When the provincial sales tax (PST) returns on April 1, 2013, British Columbia’s tax competitiveness will be dealt a major blow as the cost of investing in the province will increase dramatically. Unfortunately, the well-being of BC families will be adversely affected in many ways; one of the severest impacts will be to the level of investment in machinery, equipment, and technology—the backbone of a healthy economy.

Thankfully, the provincial government seems to understand the magnitude of the problem: earlier this year, it appointed an Expert Panel on Business Taxation to recommend ways that BC could improve its business tax competitiveness following the PST’s rebirth. While the Expert Panel is a good first step, only concrete tax changes will truly demonstrate the government’s commitment to BC’s economic competitiveness.

To understand the need for tax reform, it is important to explain why returning to the PST is so economically damaging. Currently under the HST, businesses and entrepreneurs do not pay sales tax on the inputs used in the production process. The exemption is especially important for capital inputs like machinery, equipment, and technology because these are investments that give BC workers the tools to produce goods and services more efficiently. When workers are more productive, they can command higher wages.

Once the PST is restored, business inputs will again be subject to sales tax and the cost of investing will increase significantly. BC will go from having an overall tax rate on investment that is in line with the Canadian average to one of the highest rates in Canada, putting us at a distinct disadvantage compared to key provincial competitors like Alberta, Saskatchewan, and even Ontario.

Since BC is competing with these provinces and other jurisdictions for investment dollars, it falls on the provincial government to ease the damaging impact. Fortunately, several options are available.

Most importantly, the government should consider a sales tax exemption on capital inputs (machinery, equipment, and technology). The government attempted to do something similar in 2001, but limited the exemption by narrowly interpreting the types of machinery, equipment, and companies that qualified. In the end, the exemption was not available to most businesses, which resulted in an administrative disaster and eventually deterred many companies from seeking eligibility.
Another option is to gradually reduce the general corporate income tax rate to 8% from its current 10% rate. This would provide BC with a marked advantage over other provinces, giving it the lowest rate within Canada.

To further improve BC's business tax regime, the government could also consider increasing the threshold of income eligible for the preferential small business tax rate of 2.5% from $500,000 to $1 million. Increasing the threshold would reduce the disincentive for small businesses to grow and develop, and thus allow British Columbians to reap the benefits of having an industrial landscape containing larger and more productive firms.

Property taxes are another factor that influence the province's competitiveness. Currently, many municipalities in BC subsidize low residential rates with relatively high rates on commercial property. To address discriminatory property taxation, the provincial government should consider equalizing property tax rates across different types of businesses and setting a range of fairness for the ratio of business to residential rates.

While the Expert Panel's focus is on business taxation, personal income taxes are an important component of BC's investment climate. More competitive personal income tax rates will help the province attract and retain highly-skilled professionals. In this regard, BC can ensure that its middle and top marginal income tax rates are closely aligned with those in Alberta, its closest provincial competitor. Doing so would make the province a better place to work and would encourage productive economic behaviour like entrepreneurship and risk taking.

These tax reforms could be implemented without increasing government debt. Offsetting revenues can be garnered by broadening the consumption tax base of the PST and/or by eliminating or scaling back many of the special interest driven corporate and personal income tax credits currently offered by the provincial government. However it proceeds, the provincial government should avoid increasing taxes that impose high economic costs on society, such as personal and capital-based taxes, in order to afford other tax reductions.

With the pending return of the PST, BC risks losing much needed investment that will instead gravitate to jurisdictions with more competitive tax policies. While we eagerly await the Expert Panel's final report, it will ultimately fall on the BC government to show leadership and create a new tax plan that ensures a bright economic future for the province.

Notes

1 This article is based on our submission to British Columbia's Expert Panel on Business Taxation. All references can be found in Lammam et al. (2012).

2 See http://www.fin.gov.bc.ca/experts_panel_tax.htm#tor.

3 Specifically, we estimate that returning to the PST will increase the overall tax rate on investment in BC from 20.3% to 27.3% (see Lammam et al., 2012).

4 BC's three highest marginal tax rates (14.7%, 12.3%, and 10.5%) all exceed Alberta's top rate, which is 10% for all income beyond $17,282. Most concerning, however, is the large difference in top marginal rates between BC and Alberta. A highly skilled professional earning $150,000 will pay a provincial marginal tax rate of 14.7% working in BC, but only 10% working in Alberta. Indeed, BC's rate is nearly 50% higher than that levied in neighbouring Alberta.

5 The BC government currently offers a litany of tax credits that narrow the tax base, which means a higher tax rate is required to raise the same amount of revenue. Many of these tax credits have questionable economic value, while others provide special privileges to certain individuals or businesses at the expense of others. See Lammam et al. (2012) for a complete list of BC's corporate and personal income tax credits.

6 See Clemens et al. (2007) for a complete literature review on the economic cost of different types of taxes.

References
