Examining the Mix:

Options for Changing the NWT Tax System

September 2009

Northwest Territories Finance

Kīspin ki nitawihtīn ā nīhīyawihk ōma ācimōwin, tipwēsinēn.

Cree

ʔerihtł'ís dëne sųłiné yati t'a huts'elkër xa beyéyati theʔą ʔat'e, nuwe ts'ën yółti.

Chipewyan

If you would like this information in another official language, call us.

English

Si vous voulez ces renseignements en français, contactez-nous.

Français

Jii gwandak izhii ginjìk vat'atr'ijąhch'uu zhìt yinohthan jì', diits'àt ginohknìi.

Gwich'in

Hapkua titiqqat pijumagupkit Inuinnaqtun, uvaptinnut hivajarlutit.

Inuinnaqtun

ᑕᒃᑯᐊ ᑎᑎᕐᒃᑲᐃᑦ ᐱᔪᒪᒍᕕᒋᑦ ᐃᓄᒃᑎᑐᓕᕐᒃᓯᒪᓗᑎᒃ, ᐅᕙᑦᑎᓐᓄᑦ ᐅᖃᓚ ᔪᓐᓇᖅᑐᑎᑦ.

Inuktitut

UVANITTUAQ ILITCHURISUKUPKU INUVIALUKTUN, QUQUAQLUTA.

Inuvialuktun

K'éhshó got'įne xədə k'é hederi ʔedįhtl'é yeriniwę nídé dúle.

North Slavey

Edi gondı dehgéh got'įe zhatié k'éé edatł'éh enahddhę nide.

South Slavey

Tłįchǫ yati k'èè dè wegodıı wek'èhoızǫ nęęwǫ dè, gots'ǫ goahde.

Tłįchǫ

Foreword

In September 2008, the Government of the NWT consulted with NWT residents and a committee of stakeholders to ask how best to raise additional revenues necessary to put our fiscal house in order. This revenue was to provide additional resources to fund important programs and services for Northerners.

The success of that roundtable in generating productive discussion around the Government of the NWT's fiscal choices led to a commitment to hold another roundtable discussion in 2009 to seek input from stakeholders on the appropriate mix of taxes and other revenue-raising options to help ensure that the NWT tax system is competitive, is able to fund essential programs and services, and works to achieve the goals set out by the members of the 16th Legislative Assembly.

How revenues are raised can have significant consequences for individuals, families, and businesses. An approach that's not well thought out can hurt the economy, discourage investment, or even push people into leaving the territory. So it's important that we carefully examine our tax system, and take a measured and balanced approach that is consistent with the NWT's long-term vision and goals.

This paper provides some basic information about options to change the tax system to better achieve the NWT's economic, social and environmental goals. The ideas that we will receive are part of our longer term work on the fiscal structure of the NWT. Proposals for significant change to our taxation system will require considerable research and analysis as well as further consultation, before any changes could be brought forward and implemented.

Because the options the GNWT takes will affect all NWT residents, having the input of Northerners is important. No decisions have yet been made. I encourage you to provide your comments to the contacts listed at the end of this paper.

Hon. J. Michael Miltenberger
Minister of Finance

Examining the Mix: Options for Changing the NWT Tax System

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1. Introduction

In 2007, the Members of the 16th Legislative Assembly released the document *Northerners Working Together*, which contained their vision, goals and priorities for the next four years. The document set the broad direction for the government's operations through clearly defined priorities and specific actions.

The Legislative Assembly laid out a vision of "Strong individuals, families and communities sharing the benefits and responsibilities of a unified, environmentally sustainable and prosperous Northwest Territories", and envisioned six broad goals for this government:

- A strong and independent North built on partnerships;
- An environment that will sustain present and future generations;
- Healthy, educated people;
- A diversified economy that provides all communities and regions with opportunities and choices;
- Sustainable, vibrant, safe communities; and
- Effective and efficient government.

The challenge for government has been to examine its current operating environment and set out specific actions that will stimulate progress towards these goals. A large part of this work has focussed on the expenditure side of the government's activities. However, the way government taxes its citizens and raises revenues should also be aligned with its vision and goals.

The way government raises revenues has implications beyond direct fiscal impacts. Although the main purpose of the tax system is to raise revenues to pay for government services, the way revenues are raised has implications for the economy, for population growth, for social policy and for the environment. Revenue options also go beyond taxation. Measures that increase population growth by lowering the cost of living, or that strengthen the NWT economy, will increase the government's revenue-raising capacity.

In Budget 2008 the Government of the NWT (GNWT) committed to taking a number of measures necessary to restore fiscal sustainability, including the generation of new revenues. In September 2008 the Department of Finance released a discussion document, *Revenue Options*, which focused on raising new revenues and presented the options available to the GNWT to fund new and existing programs, services and infrastructure. Comments from the public were sought and a two day roundtable discussion was organized with invited representatives from a wide spectrum of NWT business, labour and social organizations. Feedback from that consultation was incorporated into new revenue initiatives announced by the Minister of Finance in the February 2009 Budget. The work done in 2008 demonstrated the need to take a closer look at how revenues are raised in the NWT, to see if there are changes that might further our economic, social and environmental objectives, without necessarily increasing the total amount of taxes the GNWT collects.

The Minister of Finance committed to holding a second round of consultations in 2009. This consultation will focus on aspects of the tax system beyond simply revenue generation, such as how changes in the tax burden might encourage greater equity among taxpayers or encourage behaviours that benefit society, our economy and our environment.

The purpose of this paper is to examine the mix of taxes in the NWT and how changing that mix, without increasing the total tax burden, could advance one or more of the goals of the 16th Legislative Assembly. A fair, efficient tax system provides the foundation for governments to deliver essential public services and to make the investments needed to improve the quality of life for its citizens. However, making decisions about taxes will have consequences for those individuals, families and businesses that pay the higher taxes. Even changes that don't increase the total amount of tax collected, but rather lower one tax and increase another, can have important consequences. Because changes in the tax system of this nature will not affect everyone the same way, there are likely to be "winners" and "losers" for each tax change. In addition, measures designed to produce revenues that are targeted toward higher expenditures in specific program areas, don't necessarily address the government's fiscal challenges, since they focus resources on one particular area.

The GNWT needs to balance its requirement for additional revenues to fund quality programs and services with the need to achieve its policy objectives, including maintaining a strong economy and a growing population. The government needs to take an approach that is well thought out in terms of its impact on residents, on the economy, on investment, on the environment, and on the attractiveness of the NWT as a place to work and to live. Therefore, significant changes require thorough analysis and consultation before they are implemented.

The discussion and feedback generated from the Department's 2009 consultations will guide the development of tax policy proposals that will help the GNWT better align its tax structure with its vision and goals. Further consultation will take place on these proposals prior to implementation.

2. Tax facts 101

a. Constitutional and legal limits

The authority of the Government of the NWT to levy taxes comes from the *Northwest Territories Act* which allows the GNWT to levy direct taxes "within the Territories in order to raise a revenue for territorial, municipal or local purposes" (s.16(a)).

This wording is similar to the provisions in the *Constitution Act* that grant taxation powers to the provinces.

The GNWT's taxation authority is also limited by the *Canadian Charter of Rights and Freedoms,* which protects the mobility rights of Canadians to live and work in any part of Canada.

These provisions mean that the GNWT can impose direct taxes such as sales, property, income or capital taxes within the NWT. The GNWT cannot impose an indirect tax, such as a sales tax on the seller. It also cannot tax activity outside the NWT, for example by imposing a tax that would be paid by a consumer outside the NWT, or an export tax. It also cannot impose a tax directed solely to non-residents.

b. Increases in tax rates do not necessarily increase tax revenues

Theoretically, if the government taxed 100 per cent of an individual's income, taxpayers would have no incentive to work and the government would receive no tax revenues. Similarly, if a government were to impose a tax rate of zero per cent, it would of course receive zero revenue.

Between these two extremes, tax policy makers strive to achieve the right level of taxation. Tax rates that are set too high stifle economic incentives. Conversely, tax rates set too low might not provide enough revenue for the desired level of government programs and services.

Determining the optimal tax rate that would yield the necessary tax revenue is a theoretical exercise; however, all can agree that in general increasing tax rates would be counterproductive if it results in an unintended consequence of reducing tax revenues. An exception to this generality might be found where the tax is imposed to discourage a certain activity such as tobacco consumption.

c. Criteria for judging a tax system

The effectiveness of a tax system is evaluated based on a number of widely accepted criteria: efficiency, effect on economic growth, ease of collection and administration for both taxpayers and governments, and equity.

Efficiency

Taxation impacts economic efficiency by affecting decisions to invest, save and work. Almost any tax measure will distort the economy because people and businesses tend to adjust their behaviour in order to minimize the tax paid. Personal income tax, for example, affects the supply of labour. High tax rates may encourage people to move from a high tax jurisdiction to a lower tax jurisdiction, or choose to work less. High tobacco and alcohol taxes discourage consumption and encourage a healthier lifestyle, partly in order to reduce future health care costs on society. A carbon tax encourages consumers to reduce the use of fossil fuels, and companies to adopt a cleaner mode of production by investing in new technologies to reduce their greenhouse gas emissions.

Economic growth

Taxes can be judged by their effect on economic growth. Low corporate income tax can attract business investment and create more jobs, translating into better quality of life for employees, and more vibrant communities. High personal income tax reduces after-tax income, giving people less money to spend or save for the future, and discouraging people from investing in higher tax jurisdictions.

Administrative costs

Different types of taxes have different costs to administer or to comply with, either for taxpayers or tax collectors.

The tax system should be simple and easy to comply with. The value of providing exemptions, credits or other special measures should be weighed against the complexity they add to the system. Complex legislation may be necessary, but compliance by the taxpayer should be as simple as possible.

Equity

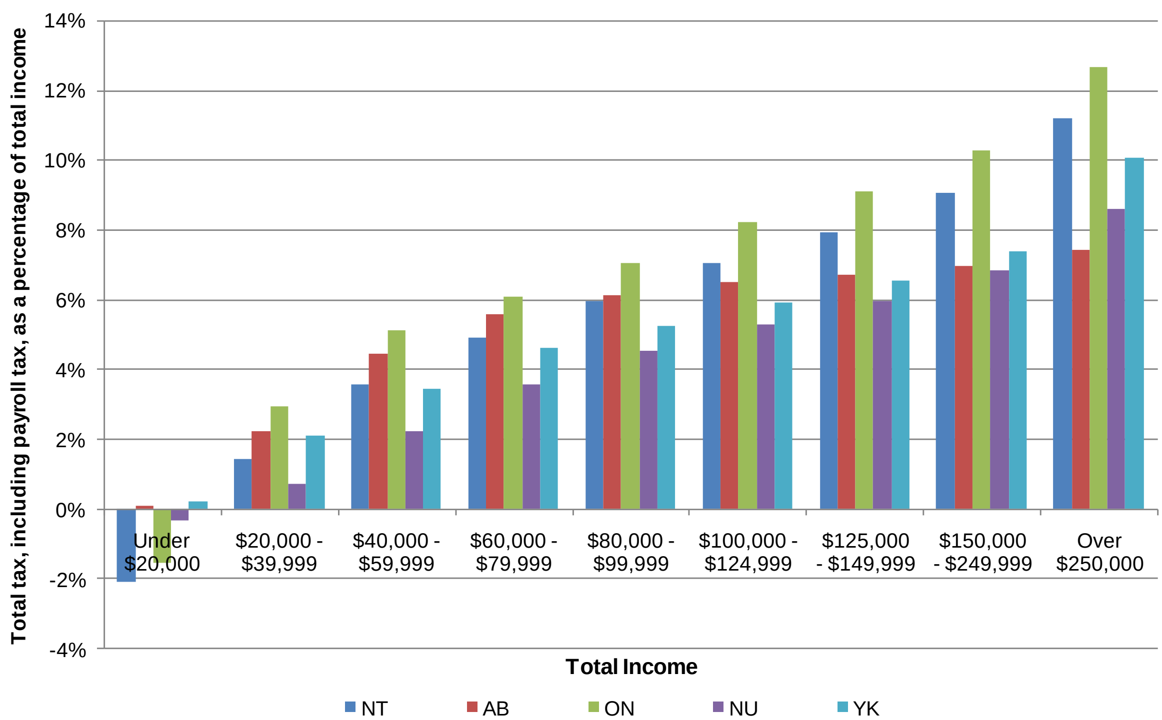
Equity refers to the manner in which the tax affects the well-being of one person compared to another. People in similar circumstances should be taxed in the same way. This means that a dollar of income earned from one source, such as employment, should be taxed the same way as a dollar earned in another way, such as from investment.

People in different circumstances should be taxed differently. The most common example of this is the “progressive” nature of most income tax systems. Taxpayers with a greater ability to pay taxes should pay more. A dollar taken from a high-income earner will not be as much of a sacrifice as a dollar taken from a low-income earner.

Personal income taxes in Canada are generally progressive: the more you make, the higher the share of your income paid in tax. Some other taxes, such as sales tax, are considered regressive because they impact the poor more significantly than the rich. The NWT payroll tax is proportional because the tax is set at a single rate for all employees on their employment income.

Chart 1 compares provincial/territorial personal income tax paid as a percentage of total income for taxpayers residing in the NWT and five other provinces and territories. Total tax in the NWT and Nunavut includes payroll tax. For example, in the NWT, an individual making under $40,000 pays on average less than 2 per cent of her total income as territorial income and payroll taxes, whereas an individual making between $80,000 and $100,000 pays an average 6 per cent of her total income. Of the five jurisdictions shown, Ontario has the highest personal income tax, while the NWT is among the most progressive.

CHART 1: PROVINCIAL/TERRITORIAL PERSONAL INCOME TAX PROGRESSIVITY



Questions:

- ***Does the existing NWT tax system reflect the goals and priorities of the 16th Legislative Assembly?***
- ***If not, what type of changes could be made to better advance these priorities?***
- ***How should the tradeoffs between issues such as economic growth, population growth, revenue needs, environmental protection, and income redistribution be made?***
- ***How should those who "lose" as a result of these changes be compensated?***

3. Goals for restructuring the NWT tax system without necessarily raising new revenues:

- ✓ **Fairness**: The NWT tax system must recognize taxpayers' ability to pay.

- ✓ **A Strong Economy**: The NWT tax system must be competitive with other Canadian jurisdictions in order to encourage business investment and job creation.

- ✓ **Population Growth:** The NWT's strategy for encouraging new residents and retaining those already here includes continuing work to reduce the cost of living, implementing programs that diversify the economy and encourage NWT residents to enhance their job skills, implementing an immigrant nominee program and a national marketing campaign to promote the NWT and reaching agreement with the NWT's diamond mines to bring more non-residents to the territory. Tax policies that support this strategy encourage economic growth with better-paying, high-skilled jobs, support families and encourage the acquisition of new skills.

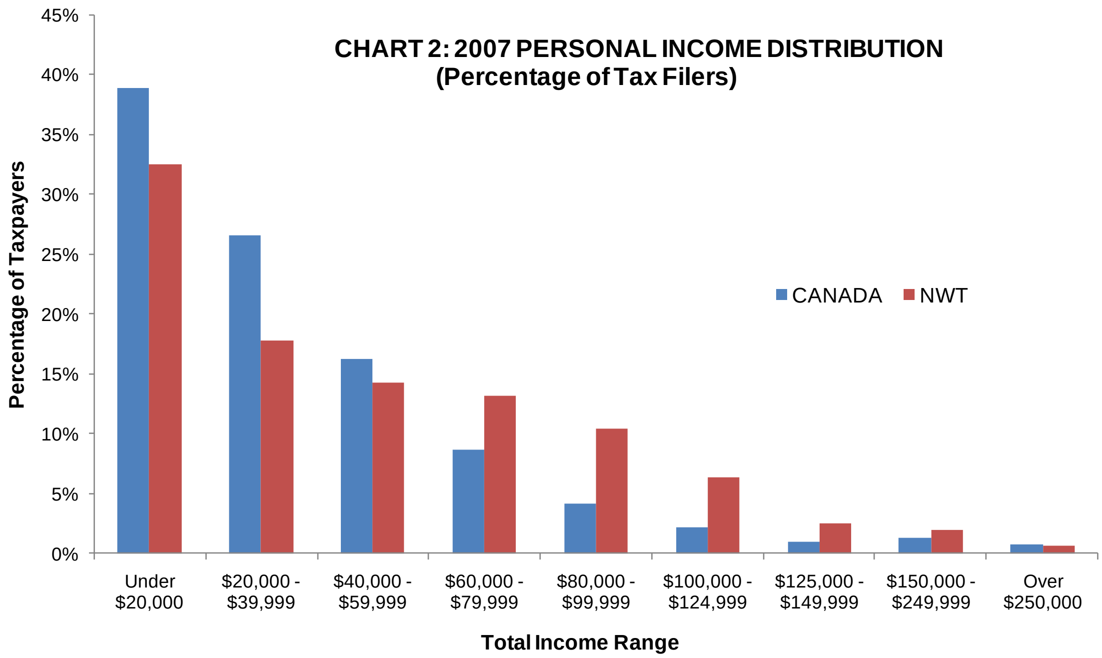
- ✓ **"Green" Choices**: The NWT tax system should encourage individuals and businesses to adopt more environmentally friendly choices in their daily activities.

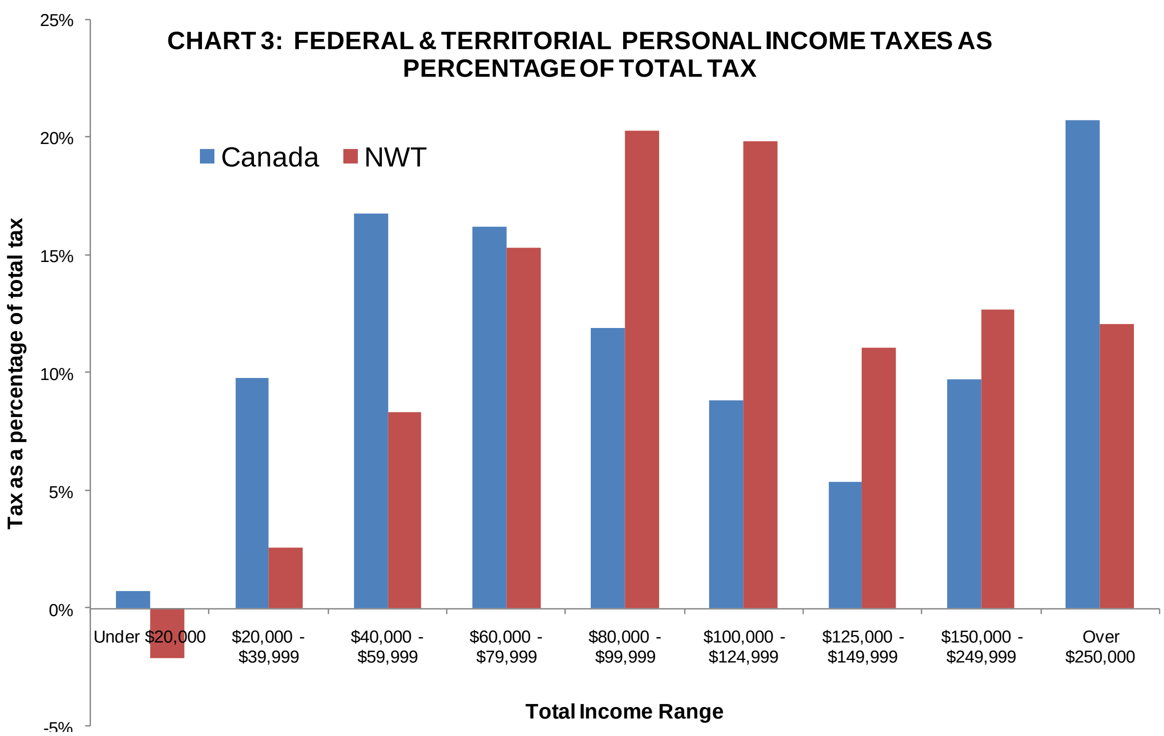
- ✓ **Fiscal Responsibility**: The majority of the GNWT's revenues come from the federal government through the Territorial Formula Financing Grant, but own-source revenues are an important and growing percentage of the GNWT's total revenues. The GNWT must work to balance the need for tax revenues required for government programs and services against the overall tax burden on its residents and businesses.

- ✓ **Social and Economic Benefits:** The NWT tax system should provide incentives for NWT residents to better themselves through education, job training and income growth.

4. Tax burden – who pays the tax

Chart 2 compares the percentage of tax filers in each income range between the NWT and Canada for the 2007 taxation year. Chart 3 compares the tax paid by taxpayers in each income range between the NWT and Canada. This chart shows that 40 per cent of income tax paid in the NWT is paid by those earning between $80,000 and $125,000 per year.





We cannot assume when we make changes to the tax system that those who pay the tax in the first instance will bear the full cost of the change. Determining who ultimately pays the tax is of concern because tax policy measures may have unintended consequences if the incidence of the tax is not considered.

Every time a litre of gasoline is put into a motor vehicle in the NWT, 10.7 cents is collected as fuel tax. However, this does not necessarily mean that the vehicle user is paying this tax. For example, while a private individual may the tax personally, a trucking company or a commercial contractor may be able to pass the tax on to their customers by increasing the price charged for the end product.

This simple example is a reminder that not all taxpayers ultimately pay the tax they were charged. Consumption taxes, such as the NWT fuel tax, are treated as an input cost by businesses and are passed indirectly to consumers through the price of the product or service. A business may also pass the tax indirectly to its employees through lower wages. However, some businesses face limits to their ability to pass on taxes, particularly if they have little control over the final price for their products. For example, because resource commodity prices are set in the global market, taxes on inputs going into their production tend to be absorbed by the producer.

Other consumption taxes such as tobacco tax and the GST/HST are paid by individuals.

Personal income tax is also paid by the individual taxpayer. However, the NWT payroll tax, which is a tax on employment income that is paid by the employee, may be partially absorbed by employers in the form of higher wages if the labour supply is tight.

Determining who pays corporation income tax is even more complicated. Corporate income tax is paid on corporate profit. When individual shareholders receive dividends, they can claim dividend tax credits as compensation for the tax already paid at the corporate level. This credit ensures that the same income is not taxed twice, and that the level of tax is similar on income whether it is earned by a corporation or directly by an individual.

So why tax corporations at all? The main reason is because corporations use government programs and services and should pay for these services through taxation. Taxing corporate income at the source ensures that it does not escape full taxation in the personal income tax system. Not all corporate taxable income flows through to dividends immediately. This could happen when income is not paid out in dividends but reinvested in the corporation. Furthermore, corporate dividends paid to non-residents may not be taxed in the jurisdiction where the corporate income was generated.

In summary, whether a tax is shifted by a business to another taxpayer depends on the extent to which that business can change prices or wages as a result.

Progressivity, as mentioned earlier, is another way of looking at the tax burden (or tax incidence). The total tax system on individuals, including taxes on income and consumption, can be made more progressive with the use of tax brackets, tax credits, deductions from income, and exemptions for specific goods (such as food and utilities) from consumption taxes.

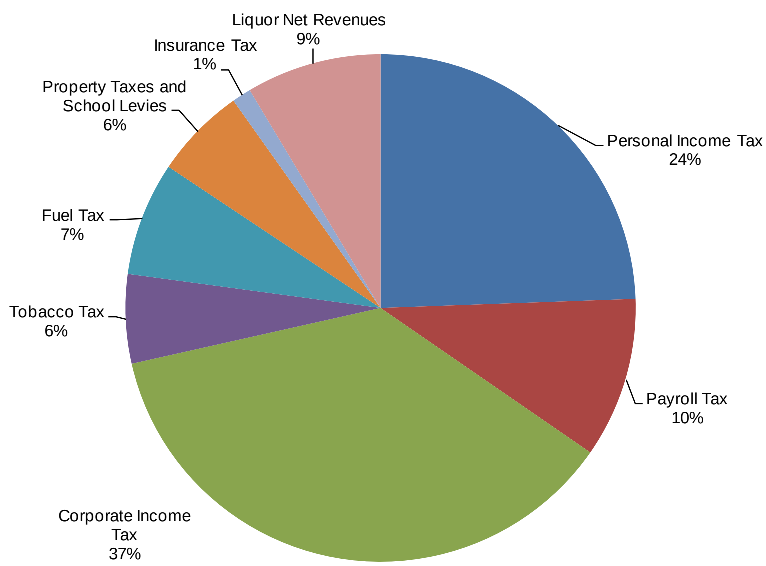
For tax policymakers, establishing who ultimately pays the tax is fundamental to determining the impact and effectiveness of the tax measure.

5. How should NWT tax burden be spread?

Question: What type of changes, if any should be made to better advance the priorities?

Any revenue neutral change to the NWT tax system will result in winners and losers. The key is to determine if changes will help achieve the goals for the tax system, and ultimately advance the goals of the GNWT.

Composition of the GNWT's Tax Revenues – average from 1999-00 to 2009-10



a. Income taxation versus consumption taxation

Many economists are of the opinion that taxes on consumption are better for the economy than taxes on income because the latter discourage saving and investment, whereas the former do not. However, income is generally accepted as an appropriate measure of a person's ability to pay, and given that consumption taxes are not progressive, most tax systems are a combination of the two.

NWT income taxes include personal income tax, payroll tax and corporate income tax. Consumption taxes are fuel tax, tobacco tax, and liquor mark-ups. Some fees and charges could also be considered consumption taxes. The mix varies, but on average since 1999-00, income taxes make up 71 per cent of GNWT tax revenues. Consumption taxes account for 22 per cent of total revenues, and property and insurance taxes make up the remainder.

GST/HST

Question: Should the NWT implement a territorial sales tax to be harmonized with the federal Goods and Services Tax (with corresponding reductions to other taxes)?

The NWT does not have a territorial sales tax.

The federal government has encouraged provinces to harmonize their provincial sales taxes with the Goods and Services Tax (GST) into a single tax (Harmonized Sales Tax or HST) to improve business competitiveness, administration and compliance. In those provinces with a retail sales tax, the HST may be more efficient for several reasons:

1. Reduction in compliance costs for businesses since they are only required to file the combined tax with the federal government.

2. Reduction in administration costs for participating provinces since the combined tax is federally administered.

3. The tax is removed from business inputs. The costs of exports are therefore cheaper, making Canadian businesses more competitive.

British Columbia and Ontario plan to have their retail sales taxes harmonized with the GST on July 1, 2010.

A territorial sales tax combined with the GST would generate a significant amount of revenue for the GNWT (estimated to be $60 million per year if the territorial tax component were set at 8 per cent). The net amount of this revenue would depend on a number of factors, including exemptions, credits and economic conditions. Under conditions of revenue neutrality, other tax rates, such as income tax, combined with new tax credits, could be decreased to compensate for this new revenue.

However, a sales tax, even if offset by lower income tax rates or higher credits, would likely have disproportionate impacts throughout the NWT. Higher prices in remote, or less accessible, communities would mean residents in those communities would pay more in sales tax than those in lower-cost areas. This would not necessarily be offset by income tax reductions.

Introducing a Harmonized Territorial Sales Tax (HST) with Corresponding Reductions in Personal Income Taxes

Advantages:

- Encourages saving and investment
- Staple source of revenue.
- Reductions in personal income tax mean more after-tax income for individuals and families.

Disadvantages:

- Increases the cost of living, especially in higher cost areas.
- Impacts the poor more than the rich, unless tax credits were structured to offset the added tax burden.
- Local businesses could suffer if consumers chose to buy "south" i.e. in Alberta where there is no provincial sales tax.

How the Tax Measure Aligns with the Goals of the 16th Legislative Assembly

Pros:

- Makes for a stronger economy.

Cons:

- An increase in the cost of living, combined with potential negative impact on businesses, would hinder progress toward the vision of the Legislative Assembly.

b. Business income taxes versus individual taxes

Question: Do we want to decrease corporate income taxes and offset the revenue loss through increases in individual personal income taxes or consumption taxes?

In recent years, the federal government has reduced the federal corporate income tax rate, and has announced plans to reduce it further to 15 per cent by 2012. At the same time, it has encouraged provinces and territories to lower their corporate income tax rates to 10 per cent in order to achieve a combined federal/provincial-territorial tax rate of 25 per cent by 2012, which would give Canada the lowest overall tax rate among G7 countries. Alberta has already met this target, while several other provinces have announced plans to reduce their rates to 10 per cent or lower in the next few years.

A lower corporate income tax rate would make Canadian companies more competitive worldwide. The federal government believes that this would encourage companies to invest in Canada, as well as encourage companies that do business in Canada to allocate a fair share of their income to Canada and pay taxes to Canada, the provinces and territories. However lower corporate income tax rates could mean less revenue in total for Canadian governments, even if they encourage business activity.

Currently, the NWT has a general corporate income tax rate of 11.5 per cent. For Canadian-controlled private corporations, the first $500,000 of taxable income is subject to a lower rate of 4 per cent.

In Canada, business income is allocated for tax purposes among provinces and territories based on rules established in the federal *Income Tax Regulations*. In general, half of income is allocated based on sales, while half is allocated based on where wages and salaries are paid. There are special rules for different business sectors, including financial institutions and transportation companies.

Larger companies have significant flexibility to arrange their affairs to allocate some income to lower tax provinces and territories in order to reduce their tax payable. The additional legal and accounting costs in doing this mean it is often not worth pursuing for smaller companies.

Because the NWT tax rates have often been lower than those of other Canadian jurisdictions, the NWT has in the past benefitted from the ability of large corporations to allocate income. As other provinces and territories lower their income tax rates, it is less likely that this will continue to occur.

Decreasing the Corporate Income Tax with a Corresponding Increase in Personal Income Tax or Consumption Taxes

Advantages:

- Promotes business investment, and encourages entrepreneurship.

Disadvantages:

- Increasing personal income tax makes it more difficult to attract new skilled workers to the NWT.
- High personal income tax reduces after-tax money for individuals and families.
- Increasing consumption taxes such as fuel tax adds to the cost of living in the territory.

How the Tax Measure Aligns with the Goals of the 16th Legislative Assembly

Pros:

- Supporting economic development in the territory.

Cons:

- Increasing the cost of living and doing business in the territory could impede efforts to sustain communities.
- High personal income tax does not support population growth since it does not attract in-migration of skilled workers.

c. Resource taxes

The NWT's economy is mainly based on the resource sector. Unlike a province, the NWT does not have the authority to levy royalties on the extraction of natural resources within the territory. However, it can impose a direct tax, such as a mining or oil and gas income tax, on the income earned from these activities. The introduction of a resource income tax requires detailed analysis to fully understand its impacts on the resource industry.

Introducing a Resource Income Tax

Advantages:

- Potential new source of revenue.

Disadvantages:

- May be viewed as "double taxation" of resource development.
- Disincentive to new resource development.

How the Tax Measure Aligns with the Goals of the 16th Legislative Assembly

Pros:

- Supporting effective and efficient government through exploring new potential sources of revenue.

Cons:

- Likely impedes the pursuit of resource revenue sharing with the federal government, a critical component of a strong and independent North.

6. Other tax issues

a. "Goods" vs. "bads"

Question: How much of the tax system should be used to encourage healthy lifestyles?

Tax policy can be directed at encouraging certain types of behaviour or activities that are deemed socially beneficial or desirable. For example, contributions to a Registered Retirement Savings Plan are tax-deductible to encourage citizens to save for their retirement. The NWT intends to implement a 25 cent per bag levy on disposable shopping bags to encourage the use of reusable bags in order to reduce the amount of plastic bags going into landfills.

Similarly, tax policy can be applied to discourage behaviours or activities that are judged socially undesirable, such as alcohol or tobacco consumption. "Sin" taxes are regressive because they tend to fall most heavily on low-income consumers. Imposing taxes on such products can discourage their use. However, evidence suggests that the greater the tax burden on these products, the higher the risk of smuggling and illicit trade. Rather than discouraging use, high taxes can drive consumption "underground" where it is much more difficult to regulate or control. A 2008 national study by GfK Research Dynamics, a market research firm, estimated that illegal cigarettes accounted for 48 per cent of the Ontario market and 40 per cent of the Quebec market, despite relatively low tobacco taxes in these provinces.

These examples highlight the trade-off in tax policy design: while considerations of equity or a desire to nudge people toward making healthy decisions might be something that could conceivably warrant vigorous tax measures, economic reality and the need to avoid excessive and potentially highly damaging distortions in the economy require that tax initiatives not be unreasonably onerous or extreme.

A tax on junk food has been advocated to encourage healthy choices in eating that reduce obesity and chronic disease while generating revenue. Candy and soft drinks typically contain large amounts of sugar, and have little nutritional value and are often blamed by health officials for the poor nourishment and dental health of many NWT residents. A tax on junk food might reduce their consumption and encourage the substitution by more nutritious foods.

The tax could be imposed on the retail price of candy, soft drinks and other snack foods as defined for the purposes of the federal GST, in order to make the administration of the tax easier for retailers.

The administrative cost of a tax on candy and soft drinks for both the retailers and the government would be high relative to its revenue yield. Every NWT retailer selling these products would have to collect the tax. These administrative costs would likely be added to the cost of all groceries.

Further Increasing Taxes on Products Considered "Bad"

Advantages:

- Increases in tax rates on products such as tobacco and alcohol would discourage consumption of these products and help improve the health of NWT residents.
- Lower alcohol consumption would help reduce crime and other social problems.

Disadvantages:

- Increased incentive for smuggling and tax evasion.
- Increased enforcement costs.
- May be seen as unfair because they target citizens who make one or two specific consumption choices rather than the public at large.
- A disproportionate share of an increase in tax revenue would come from low-income individuals.

How the Tax Measure Aligns with the Goals of the 16th Legislative Assembly

Pros:

- Improve health of NWT residents.
- Increased tax revenue would better allow the GNWT to fund programs for education, communities and environment.
- Reduced alcohol consumption would make for safer communities.

Cons:

- Increased tax rates would raise retail prices and reduce some people's choices.

b. Environmental concerns

Questions:

1. ***How can the NWT tax system discourage activity that is environmentally harmful?***
2. ***Should the NWT have a carbon tax?***
3. ***Should the NWT have a cap and trade system?***

In recent years, increasing focus has been paid to the issues of global warming and climate change. Some governments have responded to these concerns through measures such as carbon taxes, user fees on plastic bags and plastic containers, and personal income tax credits for the use of public transportation. These taxes and fees require that consumers pay when they undertake certain activities or use certain products. Tax credits, on the other hand, do not attempt to punish people for their behaviour; rather, the credits are a reward for changing behaviour to one that is deemed more acceptable. These tax credits, as expenditures, must ultimately be offset with some form of higher taxes on everyone, regardless of whether he or she claims the credits.

Although the goal of both approaches is to encourage more environmentally friendly behaviour, there can be large differences in terms of administrative requirements and enforcement difficulties that should be considered.

Carbon tax

Concerns over climate change have led policymakers in many countries to take actions to reduce the greenhouse gas emissions, and to encourage investment in clean energy. These measures include the introduction of carbon taxes based on the carbon content of a fuel being consumed.

A comprehensive carbon tax, such as British Columbia's, would apply to the consumption of any fossil fuel, including oil, gasoline, diesel fuel, natural gas, propane, butane, coal, and wood.

A carbon tax could apply to the following products or uses that are not currently taxed in the NWT under the *Petroleum Products Tax Act*:

- natural gas for heating, electricity generation, pipeline compressors, or motor vehicles;
- fuel for residential, commercial or industrial heating;
- propane for heating, cooking, and powering motor vehicles; and
- wood for heating.

Exempting any carbon-based fuel by type, activity or user would move away from the general application of a carbon tax and become a targeted tax, similar to the current fuel tax.

A carbon tax that does not significantly change the retail price will likely do little to change carbon emissions. The National Round Table on the Environment and the Economy (NRTEE) 2007 report, *Getting to 2050: Canada's Transition to a Low-Emission Future,* stated that a tax in the range of $190 to $240 per tonne of carbon dioxide equivalent would be required to attain an emission reduction of 45 per cent from 2005 levels by 2050. This would translate into an additional cost of about 50 cents per litre for gasoline and other fuel.

The NWT is highly dependent on fossil fuels. Diesel fuel is the primary heating fuel, and it is also the largest source of electricity generation in the NWT. Most goods in the NWT must be transported over long distances. Although in the longer term a carbon tax may provide an incentive to use other, more environmentally benign sources of energy, there are currently few short-term alternatives to using fossil fuels in most NWT communities. A carbon tax would increase the cost of living for NWT residents as well as the cost of doing business in the NWT.

A NWT carbon tax could be made "revenue neutral", that is, other taxes could be lowered to offset the higher tax burden on fuel consumption. However, the tax reductions would not necessarily benefit those who would bear the burden of the carbon tax. For example, decreases in personal income and corporate income tax rates similar to the rate reductions planned in British Columbia would largely benefit those currently paying those taxes (mid to high-income earners, primarily in larger centres). This may not provide the necessary offset to those who would bear the largest share of the carbon tax (heavy users of fuel for heating and electricity, particularly those in small, remote communities of the NWT). Furthermore, given that the GNWT subsidizes fuel costs for some consumers, the impacts on the GNWT itself would require analysis.

Further analysis would be required to determine the incidence of an NWT carbon tax. Appropriate measures would then need to be developed to reduce disproportionate impacts.

Introducing a Carbon Tax with Corresponding Reduction in Personal Income Taxes and New Tax Credits

Advantages:

- A consumption tax to fight climate change.

Disadvantages:

- Increases the cost of living and doing business in the territory.
- Impacts people with lower-incomes more than those with higher incomes.
- Impacts remote communities more than larger centres.

How the Tax Measure Aligns with the Goals of the 16th Legislative Assembly

Pros:

- The new tax would encourage individuals and businesses to reduce their fossil fuel consumption in order to mitigate climate change. The tax would help to protect the environment for future generations.

Cons:

- Increasing the cost of living and doing business in the territory could impede efforts to sustain smaller communities.

Cap and Trade

A cap and trade system sets limits on the greenhouse gas emissions linked to global warming per compliance period. Over time, these limits become stricter, allowing less and less pollution, until the ultimate reduction goal is achieved. The total emissions allowed under the cap are divided into credits, or allowances. The system identifies companies (emitters) that are required to comply with the overall emission target for each reporting period. Each emitter is then assigned a specific number of credits, either free or though auctioning. Emitters whose emissions exceed their credits can avoid penalties for non-compliance by purchasing unused credits from other emitters. The less polluting emitters can either sell their surplus credits in the marketplace or bank them for future use in future compliance periods.

In June 2009, Environment Canada released a draft document for public comment on Canada's Offset System for Greenhouse Gases. As a voluntary program administered under the *Canadian Environmental Protection Act, 1999*, the proposed system would offer offset credits to registered projects that prove their reductions in greenhouse gases. Each offset credit would represent one tonne of carbon dioxide equivalent reduced or removed, and could be traded in the market.

Rather than waiting for the national strategy on the cap and trade system, British Columbia, Ontario, Manitoba, and Quebec have joined the US Western Climate Initiative's system (WCI). Formed in 2007, the WCI consists of these four Canadian provinces and seven western US states (Washington, Oregon, California, Arizona, Montana, Utah, and New Mexico). Observers to the organization include Saskatchewan and several US and Mexican states. The WCI plans to launch its cap and trade system in 2012.

The NWT is a very small jurisdiction, with only a few major emitters, all from the resource sector. It is unlikely that a market for trading carbon credits could be developed in a small jurisdiction like the NWT. Should it join the WCI or wait for a national strategy? While the cap and trade system could support the goals of protecting the environment, an analysis of its feasibility in the NWT would be required.

c. Other fees and charges

Questions:

1. ***Should fees and licenses be increased?***
2. ***Should new user charges be introduced?***

Revenues from fees and charges for the GNWT amount to about $17 million annually. The GNWT imposes fees and charges for licensing and regulatory services, and for some services that are justified on a user pay basis. The current policy for charging fees and licences provides that charges for a service to the public should recover the full direct and indirect cost of the service, unless full cost recovery in the case of a fee or charge for a regulatory service is not warranted, the collection costs would constitute most of the revenue collected, or there is justification to set rates to promote social or economic goals.

Because of high costs and low volumes, it is sometimes not feasible to cover the full cost of services.

Many GNWT fees have not been increased for many years, and inflation has reduced their real revenue yield. For example, inflation since 1999 has increased prices by 23 per cent. This means that a fee that has not increased since then has lost 19 per cent of its value.

In the 2009 Budget, the Minister of Finance announced that the GNWT has initiated a review of its fees and changes would be made to financial policies to ensure that fees keep pace with inflation.

d. Property tax

The GNWT is responsible for collecting property tax in the General Taxation Area (GTA). It also establishes the education mill rate for the municipalities of Hay River, Fort Smith, Fort Simpson, Norman Wells, and Inuvik. In the GTA, the 2009 property tax on hydrocarbon, mineral, and pipeline properties was increased by 30 per cent (equally divided between the general and education portion) while other property classes were increased 15 per cent in the education portion only. This is the first GTA property tax increase since 2003.

Question: In order to minimize large increases in any one year, should the GNWT annually adjust the property tax rates to ensure they grow at least in line with inflation?

7. Conclusion

The NWT tax system is there to raise revenues to fund government programs and services but can be used to serve other purposes as well.

The GNWT is seeking the views of NWT residents and stakeholders to help ensure that the NWT tax system is competitive, is able to fund essential programs and services and works to achieve the goals set out by the members of the 16th Legislative Assembly.

A number of options discussed in this paper would require considerably more research and analysis before any changes could be brought forward and implemented.

This paper is available on the Department of Finance's web site at www.fin.gov.nt.ca. This paper will be translated into other official NWT languages on request.

You can submit your comments on NWT revenues:

By mail to:
Revenue Options Consultations
Fiscal Policy Division, Department of Finance
Government of the Northwest Territories
PO Box 1320 L-5
Yellowknife, NT X1A 2L9

Or by e-mail to:
Revenue_Options@gov.nt.ca

8. APPENDIX – The NWT Tax System

Income Taxes on Individuals

Personal Income Tax

Taxpayers in the NWT pay income tax to two levels of government: the federal government and the GNWT. Tax is levied on taxable income, which is equal to the total income less deductions and exemptions. A range of tax credits is available to offset part, and in some cases all or more, of the tax owed.

The NWT's personal income tax is imposed on an individual's taxable income in the NWT as determined under the federal *Income Tax Act* and *Regulations*. An individual is considered a resident of the NWT for income tax purposes if he or she lives in the NWT on December 31 of a given tax year. Most income is taxed by the province or territory in which the individual is considered to reside.

The NWT has a progressive income tax structure. A progressive tax structure imposes a proportionately lower tax burden on low-income taxpayers and a proportionately higher tax burden on higher income taxpayers. The NWT imposes higher tax rates on higher-income taxpayers by placing taxable income into four ranges. The NWT's income tax regime is more progressive than the federal system or most provincial income tax systems.

For example, an individual with taxable income of $80,000 will pay $6,108 in tax before credits: 5.9 per cent of the first $36,885 ($2,176), 8.6 per cent of the next $36,887 ($3,172) and 12.2 per cent of the remaining $6,228 ($760) or 7.6 per cent. An individual with taxable income of $30,000 will pay 5.9 per cent of that amount, or $1,770, before credits are included. Once credits are taken into account, the difference in average tax rates will be higher.

The detailed parameters of the personal income tax system – including both the federal and NWT components – are highlighted in the following table.

The NWT personal income tax rates are among the lowest in Canada for low income individuals. Lower territorial tax rates compensate partly for the fact that higher northern living costs result in territorial residents paying a larger portion of their real income in federal tax than residents earning the same real income in southern Canada.

The NWT personal income tax rates were last changed in 2005 when tax rates on the first two tax brackets were lowered and the tax rates on the highest two tax brackets were increased.

Personal Income Tax Structures

Federal and NWT Personal Income Tax Rates, Tax Brackets and Non-Refundable Tax Credits

	2009	
	Federal	**NWT**
Tax Rates (%)		
1st	15	5.9
2nd	22	8.6
3rd	26	12.2
4th	29	14.05
Tax Brackets		
1st	$40,726	$36,885
2nd	$81,452	$73,772
3rd	$126,264	$119,936
Amounts		
Basic personal amount	$10,320	$12,664
Spousal amount	$10,320	$12,664
Equivalent to married amount	$10,320	$12,664
Age amount	$6,408	$6,195
Disability amount	$7,196	$10,270
Caregiver amount	$4,198	$4,198
Infirm dependent amount	$4,198	$4,198
Pension income amount	$2,000	$1,000
Tuition & education transfer amount	$5,000	$5,000
Charitable donations (%)		
- first $200	15	5.9
- over $200	29	14.05
Education amounts in addition to tuition		
- part time (per month)	$120	$120
- full time (per month)	$400	$400
Dividend Tax Credit (percentage of grossed up dividends)		
Large corporations	18.96	11.5
Small corporations	13.33	6

The Cost of Living Tax Credit

The Cost of Living Tax Credit was introduced in conjunction with the Payroll Tax in 1993 to partially offset the cost-of-living impact of the Payroll Tax. This credit has increased several times since 1993. The last increase was made in 2005 to partially offset the impact of increasing the Payroll Tax rate from 1 per cent to 2 per cent.

A tax filer's 2009 Cost of Living Tax Credit is calculated in accordance with the following schedule.

Income Range	Current Rate
$0 to $12,000	2.60 %
$12,001 to $48,000	1.25%
$48,001 to $66,000	1.00%
$66,001 and above	0.00%

A Cost of Living Tax Credit is available each year, based on the information contained in an individual's income tax return. The minimum credit for individuals is $350; the minimum credit for couples is $700. As indicated in the table above, the maximum credit is reached when income reaches $66,000, at which point the amount of the credit is the maximum of $942.

Payroll Tax

The NWT Payroll Tax is 2 per cent of an employee's employment income in the NWT.

It is estimated that a significant portion of the NWT workforce does not live in the territory or pay income tax to the GNWT. The Payroll Tax was introduced in 1993 in order to ensure all workers in the NWT, including non-residents who benefit from the extraction of NWT resources, contribute to the cost of providing services in the territory.

Because the Payroll Tax is levied on only one type of income – employment income – it effectively increases the tax burden on employees compared to the self-employed, pensioners or individuals earning investment income, even for individuals in similar economic circumstances.

Taxes on Business

Corporate Income Tax

A corporation's taxable income in the NWT, as determined under the federal *Income Tax Act* and *Regulations,* is subject to NWT Corporate Income Tax.

The NWT taxes large corporations at 11.5 per cent of taxable income. Small corporations - income up to $500,000 earned by Canadian-controlled private corporations - are taxed at 4 per cent. Most of the NWT's Corporate Income Tax revenues come from large corporations.

Consumption Taxes

Sales taxes represent a significant source of revenue for many provincial governments. The federal government levies the Goods and Services Tax (GST) and most provinces either levy a retail sales tax or have harmonized their sales taxes with the GST.

The NWT has never had a sales tax.

Fuel Tax

The consumption of gasoline and diesel fuel in the NWT is taxed under the authority of the *Petroleum Products Tax Act*.

Current NWT fuel tax rates are:

Gasoline (on highway)[1]	10.7 ¢ per litre
Gasoline (off highway)[1]	6.4 ¢ per litre
Diesel (motive)	9.1 ¢ per litre
Diesel (non-motive)[2]	3.1 ¢ per litre
Rail	11.4 ¢ per litre
Aviation	1.0 ¢ per litre
Heating fuel	0.0 ¢ per litre

[1]On-highway refers to communities served by the NWT highway system. The off-highway rate applies in communities not served by the NWT's all-weather roads.
[2]Non-motive applies primarily to the generation of electricity.

The NWT gasoline and motive diesel tax rates are among the lowest in Canada. There is no NWT tax levied on fuel used for heating, propane, or natural gas. The NWT is one of the few jurisdictions where non-motive diesel fuel used in power generation and by the mining industry is taxed.

Tobacco Tax

The consumption of tobacco in the NWT is subject to taxation under the *Tobacco Tax Act*,

The cigarette tax rate is currently $53.20 per carton, the highest of any province or territory. The most recent tax rate increase took place on April 1, 2009, when the tax rate was increased to its current level of $53.20 per carton, up by $11.20 per carton from the previous level of $42 per carton. Prior to the April 1, 2009 increase, tobacco taxes had not changed since April 1, 2003.

The current NWT tobacco tax rates are:

Cigarettes	$53.20 per carton
Cigarette Tobacco	14.6 ¢ per gram
Other Tobacco	14.6 ¢ per gram
Cigars	75% of the suggested retail price in Yellowknife

Insurance Tax

The GNWT levies a tax of 3 per cent on all insurance premiums and an additional 1 per cent on fire insurance premiums. All provinces and territories in Canada levy taxes on insurance premiums. The NWT's rates are close to national averages.

Liquor Revenues

The GNWT applies a flat per-litre liquor mark-up based on the type of liquor sold.

Because beer, wine and spirits revenues are raised in different ways in different provinces and territories, it is difficult to compare the NWT mark-ups with other jurisdictions'. In general, however, liquor prices, sales, and government revenues per capita are higher in the NWT than in other jurisdictions. However, because of the NWT's flat mark-up system, a few high-priced products cost less in the NWT than in other areas of Canada.

The NWT's current liquor mark ups are as follows:

Beer	$2.10 per litre
Wine	$8.46 per litre
Spirits	$28.42 per litre

The formula used by the NWT Liquor Commission to determine prices starts with the mark-up for each category and adds supplier, freight, administration and store costs to calculate a unique price for each store location. No subsidies are involved as the price in each store reflects the full cost of bringing the product to that store. Prices in Yellowknife are set by the Liquor Commission at the wholesale level and Yellowknife store operators set their own retail prices.

Licensees are charged an additional fee of 5 per cent.

Liquor mark-ups were increased by 10 per cent on April 1, 2009. Prior to this change, the last mark-up increase was April 1, 2003.

Other Taxes

Property Tax

The GNWT raises revenue by taxing real property located in the NWT.

Property tax revenue for both general and education purposes in the General Taxation Area.

The NWT's six tax-based communities (Yellowknife, Fort Smith, Fort Simpson, Hay River, Inuvik and Norman Wells) – known as Municipal Taxation Authorities – are responsible for collecting their own municipal property taxes. Yellowknife collects property taxes for itself and the two Yellowknife school boards. The five other Municipal Taxation Authorities (MTAs) collect property tax for education on behalf of the GNWT.

Under the "New Deal" for Community Governments, non-tax-based communities will become MTAs by 2014. As taxing authorities, they will have complete control on raising local (municipal) property taxation to meet their own needs and priorities.

Property tax rates for the General Taxation Area, hydrocarbons, minerals and pipelines are set annually by order of the Minister of Finance. The Minister of Finance also determines the education tax mill rates for the General Taxation Area and all MTAs, with the exception of Yellowknife. The Minister of Finance does not determine Yellowknife's education tax mill rate, or property tax mill rates in any of the MTAs communities.

In 2009, the mill rates applicable to hydrocarbons, minerals and pipelines properties, as well as the education mill rate for all properties in the General Taxation Area, were adjusted so as to increase revenues from these sources by 15 per cent. Prior to these adjustments, the general and education mill rates had not changed since 2003 and 2000, respectively.