Summary Document

A Discussion Paper
on New Brunswick's Tax System

June 2008

Department of Finance

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Why a Discussion Paper?

A Discussion Paper is not a statement of predetermined government policy. It is one step on the road to developing sound policy. It outlines ideas and possibilities and stimulates thoughtful input to the discussion of a topic of broad public importance.

This is an open invitation to residents and stakeholder groups to consider options that have been proposed for the purpose of restructuring New Brunswick's tax system in order to leave more hard-earned dollars in the pockets of New Brunswickers, attract investment, and encourage job creation.

Not everyone is - or wishes to become - a tax expert. However, as everyone pays taxes in one form or another, everyone has a right to be informed of issues that influence tax policy and have access to the consultation process. This condensed outline of the official Discussion Paper on New Brunswick's Tax System has been produced and distributed as a general introduction. Those who wish more information are encouraged to download the complete Discussion Paper and Appendices at www.gnb.ca/finance and to attend public consultation meetings to be held across the province in June and July.

Rationale

The Government of New Brunswick has targeted 2026 as the year when the province will become self-sufficient. While that target may seem distant now, it is no small challenge. It takes time to achieve economic diversification, create jobs and generate new wealth. At present, for instance, the province generates only 60% of its revenue from provincial taxes and other sources over which it exercises direct control; yet, the demand for provincial services spirals upward as our population ages. Achieving transformative change on a scale that can deal with such challenges will require sustained leadership from all sectors of our society in order to build an economy that:

- is competitive nationally and internationally
- attracts business investment and generates well-paid jobs
- attracts and sustains a dynamic and growing population
- provides New Brunswickers more money for discretionary spending
- generates enough revenue to sustain quality public services.

A careful restructuring of the provincial tax system would play a key role in attaining these conditions.

Preparing for Change

There are **two primary objectives** behind the Discussion Paper on tax restructuring:

- To ensure New Brunswickers can keep even more of their hard-earned dollars to save and invest.
- To make the province more attractive for business, investment and people by establishing a tax structure that is more competitive globally, resulting in job creation, income generation, and a bright future for New Brunswickers.

Believing that fundamental tax restructuring is foundational to New Brunswick's long-term economic goals, the government is seeking to expand the economy by promoting investment and population growth while reducing the overall tax burden on citizens and businesses. It has sought advice from national and international tax experts. In the fall of 2007, it hosted a major forum to examine the role of taxes in transforming the economy.

The Discussion Paper outlines possible tax options based on the guiding principle that optimal economic benefits will be achieved by reducing the province's reliance on income taxes and raising a larger share of revenue through consumption taxes. In the coming weeks, a select committee of the legislature will consult with citizens and stakeholder groups to discuss the relative merits of these options.

By the fall of 2008, the committee will submit its report to government for review. The government will then develop a specific package of tax transformations as an integral part of its economic policy. Any new tax package would be introduced gradually over a five-year period, and the proposed changes would be implemented in a fiscally neutral manner.[1]

[1] Fiscally neutral means that the combined effect of tax changes put in place and careful management of expenditures will maintain the balanced budget position of the province.

A. Goals for Restructuring the Tax System

The overarching questions that any New Brunswick taxpayer might be expected to ask are: "Why do this? What good can I expect from tax restructuring?"

The reply, expressed in simple terms is this: it will make New Brunswick a better place to live. However, the answer goes beyond that. Options for a restructured tax system focus on achieving seven key policy goals:

1. **Enhancing Economic Competitiveness**: To achieve self-sufficency, New Brunswick must have a preferred tax system within Canada and be more competitive internationally. Taxes on personal income are higher for New Brunswick workers in highly skilled jobs than in other competing jurisdictions. All else being equal, investment and jobs tend to migrate to areas of lower personal and corporate taxes. To foster the economic transformation necessary to achieve self-sufficiency, New Brunswick must position itself to be more competitive globally.

2. **Income Growth**: New Brunswick's tax system must enable New Brunswickers to keep more of their hard-earned money, put spending decisions back into taxpayers' hands and encourage them to earn, save, invest, and generate wealth for themselves and their families. Income growth for New Brunswickers will lead to increased growth in the tax base and help achieve self-sufficiency for the province.

3. **Making New Brunswick a More Attractive Option for Workers and Families**: To achieve self-sufficiency, New Brunswick must grow. Growing the economy and standard of living requires the population to grow well above current estimates within the next 20 years. New Brunswick's Population Growth Strategy has four areas of focus: increasing and targeting immigration; increasing settlement and promoting multiculturalism; retaining youth and repatriating former New Brunswickers and adopting family-friendly policies. Tax policies that support this strategy encourage economic growth with better-paying, high-skilled jobs, support families and the acquisition of new skills that will help keep the next generation of New Brunswickers at home to contribute their talents to the province's drive toward self-sufficiency.

4. **Promoting Recruitment and Retention of Skilled Workers**: To achieve self-sufficiency, New Brunswick needs to create thousands of new high-skill and high-wage jobs and attract the people to fill them. To bring in new jobs and the skilled workers and tradespeople needed to expand the population and economy, New Brunswick's tax structure must ensure that the province is attractive to the high-wage economy. Workers in these fields are at a tax disadvantage under New Brunswick's current tax regime: a skilled worker earning $60,000 per year pays more personal income tax here than in all provinces except Québec.

   At higher levels, the tax gap is significant: a skilled worker making $100,000 a year in New Brunswick pays approximately $4,000 a year more in personal income taxes than a similarly paid worker in British Columbia and Alberta. This tax disadvantage hampers New Brunswick's ability to recruit and retain high-wage earners and the corporations that employ them.

5. **Promoting Entrepreneurship**: Small businesses play an important role in New Brunswick's economy. A tax system that provides all businesses with an incentive to grow and create more jobs would help move New Brunswick toward its self-sufficiency goals. The tax environment should promote this entrepreneurial spirit, encouraging business owners to invest in their futures, take risks and expand their enterprises. Under the current system, small businesses that grow must pay a higher corporate income tax rate. This is a disincentive to enterprise and can hamper job growth. Also, many small businesses are owner-operated and income received becomes personal income that is taxed at much higher rates as income increases.

   In addition, the differential property tax rate charged on non-residential property falls disproportionately on the business sector. This can discourage investment in businesses, particularly for those that require substantial real property as an important component of their overall assets. Reducing the provincial non-residential property tax rate would help remove the tax penalty for investment in these sectors.

6. **Promoting Environmentally Sustainable Choices**: Protecting the planet from the impact of climate change is a global issue, but local actions can make a difference. New Brunswick's Climate Change Action Plan sets out the province's course for reducing greenhouse gas emissions. Tax policy can encourage individuals and businesses to make more environmentally friendly choices in their daily lives. A number of jurisdictions, including British Columbia and Québec, have recently introduced taxes on carbon-based energy sources. Such taxes have a potential for dual benefit: they can encourage consumers to make choices that are better for the planet, and provide revenue that will allow government to invest in new priorities, including support for "green" initiatives.

7. **Ensuring Fiscally Responsible Budgeting**: As New Brunswick's self-sufficiency plan unfolds, the province's population will grow and its economy will expand, generating more income for New Brunswickers and increased tax revenues for the province. As the province's ability to pay its own way increases, payments under the federal equalization program will decrease as a percentage of overall government revenues. New Brunswick will ensure that it continues to manage the province's finances in a prudent and fiscally responsible manner, meeting its obligations to balance budgets while maintaining important public services including health care, education, social services and public infrastructure. Being fiscally prudent while reducing the tax burden for workers, families and businesses in New Brunswick is vital to making the province self-sufficient by 2026.

B. Principles for Restructuring the Tax System

Any restructuring of the tax system would reflect the following key principles:

1. **Competitiveness**: New Brunswick's tax system should promote economic development and growth to position the province as an attractive venue for investment in a regional, national and international context.

2. **Neutrality**: Taxes should be neutral and not interfere with personal and business decisions, except where there are clearly identifiable social costs associated with production and consumption.

3. **Simplicity**: The tax system should be easy to understand, transparent to the public and simple to apply, encouraging public compliance and discouraging tax avoidance.

4. **Balance**: New Brunswick should raise tax revenue from a variety of sources, with the mix of taxes based on maximizing opportunities for savings, investment, economic growth and job creation.

5. **Sustainable Development**: The tax system should take into account the need to protect the environment and secure it for future generations.

6. **Fairness**: New Brunswick's tax system should ensure that taxes are fair to all taxpayers.

7. **Social Development**: Fair treatment of taxpayers involves more than the tax system. Many government expenditures benefit all taxpayers and government must ensure that programs are in place to assist the less well off.

8. **Fiscal Responsibility**: Taxes should be applied in a manner that ensures that New Brunswick has sufficient revenue to provide health care, education and social services to New Brunswickers and to invest in the infrastructure necessary to sustain and expand the economy.

C. Restructuring New Brunswick's Tax System

So far, this summary has reviewed the goals and principles guiding the process of change in New Brunswick's tax system. Now, it is time to look at specific tax options aimed at producing those outcomes. These options fall into five primary categories:

- Reducing and simplifying personal income tax
- Supporting New Brunswick families
- Creating a growth-oriented business tax environment
- Promoting a cleaner and greener environment
- Rebalancing the tax system.

The Discussion Paper also highlights issues and possible solutions concerning New Brunswick's property tax regime. The Commissioner on the Future of Local Governance in New Brunswick is currently reviewing a number of issues related to local governance and will present his report in the fall of 2008. The property tax options would complement the work of the Commissioner on the Future of Local Governance.

It is important to note that this summary touches only on the most prominent details of each option. To be fully informed about the options, readers should refer to the complete Discussion Paper and its appendices available for viewing or download at www.gnb.ca/finance.

D. Reducing and Simplifying Personal Income Tax

Several other provinces, (Saskatchewan, Alberta, British Columbia and Newfoundland and Labrador) have lowered personal income taxes. Reducing provincial personal income taxes for all income levels can greatly improve New Brunswick's attractiveness to new investment, better paying jobs, and highly skilled workers.

The Discussion Paper outlines two options for reducing New Brunswick's provincial personal income tax while simplifying the system. Both would continue to use a single federal-provincial tax return, and the federal government would continue to determine taxable income for both federal and provincial income tax purposes. The key difference from the present system would be a reduction in rates and in the number of tax brackets.

The first option is the **flat tax** option. This approach would reduce the number of brackets from four to one with **one marginal tax rate of 10%** for all taxable income levels. It would maintain a progressive tax structure, since tax paid as a percentage of income would increase as income increases. A 10% single tax rate would give New Brunswick one of the lowest overall personal income tax rates in Canada, on par with the rate now levied in Alberta.

If the flat tax option were in effect now, a single-earner with taxable income of $25,000 would pay $359 less than at present, for a reduction of nearly 24%. A single-earner with taxable income of $100,000 would pay $3,160 less than now, for a reduction of 24.5%.

A one-earner family with two children earning $40,000 would pay $1,801 less in personal income taxes, a reduction of 72%, under the flat tax option compared to the current tax structure. A one-earner family with two children earning $100,000 would pay $3,689 less, a reduction of about 30%, under the flat tax option.

The second option would replace the existing four-rate, four-bracket personal income tax structure with two rates and two brackets. Under this option, the two rates would be 9% and 12%, with the 12% rate starting at $35,000 of taxable income.

A single-earner with taxable income of $25,000 would pay $326 less, a reduction of almost 22%, under the two-rate option compared to the existing tax structure. A single-earner with taxable income of $100,000 would pay $2,938 less, a reduction of nearly 23%, under the proposed two-rate option compared to the current system.

A one-earner family with two children, earning $40,000 would pay $1,325 less in personal income taxes, a reduction of 53%, under the proposed two-rate option compared to the current tax structure. A one-earner family with two children earning $100,000 would pay $3,579 less, a reduction of over 29%, under the two-rate option.

Both options reduce provincial personal income tax payable at all income levels and leave more hard-earned money in the hands of New Brunswickers. Option 1 would reduce net tax more at higher levels and offer the greatest incentive to investment in better paying jobs and skilled labour. Option 2 still offers reductions that would be highly competitive in attracting investment and stimulating growth.

E. Supporting New Brunswick Families

The tax system can do a lot to promote a family-friendly New Brunswick by providing tax advantages to help offset the cost of raising and educating children. Reducing personal income tax would be an important first step in this direction. New Brunswick currently provides benefits to families primarily through three refundable tax credits: the New Brunswick Child Tax Benefit, the New Brunswick Working Income Supplement and the New Brunswick Low Income Seniors' Benefit. To help make New Brunswick an even more family-friendly province, the Discussion Paper presents three further options to be considered.

The first of these would be the introduction of a new, non-refundable child tax credit. This would reduce personal income tax payable by up to $400 per child and would be available to all families, regardless of income level. New Brunswick's new non-refundable child tax credit would be phased in over four years.

The second family-friendly option being proposed for discussion would be a New Brunswick Universal Child Care Benefit of $50 per month ($600 annually) for each child under the age of six. The provincial benefit would be equal to half the current federal amount of $1,200, increasing the total contribution to child care costs to $1,800. This amount would be provided on the same basis as the existing federal benefit, and would be provided to all families, regardless of their income level.

The federal government introduced a new Tax-Free Savings Account (TFSA) in its February 2008 budget. Beginning in 2009, Canadians can save up to $5,000 annually in a TFSA. Although contributions to this account will not be tax deductible like those to an RRSP, interest growth and withdrawals will not be taxable. New Brunswick supports the introduction of a Tax-Free Savings Account (TFSA) and will ensure that income earned in a TFSA will not impact provincial income-tested tax benefits.

F. A Growth-Oriented Tax Structure for Business

To meet its self-sufficiency goals, New Brunswick must attract more investment by both existing and new businesses. Reduced personal income taxes will significantly benefit owners of existing New Brunswick businesses, encourage entrepreneurship and growth, and help provide a welcome and competitive environment for all businesses.

To meet its self-sufficiency goals, New Brunswick must attract more business and investment. One way to achieve this result is by lowering provincial business taxes.

New Brunswick's current general corporate income tax rate does not provide the incentive for economic growth that is required to achieve self-sufficiency. The province's 13% rate, when combined with the federal corporate income tax of 19.5%, gives a total corporate income tax in New Brunswick of 32.5%.

The federal government has pledged to reduce its corporate tax rate to 15% over the coming four years. It has challenged the provinces to drop their general corporate rate to 10%. However, to drive business growth and position New Brunswick to achieve self-sufficiency, the province must reduce corporate income taxes beyond the federal government's suggested rate so that New Brunswick is competitive on a national and global scale.

To encourage economic growth, direct taxes on business must also strive to be neutral with respect to all sectors of the economy and firm size. Reducing the general corporate income tax rate from the current 13% rate to a rate that is closer to the small business rate of 5% would provide a greater incentive for businesses to grow and be successful.

As described previously, the options to reduce personal income taxes would also provide significant benefits to entrepreneurs and small business owners throughout New Brunswick. In addition, the increased economic activity generated as a result of reductions in personal income taxes and the general corporate income tax rate would benefit all New Brunswick businesses, including small businesses.

The following three options are designed to make New Brunswick's business tax structure more competitive and support business growth and expansion. In each case, the proposed reduction would be phased in over four years, being fully implemented in 2012.

Option 1 would reduce the general corporate income tax from 13% to 10%, thereby meeting the federal challenge. New Brunswick's combined rate (25%) would then equal Alberta's. However, other provinces might also match this reduction, leaving New Brunswick with no competitive advantage when seeking national or international investment. Furthermore, it would still leave a five percentage point gap between the rates applied to large and small businesses.

Option 2 would reduce the general corporate rate to 7%, leaving only a two percentage point gap between the general and small business corporate income tax rates. This could significantly reduce the penalty on business growth. A combined federal/provincial rate of 22% would surpass the federal challenge and undoubtedly make New Brunswick a more attractive location for new investment.

Option 3 would reduce the general corporate rate to 5%, eliminating the tax differential between large and small businesses. At 20%, New Brunswick's combined federal/provincial rate would position the province as a leading competitor in the effort to attract a large amount of new investment from regional, national and international sources.

Reducing the general corporate income tax rate would simplify New Brunswick's corporate tax structure. As it phases in the general corporate income tax rate reductions, the province may wish to consider phasing out existing tax credits targeted at specific industries or sectors of the economy, and potentially developing tax policies and incentives that are broad-based and general in application. Further simplification might be achieved by replacement, reduction or elimination of the current 3% financial corporation capital tax.

G. Carbon Tax: Reduced Emissions, Cleaner Environment

New Brunswickers share a deep commitment to sound stewardship of the air, land and water of their province. It is evident that economic growth proceed hand-in-hand with environmental responsibility. In the past, this belief has led to the creative use of levies and taxes to meet environmental objectives. Since 1992, the Beverage Container Program, to name one example, has diverted millions of tons of glass, plastic and metal away from landfills and into recycling centres.

Recently, the concept of a carbon tax imposed on each unit of carbon-equivalent emissions from fuels such as heating oil, gasoline, diesel, propane, natural gas or coal, has been receiving serious consideration as a means of reducing greenhouse gas emissions.

Quebec enacted a carbon tax in October 2007 and British Columbia will do so in July of this year. The Discussion Paper invites New Brunswickers to consider the pros and cons of a similar decision by their government. An option presented in the Discussion Paper is a carbon tax based on the British Columbia model – a tax on all forms of carbon or carbon-equivalent emissions – phased in gradually over several years, with a reimbursement credit to offset the impact of this tax on low-income New Brunswickers.

A New Brunswick Carbon Tax would support the government's Climate Change Action Plan initiatives and help fund reductions to personal and corporate income taxes, allowing the overall tax changes to be fiscally neutral.

H. Harmonized Sales Tax

Restructuring the tax system to achieve self-sufficiency requires an examination of the full scope of the New Brunswick tax system. This exercise is about far more than reducing some taxes and imposing new ones. It is about achieving a balance so that the tax system actively promotes personal savings, business investment, economic growth and job creation while putting in place a structure that remains fiscally neutral.

Different kinds of taxes have different effects. For example, taxes on personal and business income can discourage productivity and business growth. In order to get the most economic benefit from a revised tax system, New Brunswick must strike a balance, ensuring that it does not place too great a tax burden on those items — increased incomes, savings, and investments — that it most wants to promote.

It is with this need in view that the Discussion Paper proposes significant reductions in taxes on income and modest increases in taxes on consumption. A two percentage point increase in the provincial portion of the HST would return the combined tax to the 15% level that was in effect two years ago. For such an increase to be put into effect, changes in the existing harmonized sales tax agreement would have to be negotiated with the federal government.

An increase in the HST would modestly increase the cost of taxable goods and services to consumers. For example, a two percentage point increase would represent an increase of 3¢ on a $1.50 cup of coffee, an additional $10 on a $500 television, and $400 on the purchase of a $20,000 automobile.

This modest increase in the provincial portion of the HST could provide revenue to support the proposed reduction of personal and corporate income taxes. More importantly, it would move the focus of the New Brunswick tax system toward the savings, investment, income generation, economic growth and job creation required to achieve self-sufficiency.

I. Property Taxes: Issues and Options for Consideration

Another aspect of the tax system to be considered in the restructuring process deals with issues relating to property tax. In examining New Brunswick's property tax system, three key challenges have been identified. These are: differential tax treatment of residential and non-residential property; uneven application of the 65¢ / $100 tax in Local Service Districts (LSDs); and assessment spikes and escalating assessments that increase property taxes over time.

Possible solutions to these issues have been presented in the Discussion Paper. This includes options to reduce provincial non-residential and residential property tax rates, and to extend the 65¢ tax to all property types in LSDs. Possible solutions to address concerns with rising property assessments are also presented. This includes the introduction of a three-year average assessment value and an adjustment mechanism that would result in greater government accountability and transparency in public expenditures.

Readers are encouraged to read the full Discussion Paper for a more complete outline of these property tax issues and possible solutions.

J. A Five-Year Plan for a Restructured Tax System

To implement a restructured tax system following consultations by the Select Committee of the Legislature, a **five-year plan** would be developed. This plan would see new tax measures begin to be put in place in 2009-2010, with full implementation by the 2013-2014 fiscal year.

This five-year plan would ensure that major changes to the tax system would be fiscally neutral over this period through a combination of: (1) tax reductions; (2) tax adjustments; and (3) management of expenditure growth. The plan would ease the transition for people and businesses, allow the changes to be fiscally neutral, respect balanced budget provisions, and interfere as little as possible in personal and business decisions that affect investment and economic growth during this period.

Conclusion

A restructured tax system for New Brunswick could do much to move the province closer to self-sufficiency. To reduce its dependence on federal equalization payments and become self-sufficient by 2026, New Brunswick must undergo an economic transformation. Simply put, the province's self-sufficiency goals will not be achieved if this transformation is not made.

To make this transformation happen, New Brunswickers must be allowed to keep more of their hard-earned money so that spending decisions are placed in the hands of taxpayers. New and existing businesses must thrive and new jobs must be created – better paying and highly skilled positions that will enable New Brunswickers to make best use of their talents and learning.

At the same time, the province must retain its ability to provide quality health care, education and other essential public services so that New Brunswick is a place where families and individuals from all income brackets have the opportunity to improve their lives. The transformation must also be fiscally neutral so that future generations of New Brunswickers are not burdened with a heavy debt load.

Tax policy is one of the most important tools available to governments to create economic change. This is why a restructured tax system is one of the most effective means by which New Brunswick can signal to the world its determination to be stronger and more self-reliant.

The options proposed in the Discussion Paper could create the conditions for economic transformation to take place while meeting the obligations to serve the people of this province.

As mentioned at the outset, these options do not represent government policy. The Discussion Paper is a consultation document only. Its options would represent a fundamental shift in New Brunswick's taxation and economic policies, so there is a need for an open and transparent public debate on them.

In the coming weeks, a select committee of the legislature will conduct consultations with residents and stakeholders on these proposals. The consultations will provide all New Brunswickers with an opportunity to present their views on these proposals and to put forth other suggestions.

The stakes are high. Restructuring the tax system could:

a. Ensure new Brunswickers keep more of their hard-earned dollars to save, spend or invest as they choose, and
b. Help bring an unprecedented level of economic growth to the province, making the province a leader, nationally and internationally, in attracting the investment and people that will fuel growth, create new jobs and increase disposable income for future generations of New Brunswickers.