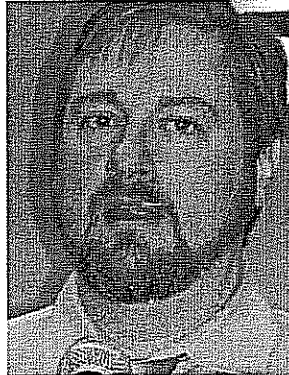


EVERYTHING YOU'VE BEEN TOLD ABOUT SALES TAX *

***Is a Lie**

by Erich Jacoby-Hawkins, Barrie, Ontario, Canada

(Following a presentation by Lindy Davies drawing on an analysis by Mason Gaffney (see July-August 2011 GroundSwell, "Why Sales Taxes?"), Erich Jacoby-Hawkins talked about the Canadian experience with GST and VAT. The following is based on a transcript of the presentation that was made August 2, 2012 in Harrisburg, PA at the annual conference of the Council of Geogist Organizations.)



Canada has a Value Added Tax and suffers for all the reasons Mason Gaffney and many others have said. We had a conservative government come in and cut taxes in one of the most uneconomical ways possible. We had a 7% Value Added Tax and they lowered it to 5%. It didn't do much to improve the economy, and every time they cut a percentage that cuts \$6 billion a year from the federal budget. Though it reduced by two-sevenths the amount of revenue generated, it maintained all the economic costs of accounting for and collecting this tax, so the tax becomes even less efficient. Our prime minister claims to be an economist from the Calgary School, and yet it is an incredibly uneconomic policy.

Let's start with some definitions. There are different sorts of things that fall under the domain of sales taxes. Excise taxes are generally limited to a specific band of things: tobacco, alcohol, luxuries, hotels. Then we get to the retail sales tax, and I think that is fairly common at the state level here (in the US). Each province in Canada sets its own retail sales tax, which is 0% in Alberta, but in other provinces it can go up as high as 11%-12%. We call it PST for Provincial Sales Tax or RST for Retail Sales Tax. Now generally that kind of tax is on hard goods purchased retail, so if you go and buy a pair of shoes or a sofa or a car, that tax applies. Generally that retail sales tax does not apply, and you would not be charged, for services like dry cleaning, plumbing or electrical work. We have a Goods and Services Tax; our federal GST covers almost all goods and services you can imagine, like when you get a haircut. When you buy a house the realtor adds GST to the real estate commission and fees. There also is a Value Added Tax, which is a special kind of sales tax, the difference being where it is collected. A sales tax is only collected at the last stage. If you are a manufacturer, distributor or a wholesaler, you are not involved in collecting that; if you are a manufacturer; you buy your inputs and manufacture your product; if you are a distributor, you sell to the retail store and the retail store sells to the customer who then pays the sales tax. Anyone else in the process is not paying the sales tax, but that can be a problem because you can claim to be

within the process but actually not. So a small business person could go to businesses who sell both retail and wholesale and get their wholesale price and not pay the sales tax on products for their own use because they claim it is for retail and buying for resale. The problem with that is that the company selling the product has no incentive to verify that the purchaser actually is going to resell the product (like shoes) and collect the tax, so the small business person could use it and not pay sales tax. If it were straight up retail they would have to charge the tax.

A Value Added Tax is supposed to catch that, as everyone in the chain pays the VAT on the new price from the original supplier, the factory, the distributor, etc. What you are doing at each stage is charging the tax to your customer, and that is repaying the tax to you that you paid your supplier. You actually deduct the difference because every time you buy something, here is an invoice that says how much is that tax, and you keep those invoices and then you charge more tax when you sell the product. You need to charge that sales tax to recoup the sales tax you have already paid. You at least get back the tax you put in. Of course, that also means collecting the tax at every stage, and there is more work in calculating it, because you have to do a difference calculation at each stage. Even worse, if you end up clearing something below what you paid for it, that gets really complicated because now you are charging less tax than you paid. There is the calculating and the collecting and the remitting of the tax. Now everyone in the process is remitting the tax. So who is this supposed to benefit?

There are five touted benefits to sales taxes.

1. Supposedly they are difficult to avoid. The income tax is by comparison much easier to avoid because of proving how much you earned and you get all kinds of deductions. The sales tax is incurred and collected every time someone buys or sells something.
2. The sales tax is simple to collect. Every time you buy something or pay for services, cash is changing hands, hence available to be taxed.
3. Sales tax is simple to calculate. Here is the price, the sales tax is a certain percent. (With land tax you have to look at assessments, at the prices of land, the potential uses of land, etc.)
4. Sales tax is fair. Everybody pays a bit. The more money you have and spend, the more money you pay in sales tax. It has the fairness of a flat tax aspect to it. Generally to make it more fair, basic necessities are exempted. If you buy an expensive luxury item, you pay more sales tax.
5. It is a non-distorting tax. It won't hinder your economy or lose jobs.

Now I am going to question each of these assertions; I will address them in reverse order.

* There are some huge distortions, as shown in Mason Gaffney's paper, like turn-over, but there are some other distortions that happen. We have a huge issue in Canada of cross border shoppers. Two things (continued on page 13)

EVERYTHING ...ABOUT SALES TAX (from page 2)
drive that: things are cheaper in the States than in Canada. Most Canadians live fairly close to the American border because that area has the more temperate climate. Most Canadians are within 20 to 100 miles of the international border. They go across the border, fill up the gas tank and go shopping for clothes and buy groceries and things you normally would do in your own neighborhood. So you will pay state sales tax but not federal tax. In Ontario that has been as high as combined 15% provincial and federal sales tax. Even in New York where it is 7%-8%, it is still a lot cheaper than Canada. Canadians can also buy an item in another province that has a lower sales tax and not have to pay sales tax when they get home. If something is shipped across the provincial borders, there is a federal tax charge, though.

As another distortion, this invoice is an example of a Canadian buying software over the internet from a Canadian supplier, using her credit card, but she lists her "shipping address" as California (note the zip code 90210), and this virtual services transaction avoids the Canadian sales tax simply by stating a fictitious address. So by purchasing over the internet, you can easily avoid the tax on some transactions, which tilts the market against local suppliers.

* Fairness is really open to debate, especially because of the exemptions. Groceries and "necessities" tend to be exempted in Canada. We don't want to put the tax on books and magazines, newspapers, etc. because of the cultural and societal benefits of reading, as we don't want to discourage people from reading. However, this exemption is on provincial sales tax, not on federal.

But there are always arguments on what things should and shouldn't be taxed; having no tax on magazines includes pornography. Real estate is another example. Buying a new house has the GST (the Value Added Tax) on it; buying a used house does not. But when you buy a new house (not resale, because that is the highest aspiration of the economy: to build and sell lots of houses), you get a rebate up to a certain amount. So if you bought sort of an average-priced house you get rebated most or all of that VAT, although if you bought a luxury home you pay the full price. It is hard to know which of these factors is actually fair to get rebated.

People get a sales tax rebate based on their income level: if you have a lower than average income, you get a rebate that is meant to reflect how much you paid in sales tax. Originally it was annually, then quarterly, and now the provincial one is monthly. However, economists note that for a poor person who can barely afford groceries and other necessities and then is taxed on purchases, getting extra money once a year or every three months to cover that extra tax isn't very effective. Are you going to set that money aside and every time you pay the sales tax take a little bit out from that separate rebate wallet? It is pretty hard for people to balance the daily sales tax burden with the periodic sales tax rebate. Plus, you have to have a bank account to receive the rebate. If you move and change jobs, it becomes difficult on a delivery basis to the people who most need it. There was an article in the paper recently that economists are saying we could actually get rid of all these taxes and put a GST

on all food and necessities and everything and that would raise another \$39 billion and actually more than double the money coming in from the sales tax and reduce other taxes like income taxes, even more so if we raise the sales tax rate. But the rebates would be quarterly while your expenses are weekly, so you can't just solve this new grocery tax by giving people rebates. The other problem is you can't just balance it by lowering the income tax because the people hit most hard by higher sales tax probably don't pay any income tax. The administration just guesses that if you make a certain amount of income you must be paying this much GST so you get this much back. You must also file your tax return to get the rebate. Overall, fairness of sales taxes is a dubious matter.

* Not so simple to calculate. Think about all the exemptions I mentioned previously. You go to the grocery store and there are variety items and grocery items; some of them are taxed, and some are not. So they have to group them on your receipt and flag each one yes or no. Some provinces include the GST in the base for calculating the provincial tax so you are taxed on the tax, and some take the same base and calculate the taxes separately and independently. Some things are exempt; other things are zero rate, which is a tax of zero, and oddly enough that makes a difference from being tax-exempt. It is the kind of thing that makes it harder for a business; you have to figure out which things are exempt or at zero rate and how to claim each. You thus have differing rates of applicability on an item for taxes. Any given item may have a federal tax or not and may have a provincial tax or not, so you have four potential tax regimes. You could have no tax, you could have one tax, you could have the other tax, or you could have both taxes. For any given item on your receipt you could have four different tax rates. That is at only two levels. It actually goes up to the power of X, so if you have three or four sales taxes including municipal and regional, with the state and federal, you have 16 potential different tax categories on your receipt. So obviously it isn't very simple. For another example, a returnable beverage container. If you buy a bottle of beer and you pay 10 cents for the bottle and get 10 cents back, they don't charge the tax on that either time. But if you pay deposit on a large shipping container that you are going to return to get your money back, after you unload it at your warehouse, they do have to charge you the Value Added Tax on that deposit refund when you return it to them. And you can either treat it as a refund and get a tax refund back, or if you are now selling them an empty container you can charge them the tax. There are two different ways to do that, you have to figure out or elect which you will use and hope the taxman agrees.

Then there are certain people who are exempt from the tax and they either prove they are exempt and do not pay at the time or they collect all the receipts and get a rebate. Status Indians, due to their treaties of long ago that said "you give us most of your land and we won't tax you," are exempt from sales taxes. But now they have to pay the sales tax and save the receipts to claim it back later. Also, whether they purchase something on the Reserve or off the Reserve affects whether some taxes apply. Diplomats are exempt from the sales tax. We didn't want sales tax to hurt tourism, so tourists can get their sales tax back; if you come to Canada, save all your receipts and you can fill out (continued on page 14)

EVERYTHING ...ABOUT SALES TAX

(from page 13)

a form and mail it in and get a check back. A few people do but the majority of tourists do not. Whether to charge sales tax on food can be really complicated, such as whether it is ingredients or prepared food, or if it's considered to be a "meal" or a "snack". A Harmonized Sales Tax is meant to make life simpler for business; this is where the federal Value Added Tax and the Provincial Retail Sales Tax are put together and added up. The first problem is the Value Added Tax overpowers the Retail Sales Tax which is on some things and goods, but the Value Added Tax is on everything. The Harmonized Sales Tax basically taxes everything. So suddenly the tax is doubled on any service because you are not only paying GST but now also PST, so electric bills and gas bills suddenly become much more expensive. Yet to complicate this even further, when a province harmonizes their PST with the federal GST, they can negotiate some exemptions, creating yet another category of sales that are only partially taxable.

One last factor is that while sales tax isn't hidden, in that you pay it every time you make a purchase, the total you pay annually isn't clear. When you file annual income taxes, the amount you paid (or will pay) for the year is presented for you to acknowledge. But it would be extremely difficult to calculate how much total sales tax you paid over the year, much less compare it with other years. In that light, the cumulative burden of sales tax is less transparent to the individual taxpayer.

* Sales tax is commonly avoided. In Canada we now have a huge "underground economy", concentrated in the trades. Wherever a tradesman primarily charges for his own labor, he is not paying sales tax on his main input so he doesn't need to get it back from his clients. A lot of tradespeople are paid cash and do not charge the GST, but this usually means they are also not paying income tax. With the underground economy we lose ability to get accurate econometrics, while the customer loses warranty protection and worker insurance premiums go unpaid. The size Canada's underground economy is at least \$36 billion. We had a recession-fighting one-year tax cut a few years ago that gave people a 15% rebate on home renovations up to \$10,000, yet to get this they had to provide their receipt, which means they had to pay the sales tax they otherwise generally would have avoided by paying cash, so in the end their total price was about the same as what it was without the rebate. Yet the government spent millions of dollars promoting this break-even tax break!

So if sales tax fails to deliver on all five of the promised benefits, why would lobbyists promote it above LVT?

Some seem to believe that it's more politically palatable than other taxes, particularly property tax (which some sales tax advocates would have it replace). Yet in Canada, new or higher sales taxes have always been unpopular. The GST remains the most hated tax in Canada, to the extent that the current government carried political favour by just lowering it a bit. In the province of British Columbia, the federal GST and

the provincial PST were merged into the Harmonized Sales Tax (HST); this led to the first-ever successful popular referendum campaign to reverse a government initiative. Yet even after the huge passion of that referendum, all that happened was the taxes were again separated; neither of them has been removed or even reduced.

Some seem to feel that sales tax is more reliable than land tax, since the latter would fluctuate with land bubbles (ignoring, of course, the bubble-dampening effect of LVT). Yet sales tax revenue will likewise follow the business cycle; in a recession sales (and income) taxes go down.

So there must be other reasons to promote sales tax as the ideal tax. I can only speculate that perhaps it is less threatening to rentiers and would-be rent-seekers, or perhaps some people just aren't looking at real-world evidence when they propose tax reforms.

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CG-NYC CHAPTER HOSTS BOOTH (from page 1)

hear this year, though I did last year, was "You want to untax the rich people and corporations even more! They pay too little already!" I don't know if it was because we couched the argument in different terms, or because people are feeling the squeeze of high taxes on labor, sales, and true capital, more acutely this year, but no one particularly objected to that part of the Single Tax.

We got a lot of interest in Monetary reform too, despite having just two fliers devoted to that in our table crowded with over a dozen, plus GroundSwell newsletters and a signup sheet, etc. Long-time members may remember we held a local chapter vote to support Henry George's view of debt-free money (aka Greenbacks) a couple of years ago. The idea of producing Sovereign Money, without borrowing it from a Central Bank, resonates more strongly than LVT. The banks are universally loathed, and the idea of eventually eliminating the debt has great appeal. One woman interjected that Occupy: Strike Debt was buying up distressed debt and eliminating it; she didn't take kindly to my suggestion that this didn't get to the root of the problem, and might even indirectly continue it, by allowing banks off the hook. This is our struggle: people are attracted to quick and visible fixes, and not so much to root surgery.

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