THE SST: REMOVAL OF HIDDEN TAXES CAN HELP CONSUMERS BY REDUCING BUSINESS COSTS

The SST will ease credit crunch and stimulate Ontario's, and Canada's, global competitive advantages, and that's good news for consumers.

The Ontario Budget 2009 announced tax reform and a move from an antiquated RST format to a value-added format. This has created an immediate backlash from consumers across the province based on what has been labeled everything from a tax grab to open larceny. Few have contemplated why this move is so important at this time.

In fact, by eliminating RST on July 1, 2010 the Province of Ontario will implement the greatest single overall cost cutting measure for Ontario business. The question is, will today's business leaders and smart consumers be savvy enough to support this important initiative to make it pay off for all Canadians? It would pay to take some time to understand this initiative more fully.

In order to best understand the effects the Single Sales Tax (SST) will have on the residents of Ontario, you must first understand the Retail Sales Tax (RST) system that is currently in place, and how it actually affects us on an everyday basis.

Each level of the supply chain, from raw materials, through manufacturing, distribution and retailers has paid RST on every item they consume, just like any other resident of Ontario. The RST adds 8 % to the costs of all these items, not just once, but continuously through the system until the product reaches the consumer. A 2007 policy paper issued by CD Howe Institute places these "hidden RST costs" at more than 40% of all RST collected in Ontario[1].

After all this tax on tax, the consumer then pays an additional 8%! This is a costly and inefficient system borne on the backs of business, when you then take into account the heavy bookkeeping and accounting costs of collecting two taxes for two levels of government. It makes us uncompetitive in relation to the rest of the world with which we must compete and that effects our ability to keep industries—like the auto industry for example—in Canada.

Removal of the RST from the chain will result in reduced costs to each level and therefore by extension, should produce lower pricing to the consumer. The Ontario

[1] Lessons in Harmony: What Experience in the Atlantic Provinces Shows about the Benefits of a Harmonized Sales Tax – Michael Smart July 2007

Chamber of Commerce estimates that the reduction in costs resulting from this change at five billion dollars[2]. The consumer will still pay the SST, but on a lower end value than before SST implementation. More important it will again give us a competitive advantage globally. Consider the following:

COMPLIANCE COSTS

The outdated RST system will reduce duplication and the cost of complying with Ontario RST legislation between $100 million[3] and $500 million[4]. This is resulting from Ontario business following one set of rules and dealing with one government agency (CRA), rather than the duplication currently in effect.

Reduction in Ontario businesses compliance costs will further reduce pricing to the consumer.

MANUFACTURING

Ontario has seen their manufacturing industries seriously hurt over the past years through declining exports, loss of jobs and shutdowns. Under the current RST system manufacturers not only pay RST on their purchases; they are also required to calculate and remit RST on the "manufactured cost" of their product.

This is calculated on the total cost of manufacturing the product including labour, machinery, equipment, supplies and a list that can go on and on. All these costs are then pro-rated based on the square footage of the manufacturing operation and charged an 8% RST component. This results in higher costs to manufacturer and therefore a higher cost to the consumer.

EXPORTS

The RST built into the cost of manufacturing outlined above results in an increased cost of goods manufactured for export. When specifically looking at the automotive and steel manufacturers, the reduction in manufactured costs by removal of the RST will improve the competitiveness, most notably against the Great Lake States, of operating these businesses in Ontario and bring in dollars from outside of Ontario.

[2] Ontario Chamber of Commerce – Made in Ontario: The Case for Sales Tax Harmonization
[3] Ontario Chamber of Commerce release – March 26, 2009
[4] Ontario Budget 2009 – Chapter III

NEW RESIDENTIAL CONSTRUCTION

The Canada Mortgage and Housing Agency[5] has calculated that the cost of RST built into new home construction between 2 and 3 percent of the value of the home. As the cost to build the home will reduce by eliminating this input cost, the budget allows for a rebate of 75% (8% RST minus 2% cost reduction) of the SST paid on a new home, up to $400,000. Home between $400,000 and $500,000 will receive a phased-out rebate becoming totally eliminated at $500,000. Homes in excess of $500,000 will be subject to SST in full.

SERVICE INDUSTRIES

Ontario Residents will see an increase in the "cash out of pocket" for service related industries. Service industries, such as lawyers, accountants and veterinarians have never been required to collect RST on behalf of the government. This is due to the fact that the services are not considered a product, but consist of knowledge and labour. While service industries will also benefit from some reduced costs, the effects will not be the same as their major expense is wages.

Reality states that the Ontario government cannot reduce RST on manufactured goods and compliance costs without making up the funds somewhere. This is a cost of doing business; there is a lower impact to collect $1 from $100 people than it is to collect $100 from one person.

Broadening of the tax base results in the lowering of prices on some products and services while raising the end cost on others. The background documentation in the Ontario Budget 2009 shows that an anticipated over-all decrease in RST revenues will result and is projected to be $121 million[6].

SMALL TO MEDIUM BUSINESSES

The budget acknowledges, for the first time from any level of government, something that small to medium sized businesses in Ontario have already known.

The Ontario Budget 2009 states, "Canadian businesses have had difficulty accessing capital markets for financing, and have had to rely more on bank lending. However, the Bank of Canada's *Senior Loan Officer Survey* reported ongoing tightening in both the pricing and availability of credit[7]."

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[5] Ontario Budget – 2009 Introduction
[6] Lessons in Harmony: What Experience in the Atlantic Provinces Shows about the Benefits of a Harmonized Sales Tax – Michael Smart July 2007
[7] Ontario Budget 2009 – Chapter II

Regardless of continuing announcements of increased funding availability from the Federal Government, Small to Medium sized business, which make up 54% of Ontario businesses, have experienced the same economic slow down as everyone else. Because the businesses are hurting, they no longer qualify for loans from financial lending institutions to assist them with their everyday expenses[8]. The reduction in compliance costs and embedded RST costs will put much needed cash into the hands of small to medium business; the backbone of the Ontario economy.

TRANSITION: GOOD FOR CONSUMERS TOO!

All of the above items will not happen over night. It will take time for the full effects of the SST to be felt in the marketplace. In order to address this issue, the budget puts two consumer related credit benefits into effect.

Ontario Sales Tax Transition Benefit results in direct payment to Ontario residents of $300 for individuals or $1,000 for families. The credits are income tested and will residents to file their 2009 personal tax return in order to receive the cash allowances.

Ontario Sales Tax Transition Benefit

	Single Individuals		Single Parents or Couples	
Payment Month	**Maximum Benefit**	**Phase-out Range**	**Maximum Benefit**	**Phase-out Range**
June 2010	$100	$80,000 - $82,000	$330	$160,000 - $166,600
December 2010	$100	$80,000 - $82,000	$335	$160,000 - $166,700
June 2011	$100	$80,000 - $82,000	$335	$160,000 - $166,700
Total	**$300**		**$1,000**	

The Ontario Sales Tax Credit is an on-going credit with advance payment of up to $260 per adult and child. The Sales Tax Credit will begin to phase out at $20,000 income for an individual and $25,000 for a family at 4% of income above the threshold.

The Ontario Sales Tax Credit replaces the current rebate system, which required the resident to wait and have the credit applied to their income taxes. The current system also was restricted to $100 per adult and $50 per child and began to phase out at $4,000.

[8] Appendix Chart – Canadian Business Lending Conditions Tightening

Ontario Sales Tax Benefit

Refundable Credit	Single Individuals		Single Parents or Couples	
	Maximum Benefit	Phase-out Range	Maximum Benefit	Phase-out Range
2009	$100	$4,000 - $9,000	$200	$4,000 - $10,000
2010	$260	$20,000 - $26,500	$520	$25,000 - $33,000

Based on the two credits, an individual would need to spend, on previously not taxable supplies, $7,000 in the first year and $2,000 in subsequent years in order to be out of pocket.

Background documentation from the Ontario government shows that after taking into account growth and inflation, the SST for all intents and purposes is ***cash neutral***[9].

SUMMARY

Why is this a good thing for Ontario and the rest of Canada?

First, taxation is no longer hidden, but is visible to everyone. The free market alone should ensure that pricing will in fact go down within the supply chain, with the result that businesses have less reliance on scarce credit to invest in equipment and people, rather than costly, non-productive government compliance costs. This should enable continued production in difficult times and potentially the production products and services at a lower cost.

Businesses, should take note of the advantage of passing such pricing advantages on to their customers.

On January 3, 1914, Henry Ford shocked the manufacturing industry and the world by more than doubling the daily wage paid to his worker while at the same time, reducing the number of hours worked. Motivation for this bold move is questionable … some reports say that it was so employees could afford to purchased the cars they were manufacturing. Other reports state it was to reduce employee turnover and training costs.[10]

[9] Appendix Chart - Sales Tax Revenue Outlook
[10] http://www.ford.com/about-ford/heritage/milestones/5dollaraday/677-5-dollar-a-day

Regardless of Henry Ford's motivation the results were massive increases in production, cost reduction and sales, bringing the cost of the Ford Model "T" from $825 in 1908 to $360 in 1916.

By eliminating RST on July 1, 2010 the Province of Ontario will implement the greatest single overall cost cutting measure for Ontario business. The question is, will the effects be the same as Henry Ford's?

The answer is up to today's business leaders and smart consumers to support this important initiative and make it pay off for themselves and all Canadians.

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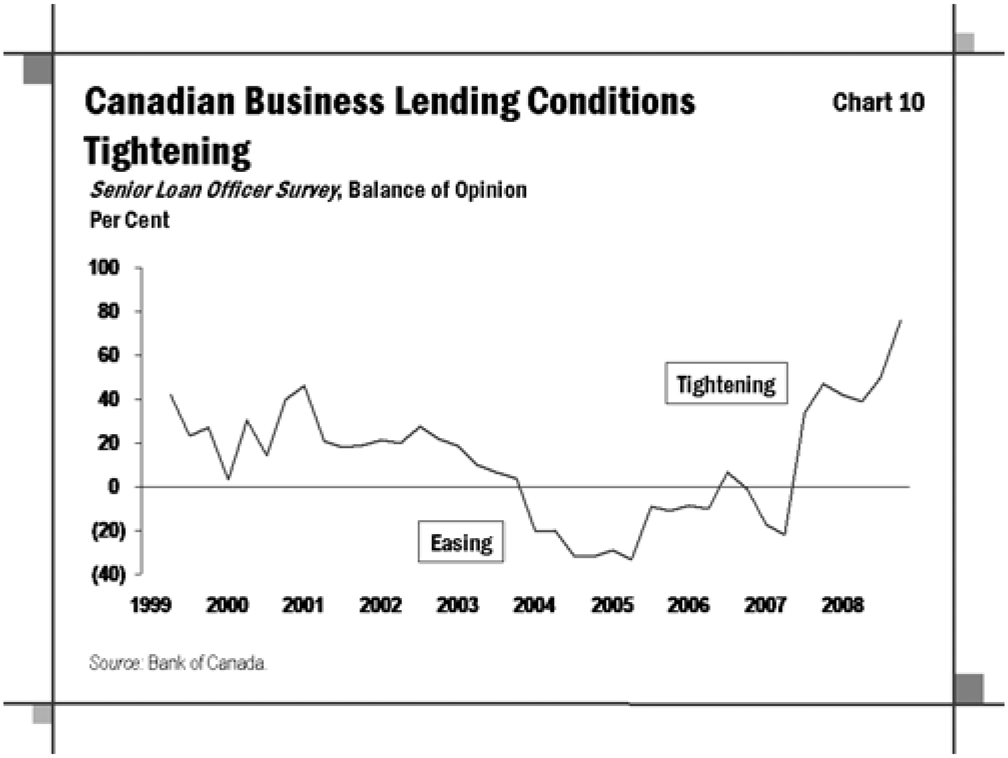

Sales Tax Revenue Outlook
($ Billions)

	Interim	Plan	Outlook	
	2008–09	**2009–10**	**2010–11**	**2011–12**
Total Projected Retail Sales Tax (RST)	17.5	17.6	4.7	–
Total Projected New Sales Tax	–	–	16.3	22.9
Measures Included in Total [1]				
ew Sales Tax Measures	–	–	1.7	2.2
emporary Restriction of Input Tax Credits for Businesses	–	–	0.9	1.3
Other	–	0.1	0.1	0.1
RST Base Revenue [2]	17.5	17.5	18.4	19.3
RST Base Revenue Growth (Per Cent)	2.8	0.5	4.6	5.3
Nominal Consumption Growth (Per Cent)	4.6	0.1	3.3	4.1

- [1] Represents the incremental revenue impact of all tax measures, announced previously and in this update, relative to their impact on revenue in 2008–09.
- [2] "Total projected revenue" less the impact of tax measures or other one-time factors such as prior-year adjustments. Base revenue reflects the impact of underlying macroeconomic factors.
- *Note*: Numbers may not add due to rounding.

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