest and Utilize,* mun.ca/care/NL_Human_Capital_Strategy.pdf

Being competitive for local small businesses is very different from competing for foreign investment. Local businesses create more jobs and economic growth per dollar invested than larger and/or foreign owned businesses.[58] Local businesses need social and physical infrastructure, programs to help with training and market access, and a healthy, educated local workforce. Government spending, enabled by taxes, can support small businesses, while incentives for competitiveness such as accelerated capital write offs often advantage larger firms over the smaller ones.

Competitive for **what**? Foreign investment is a means, not an end. So, what are the goals we are competing for? Job creation? Economic growth? Foreign investment that takes the form of mergers and acquisitions often actually reduces employment and reduces longer-term economic growth.[59] Nations that lowered their MCTRs the most significantly decreased their economic growth rates.

Failing to raise enough revenue in taxes to adequately fund social programs and tackle poverty and inequality can also undermine economic growth. Earlier in this submission we noted that poverty and inequality are a drag on our economic growth. Raising adequate tax revenues in a more progressive tax system will reduce these barriers to economic growth. Thus, the notion of competitiveness needs to be **subject to raising adequate and sustainable revenues.**

Fair

We have discussed how this province has problems of inequality and the role the tax and spending systems play in reducing inequality. We will elaborate in the section on tax mix how some instruments are more progressive than others, and that the mix should shift toward such taxes.

Above, we have made recommendations for making income taxes more progressive (corporate and personal), and for treating income sources equally—"a buck is a buck." According to one study, the differential treatment of sources of revenue, combined with the myriad individual tax credits cost the provincial treasury $275 million in 2013, excluding the provincial personal deduction."[60] Taxpayers did not share equally in this giveaway. On average, those in the top tax bracket pocketed twenty-four times the credits of those in the bottom bracket.

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[58] Common Front NL 2016, supra note 1.
[59] N. Anguelov, supra note 31.
[60] Sweeney, "Taxes and Fairness Part 2 Anti-social Transfers, *The Independent*, May 7, 2018, http://theindependent.ca/2018/05/07/taxes-and-fairness-part-2-anti-social-transfers/

The race to the bottom on taxes has meant greater poverty and inequality, including gender inequality, which undermines economic growth. The province instead should aim for being the fairest economy in Canada. For a time, strides were made in addressing the poverty rate. There is nothing stopping the government from aiming higher on this and other fairness measures—offering the best access to education, infrastructure, and other services that attract and incubate a resilient economy and home-grown business sector, and having big business and the rich pay a higher share of taxes to support a stronger economy. This review should aim to turn the province into a national leader on fairness.

2. Simplified tax system

Simplifying was the political cover given to reducing high-income tax rates in the 1980s, although it did not simplify the tax system. Adopting a less progressive income tax system didn't simplify anything; it just reduced taxes on the rich.

For citizens a solution is to move to a system where preliminary tax returns are automatically completed by government, similar to that of Sweden, Norway and Denmark.[61] Citizens can always choose to perform their own calculations and challenge those of the government, but most won't want to.

Real complexity comes from deductions, credits, exemptions, and other special tax breaks. There has been a recent tendency for governments to attempt to achieve public policy objectives through such tax expenditures, rather than actual spending. Problems with this approach include lack of transparency, poor achievement of objectives, and inefficiency. Targeted spending is generally more effective. For example, affordable childcare provision will be more effectively targeted to those who need it than a child care tax credit, and it makes for a simpler and more transparent tax system.

Another example is the small business tax credit. A goal of that credit is to create employment, but half of Canada's small businesses have no employees and the credit instead benefits many highly paid professionals—doctors, lawyers, etc. The threshold also creates a perverse incentive for businesses to stay small.

Many tax breaks are simply not necessary. Resource extraction companies, for example, are mainly attracted to NL for the resource availability and for the stability (no coups, revolutions, or oil theft, for example), not for special rules on capital cost depreciation.

[61] Dennis Howlett, "How We Can Improve the Tax Paying System," Canadians for Tax Fairness, Blog, April 3, 2018. http://www.taxfairness.ca/en/blog/how-we-could-improve-tax-paying-experience

The best way to simplify the system is to eliminate the deductions, credits, exemptions, and other special tax breaks that:

- Primarily benefit wealthy people and corporations;
- Encourage changes in behaviour aimed at gaming the system; and
- Reduce sustainable tax revenues.

The government also needs to focus on stopping aggressive tax avoidance and evasion, particularly by the wealthy and large corporations. Spending on detection and enforcement, alongside the federal government, should be increased until the point of declining returns and perhaps beyond in order to increase compliance.

Any existing or proposed tax credit or exemption should be reviewed for whether it can be replaced by more targeted spending. Any that remain as a credit or exemption must be clearly tied to a specified goal, targeted carefully for that goal, and with metrics for tracking whether it is working, and at what cost.

In addition to managing costs, such reforms will help raise adequate and sustainable revenues, and boost fairness and equality.

3. Reduced costs for government and taxpayers

There are many ways to **define cost**. For instance it can mean the costs of running the system, or the costs of complying with it. Or it can mean the costs to citizens relative to alternative forms of payment for substitute goods and services. For example, where taxes are cut, and government lacks the revenues to properly fund social programs and infrastructure, costs increase, and shift to individuals. Reducing taxes is not the same as reducing costs; often it is the opposite; lower taxes mean higher costs for taxpayers in terms of providing themselves with health care, education, transit, water and other public goods.

The single-payer cost advantage. For taxpayers, the single-payer model provided by government offers significant cost advantages due to the better negotiating power of government compared to individual taxpayers; lower administrative fees; no profit; and bulk purchase discounts, among other reasons.[62] Any assessment of costs needs to include out-of-pocket costs, which tend to be high when you have inadequately-funded public services (for example, expensive private health care insurance when public health care funding is inadequate, private security systems when policing budgets are inadequate).

[62] See Diana Gibson, *The Truth Behind Private Health Insurance*, University of Alberta, NewWest Press, 2006; and Robert H. Frank, "Why Single-Payer Health Care Saves Money," *New York Times*, July 7, 2017, nytimes.com/2017/07/07/upshot/why-single-payer-health-care-saves-money.html.

For taxpayers, reducing costs often means increasing tax revenues in order to reduce out-of-pocket payments.

Failure to adequately fund social and physical infrastructure creates other costs for government and taxpayers. Poverty increases the costs of health care, emergency services, and the social safety net more broadly. It costs money that could be spent boosting productive economic activity, and it drags down economic growth. Inequality, too, costs everyone in our society. As noted earlier, even in rich jurisdictions inequality is associated with significantly worse outcomes for child well-being, educational attainment, teenage pregnancies, obesity, drug abuse, physical and mental health, trust and community life, social mobility, violence, and imprisonment levels.

Cost assessments need to include both **short and long-term costs, and direct and indirect costs** for policy changes. For example, "public-private partnerships" (P3s) seem to be on the rise, as they appear to provide public goods at the miraculous cost of zero dollars. However, the reality is that the public eventually pays all the costs, whether in taxes or user fees, and the costs can be boosted by higher private-sector financing costs, executive payouts and contracting costs. P3s hide debt off of government books, but lock in remarkably similar "contractual obligations" to pay over time. The oft-trumpeted shifting of risk to the private sector might never happen (P3 contracts tend to be confidential), and if it did, corporations and project-specific subsidiaries can go bankrupt and leave governments holding the bag. Using private capital as a substitute for tax funding and public debt instruments undermines government accountability, and must be assessed with full and long-term cost-benefit accounting.

The loss of a local ferries construction contract for the shipyards in Marystown to a European company is an example of the false economy in procurement, where saving the taxpayers some short-term dollars on the total contract was not weighed against the longer term local economic and job multipliers. The longer-term economic benefits of the jobs and economic stimulus as well as the increasing of capacity and reputation for that NL business were not prioritized.

Costs include the **full costs of a failure to adopt Pigouvian taxes**. Pigouvian taxes are taxes that improve the economy by reducing and removing economic distortions. Economists note, for example, the social costs of high levels of pollution, and prescribe taxation as an economically efficient way to reduce that pollution and the associated economic distortions — shifting the tax burden away from goods (e.g., employment), and toward "bads" (e.g., pollution, health-impairing products). The failure to adopt Pigouvian taxes to address such negative "externalities" prolongs and deepens these economic distortions and costs.

Administrative costs for **government** include audit and enforcement costs and revenue losses due to tax avoidance and evasion. Administrative costs for **taxpayers** include time and effort spent preparing tax returns, looking into loopholes and special tax breaks. The solution to these types of costs is to simplify the system as discussed earlier — remove loopholes and special tax breaks (thereby also broadening the tax base), and replace blunt tax credits with specific and clearly and narrowly targeted spending programs where they are clearly and transparently serving a social good.

Any assessment by the Committee of costs to government and citizens needs to fully consider the long term financial and social costs as well as higher out of pocket costs to citizens in the absence of the public provision.

4. Tax mix and progressivity

Progressivity and fairness need to be priority goals for the tax system, and any budget changes from year to year need to be evaluated based on the progressiveness of the system overall, considering combined revenue and spending impacts.

As noted, the province has high levels of poverty and income inequality, as well as a relatively regressive tax mix. These come with increased cost as well as slower economic growth, neither of which Newfoundland and Labrador can afford. Thus, the provincial government should be prioritizing reducing inequality in any adjustments to the tax mix.

Income taxes are designed to be progressive — helping to alleviate economic burdens on those with lower and middle incomes, and to ensure that those who can afford to pay taxes are doing so. However, other elements of the tax system are regressive — with a greater impact on lower and middle-income people. It is important not only to design individual tax instruments to be relatively more progressive (e.g., credits and exemptions for HST), as discussed in other sections of this submission, but also to ensure that the mix of taxes emphasizes progressive tax instruments.

There is evidence that a shift from personal incomes taxes toward sales and commodity taxes would have a regressive impact. An EU study found, in respect of value-added taxes (VATs, like the HST), that the "distributional evidence suggests that a shift from personal income tax to VAT has a regressive impact on household budgets."[63]

Some argue that corporate income taxes should be replaced by sales and commodity taxes, in order to promote business investment and economic growth. However, as discussed in the section on corporate income taxes, it now appears that many years of Canadian corporate income tax cuts has failed to encourage either investment or

[63] N. Pestel and E. Sommer, "Shifting Taxes from Labor to Consumption: More Employment and more Inequality" Discussion Paper No. 15-042. Centre for European Economic Research. http://ftp.zew.de/pub/zew-docs/dp/dp15042.pdf.

economic growth. It may be that corporate income tax cuts instead have encouraged the growth of large firms through mergers and acquisitions, enabling corporate cash hoarding, reducing productive investment, and dampening economic growth and employment.

Apart from the potentially negative impact on economic growth and employment, shifting from corporate income taxes to sales and commodity taxes would have a negative impact on the progressivity of the tax mix. Lower and middle-income earners tend to pay a much higher share of their income in sales and commodity taxes, compared to those in the top 1 per cent of income. At the same time, corporate income taxes represent a higher share of income for the 1 per cent than they do for lower and middle-income earners.[64]

It is incumbent on anyone proposing to replace corporate taxes with sales and consumption taxes to explain to the public how those lower and middle-income earners are expected to carry that additional burden, when they have much lower disposable incomes, and less ability to pay.

Quebec is an example of a different tax regime that has taken inequality seriously through a combination of significantly higher tax rates and much more extensive social services. As a result, the top 1 per cent in Quebec takes half the share of income that they capture in the rest of Canada.

The Newfoundland and Labrador tax system and provincial budgets should be changed to:

- Increase the relative reliance on corporate income taxes and personal income taxes, and decrease the relative reliance on regressive taxes and user fees;
- Include annual reports on taxes by tax instrument as a percentage of income for Newfoundlanders and Labradorians (as per Figure 14); and
- Include information on the impact on overall tax system progressivity for all proposed tax changes.

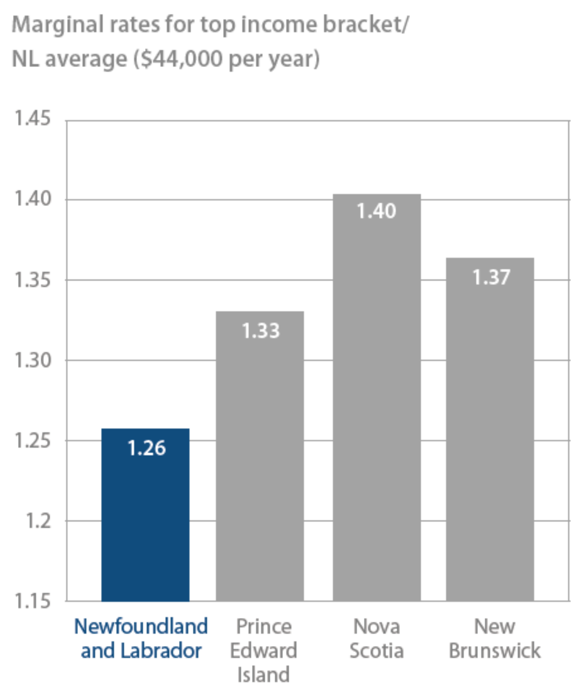
Measuring progressivity

The mandate of the Tax Review Committee includes assessing the progressivity of NL's tax system. The Committee should develop a set of metrics to be used to assess this in this report as well as for ongoing monitoring of the progressivity of the tax system on an ongoing basis.

[64] M. Lee, "Eroding Tax Fairness: Tax Incidence in Canada 1990 to 2005" (CCPA, 2007) https://www.policyalternatives.ca/sites/default/files/uploads/publications/National_Office_Pubs/2007/Eroding_Tax_Fairness_web.pdf.

The Newfoundland and Labrador Federation of Labour has suggested a number of metrics for measuring tax fairness. This included tracking and reporting on the ratio of the top income bracket tax rate to the rate for those with average income. By this measure, NL fares poorly compared to its neighbours (see Figure 10). Other metrics could include the ratio of personal income tax revenues to corporate income tax revenues, and personal income tax revenues to regressive revenues from individuals (e.g., sales tax, user fees). Many more metrics could be adopted.

Figure 10: Progressivity of high income tax rates (top marginal rate compared to rate for average NL income)



Conclusions

The tax system can—and must—be reformed to move our economy in the direction of more and better jobs, more fairness, and more sustainability. We have provided a number of recommendations. Some will require further study, but others can be implemented immediately.

A system-wide tax review is a significant opportunity to get it right. We encourage the Committee to think big, and envision a better life in this beautiful province, with its good people, its enormous wealth, and its unique character.

The tax system needs to provide adequate revenues to provide services and investments that the province needs, and to provide incentives to steer the province in the right direction for a brighter future.