ATLANTIC INSTITUTE FOR MARKET STUDIES

Policy Paper

# I'll Take New England Any Day!

## Tax Competitiveness: New England and Atlantic Canada Compared

**Dr. Mark Milke**

*Halifax, Nova Scotia*

*March 2016*

## The Atlantic Institute for Market Studies (AIMS)

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By Dr. Mark Milke

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# Executive Summary

This report analyzes the differences in major tax rates between Atlantic Canada and its nearest regional competitor — the New England states — for investment, jobs, and tax revenues. In general, these six U.S. states have a significant tax advantage on most measurements.

## Low- and High-Income Brackets

State income tax rates in New England are mostly lower than provincial income tax rates in Atlantic Canada. For example, in 2015, the lowest provincial income tax bracket threshold in the Atlantic provinces was set at 7.7 per cent (Newfoundland and Labrador), and the highest at 25.75 per cent (New Brunswick). In contrast, in New England, the lowest bracket was zero (New Hampshire), and the highest 8.95 per cent (Vermont). As of early 2016, Nova Scotia has the highest provincial income tax bracket in Atlantic Canada, at 21 per cent.

## Top Marginal Income Tax Thresholds

In Atlantic Canada, the threshold at which provincial income tax applies is significantly lower, and thus less generous, than most New England state tax thresholds. For example, in 2015, top marginal provincial income tax rates were applied at ranges between $63,969 in taxable income (Prince Edward Island) and $250,000 (New Brunswick). In early 2016, the New Brunswick budget reduced the top provincial income tax rate, and decreased the top threshold. Atlantic Canada's top marginal provincial income tax rate now applies at $150,000 for both New Brunswick and Nova Scotia.

In contrast, south of the border, New Hampshire does not tax earned income at all, while three New England states apply a top marginal rate of tax at significantly higher income levels than in Atlantic Canada. Massachusetts applies a single rate of tax to all taxable income; Maine has two brackets, the second of which begins at $26,899; and the other three states vary from $177,170 (Rhode Island) to $529,645 (Vermont). (Figures in Canadian dollars.)

## Sales Taxes

Sales taxes are also higher in Atlantic Canada. With the 5 per cent federal goods and services tax portion removed from the harmonized sales tax, provincial sales taxes in Atlantic Canada ranged from 8 per cent (Newfoundland and Labrador) to 10 per cent (Nova Scotia and New Brunswick, the latter from 8 to 10 per cent as of July 1, 2016). The range in New England was zero (New Hampshire) to 7 per cent (Rhode Island).

## Corporate Taxes

Atlantic Canada's provincial corporate tax rates for small businesses range from 3 per cent to 4.5 per cent, lower than the small business rate in the New England states except for Maine and Vermont. However, the general corporate income tax rate in New England ranges from 7.00 per cent to 8.93 per cent, almost half the standard corporate rate in Nova Scotia and Prince Edward Island (both at 16 per cent) and also significantly lower than in New Brunswick and Newfoundland and Labrador (14 per cent).

## Higher Personal Income Taxes for Atlantic Canadians in 2016

As of 2016, an additional federal 33 per cent tax bracket on personal income and selected other changes will result in further competitive tax challenges for Atlantic Canadians compared with neighbours in New England. Two New England states (Massachusetts and Maine) have reduced tax rates on income, three states (New Hampshire, Rhode Island, and Vermont) will see no change in their top marginal rate, and one state (Connecticut) has added a new top bracket. In contrast, in Atlantic Canada, three of the four provinces will see higher marginal rates due to federal tax changes.

For example, the lowest top marginal personal income tax rate in New England in 2016 is New Hampshire's, at 39.6 per cent (which is the top U.S. federal rate), compared with a top marginal rate of 54 per cent in Nova Scotia (combined provincial and federal). New Brunswick has reduced its top marginal rate in response to the federal increase, but it will still be 53.3 per cent in 2016.

## Recommendations

Atlantic Canada's provincial governments should consider the following options as a "road map" to allow for fiscal room for tax reductions in the region:

- Allow for further resource exploration and development, including onshore exploration and the development of natural gas, which has proved a boon to revenues owing to economic and job growth in other jurisdictions, such as Pennsylvania and Saskatchewan — "off" years notwithstanding.

- Tax reform to unleash untapped economic opportunities by moving to a simpler, lower and flatter income tax code with emphasis on lowering taxes on investment and job creators.

- Revisit existing spending envelopes in provincial budgets with an eye to better value-for-money expenditures and to creating room for tax reductions as part of the tax reform initiative.

The combination of new energy economic development and more carefully controlled spending would result in more revenues from an expanded corporate, personal and natural resource tax base, and free up budgetary room to reduce Atlantic Canada's high taxes, which place the region at a significant economic disadvantage with respect to its neighbours on tax rates and tax levels by almost every comparison.

# Introduction

As reports and books from the Atlantic Institute for Market Studies (AIMS) have noted since the organization's inception, the Atlantic provinces face continuing challenges in their attempts to become economically prosperous.

The challenges seemingly come from all directions: federal equalization and employment insurance policies that inadvertently hamper market-based economic realities, and thus market-based economic development on the east coast; high government spending and compensation levels that crowd out private sector hiring where employers cannot match what government pays; labour market policy that has been distorted, leading to the requirement that temporary foreign workers be used despite the region's high unemployment rates; overly interventionist economic policy that attempts to pick "winners" and "losers" in sectors and among specific businesses; and recent bans on onshore energy exploration that have lessened both the region's potential for economic growth and the additional tax revenues that would have flowed to provincial governments (Boessenkool 2002; Eisen and Milke 2014; McMahon 1996, 2000a, 2000b; Milligan 2015; Murrell 2005; Murrell and Winchester 2006).

This report focuses on the consequences of these challenges for tax rates in Atlantic Canada — that is, on the costs governments impose on the residents of the Maritime provinces and Newfoundland and Labrador. In particular, the report looks at personal tax rates — including the generosity (or lack) of basic personal exemptions from provincial personal income tax — the range of tax brackets applied to corporate income as well as, lastly, sales tax rates.

An Atlantic province's ability to succeed and prosper — in attracting private sector investment, creating jobs, and increasing wages and salaries and even its tax revenues — depends on its affordability and attractiveness relative not just to other provinces but also to competitive tax jurisdictions on the east coast of the United States. Although some taxes are obviously necessary, a jurisdiction's relative tax competitiveness matters, as taxes are real costs for residents and businesses. Tax levels that are too high can impede investment, entrepreneurial activity, and, ultimately even, dampen government revenues.

Following in the tradition of past analyses from AIMS, this report compares the six neighbouring New England states — Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont — with the provinces in Atlantic Canada. As the report make evident, Canada's east coast provinces face a significant tax competitiveness gap with New England. By almost every measure, with reference to these government-imposed costs that affect not only the daily lives of citizens, but also the attractiveness of a jurisdiction for investment and job creation, the New England states are less expensive for individual taxpayers and businesses alike.

# Comparison 1:

# Personal Income Tax — The Basic Personal Amount

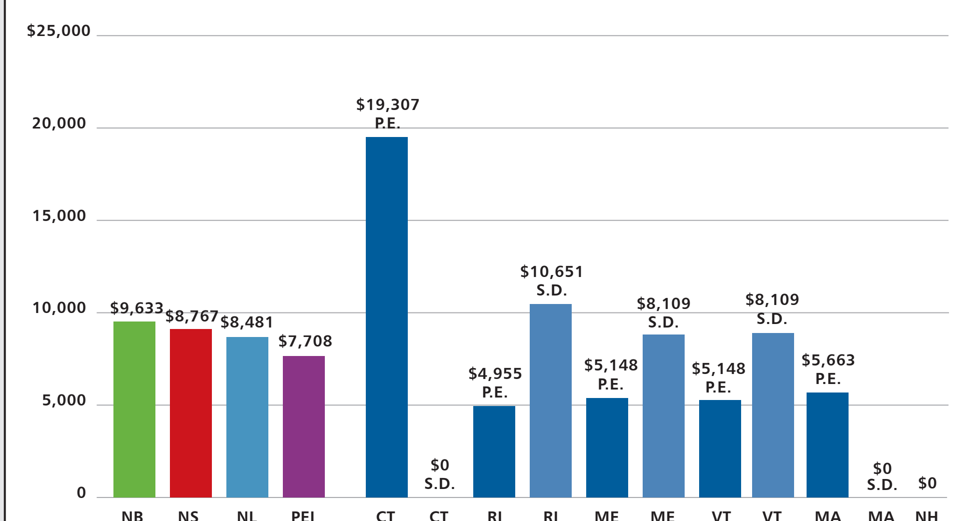
In Canada, in assessing personal income tax, both the federal government and the provinces provide a non-refundable tax credit called the Basic Personal Amount that lowers any income tax payable. Amounts vary — in 2015 the federal Basic Personal Amount was $11,327; in the Atlantic provinces, it ranged from $7,708 in Prince Edward Island to $9,633 in New Brunswick (Figure 1). A similar tax credit is provided at the federal level in the United States ($8,109 in 2015),[1] but some New England states, such as New Hampshire, do not tax personal income at all.[2] Others offer a generous standard deduction or a personal exemption or both, which helps to shield personal income from tax.[3] In 2015, the standard deduction ranged from $8,109 (Maine and Vermont) to $10,651 (Rhode Island), while the personal exemption ranged from $4,955 (Rhode Island) to $19,307 (Connecticut). With these generous exemptions from state income tax, the New England states have the advantage over the Atlantic provinces.

FIGURE 1

**Atlantic Canada and New England Compared: Basic Personal Amount/Standard Deduction/ Personal Exemption***

(Relative to provincial/ state income tax where applicable**)

CA$/2015




*Converted to Canadian dollars where applicable.

**New Hampshire taxes dividend and investment income only and not earned income.

Sources: Bank of Canada 2016; Canada Revenue Agency 2015a, 2015b, 2015c, 2015d; Walczak 2015.

# Comparison 2:

# Personal Income Tax — Brackets, Range, and Reach

Beyond personal exemptions from provincial or state income tax, tax rates, of course, are another factor that determine personal income tax payable. In 2015, in Atlantic Canada, the lowest income tax rate was 7.7 per cent (Newfoundland and Labrador) and the highest was 25.75 per cent (New Brunswick). In contrast, in New England, the lowest rate of state tax on personal income was zero (New Hampshire) and the highest was 8.95 per cent (Vermont) (Figure 2, panels a and b). As of early 2016, following some tax reductions in the New Brunswick budget, the highest tax rate was in Nova Scotia, at 21 per cent.

**FIGURE 2a**

**Range of Provincial/State Personal Tax Rates - *Lowest***

(On *taxable* income)

2015

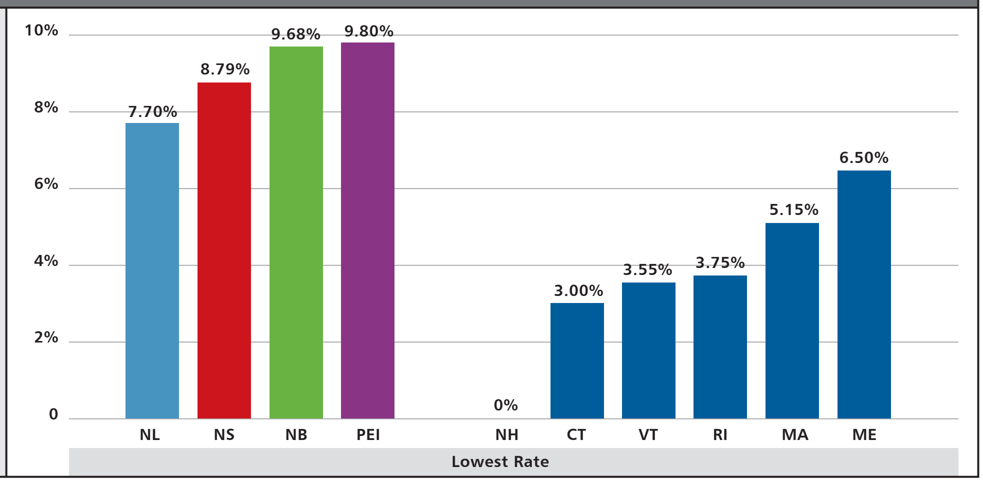
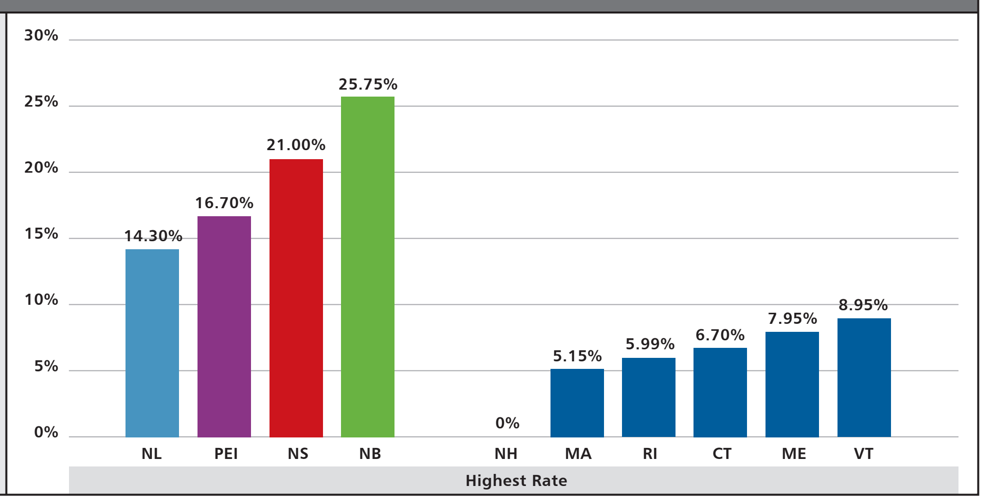



**FIGURE 2b**

**Range of Provincial/State Personal Tax Rates - *Highest***

(On *taxable* income)

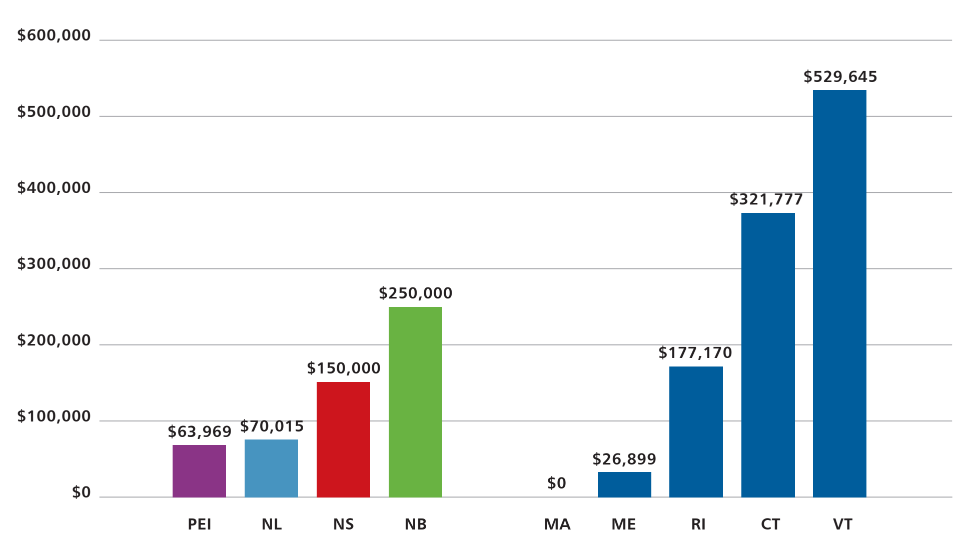
2015




*New Hampshire taxes dividend and investment income at 5.00 per cent, but not earned income. The $2,400 exemption and 5 per cent rate thus would apply only to the former. Sources: Canada Revenue Agency 2015a, 2015b, 2015c, 2015d; Walczak 2015.

FIGURE 2c

**Top Bracket Threshold**
(Provincial/State brackets, on *taxable* income, C$ 2015)




Sources: Bank of Canada 2016; Canada Revenue Agency 2015a, 2015b, 2015c, 2015d; Champagne and Neale 2015; Walczak 2015; various state governments.

# High-Income Thresholds:

# All Atlantic Provinces/All New England States

The threshold at which the top rate of provincial/state income tax is applied differs substantially and is mostly to the advantage of New England taxpayers, especially when the lower state rates (or absence of the same) are considered. In Atlantic Canada in 2015, the threshold for the highest marginal rate ranged from $63,969 (Prince Edward Island) to $250,000 (New Brunswick). In early 2016, after New Brunswick budget changes to tax levels and brackets, the top threshold became $150,000 for both New Brunswick and Nova Scotia.

In contrast, south of the border, New Hampshire does not tax earned income at all, while three states apply the top marginal tax rate at significantly higher income levels than in the Atlantic provinces. Massachusetts applies a single rate of tax to all taxable income; Maine has two brackets, the second of which begins at $26,899; and the high-income threshold in the other three states varies from $177,170 (Rhode Island) to $529,645 (Vermont).

# Comparison 3:

# Top Marginal Rates Including Federal Tax Rates and Brackets

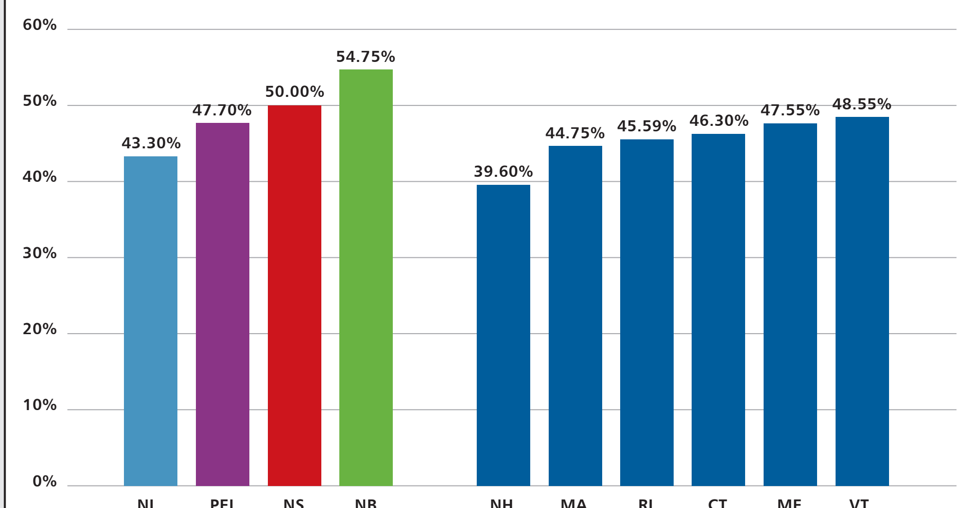
Tax competitiveness is not the creature of subnational governments alone. In both Canada and the United States, federal income taxes account for the largest share of total income tax paid.[4] Thus, to illustrate the total personal income tax rates of Atlantic Canadians and New Englanders, Figure 3a shows provincial and state tax rates on taxable income combined with federal rates in 2015. Again, New Brunswick's top combined rate is 53.3 per cent in 2016 owing to the province's tax changes early this year.

Here, the New England states had a slight advantage — New Hampshire applies no state income tax, so only federal income tax rates applied there. On the Canadian side, Newfoundland and Labrador was the one province with a top marginal income tax rate below that of any New England state (the exception was New Hampshire). In the rest of Atlantic Canada, Nova Scotia taxpayers faced a combined top marginal income tax rate above that in New Hampshire, Massachusetts, Rhode Island, Connecticut, and Vermont; Prince Edward Island's rate was also higher than any New England state except Vermont and Maine. New Brunswick's top marginal rate, provincial and

FIGURE 3a

**Top Marginal Income Tax Rates**

(Provincial/State and Federal combined) 2015




Note: In Newfoundland and Labrador, the 2015 budget added two additional tax brackets, including a fifth bracket of 15.3 per cent (14.3 per cent for 2015). In New Brunswick, the 2015 budget added two additional tax brackets, including a sixth bracket of 25.75 per cent.

Sources: Bank of Canada 2016; Champagne and Neale 2015; KPMG 2015; Pomerleau 2014; Walczak 2015; various state governments.

federal combined, exceeded that of all other Atlantic provinces and all New England states in 2015, but fell below Nova Scotia's in 2016.

At first glance, Atlantic Canada and New England might seem close in this particular "competition." But the thresholds at which federal tax rates apply changes the picture. Figure 3b illustrates the taxable income levels at which all federal rates applied in the two countries in 2015.

**FIGURE 3b**

**Canada and U.S. Federal Tax Brackets**

(Rates applied to taxable income beginning at...)

C$ 2015

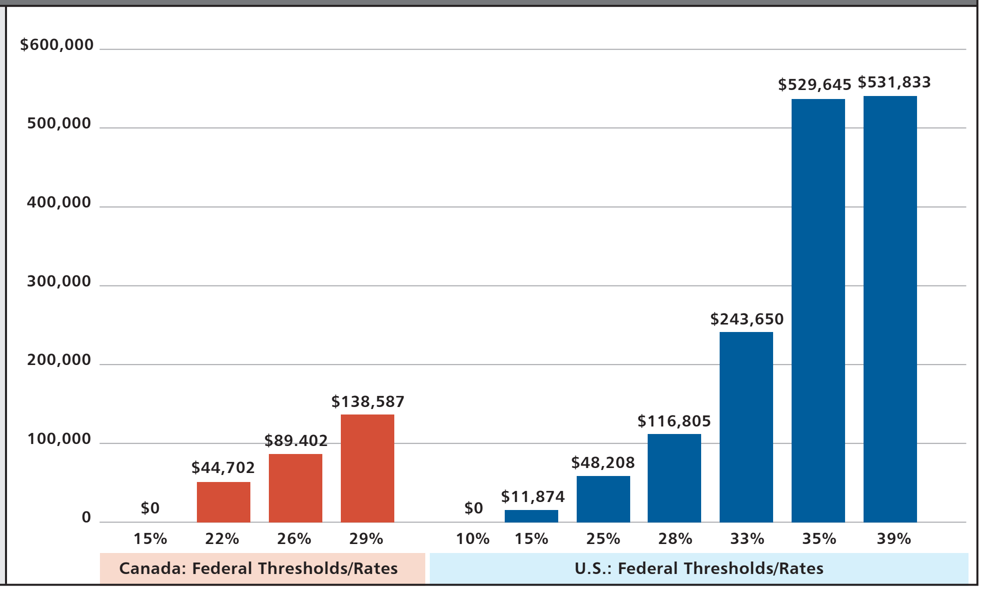
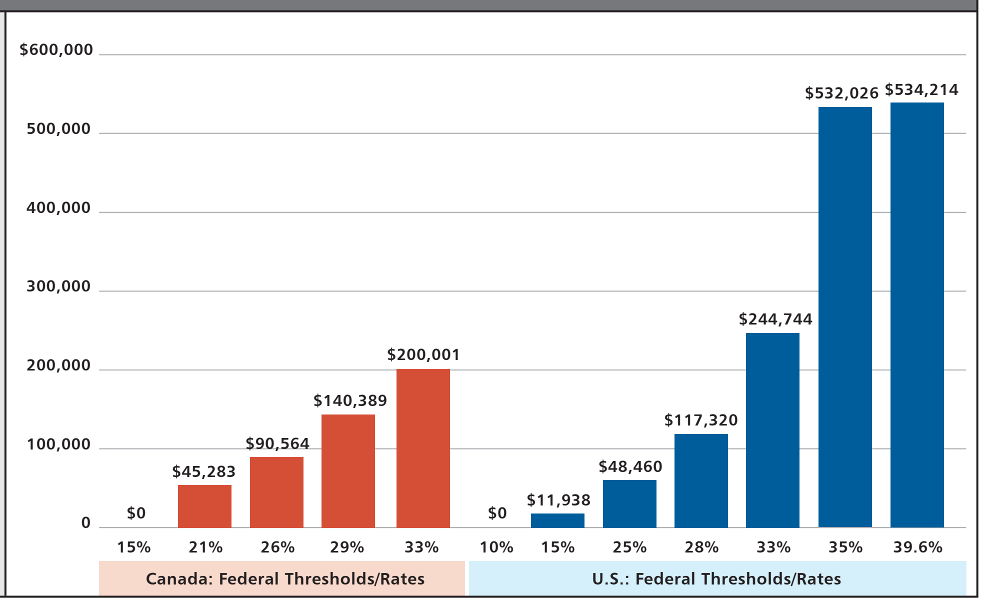



**FIGURE 3c**

**Canada and U.S. Federal Tax Brackets**

(Rates applied to taxable income beginning at...)

C$ 2016




Note: The 2016 Canadian-US dollar exchange rate assumes the average annual exchange rate in 2015.
Sources: Bank of Canada 2016; KPMG 2015, 2016; Pomerleau, 2016.

In Canada, the federal tax bracket of 22 per cent applied to taxable income of between $44,702 and $89,401. In the United States, a slightly higher rate of 25 per cent applied at nearly the same lowest level ($48,202), but the next bracket did not apply until taxable income of $116,805, allowing New England taxpayers to earn roughly $32,000 more before reaching the next highest tax bracket. Similarly, in Canada, the top federal rate of 29 per cent in 2015 applied at $138,587 in taxable income; in the United States, the top bracket was not reached until $531,833.[5]

# Comparison 4: Provincial and State Sales Taxes

A comparison immediately relevant to most consumers is the provincial or state sales tax. In 2015, the harmonized sales tax (HST) applied in the Atlantic provinces ranged from 13 per cent to 15 per cent; in New England, state sales taxes ranged from zero (New Hampshire) to 7 per cent (Rhode Island); see Figure 4a.

However, as the HST includes the federal portion (the 5 per cent goods and services tax), a more accurate comparison of provincial and state sales tax is that shown in Figure 4b, next page. But even with the GST removed, provincial sales taxes in 2015 were higher than state taxes, ranging from 8 per cent (New Brunswick, Newfoundland and Labrador) to 10 per cent (Nova Scotia).

FIGURE 4a

**Provincial/State Sales Tax Rates**

(Including GST)

2015

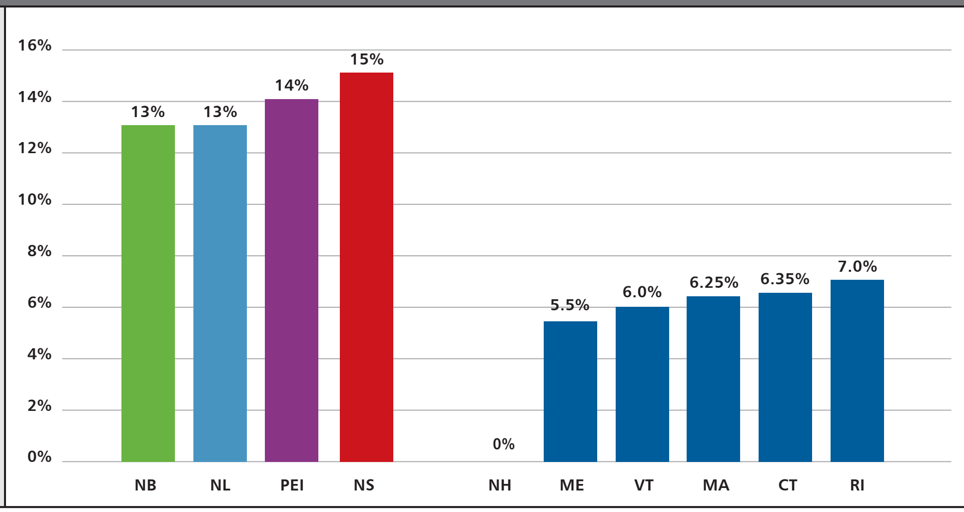
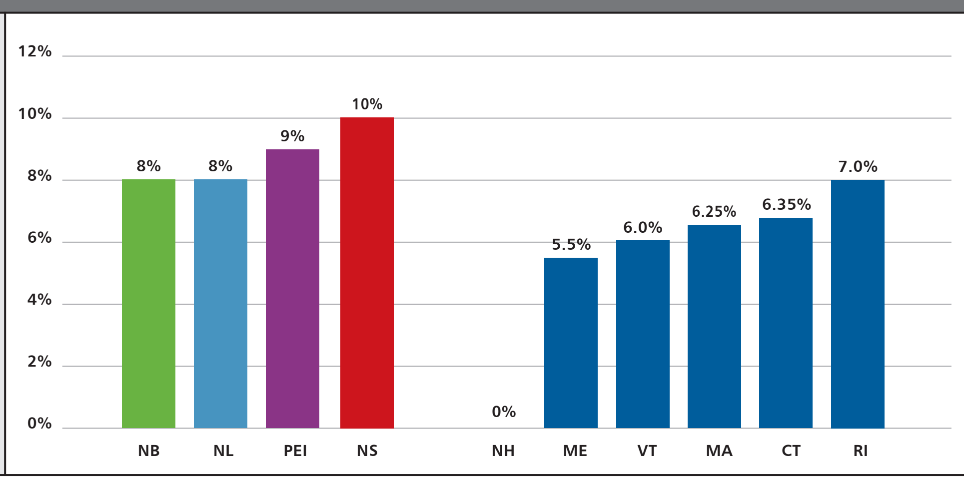



FIGURE 4b

**Provincial/State Sales Tax Rates****

(Not including GST)

2015




Note: Vermont adds average local taxes of 0.14 per cent, making its combined state sales tax 6.14.

Sources: Canada Revenue Agency 2015a, 2015b, 2015c, 2015d; Walczak 2015.

# Sales Tax Rates in 2016

In February 2016, New Brunswick government announced it will increase its HST rate to 15 per cent on July 1, two points higher than in 2015. Figures 4c and 4d show the current comparative provincial and state tax rates, with and without the GST.

FIGURE 4c

**Provincial/State Sales Tax Rates***
**(Including GST)**
**2016**

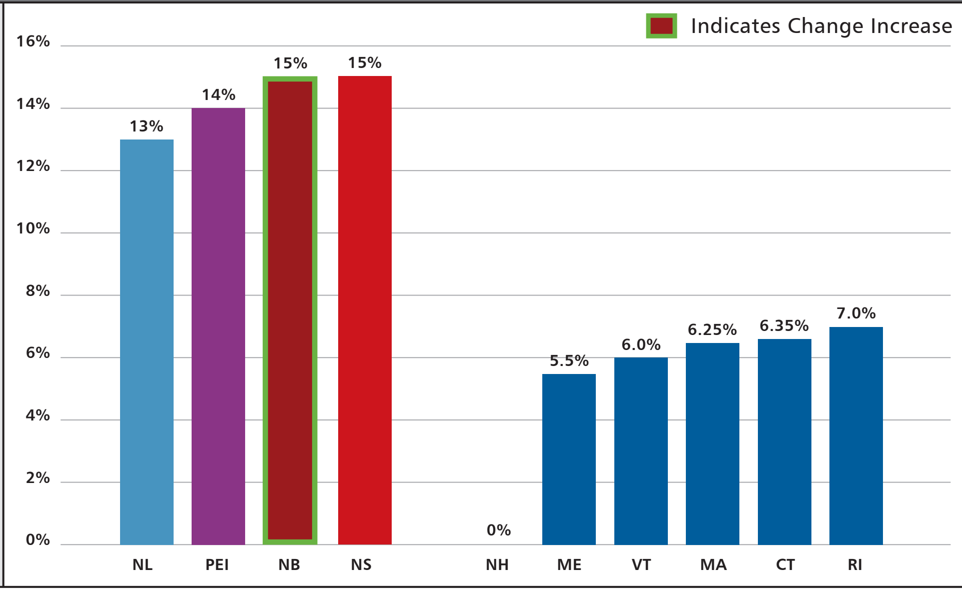
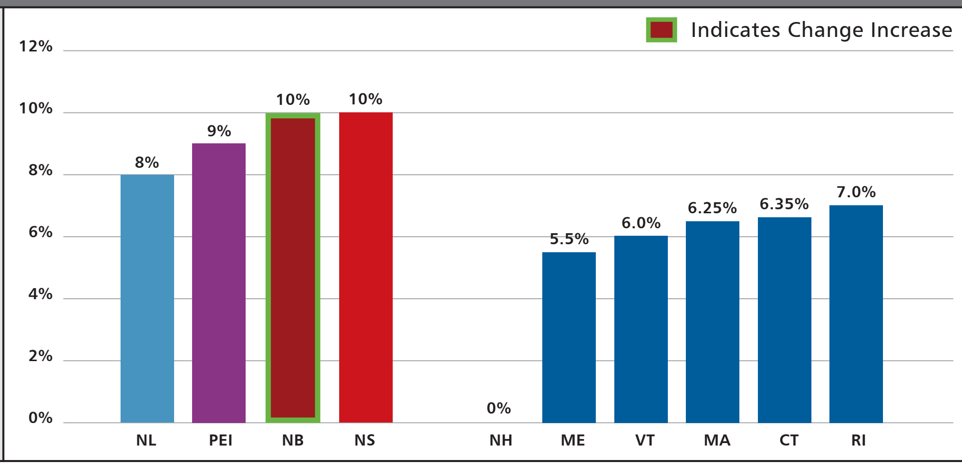



FIGURE 4d

**Provincial/State Sales Tax Rates****
**(Not including GST)**
**2016**




Sources: Canada Revenue Agency 2015a, 2015b, 2015c, 2015d; New Brunswick 2016a; Pomerleau, 2016; Walczak 2015.

# Comparison 5: Provincial and State Corporate Taxes

One advantage for Atlantic Canada is in small business tax rates, which in 2015 ranged from 3.0 to 4.5 per cent, lower than four of the six New England states (the exceptions were Maine and Vermont). However, the main corporate income tax rate in New England ranged from 7.00 to 8.93 per cent, almost half the standard corporate rate in Nova Scotia and Prince Edward Island (16 per cent) and also significantly

FIGURE 5a

**Range of Provincial/State Corporate Tax Rates**
2015

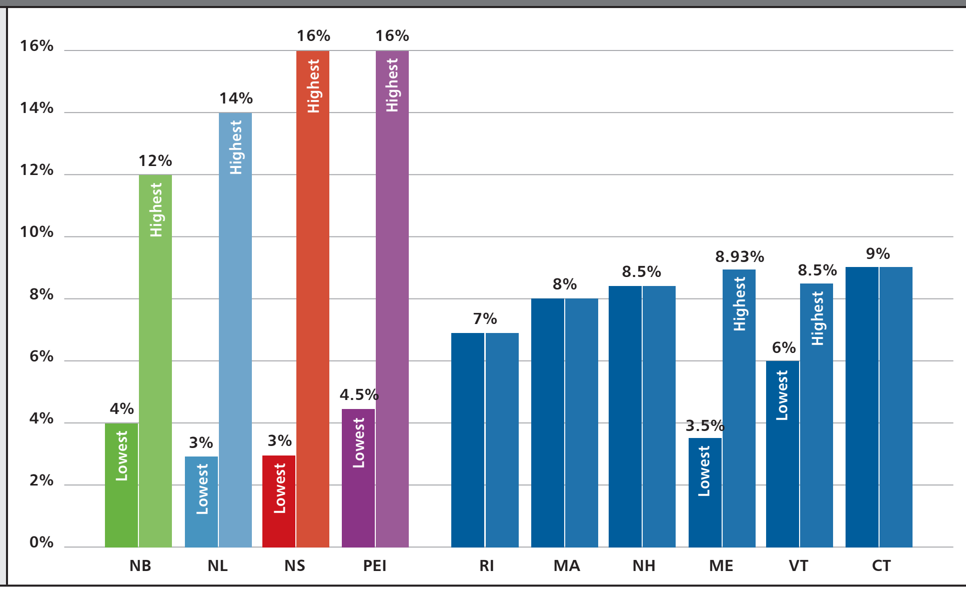
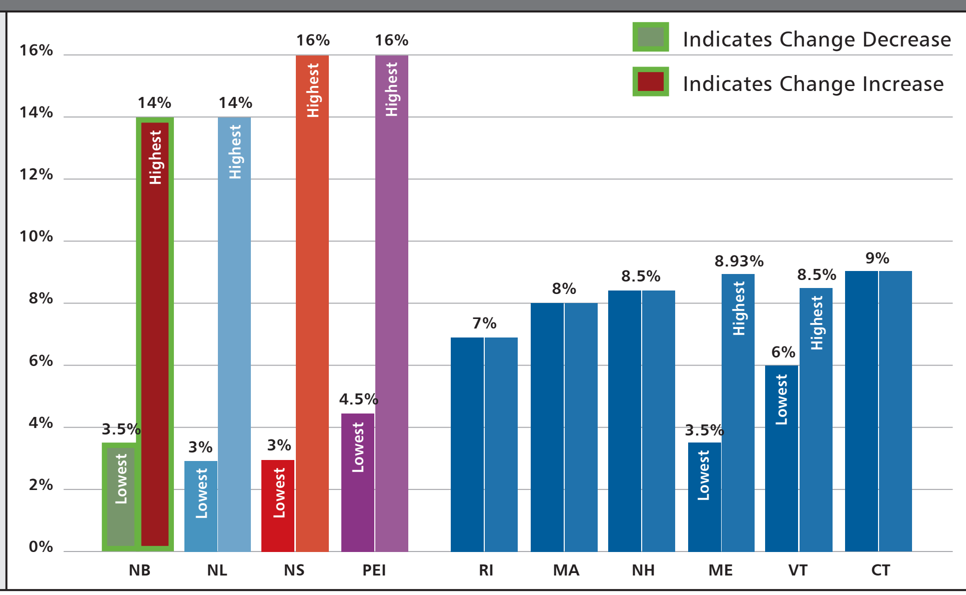



FIGURE 5b

**Range of Provincial/State Corporate Tax Rates**
2016




Sources: Canada Revenue Agency 2015a, 2015b, 2015c, 2015d; New Brunswick 2016a; Pomerleau, 2016, Walczak 2015.

lower than in New Brunswick and Newfoundland and Labrador (12 per cent and 14 per cent, respectively) (Figure 5a). In 2016, New Brunswick raised its corporate rate from 12 per cent to 14 per cent (Figure 5b).

## Summary and Future Watch:

## Top Marginal Income Tax Rates in 2016

That every Atlantic province is struggling with poor economic indicators is hardly a new story (for background, see McMahon 1996, 2000a, 2000b). Newfoundland and Labrador recently has performed well on indicators such as private sector investment and per capita income, but all the Atlantic provinces demonstrate low employment rates, weak job creation, and high unemployment relative to the rest of the country.[6] All four provinces also have relatively high provincial personal and business tax burdens relative to other provinces — dramatically so when compared with the western provinces (Alberta 2015, 100).

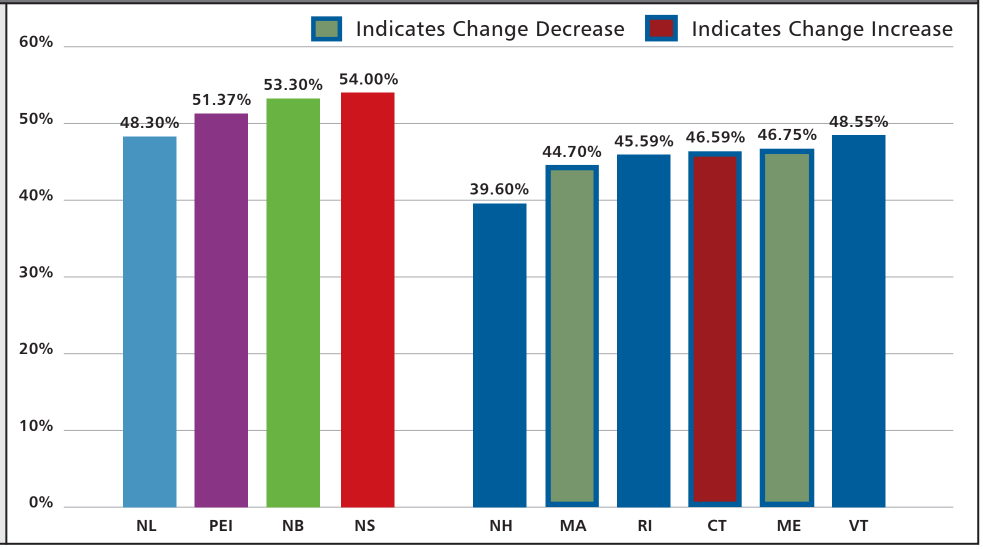
Although the generally poor economic and fiscal record of the Maritime provinces and Newfoundland and Labrador is well known, less discussed is the significant difference in rates of personal, corporate, and consumption/sales tax between Atlantic Canada and New England. The difference is of concern both because of the tax burden it places upon Canadians who live in the four easternmost provinces, and because chronic high tax rates form part of the deleterious policy mix that results in low investment, high unemployment, and weak income growth.

As well, recent federal tax changes affecting the highest-income earners will only exacerbate the difference between what such earners, in many cases entrepreneurs and skilled professionals, would pay if resident in Atlantic Canada as opposed to New England.

Lastly, competition on tax matters is not static. On the next page, Figure 6 illustrates the top marginal tax rates for 2016 based on the most recent data available. In New England, two states (Massachusetts and Maine, illustrated in green) have reduced their tax rates on income; three states (Rhode Island, Vermont, and New Hampshire, which applies no state income tax and thus would be affected only by federal changes) will see no change in the top marginal rate; one state (Connecticut) added a new top bracket at 6.99 per cent (the top bracket in 2015 was 6.7 per cent).

**FIGURE 6**

**Top Marginal Income Tax Rates**
**(Provincial/State and Federal Combined) 2016**




Sources: Bank of Canada 2016; Canada Revenue Agency 2015a, 2015b, 2015c, 2015d; KPMG 2016; New Brunswick 2016a; Pomerleau 2014; Pomerleau 2016; Walczak 2015; various state governments.

In contrast, in Atlantic Canada, three of four provinces will see higher marginal rates due to federal tax changes, which have exacerbated a significant tax competitiveness gap. For example, compare the lowest marginal rate in New England and the highest marginal rate in Atlantic Canada: New Hampshire's top marginal rate on income tax in 2016 will be 39.6 per cent; in Nova Scotia, the top marginal rate will be 54.0 per cent. So far, only New Brunswick has reduced its top marginal rate in response to the federal increase, but that province will still have a federal-provincial combined top marginal rate of 53.3 per cent in 2016.

Problematically, even as Atlantic Canada falls behind in the tax competition with New England because of federal measures, some Atlantic Canadian politicians are urging still-higher rates of taxation in the region. In January 2016, Nova Scotia Premier Stephen McNeil urged other provinces to raise their HST rates to match Nova Scotia's rate of 15 per cent (Walsh 2016) — and New Brunswick did so in its early February budget (New Brunswick 2016a). Such moves are unhelpful if Atlantic Canada wishes to close the tax competitiveness gap one day, not only with the rest of Canada but with its nearest regional competitor, New England.

# Recommendations

Are Atlantic Canadian governments competitive with their New England neighbours on measures of taxation? This paper has shown they are not.[7] Accordingly, with a "nod" to previous reports from the Atlantic Institute for Market Studies which laid the groundwork for this analysis, Atlantic Canada's provincial governments should consider the following options as a "road map" to allow for fiscal room and thus for tax reductions in the region:

- Allow for further resource exploration and development, including onshore exploration and the development of natural gas, which has proved a boon to revenues owing to economic and job growth in other jurisdictions, such as Pennsylvania and Saskatchewan — "off" years notwithstanding.
- Tax reform to unleash untapped economic opportunities by moving to a simpler, lower and flatter income tax code with emphasis on lowering taxes on investment and job creators.
- Revisit existing spending envelopes in provincial budgets with an eye to better value-for-money expenditures and the creation of room for tax reductions.

The combination of new energy economic development and more carefully controlled spending would result in more revenues from an expanded corporate, personal and natural resource tax base, and free up budgetary room to reduce Atlantic Canada's high taxes, which put the region at a significant tax disadvantage relative to its neighbours.

And it is worth repeating that Atlantic Canada's ability to succeed and prosper — in attracting private sector investment, creating jobs, and increasing wages and salaries and even its tax revenues — depends on its affordability and attractiveness relative not just to other provinces but also to competitive tax jurisdictions on the east coast of the United States. Tax competitiveness matters because taxes are real costs for residents and businesses. Tax levels that are too high can impede investment, entrepreneurial activity, and, ultimately even, dampen government revenues.

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# Endnotes

1. All dollar amounts in this report are in Canadian dollars. Figures quoted in this section apply to single-income filers.
2. New Hampshire's basic exemption is $3,089, but applies only to dividend and investment income; New Hampshire does not tax earned income.
3. Most individual tax filers in the United States have a choice (both federally and at the state level) between using the itemized or non-itemized approach, with the latter able to then use the standard deduction.
4. In Canada in fiscal year 2014/15, of $657.6 billion in total revenues to three levels of governments, 43 per cent was collected by the federal government and 57 per cent by provincial and local governments (Canada 2015). In the United States in 2013, collected tax revenues accrued to governments amounted to $4.5 trillion, with two-thirds going to the federal government and one-third to state and local governments (Agresti and Bohn 2015).
5. As of 2016, a new and higher federal tax bracket and selected other changes means that Atlantic Canadians will see competitiveness on taxes, rates, and brackets further eroded. The addition of a new 33 per cent tax bracket on income means that additional income in Atlantic Canada will be subject to higher rates of federal income tax sooner (See Figure 6 later in this report).
6. See Milke (2014), which analyzes private sector investment (non-residential, total and per person), employment rates, unemployment rates, chronic unemployment, weekly wage rates, income, and other measurements for all ten provinces.
7. Another perspective on Canadian-US tax differences in general is that various levels of government have different roles in the two countries, and that health care costs attributed to government also differ. This is true, but the differences are often overstated. Regional breakdowns are not available, but in the United States, 47.6 per cent of health care spending is public; the figure for Canada is 70.1 per cent. Meanwhile, the United States spends 3.5 per cent of GDP on defence, while Canada's proportion is 1.0 per cent (CIHI 2014; World Bank 2015). That governments will differ by function is clear, but not overly illuminating by virtue of stated differences. What is less clear is value-for-money for one country's health system over another's, the necessity of defence to a country and its allies for protection, and so forth — questions beyond the scope of this paper.

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