

## **BUSINESSES, TAXES AND INVESTMENT CLIMATE IN SASKATCHEWAN**

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### *Abstract*

The objective of every effective economic system is to facilitate and enhance the citizens' standard of living and promote economic growth and stability. The achievement of this objective is dependent on sustaining and increasing the level of investment in the economy and the resulting improved standards of living. Everywhere in the world, basic economic success depends on the following three major elements: National and international terms and regulations of trade in a country; the creation of employment in the economy driven largely by investments, and the level of productivity driven by a number of social and economic factors.

The above three factors can be impacted by a single lever. What is that lever? That lever is the role that governments' policy plays on both the existing and the potential business activities in the economy. In the same context, taxation is a powerful policy tool, in addition to its role as a source of government revenue. The economic effectiveness of a tax policy for specific industries depends neither on high tax levels nor low tax levels. Rather, compatibility of a tax system along with the needs of the market is what should determine the level, as well as the structure of a tax policy.

In a competitive environment, tax differentials relative to Marginal Effective Tax Rates (METR), play a crucial role in classifying a location as investment friendly or unfriendly. Similarly, higher business sales taxes in Saskatchewan, Canada, relative to other competitive alternative locations within and outside Canada, simply make Saskatchewan a secondary choice for investors. This leads to numerous economic weaknesses both in the short and the long run. As a result, all else being equal, higher provincial tax rates make investment in a given jurisdiction less attractive. In addition,

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higher taxes reduce the amount of return available on an after tax basis for aggregate businesses. The business sales tax in Saskatchewan puts burdensome pressure on local businesses, while making it difficult for new and expanding businesses to invest in the province. Therefore, the above factors exemplify the need for a harmonized tax system in Saskatchewan.

## I. INTRODUCTION

Due to its nature, governments' business taxation policies heavily impact the ongoing business investment climate in any jurisdiction. The analysis in this paper focuses on business sales tax policy in Saskatchewan and its effects on local business competitiveness. The more competitive the business climate, the more business investment takes place within the framework of a given set of economic circumstances. A low level of business investment and slower business growth rate not only reduces the general standard of living, but in turn, negatively impacts the economic and social fabric of a jurisdiction.

This paper looks at a number of issues that address the uncompetitive nature of the sales tax system in Saskatchewan, in addition to the negative impacts on the local corporate sector. The paper highlights the fact that in today's fast-paced business world, with the availability of latest technology and information, and growing commerce and e-business facilities, business location decisions have become exceptionally flexible. Therefore, the key to retaining, inviting and attracting investment, at any location, is in providing a favorable corporate taxation and regulatory environment. A favorable and regulatory business taxation climate can be described in terms of promoting a competitive corporate sector that is capable of receiving higher levels of investment.

Investment is often referred to as the 'life blood' of an economy. A surprising reality: "from the perspective of non-government equity investors [is that] Saskatchewan has traditionally attracted approximately [only] 2% of the total dollars invested in Canada" (The StarPhoenix). This percentage figure needs to increase for the long-term economic viability of Saskatchewan. "Sure, [Saskatchewan] need[s] good public services, but at the end of the day high relative taxes, especially in the very mobile world", only promotes stagflation (Peter M. Holle). One of the fundamental requirements for economic growth is the creation of wealth. Wealth is created when risk capital is successfully invested with the view of generating a positive return. Hence, wealth creation is impossible without taking measures to accommodate investment. This, in the case of

Saskatchewan, can be acquired with the help of harmonizing the local sales tax system, thus creating a suitable and competitive business climate.

## **II. THE CHOICE OF TAXES AND TAXPAYERS**

Higher comparative taxes in Saskatchewan diminish attractiveness for new investors within and outside Canada. The present economic potential of Saskatchewan should, in fact, be explored by means of rectifying and harmonizing business policies, like the harmonization of business sales tax system. Now, what does this mean in real terms? This means to provide incentives for businesses, in terms of cost effectiveness, in order to help the business sector in Saskatchewan to perform economically, while utilizing their full potential. Moreover, to grow and prosper or to create wealth, a jurisdiction must effectively attract capital. The prevalence of higher business tax levels in Saskatchewan, or elsewhere, has a negative impact on the investment rates. If not altered or modified, higher taxes in Saskatchewan will remain a threat to capital creation and investment attraction in the province. The current tax policy structure is likely to further lower the level and rate of investment in a competitive environment. Over time, modifications in government policies would not only help to maintain investment levels but also increase the policy effectiveness. It is unfortunate, but the fact is with the current sales tax structure, the Government of Saskatchewan has hardly been able to keep the existing businesses in the economy, while attracting new businesses, relative to the economic potential, seems to be out of reach.

The presence of enormous amounts of natural resources in Saskatchewan provides a huge scope of opportunities for different industrial sectors to practice their businesses in the province. Again, the present tax regime does not match the scenario. The tax policy system in Saskatchewan, if rectified and made competitive and used appropriately, would play a critical role in stimulating existing businesses. As well, it would likely attract counterpart-operations of different local and foreign industrial sectors creating further opportunities for an overall smoother business operation. Comparable and competitive tax policy will accelerate business investment levels. In addition, it would support Saskatchewan's efforts to improve the youth retention rates and provide a broader and deeper tax base from which to fund needed public services. In simple terms: more tax payers are needed, not more taxes.

### III. RECTIFYING THE SALES TAX SYSTEM IN SASKATCHEWAN

The proponents of higher taxes often say “state and local taxes are relatively a small burden on businesses and reduce profit rates by [comparatively] small amounts” (Robert G. Lynch). Indeed, this might hold true, but only for a few businesses that either face limited competition or have a set demand in market places: for example, businesses providing commodities of daily use like gasoline and some food items to a local that is far from a competing services centre. On the other hand, businesses that usually are large by nature, like those in the manufacturing sector industry, when reaching maturity and entering into the phase of expansion and/or relocation decisions, mostly look and ultimately prefer to choose a location that has comparative after-tax cost advantages; as they operate in a progressively more competitive environment. Failure to follow this discipline places the business at the hands of a competitor who does follow this discipline. Capital and other business taxes, like PST in Saskatchewan, tend to inflate the cost of doing business, increasing the relative amount of equity and investment level without a commensurate increase in return. This increases the amount of equity required to finance a project. Cumbersome tax regulations can reduce gross margin on operations through administrative overburden. As a result, the business community can experience all or any one of the following consequences:

1. The business may not be able to keep up with the extra costs imposed by taxes in the long run, leading to operational failure.
2. Presuming the tax costs are transferable to customers, businesses may decide not to shutdown operations, but rather, start passing on the tax costs to the consumers in the form of higher prices (increased tax incidence). This can lead to a number of economic complications, like, significantly rising inflation rates. At the same time, costs driven by provincially-based tax policies are rarely capable of being passed on to external markets where market competition sets the price. This is particularly true for the trades in commodity markets. This cost transfer analysis is really applicable only to indigenous service businesses with no external competition. With global communication, this category of business sector becomes smaller as internet based competition expands. As a consequence, the businesses that are no longer able to transfer costs while maintaining customer base, experience margin

compression compared to competitors who discipline their investments to after tax rate of return on equity analysis.

3. The differential in sales tax rates across jurisdictions tends to drive up the final purchasing prices at locations with higher sales tax, even though the selling prices or the cost of producing remain closely competitive. This benefits neither the producer, nor the consumer. In such cases, sales taxes, like the PST in Saskatchewan, end up only decreasing the quantity produced and consumed, creating deadweight loss. Reduced consumer and producer surpluses results in lower economic activity, lower investment rates and slower job creation rates. The above possible scenarios raise the following question: Is our government or the whole public sector so oblivious to think that businesses are somehow locked in the province, and that there is no other place in Canada or elsewhere to move the business where all extra taxes and the associated unproductive efforts can be avoided? The answer is perhaps no; although, to some, it may seem to be an unmindful situation.

Next door to Saskatchewan, in Alberta, incoming businesses feel far more confident and hopeful by getting a chance to save some dollars that they would have to pay in the form of taxes, like the PST in locations like Saskatchewan. With increasing competition levels, availability of the latest infrastructure, and abundant accurate information, businesses opt for the practical approach and choose to relocate to a place that does not unnecessarily encroach their business revenues in the form of extra taxes, and to avoid all the associated, unproductive efforts to manage the tax in their books. This makes a considerable difference in the long run. This observation is also mentioned in a report published by the National Post in April 2007, by the name; "A tale of two provinces". The report contrasts Alberta and Saskatchewan investment in Lloydminster. Although "cheaper Saskatchewan real estate has traditionally helped balance the costs, the divide in commercial development remains all too visible in [the province of Saskatchewan]". This highlights the need to rectify government policies, such as introducing harmonized sales tax. The above is not to say that the government should not have any revenue in the form of taxes, but that the current sales tax system in Saskatchewan is not investment neutral. Government revenue has its own significance and critical importance, but taxes must be structured to ensure they do not negatively affect investment or the ability of businesses to experience an after tax rate of return that is superior or equivalent to investment location alternatives. Even in Alberta, there

are continuous comments that taxes are too high and should be lowered. Given Alberta's history of tax cuts by leadership, investors have come to rationally expect that tax rates will, if anything, be still lower in Alberta in the future. This rational expectation has the consequence of providing an inherent preference for Alberta versus Saskatchewan investment.

The fact is that Saskatchewan lags in investment growth in relative terms. This imposes a danger for economic sustainability in the coming years. In brief, the public sector in Saskatchewan can shape a tax system that: treats the public with a supportive view, instead of looking at the public or investors as just a source of tax revenue; supports the business community at large; promotes economic growth; and adds stability for the people of the province and the generations that are yet to come. An uncompetitive tax system indeed creates a wedge between marginal benefits and marginal costs.

Reviewing a number of studies show that, a 1% increase in costs can lead to a decrease in investment in machinery and equipment by as much as 1%. Furthermore, all manufacturers in Saskatchewan must collect the tax on taxable sales. If the goods sold are for resale or further manufacture, the purchaser must quote their Provincial Sales Tax license number to obtain the goods without tax. This exemplifies the difficulty in correctly identifying, as well as increases the probability of missing out the good that should be taxed and which should not be. For example, industries within the manufacturing sector use numerous products as raw material components to manufacture the final product. These businesses often end up paying PST on components that, for them, are raw material and should, in fact, be tax free. Arguing a sales tax ruling can be time consuming and costly, so many businesses, as a consequence, just bear an incorrect tax load. Over time, this promotes inefficiency in business activity, and ultimately, does not work in favor of the overall economic setup.

#### **IV. TAXATION AND SUBSTANCIAL RISKS FOR THE LOCAL TRANSPORTATION SECTOR**

The performance of the transportation sector in Saskatchewan is hindered by the current sales tax system. Every now and then, we hear about the 'frail transportation system' in Saskatchewan, and how, if this sector is regulated in terms of being: economical, versatile, more reliable and efficient, can it help local businesses become financially and organizationally stronger? This is dramatically underscored by the export and trade development nature of the Saskatchewan economy. Everybody agrees that the transportation sector is central and directly related to almost all economic activities in North America, including many social and

environmental priorities. In addition, transportation is a ‘major input into trade liberalization as it links all facets of the economy with different regions of the world’. Due to changing markets, specialization in production and increasing demand and need for international trade, there is a need for a more efficient transportation system to weave a net of physical connectivity.

In the same context, there is a saying that goes: “If you got it – a truck brought it!” In fact, the above holds true, not only in Canada, but in North America as a whole. We all know that rapid development in Information Technology (IT) has introduced an endless means of improvement and digitization of the way things were done some years ago. IT has helped the transportation sector become more viable, economical, track-able and environmentally feasible. This is done with the assistance of Satellite Monitoring System (SMS), which, over time, reduce a great deal of effort and associated costs. SMS technology is rapidly becoming necessary to facilitate the effective operation of the entire transportation sector. This makes it possible for the trucking sector to make the best use of every road trip; hence, making the whole transportation sector reliable and relatively far more environmental friendly. Knowing the importance of the transportation sector, the following comes to mind: Does the current sales tax system foster a competitive transportation system? Unfortunately, the answer to this question is NO!

It may be surprising to some, but the reality is that under the current PST policy for inter-jurisdictional carriers, “all base equipment located in Saskatchewan is subject to the Provincial Sales Tax. Satellite tracking charges are subject to tax as a telecommunication service... satellite tracking equipment installed in the vehicle is subject to tax as a taxable accessory”, (The Provincial Sales Tax Act, 2007).

The above levy simply means an extra percentage of cost has to be paid if the transportation sector wants to keep serving, facilitating and helping the local economy. As a matter of fact, the government should be welcoming the transportation sector to adopt the economical SMS technology. Indeed, the lack in ability to facilitate the transportation system represents just one of the leaky holes in the tax system in Saskatchewan.

Furthermore, do the current sales tax system foster modernized mechanical systems and building standards? Unfortunately the answer is NO! The engineering and architecture services for site-specific developments of facilities or projects located in Saskatchewan are also subject to sales tax, whether the services are provided by an engineer, geoscientist, or an architect within the province or outside Saskatchewan. Now, this

definitely is like pushing and forcing both the investors and the skilled workers to go invest and work elsewhere.

In metaphorical terms, to some, the presence of the above and other similar policies may sound like they are saying: “Don’t you dare try to do any kind of developmental work in Saskatchewan!” Hence, sales taxes in the above-mentioned sector, and in other similar situations tend to work like an obstruction instead of working as a facilitator in the process of increasing the ability, productivity, competitiveness and functionality of the industrial sector in Saskatchewan.

## **V. DO SALES TAXES AFFECT RATES OF RETURN? ANALYSIS SAYS YES**

Do sales taxes reduce after tax rates of return on investment in Saskatchewan? Unfortunately the answer is YES! Saskatoon, being the largest employer base, as a proportion of Saskatchewan, is used as an example later in the paper to explain the importance of the after tax rate of return and its relation to future investments. According to the KPMG Competitive Alternatives study, superficial analysis has found that Saskatoon among mid-sized cities ranks No.1 in terms of costs. After hearing this news, a foreign person or a person unaware of economic theory may think this to be good news for Saskatoon. At the first glance, and in a way, news reports do make it sound like Saskatoon is or will be home, for many businesses in the IT industry. As a matter of fact, the above may create a wonderful, yet illusionary picture, but this ranking is, in fact, not the case from an after tax return on equity perspective. If we look at Saskatoon’s rank with an after tax return on equity perspective, the reality is not as wonderful as the news reports make it appear. It appears that the above ‘good’ standing of Saskatoon may actually do less good for our economy, unless, we also have a competitive marginal effective rate of taxes relative to other competing locations that may otherwise be preferred by prospective investors. “Although, politicians often claim that taxes levied on capital investments fall on the rich and powerful, more evidence suggests that workers bear the brunt of corporate taxation. A recent UK paper (Arulampalem, Devereux and Maffini 2007) estimated that 54% of the corporate tax reduces employment income in the short run, while more than 100% of the tax falls on employment income in the long run due to reduced worker productivity. Corporate taxes have little short run effect on the Toronto Stock Exchange after-tax profitability earned by shareholders (Mintz 2006) thereby implying that corporate tax ultimately falls primarily on labour incomes, consistent with the UK study.” (Chen, Mintz, Tarasov July, 2007.)



### *A Look at Marginal Effective Tax Rates (METR)*

All else being equal, the user cost of capital represents the annualized cost of purchases of additional units of capital. Firms prefer to invest at locations where the user cost of capital is lowest. Certainly, in comparison to international tax reform reductions, the progress both at the national and provincial level in Canada has been very slow. Higher marginal effective tax rates tend to reduce the level of economic motivation for businesses to sustain their operations. For continuing businesses, a high marginal tax rate reduces returns, as well as the incentive to put in additional hours at work and possibly causes a significant decline in productivity levels. For potential investors, high marginal tax rates reduce the appetite to assume risk. In comparison to other OECD countries, Canada imposes a very high effective tax rate on production capital, which is about more than two times higher than Sweden. This explains the reason for a lower level of investment in Canada and varying provincial investment levels caused by different METR and tax regimes within Canada. Different tax rates in neighboring Saskatchewan and Alberta is a good illustrative example.

Economic literature and data suggests that lower effective tax rates on capital tend to attract Foreign Direct Investment (FDI). Foreign investment, as a share of GDP, is relatively high in Ireland (18.2%), Singapore (14.1 %), Hong Kong (15.2%) and Sweden (8.2%). When we compare these jurisdictions to Canada and Germany, we find these jurisdictions have relatively lower marginal effective tax rates on business activity. Foreign direct investment is much lower, at 3.8%, in Canada, and 2.7% of GDP in Germany. This is, at least, partially because Canada and Germany have higher marginal effective tax rates. Supposing a manufacturing business earns a risk and inflation adjusted rate of return (ROR) on an investment project of 15%, but this ROR is reduced by taxes by one half to 7.5%. If 7.5% is as good as what an investor could get elsewhere on an after-tax, risk-adjusted basis for an investment, then the investor would be willing to provide funds to the business to undertake the project. In addition to the above, the Canadian tax system is not competitive relative to international tax rates. While within Canada, Saskatchewan ranks poorly, at 6<sup>th</sup> place, when compared to other provinces. The situation in Canada, at the time, is such that all jurisdictions have a dissimilar base of tax system. Comparing Saskatchewan tax system with that of Alberta clarifies this point. Saskatchewan collects 5% GST, in addition to a 5% PST; 10% in total. On the other hand, Alberta collects only a 5% GST. This plants a growing incentive for the investors to choose Alberta over Saskatchewan. Having very similar social and climatic

atmosphere; the above differential provides an easily achievable incentive for many businesses currently located in Saskatchewan to relocate to places in Alberta and save tax money and the associated administrative costs.

A study for the three major tax revisions in the postwar period in the United States on changes in tax policy and the impacts on investment behavior, suggests that tax policy is highly effective in changing the level and rate of investment expenditures over time (Hall and Jorgenson–1967). In short, marginal effective tax rates impact the proportion of income that is left after taxes. The thought cycle of every investor revolves around the fact that, a little saving in the short run, often makes a huge and critical difference in the long run.

According to another study on foreign direct investment, a 1% reduction in the effective tax rate on capital can nearly amplify the foreign direct capital stock (or investment) by 3.3% (CD Howe, 2006 Tax competitiveness report). The investors, therefore, find it much easier for their businesses to relocate, refurbish and reestablish at a place that offers lower marginal effective tax rates. In addition, it is not favorable for a person, an organization, or any of their product/resulting outcomes, to intentionally become ‘an odd ball’ and then wish to be the favorite of all, at the same time. Similarly, sales tax policy in Saskatchewan does not match those that compete with Saskatchewan in investment. Table 1 shows the current and the expected METRs in 2010. The table indicates the uncompetitive position of Saskatchewan relative to other jurisdictions that compete in acquiring higher investment levels. New Brunswick, for example, has harmonized its tax system, and thus has a much more competitive and favorable sales tax system. The established business community can therefore avoid unnecessary efforts and extra costs associated with managing “extra” taxes in these jurisdictions. This puts Saskatchewan at a clear cut comparative disadvantage under the current system. This analysis shows that Saskatchewan’s historically high marginal effective tax rate is the primary reason for the provincial trend of attracting only 2% of the total investment in Canada per annum. The prevailing sales tax rate is a comprehensible indicator of additional costs to be paid on every additional dollar generated through current and additional investment in Saskatchewan.

### ***METR and Economics in Saskatchewan***

When the marginal effective tax rate of Saskatchewan is compared to tax regimes within Canada, like New Brunswick and Alberta, it is just not competitive enough. In fact, Saskatchewan had the highest general corporate tax rate and corporate capital tax on capital investments of all jurisdictions in 2005. Saskatchewan's ranking over the coming years needs to be the most competitive in order to divert this trend and to see the required minimum investment levels and economic activity in different industrial and agricultural sectors. This indeed appears to be the 'need of the time' for long term economic stability and for Saskatchewan to be able to compete at the national and international level. The aggregate provincial combined marginal effective tax rates (shown in Table 1) highlight Saskatchewan's ongoing/expected uncompetitive position in the year 2010. With this data, Saskatchewan has an aggregate METR of 31.7%. With the complete harmonization of the sales tax system, the aggregate METR for Saskatchewan moves from 31.7% to 27.5%, improving the current rank of Saskatchewan from 6<sup>th</sup> to 5<sup>th</sup> out of the ten provinces. This improves the outlook of the Canadian economy, while making the provincial economy much more competitive. Potential investors for Saskatchewan too often end up going to other locations with lower marginal effective tax rates. Indeed, it is bad for the Canadian economy, as a whole, when one jurisdiction pushes away investment with higher tax levels to the neighbor next door or elsewhere. The latter may hold true, if, the very goal is to have the capital and young people to move next door [or elsewhere, with] more economic opportunities. Certainly, "tax competitiveness is an important consideration for Saskatchewan policy makers, because of both the investment climate and the labour market effects." (Saskatchewan Check Up, 2006) The above point illustrates how the business tax regime in Saskatchewan hinders investment and depletes potential in the province, and is forcing the economy to stagger due to the uncompetitive tax policy framework.

Businesses are increasingly more sophisticated in their investment analysis and project location options. Location sensitivity particularly increases in knowledge-driven industries like software development and information technology. The reason being, is that these kinds of businesses are not location bound for their operations to succeed. Therefore, they settle in a location that does not, directly or indirectly, threaten their revenues and hence their day-to-day operations. To select an investment location, investors often follow the prudence principle. According to the prudence approach, potential profits are slightly deflated and costs are slightly inflated in startup location analysis, this creates a safety margin for

the operation of business in question. Therefore, the location that offers relatively more profitability or safety margin after taxes gets a better ranking in terms of the investment location preference. In other words, businesses are in a way bound to seek the highest after tax return on their risk capital; because to do otherwise, puts the business in an uncompetitive situation versus a competitor that takes advantage of the after-tax return differential.

## **VI. BUSINESS TAXATION AND IMPACTS IN SASKATCHEWAN**

Even after the 2006 tax cuts, aggregate corporate taxes in Saskatchewan are one of the highest in the country. "Saskatchewan companies are paying 14% on their 2006 income. Although [this] figure will fall to 12% for 2008 earnings, it is still higher than Alberta's corporate tax rate of 10%. And, while it will be phased out by 2009, Saskatchewan still levies capital taxes." (Financial Post: April 7, 2007).

The above underlines how far out of balance Saskatchewan's tax policies were prior the 2006 business tax cuts. With a harmonized taxation policy framework, Saskatchewan is likely to boost business investment, increase job creation and enhance general income levels. It is also likely to improve overall productivity levels of the corporate sector. The prevailing uncompetitive, and therefore ineffective, sales tax system in Saskatchewan tends to inflate costs, either directly or indirectly for all businesses, in addition to reducing the level of return on investment. Consequently, the sales tax system also reduces income level and the retention rate of local businesses and the general population. This, in turn, reduces real market-based wage rates and the level of investment itself. Investment growth in Saskatchewan may particularly help "Saskatchewan's labour force [in] acquiring... the physical means to work smarter and [to learn to] produce more without necessarily working longer." (Sask Check Up, 2006.) According to an estimate, in 2005, 3,800 new jobs were created in Saskatchewan by the goods producing sector alone. This indicates the tendency and inclination towards business expansion, indicating the presence of unexploited potential in Saskatchewan's economy. The reason for Saskatchewan's slower rate of investment, particularly in equipment and machinery, has other components but the present business sales tax regime is certainly part of the problem.

To justify an investment, it is important for businesses to earn a positive return on investment. Businesses seek to operate within a safety margin of profitability to further expand in the future. Businesses prefer maximum possible safety margin to take care of the extra costs of taxes on one side and improve after tax return on the other. This helps expansion of

the local sub economies to support the overall economic expansion. Therefore, it all depends on the public sector to provide a competitive and suitable tax policy structure instead of a tax system that engages businesses in unproductive efforts and forces investors to pay extra costs associated with a weak tax structure.

The Harmonization between the federal and provincial tax systems would help Saskatchewan improve its METR by 8.7% to become competitive and attractive for investors. What will this do? This will result in an enhanced level of investment, expansion of the economy, and most importantly will provide incentives for people to come and work in Saskatchewan. This will in turn broaden the tax base and spin out additional job creation rates.

### *Economic Competitiveness of Saskatchewan*

With sales tax harmonization, businesses in Saskatchewan will be able to avoid individual administrative and other costs. Also, when it comes to investment location decision, Saskatchewan would be in a better position. In case, “if the differences in the primary location factors at alternative sites are relatively small”, the effects of harmonizing the current tax system will be minimal. However, this is not the case in Canada or at the international level. “Goss and Phillips found a negative and statistically significant effect of state and local personal taxes on state employment growth rates”. “Several [other] recent economic studies suggest that state and local tax cuts and incentives may have a positive effect on economic growth, provided that government services are not reduced to pay for the tax cuts.” (C.D. Howe Institute, June 2006) Despite opportunities for manufacturing activity in Saskatchewan, the province still does not have much of the manufacturing or product design companies operating in the province. So, reasonably, we as an economy may have more opportunities to attract additional investments by introducing harmonized sales tax.

The following are some impacts that include, but are not limited to the impact of the current sales tax system on the business sector in general:

- Higher operating costs - hence lower margins due to sales tax administrative overhead costs;
- Business sales taxes on operational incidentals like stationary, utilities, cleaning supplies etc;
- Business sales taxes on software upgrades;
- Business sales tax costs on professional services;
- Business sales taxes on maintenance costs; and,
- Business sales taxes create higher initial investment in building costs, supplies, equipment, engineering, consulting

services etc; thus requiring more equity relative to the scale of the investment. The combined effect of these costs is higher investment level, required to achieve the same scale of business volume, hence an even further lowering of the rate of return on investment.

In the same context, taxes in Saskatchewan, and therefore in Saskatoon, make the expected rate of return on an after tax basis look rather discouraging in comparison to other places. This discourages investors from choosing jurisdictions within Saskatchewan, like Saskatoon, as priority locations over other alternatives to setup and operate businesses. Restructuring of provincial retail sales taxes would make a significant contribution to Canada's tax advantage. Including Saskatchewan, if the remaining five provinces with retail sales taxes would move to a Value Added Tax (VAT) harmonized with the GST, Canada's overall METR would improve by 6.2% points. An improvement of this magnitude would have a significant impact on the competitiveness of Canadian businesses and the standard of living of Canadians. Canada, as a democratic society, has a public sector that is charged by the public to provide services based on a general consensus view. Business operations and the rate of their growth are directly affected by the costs and levies imposed by the government to partly fund these services. Therefore, it is the authority imbedded within the public sector and government representatives that can impact and help the economy to be a success story.

One of the fundamental requirements for successfully running a business, is the ability to make efficient use of capital. This efficient use of capital ultimately rewards employees through wage level growth and motivates both the labour force and the investor to increase productivity levels in general. The solution seems to be in governments stepping forward to create a policy framework that facilitates investment. Investment growth results in a higher standard of living. This achieves the goal of providing benefits to the general public at large. Also, it is likely to increase the number of businesses, hence, increasing the stream of revenues for government. The above is important for the government to be in a better position to provide services and support the economic and social fabric of Saskatchewan. Many businesses are hesitant from investing and doing business in Saskatchewan, due to a fear of not making a level of profit on an after tax basis that is equal to or better than alternative investment locations.

### ***Economic Benefits of PST Harmonization at Large***

PST harmonization is likely to help minimize distortions in investment decisions resulting in more investment in the economy. Beside the macro level benefits, harmonization of sales tax will also help business to economize the costs of inputs. In addition, harmonization will eliminate the tax cascade that is inherent in existing provincial retail sales tax systems. Existing provincial sales taxes do not have a proper mechanism to define tax free raw material purchases by businesses. Therefore, in the course of producing goods and services, taxes often end up increasing the cost. Ultimately, the selling prices of goods and services produced must rise, in a competitive environment where costs cannot be transferred; margins (profitability) are reduced. As margins are reduced, investment also declines. A vicious cycle of lower investment, wages and an eroding tax base ensues. A key advantage of a harmonized sales tax (HST) will also be the removal of embedded extra taxes which for the current corporate sector are more like a burden beyond capacity. Furthermore, harmonization will make the tax payable on goods and services more transparent for consumers as well. Saskatchewan companies will be able to price their goods more competitively. In the same context, HST will enhance the international trade of Saskatchewan-made goods and services. The resulting new system will provide a better chance for newly registered and other small businesses to thrive. In addition to the promotion of fiscal co-operation and harmonization among federal and provincial governments, a harmonized sales tax would also reduce overall government overhead costs. "In 2005, Saskatchewan posted one of the highest ratios of after-tax profits to GDP, at 15.9%." This clearly suggests that Saskatchewan's economy is almost doing the best it can with the present cost structures that are associated with the government tax policies. Regardless of the business size, tax harmonization in the coming years is likely to have a greater prospective impact to help the after tax profits of each and every local business in Saskatchewan. The increasing after tax profits mean a more successful operation, and having lower taxes, will be like a booster for economic growth. All the above benefits of a harmonized sales tax system in Saskatchewan will shape a stronger business community and improve the province's lowest ranking of long term employment growth as shown in Chart 1.

### ***Tax Harmonization; One Rate, One Set of Rules***

The portability of investment, based on the usability and availability of near-accurate financial information, has indeed become a reason for

businesses to establish themselves in an economy with relatively greater expected after tax returns. For simplicity, assume two similar and equivalent companies operating in the same market, for instance, companies in the IT industry. It is reasonably true to say that the company with a higher marginal rate of return (ROR) would be the ultimate winner in the long run. Therefore, companies need to retain and sustain a competitive position. In order to do so, businesses need a tax system that gives them the capability to sustain a competitive position at the local and foreign level by having a positive ROR after taxes, which also represents the marginal rate of profits. Furthermore, according to Lorwertha and Danforth, a 10% reduction in the cost of capital in Canada can increase investment in machinery and equipment by 10%. Holding all else constant, the above will likely be true for rest of the industrial sectors as well.

Prolonging the time in achieving a competitive tax regime in Saskatchewan will prolong lower levels of investment and employment growth. The sooner this change takes place, the sooner the benefits start emerging.

The following are summary points of some of the prominent and potential benefits of HST in Saskatchewan:

- Businesses will be better able to provide their employees with compensation packages and other fringe benefits (education, training and so on), adequately increasing the quality and attracting a greater quantity of labour, thus improving the productive capacity of human resources.
- Higher profits at the margin will foster greater investment levels and the accompanying growth in employment rates.
- Higher real income for individuals and higher profits for the industrial sector encourages further investment, thus improving productivity levels and the standards of living.
- Greater economic activity encourages the potential to specialize and creates opportunities to earn higher profits; opens the door for the labour force to acquire professional education and learning. This provides a reason for other businesses to effectively adopt new technology. Hence, this all leads to an overall benefit for all parties engaged in an economy.
- The expanded tax base can increase revenue for the Saskatchewan government in the long run. Initial tax cuts will also reduce tax avoidance, and is likely to result in more hours worked and more investment.



Efficiency and economic gains always requires some kind of effort. The negative effects of higher taxes associated with the current tax regime reduce the reward for additional effort. With the current tax system in Saskatchewan, efficiency is largely restricted to increasing effort levels and more hours worked. The sales tax system in its present form, turns out to be an 'extra tax expenditure' and a associated extra effort for both businesses and employees. To sustain business activity in the short run or grow business activity in the long run requires equivalent or superior after tax rates of return. Sales taxes generally apply to business inputs that contribute to making Canadian businesses less competitive due to higher production costs. Provincial governments have an important role to play in making Canada's economy more competitive through better tax policy. Saskatchewan government's effective taxation policies can pave the way for investment in Saskatchewan and harmonization is an important means to that end.

## VII. CONCLUSION

A harmonized tax system can help the Saskatchewan economy to focus on three influential factors to make Saskatchewan a better place to live, work, as well as invest. If the province wants to protect and increase revenues in the long run, while helping investment capital formation and job growth, it should harmonize the PST and GST. This would end the imprudence of making businesses administer two parallels, and disperse material productivity and prosperity.

For a sustainable future, the marginal rate of return after taxes has to be competitive in order to sustain and attract future investments. The current business sales tax in Saskatchewan puts burdensome pressure on the local businesses, while making it difficult for new and expanding businesses to stay and invest in Saskatchewan. At the same time, there is a heightened need to expedite the investment process, and sustain and improve the level of productivity. "Tax reform to remove sales tax levied on business inputs should be a significant part of the policy agenda in...Saskatchewan." Harmonization of the tax regime in Saskatchewan is likely to provide an important tool to attract local and foreign investment and bring prosperity for the people of Saskatchewan, the economy in general and for the generations that are yet to come. The potential in Saskatchewan can pave the way for investment in Saskatchewan, and harmonization is an important means to that end.

APPENDIX

Chart 1

Long term job creation records (Stat Canada)

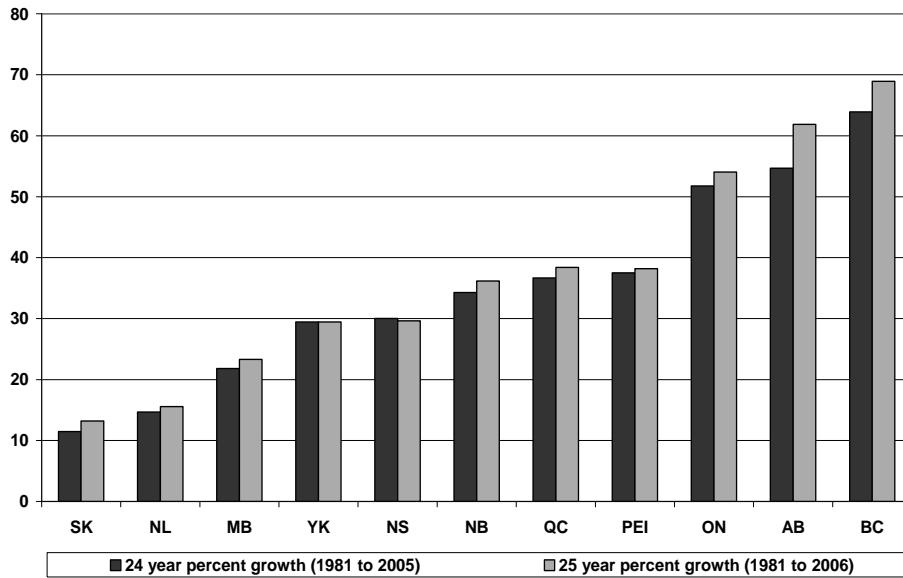


Table 1: C.D. Howe Institute Provincial Rankings by METR in 2010

Province	BC	AB	SK	MB	ON	QC	NB	NS	PEI	NL
<b>METR</b>	34.9	25.8	<b>27.5</b>	33.2	38.6	31.0	9.7	20.0	33.7	15.3
<b>Rank</b>	9	4	<b>5</b>	7	10	6	1	3	8	2

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