



BACKGROUND – Strategic elimination of the Payroll Tax

With the provincial budget set to be announced on Tuesday, the St. John's Board of Trade is releasing information to support its advocacy work to eliminate the Health and Post-Secondary Education Tax, commonly referred to as the payroll tax.

BACKGROUND

The payroll tax is payable by employers whose annual remuneration in this province exceeds a pre-determined exemption threshold. The rate for the tax is two per cent. Since January 1, 2008, the exemption threshold has been \$1 million for all employers. This means that employers who pay their Newfoundland and Labrador employees more than \$1 million must pay a tax on payroll above the \$1 million threshold.

THE CHALLENGE

The payroll tax adds a tax onto a larger payroll. A larger payroll is created when a group of employees make more money or an organization hires more people, or a combination of the two. This does not provide an incentive to hire more people or pay higher wages and salaries; it is also a disadvantage to locating in the province.

BENEFITS OF ELIMINATION

One Texas economist's analysis estimated that reducing the payroll tax by just 10 percentage points would increase employment by 10% in the long run.

One example illustrates positive effects: a Board of Trade member whose business meets the \$1 million payroll threshold has a stated desire to hire additional administrative support with the money he would save if he did not have to pay the payroll tax. These staff would help him run a more effective and efficient labour-intensive business and deliver higher quality service to his clients and the people they serve.

The overall effect: more people employed, a more effective employer and better service to local clients and their customers.

NEGATIVE EFFECTS

There are a number of current and potential negative effects for businesses and other organizations while the payroll tax remains in effect:

- Decreases motivation to hire additional staff
- Decreases motivation to invest more in wages and salaries
- Increases motivation to consider other provincial jurisdictions for locating employees, especially higher paid employees (such as management and other decision-makers)

- Increases motivation to work with partners in other jurisdictions due to lower costs of labour

There are also other trickle-down potential effects:

- Less personal income tax available due to jobs moving to other jurisdictions
- Less corporate income tax due to smaller offices and payroll in high payroll tax jurisdictions
- Fewer job opportunities for youth
- Local companies not being able to compete with outside businesses for work within Newfoundland and Labrador because of the costs

The example above also illustrates negative effects: a Board of Trade member who was approached by a former Premier in another jurisdiction, encouraging him to move his operations out of Newfoundland and Labrador because of the added costs of payroll tax. This individual has a stated desire to hire additional staff. This business leader is also an active volunteer and philanthropist; if he moved his operations to another jurisdiction, he would be a part of another community and support that community's social sector.

The overall effect: fewer jobs in this province, an inability to hire new staff, and the loss of volunteer hours and funds in the broader community.

GOVERNMENT OPTIONS

The provincial government has, in the past few years, increased the threshold at which the tax applies, and currently only payrolls above \$1 million are subject to the tax.

Financially, the province has limited options:

- Enhance and expand expenditure controls;
- Tax something other than jobs; or
- Absorb the cost in the existing budget, recognizing the success other places have had in the medium term with economic payback

OTHER JURISDICTIONS

Finland

An experiment in Finland temporarily removed taxes on jobs in a target area between 2003 and 2005; this reduced payroll taxes by 4.1% on average. About half of the effect of the payroll tax reduction was offset by faster wage growth in firms that were eligible for the tax cut and a rise in employment of 1.3% was also observed in the experimental group.

[Reference: Author: Korkeamaki, Ossi; Title: Employment and wage effects of a payroll-tax cut-evidence from a regional experiment; Journal: International Tax and Public Finance, Vol. 16, Issue 6; Date: 2009-12-01; Pages 753-772]

Chile

Chile's payroll tax dropped 25% over six years; the reduced cost of payroll tax appears to have fully passed on to workers in the form of higher wages, though with little effect on employment.

[Reference: Author: Gruber, Jonathan; Title: The Incidence of Payroll Taxation: Evidence for Chile; Journal: Journal of Labor Economics; Vol. 15, Issue 3; Date: 1997; Pages S72]

Spain

Spanish reform in 1997 reduced the payroll tax 40-90%, increasing the number of permanent contracts and the conversions from temporary to permanent contracts. Estimates suggest that the reform increased permanent employment probabilities, particularly for young workers. [Reference: <http://www.recercat.net/bitstream/2072/796/1/651.pdf>; Title: Employment Consequences of Restrictive Permanent Contracts: Evidence from Spanish Labor Market Reforms; Authors: Adriana Kugler, Universitat Pompeu Fabra, CEPR and IZA; Juan F. Jimeno, Universidad de Alcal, FEDEA, CEPR and IZA; Virginia Hernanz, Universidad de Alcal]

IMPACT ON COMPETITIVENESS

Newfoundland and Labrador's payroll tax can be, and has been used, by other jurisdictions to attract and retain investment and business. While the overall income tax system in this province is competitive, other jurisdictions can rightly or wrongly point to the payroll tax as a reason not to invest and grow in Newfoundland and Labrador.

Other jurisdictions are trying to keep their local businesses while competing for the attention of national and multi-national businesses. There is a need to prevent other provinces and places from saying to Newfoundland and Labrador's existing businesses or businesses thinking about setting up in this province 'the jurisdiction you are operating in levies taxes on the creation of jobs and wealth'.

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