TD Bank Financial Group

TD Economics

Special Report

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NEW BRUNSWICK: THE ATLANTIC TIGER?

In its March 2008 Budget, the New Brunswick government announced it would look into completely revamping its tax system in an effort to achieve "self-sufficiency" by 2026. Own-source revenues currently constitute only about 60% of total revenues, and the aim is to increase this percentage over the long-term all the while reducing their dependence on federal equalization payments – a laudable goal if any. Equalization payments account for almost a fourth of total gross ordinary revenues.

On June 4th, the government released a Discussion Paper outlining options up for discussion at public consultations to be held across the province in June-July. By the fall of this year, a committee will submit its report to government for review. The government will then develop a specific package of tax changes. The changes would be introduced gradually over a 5-year period (FY 2009-10 to 2013-14). This Discussion Paper is clearly not government policy and serves as no more than a starting point, but it does set the tone. A Summary and the more complete Discussion Paper are available at: http://www.gnb.ca/0162/New_Brunswick_Tax_System/index-e.asp

HIGHLIGHTS

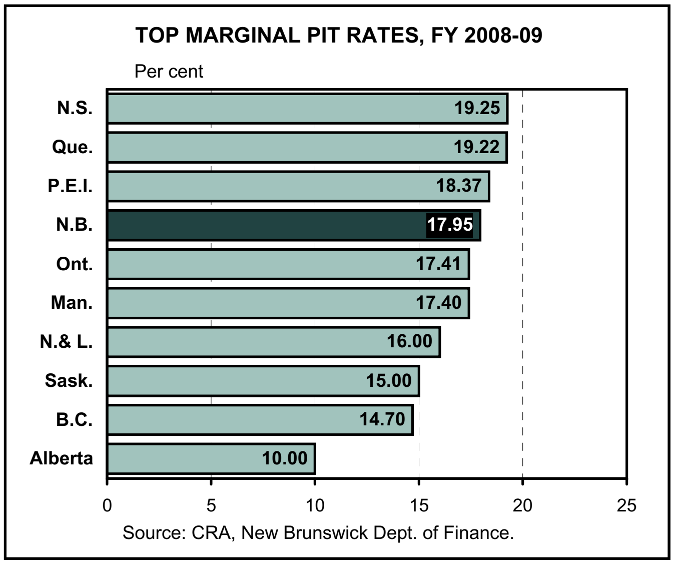
- **New Brunswick has put forth specific options for revamping its tax system**
- **The province wants to reduce its reliance on federal equalization payments, which currently account for about one-fourth of revenues**
- **Main proposals to fund personal and business tax relief through higher consumption (sales) tax and a carbon tax**
- **Other proposals include improving child benefits and reforming property taxes**
- **Stakeholders should rally around these bold proposals that would significantly improve New Brunswick's competitiveness**

BACKGROUND

New Brunswick's tax regime compares somewhat favourably to its Atlantic region counterparts. It is currently not at a particular competitive disadvantage against these jurisdictions on the tax front as a whole. But the picture is mixed depending on where you look exactly.

For example, its marginal effective tax rate (METR) on business capital investment is the lowest by far among Canadian provinces. Its general corporate income tax (CIT) rate is the lowest in the Atlantic at 13%, but only Ontario's is higher in the rest of the country. Its small business tax rate of 5% is on par with that of Nova Scotia and Newfoundland & Labrador, but P.E.I. has the clear edge here at 3.2%, scheduled to fall to 1% by 2012. These differences don't explain why New Brunswick's METR on capital is so low. A key reason is the federal government's Atlantic Investment Tax Credit, targeted to resource and manufacturing companies, which account for a larger share of investment than in other parts of the country. Without this tax credit, New Brunswick's METR on capital investment would still be lower than the national average but much closer to that of many other provinces. New Brunswick also does not tax business inputs – its sales tax is harmonized with the federal value-added GST. The phasing out of its general large corporation capital tax, to be eliminated next year, is another factor helping to lower the province's METR on capital.

While its capital investment tax regime is favourable, the same advantage cannot be claimed for labour taxes, where New Brunswick has the nation's fourth lowest METR. At nearly 18%, New Brunswick's top marginal



personal income tax (PIT) rate is the fourth highest in the nation. It is only marginally lower than Québec, Nova Scotia and P.E.I. Newfoundland & Labrador's top marginal PIT rate of 16% is the lowest in the region and anywhere east of Saskatchewan.

PROPOSALS

A variety of interesting options have been put forth in the Discussion Paper. Here are some of the highlights:

Personal income taxes (PIT)

New Brunswick currently has four PIT brackets, each with a different rate, increasing with income (progressive), as follows:

- 10.12% on the first $34,836 of taxable income,
- 15.48% on the next $34,837,
- 16.8% on the next $43,600,
- 17.95% on the amount over $113,273

- Option 1 proposes a single income bracket taxed at a single (flat) rate of 10%
- Option 2 proposes 2 brackets with 9% and 12% rates

Compared to the status-quo, taxpayer savings can vary greatly depending on income and family situation, but typically would be no less than 16%, which is substantial. Tax savings could reach 31% for higher incomes and 100% for lower incomes. The difference lies mainly in the distribution of benefits in the income distribution between the two proposals. The flat tax proposal benefits higher incomes the most, and as such will likely get less traction but any significant simplification and reduction in PIT should be welcome. Note that because of the basic personal exemption, such a flat tax proposal remains progressive in nature if not in its rate structure. Once fully implemented, the flat 10% PIT would place the province on par with Alberta, the least taxed Canadian jurisdiction.

Child tax credits & benefits

Two new non-exclusive measures are being considered,

1. Introduction of a new, non-refundable child tax credit. Phased in over four years, this would effectively double

GENERAL CIT RATES, PER CENT

	2008		2013	
Federal	19.5	***Combined***	15.0	***Combined***
B.C.	12.0	*31.5*	10.0	*25.0*
Alta.	10.0	*29.5*	10.0	*25.0*
Sask.	12.0^	*31.5*	12.0	*27.0*
Man.*	13.0	*32.5*	12.0	*27.0*
Ont.	14.0	*33.5*	14.0	*29.0*
Que.	11.4	*30.9*	11.9	*26.9*
N.B. (status quo)	13.0	*32.5*	13.0	*28.0*
N.B. (option 1)	13.0	*32.5*	10.0	*25.0*
N.B. (option 2)	13.0	*32.5*	7.0	*22.0*
N.B. (option 3)	13.0	*32.5*	5.0	*20.0*
N.S.	16.0	*35.5*	16.0	*31.0*
P.E.I.	16.0	*35.5*	16.0	*31.0*
N.&L.	14.0	*33.5*	14.0	*29.0*

^ Effective July 1, 2008. * Effective July 1 subject to balanced budget requirements.

Source: KPMG, Finance Canada, provincial Finance departments.

SMALL BUSINESS* CIT RATES, PER CENT

	2008		2013	
Federal	11.0	***Combined***	11.0	***Combined***
B.C.	4.5	*15.5*	4.5	*15.5*
Alta.**	3.0	*14.0 ~*	3.0	*14.0 ~*
Sask.^	4.5	*15.5 ~*	4.5	*15.5 ~*
Man.	2.0	*13.0*	1.0	*12.0*
Ont.^^	5.5	*16.5 ~*	5.5	*16.5 ~*
Que.	8.0	*19.0*	8.0	*19.0*
N.B.	5.0	*16.0*	5.0	*16.0*
N.S.	5.0	*16.0*	5.0	*16.0*
P.E.I.	3.2	*14.2*	1.0	*12.0*
N.&L.	5.0	*16.0*	5.0	*16.0*

* For federal and most provinces, the active business income threshold is $400,000.

** Threshold is $460,000.

^ Current threshold is $450,000. Effective July 1, 2008, threshold will be $500,000.

^^ Threshold is $500,000.

~ Income above the federal threshold taxed at the federal rate plus provincial SME rate.

Source: KPMG, Finance Canada, provincial Finance departments.

METR* on New Business Investment by Component, per cent in 2012	CANADA	B.C.	Alta	Sask.	Man.	Ont.	Que.	N.B.	N.S.	P.E.I.	N.&L.
Provincial sales tax	7.1	10.0	0.0	5.9	11.8	11.2	0.8	0.0	0.0	15.7	0.0
Provincial capital tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Provincial corporate income tax	8.4	8.0	6.6	7.7	5.3	9.2	8.0	9.2	11.2	9.7	8.9
Federal corporate income tax	9.6	10.0	10.0	9.9	9.3	10.2	10.1	-0.3	3.5	3.1	4.3
Overall ^	**25.1**	**27.9**	**16.6**	**23.4**	**26.4**	**30.7**	**18.8**	**8.9**	**14.7**	**28.5**	**13.2**

* Excludes resource and financial sectors and tax provisions related to R&D. Includes measures as of Feb. 2008

^ May not add up due to rounding. Source: Department of Finance canada, Budget 2008.

the basic personal amount for children to $4,000 and reduce PIT payable by $400 per child under the 10% flat rate.

2. Universal Child Care Benefit of $50/month ($600/year) for each child under the age of 6. This would equal half the federal amount of $1,200 and bring the total child care cost benefit to $1,800. It would be provided on the same basis as the existing federal benefit, to all families regardless of income.

Corporate income taxes (CIT)

The province recognizes the need to lower the combined (federal & provincial) general business CIT rate to 25%, as proposed by the federal government. The federal CIT rate is on target to reach 15% by 2012.

- The provincial target is therefore a general business CIT rate of 10% (Option 1).

In order to secure a competitive advantage, recognizing that some provinces, like B.C., are already committed to this goal and that others are likely to be moving towards that target, the government proposes bolder cuts:

- Option 2 would reduce the CIT rate to 7%
- Option 3 would reduce the CIT rate to 5%. This would place it at par with the small business rate

Financial corporate capital tax

The general large corporation capital tax is already being phased down and will be eliminated next year. But a capital tax is still imposed on large financial institutions. The document states that

“Further simplification might be achieved by replacement, reduction or elimination of the current 3% financial corporation capital tax.”

New Brunswick’s financial corporation capital tax is high at 3% but lower than its Atlantic counterparts which stand at 4-5%. Capital taxes generate about $21 million in revenue for the province, only 0.6% of own-source revenues. The Ontario and Québec financial corporation capital taxes are being phased-out and will be fully eliminated by 2012. B.C. will replace theirs with a minimum tax of 1% of paid-up capital, deductible against provincial income tax.

Property taxes

Three key challenges were identified in this area:

- Differential treatment of residential and non-residential properties
- Uneven application of the 65 cent per $100 tax in Local Service Districts (LSDs)
- Assessment spikes and escalating assessments that increase property taxes over time

Options include reducing all property taxes, extending the 65 cent tax to all property types in LSDs, and introducing a 3-year average valuation assessment.

In order to partly fund these tax relief measures, the government is proposing mainly to increase consumption taxes.

Sales tax

It is proposed to increase the provincial Harmonized Sales Tax (HST) by 2 percentage points. This would in effect take back the 2 percentage point reduction in the federal GST over the last 2 years, and bring the combined sales tax rate back to 15%. It is estimated that this would bring in an additional $250 million annually.

Carbon tax

A carbon tax based on the B.C. model (introduced in their last Budget): a tax on all forms of carbon or carbon-equivalent emissions, to be phased in gradually over several years and with a reimbursement credit to low-income New Brunswickers. Once fully implemented, the government estimates that $100 million in revenue can be generated with carbon tax rates at about half of those proposed in B.C., which are $10/tonne plus $5 per year to reach $30/tonne by 2012.

ANALYSIS

The government's proposals go a long way in the direction that TD Economics favours, specifically with respect to shifting the tax mix – less on income and more on consumption – in a revenue-neutral fashion. Shifting the mix towards consumption and away from income taxes encourages savings, investment, and work, all the while helping to reduce greenhouse gas emissions in the case of a carbon tax. The Discussion Paper does not propose that the reforms be exactly revenue-neutral, which would commit that any foregone revenue from tax relief would be exactly offset by increases in sales and carbon taxes. However, there is mention that any tax changes should be implemented in a 'fiscally neutral' manner, by which it is meant a balanced budget position not be compromised.

Costing the PIT and CIT reduction proposals is entirely dependent on which option is considered but estimated to be in the ballpark of $500 million annually. Reducing CIT rates helps profitability, attracts investment and helps stimulate job creation. Lowering the general CIT rate all the way down to 5% would also eliminate the disincentive for enterprises to grow beyond the fiscal small business threshold – which in New Brunswick and most provinces is $400,000 of active business income. Eliminating the capital tax on financial institutions would ensure that the industry is not treated differently from other revenue-generating economic activities. Under the most recent Budget 2008 round, we would be left with only Manitoba and Saskatchewan and the four Atlantic provinces with a capital tax on financials by 2012. New Brunswick could lead the way in the Atlantic.

Lowering and simplifying PIT rates puts more hard-earned money back into the pockets of every taxpayer. Individual and family tax savings could be tax-sheltered using the new Tax-Free Savings Account (TFSA). Granted, consumption taxes would increase but this helps maintain the fiscal position of the province (avoiding the vicious cycle of deficits and increasing debt burden) while impacting overall consumption only for big-ticket items, and encouraging environmentally responsible behaviour.

If implemented, these tax reforms would position New Brunswick near Alberta as being the most competitive. It would surely have higher consumption (HST) taxes than it does now, but this is relatively neutral for competitiveness and growth, while lower income taxes have a long-lasting positive impact.

The (500) million dollar question remains: how much of these proposals will actually be implemented? We should definitely stay tuned. Before you know it, New Brunswick could become the Canadian version of the Irish (Celtic) tiger, our very own Atlantic tiger. Stakeholders should rally in support of these bold proposals which would give the province a clear and significant taxation competitive edge in Canada – key to attracting and retaining investment and skilled labour, both of which are necessary to ensure the province's standard of living keeps improving.

Pascal Gauthier, Economist
416-944-5730

CAPITAL TAX RATES ON NON-FINANCIAL INSTITUTIONS
Per cent

	Actual			Scheduled					
(As at Jan.)	2005	2006	2007	2008	2009	2010	2011	2012	2013
Canada (Federal)	0.175	--	--	--	--	--	--	--	--
Newfoundland & Labrador	--	--	--	--	--	--	--	--	--
Prince-Edward Island	--	--	--	--	--	--	--	--	--
Nova Scotia	0.600	0.600	0.250	0.250	0.225	0.200	0.150	0.100	--
New Brunswick	0.300	0.250	0.200	0.100	--	--	--	--	--
Québec	0.600	0.525	0.490	0.360	0.240	0.120	--	--	--
Ontario	0.300	0.300	0.285	0.285	0.225	0.150	--	--	--
Manitoba	0.500	0.500	0.500	0.500	0.400	0.400	--	--	--
Saskatchewan	0.600	0.600	0.300	0.150	--	--	--	--	--
Alberta	--	--	--	--	--	--	--	--	--
British Columbia	--	--	--	--	--	--	--	--	--

'--' Indicates no tax or tax eliminated; Source: Federal and Provincial Governments' Ministry of Finance, Canadian Tax Foundation.

CAPITAL TAX RATES ON FINANCIAL INSTITUTIONS
Per cent

	Actual			Scheduled				
(As at Jan.)	2005	2006	2007	2008	2009	2010	2011	2012
Canada (Federal)	1.40	1.40	--	--	--	--	--	--
Newfoundland & Labrador	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Prince-Edward Island	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
Nova Scotia	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
New Brunswick (status quo)	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
(phase out)	3.00	3.00	3.00	3.00	2.00	1.00	--	--
Québec	1.45	1.05	0.98	0.72	0.48	0.24	--	--
Ontario	0.90	0.90	0.86	0.86	0.68	0.45	--	--
Manitoba	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Saskatchewan	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Alberta	--	--	--	--	--	--	--	--
British Columbia	3.00	3.00	3.00	2.00	1.00	--*	--*	--*

'--' Indicates no tax or tax eliminated; Source: Federal and Provincial Governments' Ministry of Finance, Canadian Tax Foundation.

* Replaced by a minimum tax of 1% of paid-up capital, deductible against B.C. corporate income tax