NORTHWEST TERRITORIES

REVENUE OPTIONS

Public Consultation Paper

Issued by the Honourable J. Michael Miltenberger
Minister of Finance

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Foreword

In Budget 2008, the Government of the NWT committed to taking a number of measures necessary to put our fiscal house in order, including raising new revenues starting in the 2009-10 fiscal year. This revenue will provide additional resources to fund important programs and services for Northerners.

- How should additional revenues be raised?

The question is more complex than you might think. We can raise revenues simply by increasing taxes or creating new fees; however the way it's done 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 options, 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 where the NWT currently gets its revenues. It identifies different approaches that could be used and discusses their pros and cons. 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 booklet.

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Table of Contents

Introduction

The tax system should raise revenues to pay for government expenditures as fairly, efficiently and simply as possible. Because taxes affect all of us, directly and indirectly, we should all have a chance to comment on any proposed changes.

The Government of the NWT (GNWT) is looking at ways to increase revenues to help pay for programs and services, and to finance investments in infrastructure. However, the Government also wishes to use this opportunity to take a broader look at the NWT tax and revenue system, to see what policies and measures are available to advance the vision, goals and priorities of the 16th Legislative Assembly – encouraging the creation of a NWT where strong individuals, families and communities share the benefits and responsibilities of a unified, environmentally sustainable and prosperous territory.

Because the tax system is often expected to achieve a number of goals, some of which may be competing, it is important that the objectives of any restructuring be considered and clarified. The tax system needs to generate revenues for government – the amount, however, depends on the amount the government desires to spend. The more government needs or wants to spend, the more taxes it needs to raise.

The tax system is used to achieve other objectives beyond raising revenues. It is used to promote economic activity and growth. It is used to redistribute income from higher to lower income individuals and from one region to another. It is also used to promote some activities, like saving for retirement or post-secondary education, or to discourage other activities, such as tobacco or alcohol use.

The challenge for tax policy is to find the appropriate balance between:

- revenue needs, economic growth and environmental sustainability;
- income redistribution and incentives to work and live in the NWT; and,
- businesses and individuals.

This paper outlines a number of ways that the GNWT could generate the additional revenues needed to finance ongoing public services and new investments. The options are considered using the following criteria:

- their revenue-raising potential;
- the extent to which they advance the vision, goals and priorities of the 16th Legislative Assembly;
- the impact they may have on the NWT economy, particularly the criteria described in the GNWT macroeconomic policy framework; and
- the principles of sound tax policy.

The options are also considered in light of current trends in tax policy in Canada and internationally, in which certain types of taxation are viewed as more economically efficient than others. For example, many economists argue that taxing income is inefficient, as this type of taxation acts as a disincentive to invest, seek higher paying employment, and save. This view favours consumption taxes because they do not tax productive activity and encourage saving and investment. Federal tax policy in recent years has focused on reducing the general tax burden, with reductions in income taxes (personal and corporate), capital taxes, and the Goods and Services Tax (GST).

One type of consumption tax that is receiving increasing support from economists is the carbon tax, on the grounds that this tax provides an economic incentive to reduce the carbon emissions that are contributing to climate change.

Northwest Territories Fiscal Situation

The GNWT is forecasting annual revenues of more than $1.23 billion in 2008-09, growing at an average rate of four per cent annually to 2011-12. However, demands on government programs and services, and the need to replace aging infrastructure, mean that without fiscal action the government will be running operating deficits and borrowing to pay for day-to-day expenses.

The Government plans to address these demands on both the spending and the revenue sides of the budget. The 2008 Budget outlined plans to manage these demands by reallocating expenditures and capping future spending growth and by raising new revenues.

The GNWT depends on transfers from the federal government for over two-thirds of its revenues. This is because per capita spending needs in the NWT are far greater than the territory’s per capita revenue raising capacity. The main federal transfer, the Territorial Formula Financing grant, is designed to fill the gap between the GNWT’s spending needs and revenue raising capacity. New Territorial Formula Financing arrangements put in place in 2007 will provide a predictable, principle-based funding source. But these arrangements will not change in the near future and additional revenues are not expected.

The GNWT generates only slightly more than 20 per cent of its revenue needs from taxation. This small tax base, compared to spending needs, means that revenue measures have a relatively small impact compared with spending growth.

Any tax measure will affect either the cost of living or the cost of doing business in the NWT. The revenue measures undertaken must be consistent with the Legislative Assembly’s overall goals and with sound tax policy.

Higher taxes versus higher revenues – the NWT Economy

There are two ways the GNWT can increase its revenues: through economic and population growth, and through tax increases. Each has its advantages and disadvantages.

The NWT continues to benefit from a healthy economy. At 13.1 per cent, the growth in the NWT economy was the highest in Canada in 2007. This growth was driven primarily by the diamond mining sector. The NWT's three producing diamond mines contributed over $1.2 billion, or over 31 per cent, to the territorial Gross Domestic Product in 2007.

Without economic growth, GNWT tax bases will not grow. Fortunately, the NWT economy continues to show great promise. A fourth diamond mine is in the environmental assessment phase. NWT oil and gas resources also hold tremendous potential. The proposed Mackenzie Valley natural gas pipeline will be the single largest investment in the history of the NWT and will launch a whole new era for economic development in the NWT. If these developments proceed, together with a number of relatively smaller construction and resource projects, the NWT economy will double in size by 2016.

The NWT's prospects for economic growth do not necessarily translate into comparable revenue growth for GNWT. Much of the benefit of economic activity in the NWT "leaks out" to other jurisdictions. For example, large resource projects employ non-resident workers and most goods are imported. Under the GNWT's funding arrangements with Canada, the GNWT keeps 100 per cent of the money raised through tax rate increases, but a large part of the increase in own-source revenues that result from a growing economy is offset by a lower Territorial Formula Financing Grant. Furthermore, resource royalties continue to be paid to the federal government, not to NWT governments.

The GNWT continues to pursue devolution and resource revenue sharing with the Government of Canada, but a resource devolution agreement will likely not produce additional revenues during the life of the 16th Legislative Assembly. Even with an agreement, resource revenues alone would not be sufficient to overcome the higher growth in GNWT expenditures.

Revenue options can be examined on two fronts. Changes in the NWT tax system, whether rate changes or new taxes, can provide additional revenues. But other measures, taken to strengthen economic linkages and advance the goals of the 16th Legislative Assembly, can also have an effect on revenues. For example, investments or policy changes that affect the NWT's population growth rate can affect future revenue growth. Tax initiatives should be examined through the lens of the GNWT's Macroeconomic Policy Framework (see box).

This review of the NWT tax system is an opportunity to look at both of these approaches.

The GNWT Macroeconomic Policy Framework

In 2007 the GNWT adopted a macroeconomic policy framework to help decision makers evaluate policy options. Some of the questions the framework asks include:

- What is the impact on the NWT economy and how does the measure contribute to NWT economic growth and diversification?
- What are the impacts on NWT regions and communities?
- Does the initiative strengthen economic linkages in the NWT?
- Is the initiative likely to increase employment opportunities in the NWT?
- Will the initiative lower costs for NWT residents and businesses?
- What are the impacts on large and small businesses?
- Will the initiative have an impact on the environment?
- What are the expected tax revenues, and what are the direct and indirect costs to the government?

Objectives of the Tax System

The following describes the objectives used by the GNWT to evaluate tax rate changes or new taxes. Some of these objectives may conflict with others. No tax change will meet all objectives.

Taxes should raise sufficient revenues.

The main objective of the tax system is to raise revenues so that the government is able to provide essential services. Taxes should raise revenue for government in a way that is as fair, efficient and simple as possible.

Revenue raising potential needs to take into account the costs of implementing and administering a tax and other costs the tax may create for government operations. For example, a hotel room tax would add to government travel costs.

Taxes should be fair.

A fair tax system levies taxes proportional to a taxpayer’s ability to pay.

Taxpayers who have a similar ability to pay should have a similar tax burden. Those who have a greater ability to pay should bear a greater burden. Ability to pay is measured by income, adjusted to reflect varied family and personal circumstances and the costs of earning income.

The tax system should be balanced.

Governments levy taxes on a variety of bases, in part to provide a mix of tax sources that can minimize the risk of any one base declining substantially, but also to spread the tax burden across sectors of the economy and individuals. Changes to the tax system must take into account resulting shifts in the tax burden.

The tax system should be neutral.

An economically efficient tax system should influence a taxpayer’s behaviour as little as possible. Decisions made based on tax considerations, rather than sound business or personal reasons, can cause distortions in the economy. However, in some cases, tax incentives may increase efficiency if they encourage activities which benefit society or activities which indirectly benefit the taxpayer.

Taxes may help promote other Government objectives.

Taxes may also be used to promote economic, social or environmental goals, such as stimulating certain industries or regions, or encouraging or discouraging certain kinds of activities. For example, higher alcohol or tobacco taxes should lead to lower consumption. On the other hand, increases in tobacco taxes relative to those of other jurisdictions could increase illegal activities like smuggling and black market sales.

The tax system should be simple.

The tax system should be simple and easy to comply with. The reason for 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.

The NWT tax system should be competitive and predictable.

A tax system must be competitive with those in other jurisdictions. Most large corporations in the NWT operate in other provinces and in other countries, and many individuals, especially those at higher income levels, are mobile and can easily move within Canada. If the tax burden is too heavy, these corporations may transfer income and taxes outside the NWT or individuals may move to a jurisdiction with a lower tax rate, reducing the government's tax base and revenues. The cost of living and doing business in the NWT is high compared to southern jurisdictions, reducing the attractiveness of the territory as a place to live and invest. Higher taxes add to this relative disadvantage.

The tax system should also be stable. Changes should be infrequent and, where possible, should be predictable to the taxpayer.

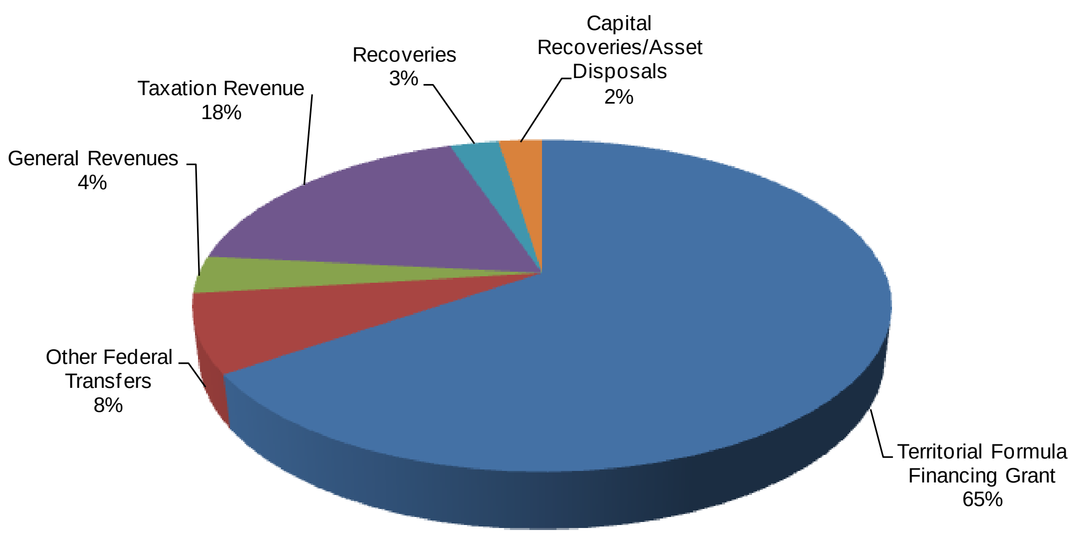
Revenue Options - Growing the NWT Economy and Population

As a general rule, a growing economy and population result in increased revenues for government. As an economy grows, more people are employed and earn higher incomes, more businesses start and earn larger profits, and tax revenues rise. As a population grows, there are usually more people paying taxes and more opportunities for businesses to provide goods and services.

The extent to which this rule applies, however, depends on how closely linked a government's revenues are to the economy in which it operates. The Northwest Territories is a good example of how these linkages can be relatively weak. Between 1999 and 2007, the NWT economy doubled in size, largely due to the emergence of the diamond mining industry. However, since 1999-00 the GNWT's total revenues have grown only 79 per cent.

The GNWT has seen fiscal benefits from the NWT's economic growth. In 2007, it is estimated that 83 per cent of the government's corporate income tax revenues were generated by the resource development sector.

Total 2008-09 GNWT Revenues by Source



However, many of the benefits of the non-renewable resource sector driven economic growth go to southern jurisdictions. Most of the goods, machinery and equipment used in resource development projects are imported and the income generated by the production and sale of those products is taxed in the southern jurisdictions. As well, a large number of the non-renewable resource projects employ many non-resident workers who pay income taxes in other jurisdictions. Resource royalties are collected and retained by the federal government.

The bulk of the GNWT's revenues come in the form of transfer payments from the federal government – 70 per cent through the Territorial Formula Financing Grant, and a further 7 per cent from other transfers. This heavy reliance on federal funding reflects the fact that the cost of providing public services in the North is very high relative to the GNWT's ability to raise money from its tax bases. Territorial Formula Financing arrangements were designed to provide a stable, predictable source of funding to pay for programs, services and infrastructure for residents, such as education, health care, and social services.

The Territorial Formula Financing Grant increases in response to higher spending levels by the provinces, territories and municipal governments on programs and services; and to higher rates of NWT population growth. However, Territorial Formula Financing does not respond to increases in economic activity that create expenditure demands for roads, airports, bridges or other infrastructure. This means the GNWT has limited capacity to make investments that would encourage further economic growth and development.

Own source revenues from taxes and other sources have increased with the growing economy, but a large part of these revenues is offset by a lower Territorial Formula Financing Grant.

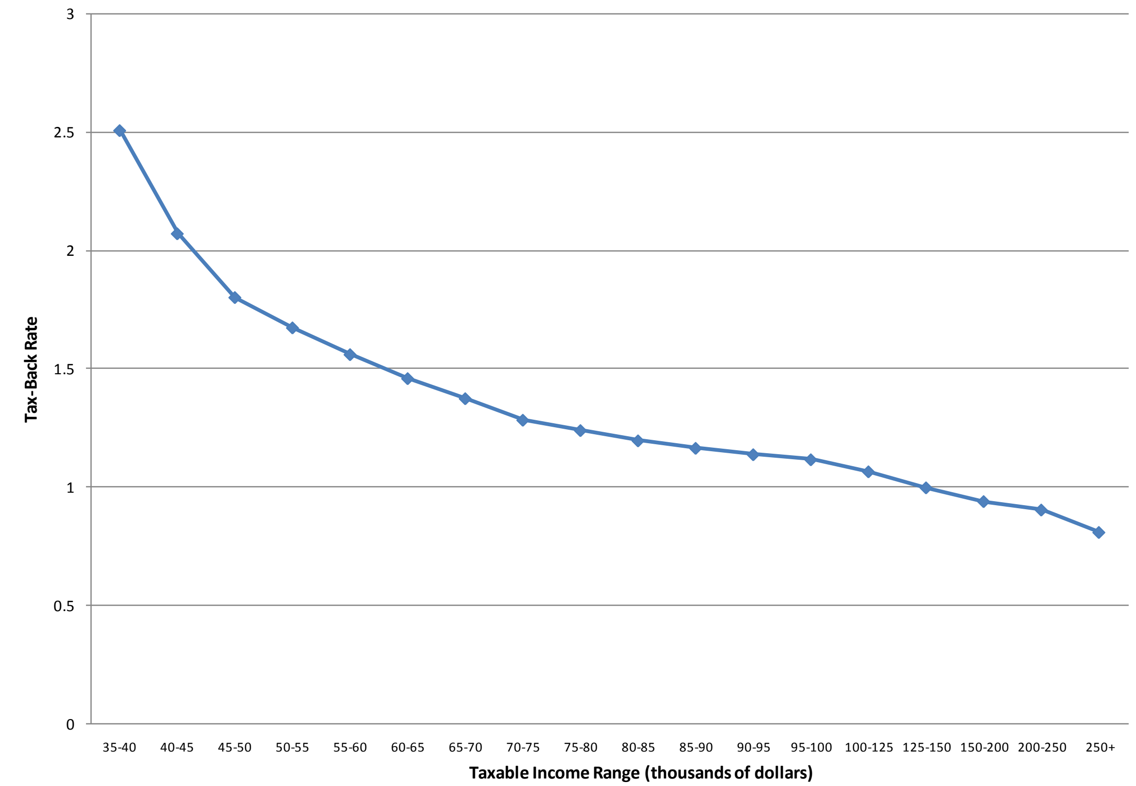
Economic Growth

Economic growth will lead to higher revenues for the GNWT through higher tax revenues and population growth, even after leakages to other jurisdictions. However, a portion of own source revenues is "clawed back" under Territorial Formula Financing arrangements so the Territorial Formula Financing Grant is reduced as the GNWT's own revenues grow.

The clawback, on average, is less than 100 per cent. Although the GNWT realizes an average net benefit from the growth of tax revenues of 30 per cent, the specific benefit depends on whether the GNWT tax rate is above or below the national average rate for a given tax base. The Territorial Formula Financing Grant is calculated on the assumption that the GNWT levies the same taxes as the provinces, at national average tax rates. (See box.) If the GNWT lowers its tax rates below national average rates, the offset rate is more than 70 per cent, and can be more than 100 per cent if rates are significantly below the national average. The offset drops below 70 per cent when tax rates are above the national average.

Revenue offsets under Territorial Formula Financing may vary for individual taxes as well. For example, personal income tax offsets are lower at higher income ranges because the GNWT personal income tax system is more progressive than the national average. Relative to the national average tax rate for each income range, the GNWT is more generous at lower income ranges than at the higher income ranges, primarily because of the Cost of Living Tax Credit.

Personal Income Tax Claw Back Rates by Taxable Income Ranges



Note: Data are derived from the federal government's PITAX model (2005 tax year). Tax-back rates are estimates and are subject to change.

It is sometimes suggested that governments can boost their tax revenues by lowering tax rates, based on the assumption that lower tax rates will encourage greater economic activity and therefore generate additional tax revenues. Although lower tax rates generally do benefit the economy, they will not necessarily lead to enough economic growth to increase total tax revenues. Even if total tax revenues increase, however, the interaction between tax revenues and the Territorial Formula Financing must be considered, as it is possible for the GNWT to lose more in Territorial Formula Financing revenue than it gains in tax revenue by lowering tax rates. In other words, a tax rate decrease must be able to provide enough of a tax base increase to counter the reduced revenue effect of the tax rate decrease.

Population Growth

The GNWT can also generate higher revenues from population growth. If the NWT population grows, funding under Territorial Formula Financing will increase. Every additional resident represents about $22,000 annually in additional revenue. As well, new residents who are employed will pay taxes to the GNWT, generating further revenues. Costs associated with new residents will likely be less than the additional revenues as increased economies of scale are realized.

A significant portion of the NWT's workforce does not live in the NWT. The share of NWT labour income earned by non-residents was about 18 per cent in 2007. By comparison, the share of non-resident labour income in total labour income in other jurisdictions is small, ranging from negative 4.2 per cent in Newfoundland to 1.3 per cent in Ontario. Although each individual's reasons for choosing to live in another jurisdiction are unique, it can be assumed that the NWT's high cost of living is a factor. The average cost of living in the NWT is about 25 per cent higher than in southern Canada.

Lower living costs might encourage people to live in the NWT, resulting in higher government revenues. However, many of the investments in roads, bridges, and energy infrastructure that would accomplish this are beyond the government's current fiscal capacity.

Questions for Consideration:

1. **Should the GNWT actively try to increase revenues by increasing the size of the NWT economy and population?**

2. **If so, what policies should be pursued?**

Territorial Formula Financing

The GNWT has received the bulk of its revenues through Territorial Formula Financing arrangements since 1985. Arrangements have evolved over the years and following a major review in 2005 and 2006, the federal government put new Territorial Formula Financing arrangements in place in 2007. Although these new arrangements maintain the basic structure of the previous Territorial Formula Financing arrangements, they also included some changes, especially in the calculation of revenue raising ability.

The Territorial Formula Financing Grant is based on a "gap-filling" principle and theoretically measures the difference between what the GNWT would need to spend to provide comparable levels of public services as the provinces and its ability to raise its own revenues at comparable levels of taxation:

TFF Grant *equals* Expenditure Requirements *minus* Revenue-Raising Ability

The GNWT's expenditure requirements are represented by a Gross Expenditure Base (GEB) which is a proxy for the fiscal resources required to deliver public services of similar quality to those in the provinces while taking into account the higher costs and needs in the North.

The Gross Expenditure Base is escalated every year by the growth in provincial/territorial-local government spending, adjusted by the rate of population growth in the NWT compared to that of Canada. The escalator ensures that the Gross Expenditure Base grows at the same rate as total provincial/territorial-local per capita government expenditures.

The GNWT's revenue-raising ability takes into account the various revenue sources that the government has at its disposal to raise revenues, including taxes and fees, and measures how much the GNWT could raise from these sources if it levied the same taxes as the provinces at national average tax rates. This revenue-raising ability is referred to as Eligible Revenues. It should be noted that the Territorial Formula Financing Grant calculation is based on what the GNWT could raise in tax revenues, whether or not it chooses to do so.

An Economic Development Incentive is applied to Eligible Revenues, effectively excluding 30 per cent of Eligible Revenues from the Grant calculation. This is meant to provide a fiscal incentive for the GNWT to promote economic growth. Without it, a dollar of increased tax revenue would simply be offset by an equal reduction in the Grant.

The combination of the revenues measured at National Average Tax Rates and the Economic Development Incentive produce different rates at which each revenue reduces the Territorial Formula Financing Grant. The following table shows the claw back rates for the major GNWT revenues, which apply when the tax base changes. **Changes in NWT tax rates do not affect the claw back rates**. For example, on average for every dollar raised in personal income taxes from an increase in the tax base, the Territorial Formula Financing Grant is reduced by $1.10 because NWT personal income tax rates are significantly lower than the National Average Tax Rate. However, this claw back amount fails to capture the fact that NWT payroll tax revenue and personal income tax revenues are very highly correlated in the NWT. Employment income is approximately 85 per cent of total NWT income. Therefore when Personal Income Tax increases as a result of increases in employment income, payroll tax also increases and the payroll tax-back rate is about 58 per cent. The Personal Income Tax clawback rate is an average, and the actual rate is higher at lower incomes and lower at higher incomes.

*Territorial Formula Financing Arrangements - Claw Back Rates**

Personal Income Tax	110%
Corporate Income Tax	
General Rate	75%
Small Business Rate	88%
Tobacco Tax	46%
Gasoline Tax	
Highway	91%
Off-highway	68%
Diesel Fuel Tax	
Motive rates	104%
Non-motive rates	0%
Alcohol Sales	32%
Payroll Tax	58%

* Based on the 2006-07 fiscal year as of December 2007.

Note: The claw-back rates may change materially due to changes in national average tax rates or tax bases.

Revenue Options – Increasing Tax Rates and Introducing New Taxes

A second option for increasing revenues is to increase tax rates or introduce new taxes. Under Territorial Formula Financing, there is no claw back of revenue generated by tax rate increases or from new taxes.

What can the GNWT tax?

Under the federal *Northwest Territories Act*, the GNWT has the legislative power to levy direct taxes within the NWT in order to raise revenue for territorial, municipal or local purposes.

The *Act* limits the options that can be considered. For example, since the GNWT only has the authority to levy direct taxes, a sales tax levied on exports, or only on imports, or on a business with the expectation that it would be passed on to consumers, would be outside the authority of the GNWT. The GNWT can tax fuel purchased or used within the NWT, but cannot tax fuel produced in the NWT and exported.

The GNWT does not have the authority to levy royalties on the production of natural resources within the NWT. Until a resource devolution agreement is finalized and implemented, this authority rests with the federal government. (See box.)

The *Charter of Rights and Freedoms* restricts governments from passing laws that discriminate primarily on the basis of present or previous residence. The Constitution also prohibits provinces and territories from imposing taxes or duties on goods imported into their jurisdiction.

The GNWT is also bound by the terms of the Tax Collection Agreement with Canada. Nine provinces and all three territories have signed these agreements that harmonize income tax legislation and collection, and minimize administrative costs for taxpayers and governments.

The GNWT recognizes the inherent right of Aboriginal peoples to self-government, including the power to tax their citizens on their lands and in their communities. In addition, the GNWT is prepared to enter into tax sharing arrangements with Aboriginal governments for certain tax bases, where those governments also assume expenditure responsibilities from the GNWT. Although no tax sharing agreements are currently in place, changes to the NWT tax system need to consider possible implications for future tax agreements.

Finally, tax policy has economic consequences. Although the GNWT may have the legal authority to impose a tax, taxpayers are free to take legal measures to minimize their tax burden, including restructuring their affairs, moving to other jurisdictions, or changing their purchasing habits. These changes may affect the yield from any particular tax measure. In addition, some residents may attempt to evade tax, reducing revenues and increasing administration and compliance costs for government.

Devolution and Resource Revenue Sharing

In 2001 the GNWT signed a Memorandum of Intent with Canada and NWT Aboriginal organizations to negotiate an agreement to transfer responsibility for NWT lands, waters and resources to NWT governments. The transfer would include the authority to develop, conserve, manage and regulate surface and subsurface natural resources in the NWT as well as the power to levy and collect resource royalties and other revenues from natural resources.

The Memorandum of Intent included a commitment that the NWT governments would receive a fair “net fiscal benefit”. Net fiscal benefit refers to the net amount that NWT governments would received from resource revenues collected in the NWT, after offsets against federal transfers like Territorial Formula Financing.

Discussions on a Devolution Agreement are ongoing. Canada has stated that resource revenue sharing discussions would continue within the context of overall devolution negotiations. The 2007 federal Budget stated that, consistent with Equalization, 50 per cent of resource revenues would be excluded from the Territorial Formula Financing offset calculation, up to an overall cap that has yet to be determined.

In May 2007 the GNWT entered into an Agreement in Principle with four Aboriginal groups that would see the sharing of a minimum of 25 per cent of the net fiscal benefit from resource revenues with Aboriginal governments.

What does the GNWT currently tax?

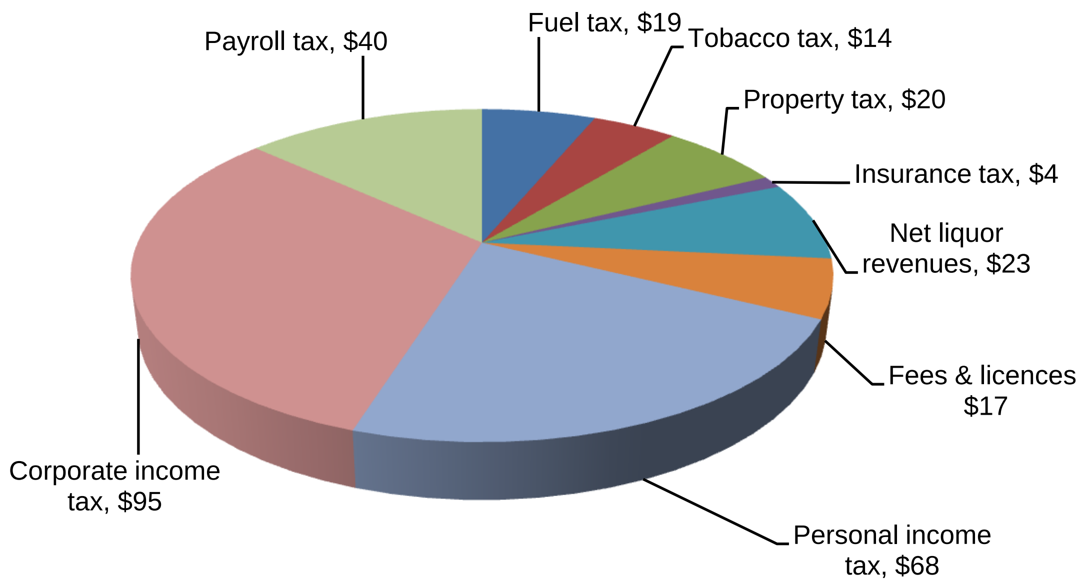
Over the next four years the GNWT is expected to raise an average of about $300 million annually in tax and fee revenues from the following sources:

Personal Income Tax	$68 million
Corporate Income Tax	$95 million
Payroll Tax	$40 million
Fuel Tax	$19 million
Tobacco Tax	$14 million
Property Tax	$20 million
Insurance Tax	$4 million
Net Liquor Revenues	$23 million
Fees and Licenses	$17 million

The GNWT does not levy a sales tax, hotel tax, or capital tax, although most provinces do.

The following sections describe some of the options open to the GNWT to raise revenues from taxation.

Tax and Fee Revenue (millions)



In reviewing the options, consider the following:

1. **What is the best way for the GNWT to start raising additional revenues in 2009-10?**

2. **What longer-term objectives should the GNWT pursue for its tax system?**

3. **Given these objectives, what revenue options should the GNWT consider**

Tax Options

Income Taxes on Individuals

Income taxes are, on average, the largest source of revenue for the federal, provincial and territorial governments. The federal government and all provinces and territories levy income taxes on individuals. The federal government and four provinces levy payroll taxes on employers, based on employee earnings. The Northwest Territories and Nunavut levy payroll taxes on employees working in their jurisdictions.

Personal Income Tax

Canadians pay income tax to the federal government and to their respective provincial or territorial government. Tax is levied on taxable income, which is total income of the taxpayer 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 raises revenue by imposing a tax 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.

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 or most provincial income taxes.

Taxable Income Range	Tax Rate
$0 to $ 35,986	5.90 per cent
$35,986 to $ 71,973	8.60 per cent
$71,973 to $117,011	12.20 per cent
Over $117,011	14.05 per cent

For example, an individual with taxable income of $75,000 will pay $5,587 in tax before credits: 5.9 per cent of the first $35,986 ($2,123), 8.6 per cent of the next $35,987 ($3,095) and 12.2 per cent of the remaining $3,027 ($369). An individual with taxable income of $30,000 will pay 5.9 per cent of that amount, or $1,770 before credits are included. Ignoring the effect of tax credits, the higher income taxpayer will pay 7.4 per cent of his or her income in taxes, compared to 5.9 per cent for the lower-income individual. Once credits are taken into account, the difference in average tax rates will be higher.

NWT Personal Income Tax rates are among the lowest in Canada. Nunavut has lower rates and Alberta and Yukon have lower rates for the upper income ranges. (See Appendix Table A1) 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.

NWT Personal Income Tax rates were last changed in 2005. The tax rates on the first two tax brackets were lowered and the tax rates on the highest two tax brackets increased.

Several provinces and the Yukon have a high-income surtax in addition to their regular Personal Income Tax rates. Although the NWT does not have a high-income surtax, for employees the current Payroll Tax/Cost of Living Tax Credit combination has a similar effect as a surtax. All employees pay the 2 per cent Payroll Tax but the Cost of Living Tax Credit is capped at $942. An employee earning wages of $70,000 would pay $1,400 in Payroll Tax and be eligible for a maximum credit of $942.

The federal government collects Personal Income Tax for the three territories and for all provinces except Quebec under Tax Collection Agreements. These agreements maintain the uniformity of the Canadian tax system, encouraging economic efficiency and reducing costs for businesses and individuals. The agreements limit the flexibility of the provinces and territories to change the common tax base. For example, the GNWT could not change the definition of income or make employment income by non-residents subject to income tax in the NWT. However, the GNWT can set its own tax brackets and rates, and can introduce specific tax credits. The federal government does not charge the GNWT for income tax collection, except to administer specific GNWT tax measures such as the child benefit and cost of living tax credit.

There are two types of Personal Income Tax increases the GNWT could introduce to increase revenues: an increase in Personal Income Tax rates or the introduction of a high-income surtax.

Rate Increases

Increasing the lowest tax bracket rate from 5.9 per cent to 7.9 per cent would increase Personal Income Tax revenues by $7 million. Increasing the next bracket rate from 8.6 per cent to 10.6 per cent is also estimated to increase Personal Income Tax revenues by $7 million. Increasing the third bracket rate from 12.2 per cent to 14.2 per cent is estimated to increase Personal Income Tax revenue by $2 million. Increasing the highest tax bracket rate from 14.05 per cent to 16.05 per cent is estimated to increase Personal Income Tax revenues by another $2 million.

High Income Surtax

An example of a potential surtax, which would raise $2.2 million per year, is a levy of 8 per cent on territorial tax over $3,500. Most taxpayers with incomes less than $70,000 would pay no additional tax. Individuals with incomes of above $70,000 would pay the additional tax shown in the last column of the following table.

Personal Income Tax Increases: Annual Cost for a Single Taxpayer

Taxable Income ($)	**Increase 1st tax rate to 7.9%**	**Increase 2nd tax rate to 10.6%**	**Increase 3rd tax rate to 14.2%**	**Increase 4th tax rate to 16.05%**	**An 8% surtax on NWT PIT over $3,500**
30,000	315	-	-	-	-
40,000	422	80	-	-	-
50,000	417	280	-	-	-
60,000	417	480	-	-	-
70,000	417	680	-	-	53
80,000	417	720	161	-	144
90,000	417	720	361	-	242
100,000	417	720	561	-	339
110,000	417	720	761	-	437
120,000	417	720	901	60	539

A Personal Income Tax increase would lower the after-tax income of individuals living in the NWT. Lower after-tax incomes relative to other jurisdictions would increase the difficulty attracting and retaining skilled and professional staff in the North.

Increases to Personal Income Tax rates can be set so that they are more progressive. However, higher income earners are more mobile and could more easily make a decision to live outside the NWT.

Lower after-tax incomes would also impact consumption, and would likely reduce retail activity.

The Cost of Living Tax Credit

Another option for increasing revenues is to reduce the NWT Cost of Living Tax Credit. The credit was introduced in conjunction with the Payroll Tax in 1993 to partially offset the cost of living impact of the Payroll Tax.

The Cost of Living Tax 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.

Returning to the rate structure that was in place before the 2005 increase, but leaving the minimum credits in place, would increase GNWT revenues by $2.6 million.

Single people making over $24,640 would see their annual credit decrease by $120. However, single people earning under $15,000 would not see a change.

The revised rate structure would be as follows:

Income Range	Current Rate	2004 Rate
$0 to $12,000	2.60%	1.60%
$12,000 to $48,000	1.25%	1.25%
$48,000 to $66,000	1.00%	1.00%
$66,000 and above	0.00%	0.00%

Payroll Tax

The NWT Payroll Tax is 2 per cent of an **employee's** employment income in the NWT, and generates almost $40 million annually.

Four provinces have payroll taxes levied on **employers**. Rates range from 1.95 to 4.26 per cent of employer payrolls. The NWT and Nunavut are the only jurisdictions in Canada that have a payroll tax on employees.

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. The tax is imposed on all workers in the NWT, as a tax levied solely on non-residents would contravene the Charter of Rights and Freedoms' guarantee of labour mobility within Canada.

An increase in the Payroll Tax from 2 to 3 per cent, without offsetting measures, would generate an estimated $20 million per year in additional revenue.

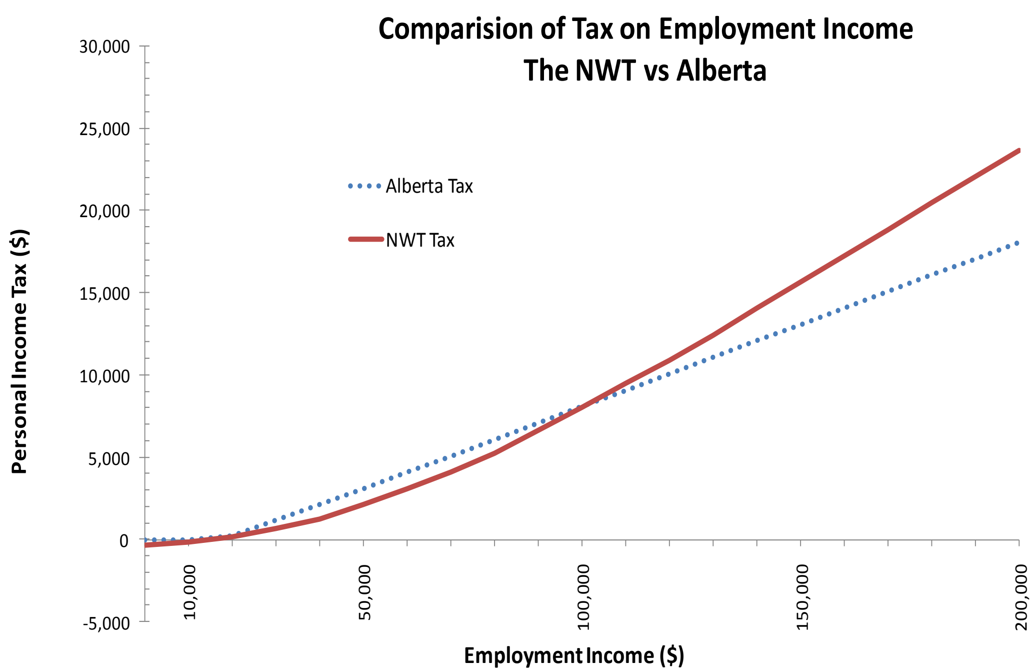
Because the Payroll Tax is levied only on employment income, a rate increase would increase the tax burden of employees compared to the self-employed, pensioners or individuals earning investment income. A portion of this increase could be offset by an increase in the Cost of Living Tax Credit. However, this has several implications:

- A Cost of Living Tax Credit increase would partially offset the revenues gained from increasing the Payroll Tax and further increase the tax burden of those with employment income compared to those with the same amount of income from other sources. (Under the Tax Collection Agreement the GNWT cannot base the Cost of Living Tax Credit on employment income only.)

- Increasing the combined impact of the Cost of Living Tax Credit and the Payroll Tax could also be seen as imposing a targeted tax on non-residents, which may have *Charter of Rights* implications.

- Changes to the NWT Income Tax/Payroll Tax regimes would also impact the NWT's competitiveness compared with other provinces and territories.

The following chart shows that single taxpayers working and living in the NWT who earn less than $100,000 pay less in personal income tax and payroll tax than they would in Alberta. Alberta's tax structure favours single taxpayers earning more than $100,000.



Notes:

1. Assumes that the NWT taxpayer claims the $6,022.50 Northern Deduction while the Alberta taxpayer does not.
2. Includes Income Tax, Payroll Tax and Cost of Living Tax Credit paid by a single resident and assumes that all income is derived from employment.
3. Does not take price differentials into account. The higher cost of living in the NWT reduces a household's after-tax purchasing power.

A family of two adults with one income earner would pay more tax in the NWT once employment income reached $80,000.

While those with low incomes pay less tax in the NWT than in Alberta, higher income individuals and families pay less tax in Alberta. The higher tax burden in the NWT may contribute to the reluctance of some higher income individuals to move to the NWT.

Increasing the Payroll Tax with a corresponding increase to the Cost of Living Tax Credit, or a reduction in the rates applicable to some or all of the Personal Income Tax brackets, would provide a greater incentive for those who work in the NWT to also live here. However, such a change would not by itself be sufficient to offset the higher cost of living in the NWT. The GNWT would need to levy a payroll tax of 13 per cent (an increase of 11 percentage points) with an increase to the Cost of Living Tax Credit of 11 percentage points to bring the average after tax and cost of living income of a NWT resident working in the NWT to the same level as an Alberta resident working in the NWT. A Cost of Living Tax Credit of 11 per cent would exceed NWT income tax for all but a very few high income taxpayers. Furthermore, tax inequity would increase significantly, as self-employed persons, and others with income from sources other than employment, would not pay payroll tax on their incomes but would benefit from increases to the Cost of Living Tax Credit.

Taxes on Business

The federal government and all provinces and territories levy income taxes on corporations. A number of provinces and the federal government levy taxes on corporate capital, although most jurisdictions intend to phase these taxes out over the next few years. Provincial governments also levy taxes and royalties on resource extraction. The federal government collects royalties in the NWT.

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.

Corporate Income Tax is forecast to be the NWT's largest own-source revenue over the next four years, at a forecast average of $95 million per year. Corporate tax revenues are subject to significant variation due to movement of investment income and changes in the economic environment, especially in the resource sector. Corporate Income Tax revenues have ranged from a high of $486 million in 2001-02 to a low of negative $225 million in 2003-04.

The NWT taxes large corporations at 11.5 per cent of taxable income. Small corporations - income up to $400,000 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.

Among Canadian jurisdictions, only Quebec, Alberta and British Columbia have lower Corporate Income Tax rates than the NWT.

Corporations that operate in more than one province or territory must allocate their income according to a formula set out in the federal *Income Tax Regulations*. For most corporations, income, including investment income, is allocated to those provinces and territories in which the corporation has a permanent establishment. The allocation is based on where the corporation's employees are located (wages and salaries paid) and where sales take place (revenues). There are different formulas for some types of corporations, such as financial institutions, transportation companies or pipelines. The allocation is calculated separately for each separate corporation, so a company with an establishment in several jurisdictions can have a subsidiary in only one jurisdiction. All income from that subsidiary would be allocated to its permanent establishment. The low NWT rate may encourage companies to structure their affairs to allocate their income, particularly investment income, to the NWT. This change can be accomplished relatively easily, though there would be little or no increase in economic activity or employment in the territory.

A one percentage point increase in the tax rate for large corporations could raise approximately $8 million per year in additional revenues **assuming no shift in allocation of corporate income outside the NWT.** However, the revenue gains from an increase in Corporate Income Tax rates could be lower since corporations might shift income to other jurisdictions. It is difficult to predict how tax rate changes will affect Corporate Income Tax revenues.

Each percentage point increase in the CIT rate for small corporations would generate an estimated $360,000 per year.

Corporate Income Tax Revenues

	Current Rate	**Estimated Annual Revenue***	**Additional Revenue per 1% Increase**
Large Corporations	11.50%	$93,500,000	$8,000,000
Small Corporations	4.00%	1,500,000	360,000
Total		$95,000,000	$8,360,000

*These estimates do not take into account any likely reduction in income reported in the NWT as a result of higher rates.

Any increase in Corporate Income Tax rates would make the NWT less attractive for business, and could hamper investment in the territory. Furthermore, the federal government has recently challenged all provinces and territories to lower their Corporate Income Tax rates to 10 per cent to increase Canada's international competitiveness.

Capital Tax

A capital tax is a tax on a corporation's paid up capital. Paid-up capital generally includes retained earnings, capital stock, and long-term debt. Capital taxes distort the investment regime, reduce competitiveness and discourage innovation. The NWT does not levy a capital tax.

For multi-jurisdictional companies, the capital tax base is allocated among provinces and territories on the same basis as income tax. A capital tax in the NWT could encourage companies to allocate income to other jurisdictions.

Capital tax revenues are more stable than Corporate Income Tax revenues because capital does not fluctuate from year to year as widely as does corporate income. However, since the capital tax is allocated on the same basis as Corporate Income Tax, fluctuations in how corporate income is allocated could affect the collections of a capital tax.

Until 2006, the federal government imposed a general capital tax and some provinces still impose capital taxes. However, many provinces are in the process of eliminating their general capital taxes. All provinces and territories, and the federal government, will eliminate general capital taxes by July 1, 2012

Most provinces exempt small businesses from capital taxes.

It is estimated that a tax of 0.3 per cent on the paid-up capital of large corporations could generate around $12 million per year once fully implemented. A tax of 1.0 per cent on the paid-up capital of financial institutions (mainly chartered banks) would generate $0.6 million per year. However, since the NWT does not now have a capital tax, these estimates are approximations. There may also be significant administrative costs. Although the Canada Revenue Agency administers some provinces' capital taxes, the federal government may be unwilling to administer new capital taxes.

A capital tax would allow the NWT to tax companies that are still developing resources but have not yet started production. Companies that have income but do not pay income tax because of capital cost allowances or other factors would pay capital tax. Companies in financial difficulties would also be liable for capital tax.

Capital taxes are strongly opposed by the corporate sector because the tax is not related to profitability and must be paid even when a company is losing money.

Resource Income Tax

Although the GNWT does not have the authority to levy a royalty on the production of non-renewable resources, it does have the authority to levy an income tax on the income earned from the extraction of the resource. Either a mining income tax or an oil and gas income tax could be levied. The structure of each would likely differ since the industries operate differently.

A Resource Income Tax would be an additional method of raising revenues from resource activity in the NWT, particularly in the absence of any access to royalty revenues. Some provinces levy mining income taxes in lieu of collecting royalties. No provinces levy oil and gas income taxes, although some use a similar approach to determine oil and gas royalties.

A Mining Income Tax would allow the GNWT to capture some of the fiscal benefits from mining activity that escape the NWT corporate income tax system. The structure of a Mining Income Tax could take into account less profitable mining entities.

A Mining Income Tax could have the following components: a creditable 3 per cent minimum tax payable by all companies, a creditable 12 per cent rate for companies with rates of return of up to 8 per cent and a 20 per cent rate for corporations with rates of return greater than 15 per cent. Based on a number of assumptions, including capital costs of $2.1 billion and a pre-tax rate of return of 26.8 per cent, this option would generate an estimated $550 million over the 16-year life of a 'typical" diamond mine or an average of $34 million per year. However, it is difficult, given the lack of information available to the GNWT, to estimate the actual revenues that could be generated.

The following table compares the combined effects of a mining income tax and royalties for the mining sector in the NWT versus the royalties in several other jurisdictions for several hypothetical mines.

Mining Income Taxes and Royalties

	NWT With Mining Income Tax	NWT Without Mining Income Tax	Alberta	BC	Ontario
Profitable medium-term diamond mine	60.0%	41.8%	39.3%	40.0%	45.6%
Marginally profitable longer-term diamond mine	54.3%	43.6%	42.6%	43.4%	60.3%
Very profitable short-term base metal mine	53.2%	35.4%	37.4%	38.0%	40.5%
Profitable medium-term gold mine	52.8%	42.6%	33.8%	36.1%	45.4%

Similar to a Mining Income Tax, an Oil and Gas Income Tax could allow the GNWT to capture some of the fiscal benefits from petroleum activity that escape the NWT corporate income tax system.

Firms paying royalties to Canada, and also liable for the Mining Income Tax or the Oil and Gas Income Tax, may consider the introduction of Resource Income Taxes to be double taxation. Such taxes could also act as disincentives to new development.

The introduction of a Resource Income Tax, whether on mining or oil and gas income earned in the NWT, would require further analysis to fully understand the implications for the resource industry.

Consumption Taxes

Sales taxes are significant source of revenue for many provincial governments. The federal government levies the Goods and Services Tax (GST), and most provinces levy a Retail Sales Tax (RST) or have harmonized their sales taxes with the GST. Only Alberta and the three territories do not levy a general sales tax. All provinces and territories levy specific taxes on some products and services, such as hotel rooms, tobacco, or fuel.

Sales taxes are based on consumption, not income, and thus favour saving and investment. Because sales taxes are imposed at the same rate on all taxpayers, they tend to be less progressive than income taxes. Provinces and the federal government partially compensate for this lack of progressivity by exempting food and other necessities. Because these exemptions apply to a larger portion of the spending of lower income groups, these groups are partially shielded from the tax. The federal government also provides a GST credit through the income tax system to lower-income individuals to help alleviate the effect of the GST. Some provinces also provide sales tax credits.

Because provinces and territories can only levy direct taxes within their borders, the GNWT could only impose a sales tax on consumption within the NWT. A province or territory cannot impose a sales tax on goods destined for export, or only on imported goods.

Fuel Tax

The NWT *Petroleum Products Tax Act* taxes the consumption of gasoline and diesel fuel in the NWT. The GNWT expects to raise almost $20 million per year from fuel taxes over the next four years.

Current NWT fuel tax rates are:

Petroleum Product	Rate (cents/litre)
Gasoline (on highway) [1]	10.7
Gasoline (off highway)[1]	6.4
Diesel (motive)	9.1
Diesel (non-motive)[2]	3.1
Rail	11.4
Aviation	1.0
Heating fuel	0.0

[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. The NWT gasoline tax rate is the same as New Brunswick but lower than in all other provinces except Alberta, Nunavut and Yukon. Only Alberta and Yukon have lower motive diesel fuel tax rates. There is no NWT tax levied on fuel used for heating, propane, or natural gas.

Non-motive diesel fuel taxes are, however, higher in the NWT than in most provinces. The NWT is one of the few jurisdictions where non-motive diesel fuel used in power generation and by the mining industry is taxed.

The *Petroleum Products Tax Act* and *Regulations* calculate the on-highway gasoline tax as a percentage of the Yellowknife prices. All other fuel tax rates, except aviation fuel tax rate, are set as a percentage of the on-highway gasoline tax rate. Although Yellowknife gasoline prices are surveyed quarterly under the *Act*, tax rate changes are the Minister of Finance's decision. The last time rates were changed was 1997, even though subsequent surveys would have allowed for increases. The most recent survey would support a 95 percent increase in all rates except the aviation rate, which is fixed at 1 cent per litre.

With the exception of aviation fuel, a 1 cent per litre increase in fuel tax rates would generate an additional $2.6 million in tax revenues.

Allowing rates to increase to the surveyed rates would generate $17.8 million in revenue but would increase tax rates to 19.4 cents per litre for on-highway gasoline, 11.6 cents per litre for off-highway gasoline, 16.5 cents per litre for motive diesel and 5.6 cents per litre for non-motive diesel.

A fuel tax increase would raise the cost of freight and, therefore, add to the cost of living in the NWT. Higher fuel costs could also encourage greater energy conservation and efficiency. However, NWT residents and businesses are currently facing the highest oil prices on record and this in itself is likely to encourage conservation.

An increase in the non-motive diesel fuel tax rate to equal the motive diesel rate would raise $6 million but would also increase the costs of power generation for the NWT Power Corporation and other electricity producers. A portion of the higher cost to consumers and small businesses outside of Yellowknife would be covered by the Territorial Power Support Program and would, therefore, reduce the net revenue gain to the GNWT.

Fuel taxes are often linked to the expense of building and operating highways, and that link justifies higher taxes on fuel used for motor vehicles and exemptions for vehicles that are not used on roads. In the NWT total fuel tax collections are significantly less than the amount spent on highways, despite significant revenue from uses other than transportation.

Tobacco Tax

The NWT *Tobacco Tax Act* raises revenue by taxing the consumption of tobacco in the NWT. The GNWT's tobacco taxes will generate an estimated $14 million per year over the next four years.

The cigarette tax rate is currently $42.00 per carton, compared to the average provincial-territorial tax rate of $27.65. Along with the Yukon and Nunavut, the GNWT levies the highest cigarette tax rate in Canada.

The *Tobacco Tax Act* and *Regulations* calculate taxes on tobacco as a percentage of surveyed Yellowknife prices. Although surveys are conducted quarterly, the tax was last changed on April 1, 2003.

Tobacco is taxed at a rate much higher than other goods because of the health risks associated with its use. The evidence suggests that increasing cigarette taxes is an effective tool in reducing consumption, particularly among teenagers. Per capita cigarette sales in the NWT fell sharply between 1999 and 2006; a period in which federal and territorial rates increased substantially.

Other things being equal, low-income smokers bear a disproportionate share of an increase in tobacco tax than high-income smokers.

An increase in the tax rate on cigarettes and loose tobacco to the rate currently provided in legislation would generate close to $1.3 million per year, assuming that consumption would fall by 1 per cent as a result of the tax change.

The increases would raise the per carton tax on cigarettes from the current $42.00 per carton to $46.40 per carton, and loose tobacco from 13.6¢ to 15.2¢ per gram.

	Current Rates	
	% of Price	**($)**
Cigarettes	90%	$42.00 / carton
Cigarette Tobacco	90%	13.6 ¢ / gram
Other Tobacco	90%	13.6 ¢ / gram
Cigars	75%	75%

A tobacco tax increase may increase smuggling and tax evasion. The cigarette price difference between the NWT and Alberta is now $7.25 per carton. The incidence of smuggling in southern Canada has increased substantially in recent years, and although there is not a lot of evidence of smuggling in the NWT, the larger the difference in price, the greater the incentive for smuggling.

Insurance Tax

The GNWT levies taxes 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 rates are close to the national averages. Insurance taxes will generate an estimated $3.5 million per year over the next four years.

A one percentage point increase in the 3 per cent general insurance tax would raise $1.2 million per year in revenue.

Although insurance companies would face a higher cost of doing business in the NWT, the effect on their overall operations would be small, because NWT customers account for only a small portion of their total earnings. Insurance premiums have increased substantially over the last five years. An increase in the insurance tax would add to this cost.

Liquor Revenues

The GNWT applies a flat per litre liquor mark-up based on the type of liquor sold. The NWT Liquor Commission generates approximately $22 million per year in net liquor revenues. These revenues are remitted to the GNWT and are used to fund government programs and services.

Because beer, wine and spirit revenues are raised in different ways in different provinces, it is difficult to compare NWT mark-ups with other jurisdictions. In general, 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 than in other areas of Canada.

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

Beer	$1.91 per litre
Wine	$7.69 per litre
Spirits	$25.84 per litre

The formula used by the NWT Liquor Commission to determine prices takes 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 Commission at the wholesale level, and Yellowknife store operators set their own retail prices.

Licensees are charged an additional fee of 5 per cent.

A 10 per cent increase in mark-ups charged by the NWT Liquor Commission would raise an estimated $1.2 million per year in new revenues. The per-litre mark-ups would increase to $2.10 on beer, $8.45 on wine, and $28.42 on spirits.

The current fixed price per litre mark-up system could be converted to an *ad valorem* system, which charges a percentage of the selling price. Another approach would be similar to that used for tobacco and fuel where a fixed dollar charge is adjusted periodically based on either a price survey or a change in a price index like the Consumer Price Index.

Liquor mark-ups were increased by 10 per cent on April 1, 2003.

Higher mark-ups on liquor could generate additional revenue with no added administrative costs. Higher prices could provide added incentives to reduce consumption. A review of the last three mark-up increases, in 1995, 1999, and 2003, revealed that volumes in retail outlets declined in the year following the increase, stabilized the next year, and increased the year after that. Licensee sales also decreased after each mark-up increase, and have continued to drop every year since the 2003 mark up change.

If higher prices discourage drinking, some of the health and social problems associated with alcohol abuse may be alleviated.

Prices of many liquor products in the NWT are higher than those in the south. Further price increases could result in residents purchasing more liquor products in southern Canada and could encourage smuggling.

Sales Tax

There are two major approaches to sales taxation followed in Canada: the *retail sales tax (RST)* approach, where tax is applied only at the point of sale to the consumer; and the *value-added approach*, where tax is collected at each stage of the production process, but subsequently refunded to all who paid it at an intermediate stage, thus leaving only the final consumer liable for the tax. Under the value-added approach, most tax paid by businesses would be credited back to the purchaser, so almost all the tax is paid by individuals. Under an RST, a significant part of the tax may be paid by businesses on their purchases. The GST is an example of a value-added tax.

Five provinces have RSTs: British Columbia, Saskatchewan, Manitoba, Ontario and Prince Edward Island. Since 1997, three provinces, Newfoundland and Labrador, Nova Scotia, New Brunswick, have participated in a Harmonized Sales Tax (HST), which currently consists of the 5 per cent GST and an 8 per cent provincial portion, for a total of 13 per cent. In 1992, Quebec harmonized its tax base, with only minor exceptions, with the GST, but continues to collects its own tax (as well as the GST in Quebec). Alberta does not have a general sales tax; nor do any of the three territories.

Rates and exemptions vary from province to province, with the HST provinces and Quebec having the fewest exemptions. The RST provinces generally have narrower tax bases, despite their imposing tax on many business inputs that are not taxed under the HST.

The GNWT has three options for levying a sales tax: join the HST system, introduce a value-added tax at a different rate, or impose a retail sales tax.

Joining the HST would require the introduction of a value-added tax of 8 per cent on the same goods and services that are currently subject to federal GST. This would generate an estimated $59 million annually.

Each RST percentage point would generate about $6 million annually, so a 5 per cent sales tax would generate close to $30 million annually.

An HST would be administered by the federal government and would not require any additional administration or policy staff. For an RST, territorial administration would have to be set up. This would cost an estimated $600,000 in ongoing expenditures and an additional $450,000 in start-up costs.

A value added tax similar to Quebec's would probably cost more to administer than an RST. Although Quebec administers the federal GST in Quebec, it is not likely that the federal government would be prepared to do something similar in the NWT because of the small size of the NWT economy.

The introduction of an HST would not change the administrative burden for businesses because they already operate under the GST. Under an RST regime, however, businesses would have to administer two separate taxes.

The burden of an HST, like the GST, would be borne almost entirely by consumers, since most businesses would receive credit for the tax paid on their inputs. More of the burden would be borne by businesses under a RST since some business inputs would be taxed.

A sales tax would increase the cost of living in the NWT, particularly in remote communities where prices are very high. An 8 per cent HST would raise the general price level by about 5 per cent[1], while a 5 per cent RST would raise the general price level by roughly 3 per cent, depending on what goods and services were taxed.

Higher costs may reduce retail sales volumes in the NWT, as residents either reduce their spending or purchase goods in lower cost jurisdictions.

Sales taxes impose a relatively higher tax burden on low-income households than higher income households because they tend to spend a higher proportion of their income on consumption.

Hotel Tax

A Hotel Room Tax, applied to rooms in hotels, motels, inns, bed and breakfasts, and lodges, would raise revenues primarily from visitors to the NWT. The tax would not substantially increase the cost of travelling to the NWT relative to the

[1] The price rise would be less than the tax rate because some goods and services would be exempt. According to Statistics Canada's 2001 Family Expenditure Survey, Yellowknife households allocate about 36 per cent of their expenditures to food, shelter and health care, which would be mainly exempt under an HST.

cost of airfare, room charges, hunting licenses and other vacation expenditures, and therefore a tax would not be expected to have a material impact on tourism.

The NWT is one of the few jurisdictions in Canada, along with the Yukon and Nunavut, which does not levy a tax specific to hotel accommodation. The tax can take the form of either a flat charge per room per night or a percentage of the room charge, similar to the GST. The GST is also levied on hotel room charges.

A Hotel Room Tax rate of 5 per cent per room would raise about $2.5 million annually. However, it would also add about $120,000 annually to GNWT travel costs and create additional tax administration costs of about $100,000 per year.

The imposition of a Hotel Room Tax would also result in additional tax administration costs for accommodation operators. Administration would also be more complicated for operators of bed and breakfasts and lodges that bundle their services. The cost of compliance could also be relatively high for small operators, although exemptions could be provided for establishments with fewer than a specific number of rooms.

Carbon Tax

Concerns over climate change have led policy makers in many countries to consider using the tax system to reduce the use of carbon-based fuels and encourage investment in energy alternatives. A growing number of jurisdictions have introduced “carbon taxes”, which are taxes based on the carbon content of a fuel being consumed.

A comprehensive carbon tax would apply to the consumption of any carbon-based fuel that produces carbon dioxide emissions, 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 number of European countries levy environmental taxes they refer to as carbon taxes on carbon dioxide (CO_2) emissions. All these countries provide for significant exemptions from their carbon taxes, mainly to protect the competitiveness of their economies. Table A3 lists selected European environmental taxes and their exemptions.

In 2006, Quebec introduced a carbon tax of $3.40 per tonne of CO_2 with the revenue generated in to a Green Fund. The carbon tax converts to a tax of 0.8 cent per litre of gasoline, 0.94 cents per litre on diesel, and 0.97 cents per litre on fuel oil. The tax applies also to petroleum coke, coal, propane and natural gas.

The NWT could generate $4 million in tax revenue by imposing a Quebec-style carbon 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¢/litre for gasoline and other fuel.

The 2008 British Columbia budget introduced a Carbon Tax of $10 per tonne CO_2 which will be increased by $5 per tonne in each of the next four years to reach $30 per tonne by 2012. The following table shows that the tax will increase the price of gasoline by 7.24 cents per litre and diesel fuel by 8.27 cents per litre when fully implemented.

British Columbia Carbon Fuel Tax Rates by Fuel Type

	Units for Tax Rates	July 1, 2008	July 1, 2009	July 1, 2010	July 1, 2011	July 1, 2012
Liquid Fuels						
Gasoline	¢/Litre	2.41	3.62	4.82	6.03	7.24
Diesel	¢/Litre	2.76	4.14	5.52	6.89	8.27
Light Fuel Oil	¢/Litre	2.76	4.14	5.52	6.89	8.27
Heavy Fuel Oil	¢/Litre	3.11	4.67	6.22	7.78	9.33
Aviation Gasoline	¢/Litre	2.45	3.67	4.90	6.12	7.34
Jet Fuel	¢/Litre	2.62	3.93	5.25	6.56	7.87
Kerosene	¢/Litre	2.56	3.84	5.12	6.40	7.68
Gaseous Fuels						
Natural Gas	¢/GJ	49.88	74.82	99.76	124.70	149.64
Propane	¢/Litre	1.53	2.30	3.06	3.83	4.60
Butane	¢/Litre	1.76	2.65	3.53	4.41	5.29
Ethane	¢/Litre	0.98	1.46	1.95	2.44	2.93
Pentane	¢/Litre	1.76	2.65	3.53	4.41	5.29
Coke Oven Gas	¢/GJ	42.31	63.47	84.62	105.78	126.93
Still Gas	¢/GJ	51.22	76.83	102.44	128.05	153.66
Solid Fuels						
Coal - Canadian Bituminous	$/Tonne	20.79	31.18	41.58	51.97	62.36
Coal - Sub-Bituminous	$/Tonne	17.72	26.58	35.44	44.30	53.15
Coal - US Bituminous	$/Tonne	24.39	36.58	48.78	60.97	73.16
Coke	$/Tonne	24.87	37.30	49.74	62.17	74.60
Petroleum Coke	¢/Litre	3.67	5.51	7.34	9.18	11.01
Tires - shredded	$/Tonne	23.91	35.87	47.82	59.78	71.73
Tires - whole tires	$/Tonne	20.80	31.20	41.60	52.00	62.40

Source: Province of British Columbia

The proceeds from British Columbia's Carbon Tax will be offset by reductions to other taxes such as personal and corporate income taxes. Therefore, British Columbia's tax will be revenue neutral, substituting a tax on a "good" activity (earning income) with a tax on a "bad" activity (emitting carbon). British Columbia will reduce 2008 taxes on personal income, corporate income (both for large and small corporations) and provide a quarterly Climate Action Credit to lower-income tax filers. For subsequent years, British Columbia stated that it will introduce other tax reductions to offset the future increased revenue from the Carbon Tax.

A carbon tax based on the B.C. model could raise approximately $41 million in the NWT.

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

An NWT carbon tax could be made "revenue neutral", that is, other taxes could be lowered to offset the higher tax burden on carbon consumption. However, this would not meet the objective of raising additional revenues, nor would the tax reductions necessarily benefit those bearing the burden of the carbon tax. For example, decreases in PIT and CIT rates similar to the rate reductions planned in British Columbia would largely benefit those paying those taxes. This may not provide the necessary offset to those bearing the largest share of the carbon tax.

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

Other Taxes

Property Tax

The GNWT raises revenue from taxing NWT properties. It collects property taxes 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) – or Municipal Taxation Authorities - are responsible for collecting their own property taxes. Yellowknife collects property taxes for itself and the two Yellowknife school boards. The five other Municipal Taxation Authorities collect property tax for education on behalf of the GNWT.

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

Property tax rates in the General Taxation Area are significantly lower than rates in Municipal Taxation Authorities. General Taxation Area mill rates on properties other than minerals, hydrocarbons and pipelines have increased 40 per cent since they were established in 1967. Given that the Canadian Consumer Price Index has increased 600 per cent since 1967, General Taxation Area property taxes have fallen substantially in real terms. There is currently a large differential in the property tax burden between the General Taxation Area and Municipal Taxation Authorities communities. For example, the tax on a single family home in Fort Simpson is about $1,400 compared to $300 in Behchokǫ̀. These differences are largely the result of differing mill rates.

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 Municipal Taxation Authorities 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 Municipal Taxation Authorities communities.

A 10 per cent increase in general and education property tax mill rates would raise roughly $2 million per year for the GNWT, or $30 per property in General Taxation Area communities.

The NWT Housing Corporation is one of the largest property taxpayers in the NWT. An increase in property taxes would result in higher operating costs for the NWT Housing Corporation.

2008 Property Tax General and Education Rates

General Taxation Area General Mill Rates	
(i) Hydrocarbons (Class 3)	13.88
(ii) Minerals (Class 4)	13.88
(iii) Pipeline (Class 5)	28.42
(iv) All others	2.68
General Taxation Area Education Mill Rate	2.47
Municipal Taxation Area Education Mill Rates	
(i) Fort Simpson	2.43
(ii) Fort Smith	3.50
(iii) Hay River	3.52
(iv) Inuvik	3.57
(v) Norman Wells	4.28

Non-tax Revenues: Fees, Licenses, Permits and Charges

Apart from major tax revenues, the GNWT raises revenues through charges for licenses and permits, rental of housing or buildings, and other recoveries. These revenues and recoveries account for about $18 million annually.

	2008-09 Main Estimates (thousands)
Airport Fees	$5,115
Land Titles and Legal Registries	$3,531
Motor Vehicle Registrations	$3,196
Driver's Fees, Licenses and Permits	$1,108
Other Licenses and Permits	$1,768
Other Fees and Miscellaneous	$1,164
Land Leases	$700
Fines and Court Fees	$532

These revenues and recoveries should be considered for possible revenue-raising options in cases where the GNWT has control over the amounts or rates charged.

The GNWT may provide some free services for which a fee or permit would be appropriate; however, it is unlikely that increased fees would provide substantial new revenues.

Any potential change to fees, licenses, or other charges should be considered in light of a Supreme Court decision which directed that, in general, fee and license charges should be reasonably related to the costs of providing the service.

Health Insurance Premiums

Currently, only British Columbia, Alberta, and Ontario use health care premiums to help finance their health care systems. However, Alberta plans to eliminate its health care premiums effective January 1, 2009. Premium subsidies are available to low-income families and individuals whose income is below a certain threshold. Ontario health care premiums are based on taxable income, while Alberta and British Columbia's premiums are based on household income and size.

There are no health care premiums in the NWT. If the GNWT applied the Ontario health care premium structure, it would be able to raise approximately $9 million in health care premiums. Although premium assistance could be made available to low-income families, health care premiums would add to the cost of living in the NWT.

Highway Toll

The GNWT considered imposing a highway toll in 2001. The proposed commercial vehicle toll was based on weight of the transported goods and vehicle and distance travelled. The toll would have applied to both extra-territorial and intra-territorial commercial trucking of goods on the all-weather public highways but would not apply to local freight movements. The toll revenue would have been deposited into a Public Highway Trust Fund, and used to finance the improvement and upgrades of the territorial public highway system. At the time, it was estimated that a toll of 5 cents per tonne-kilometre would raise over $15 million in gross revenue and would increase annual household costs by $38 in Inuvik, $277 in Wrigley, and $191 in Yellowknife. The impact on business was not considered in the analysis. The commercial vehicle toll proposal was not implemented.

The Deh Cho Bridge will be financed in part through a toll levied on commercial vehicles using the bridge.

Airport Improvement Fee or Departure Tax

Many airports in Canada impose airport improvement fees, ranging from $5 to $40 per person on departing passengers, as a way of raising funds for airport capital projects. The GNWT could introduce a similar user-fee on air travellers leaving the NWT; however, it would be difficult to levy such a fee on passengers departing from privately operated runways.

Instead of a user fee, which is intended for a specific purpose and expected to be related to the costs of the service, the GNWT could raise revenue through an airport departure tax, which would affect all air travellers leaving the NWT. If implemented, this tax would be the first of its kind in Canada.

Based on an estimate of 117,300 passengers leaving the NWT through the Yellowknife airport in 2004, a $30 fee or tax on passengers leaving the NWT would generate about $3.5 million annually.

In the coming weeks, the GNWT will be consulting Northerners about these and other questions. We encourage your input. After all, it's your tax dollar.

The GNWT is committed to ensuring that the NWT's tax structure is competitive, is able to fund essential programs and services, and works for NWT residents. Your input and ideas will help achieve these goals.

Copies of this paper are 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
Yellowknife NT X1A 2L9

Or by e-mail to:

Revenue_Options@gov.nt.ca

Appendix – Supplementary Tables

Table A1 – Provincial and Territorial Personal Income Tax Rates

2008 FEDERAL & PROVINCIAL TAX RATES, BRACKETS & SURTAXES				
		Tax rate	Surtax	
	Tax brackets	(%)	(%)	Threshold
Federal	0 - $37,885	15.00		
	$37,885 - $75,769	22.00		
	$75,769 - $123,184	26.00		
	> $123,184	29.00		
Newfoundland	0 - $30,215	8.20		
	$30,215 - $60,429	13.30		
	> $60,429	16.00		
Prince Edward Island	0 - $31,984	9.80	10	$12,500
	$31,984 - $63,969	13.80		
	> $63,969	16.70		
Nova Scotia	0 - $29,590	8.79	10	$10,000
	$29,590- $59,180	14.95		
	$59,180 - $93,000	16.67		
	> $93,000	17.50		
New Brunswick	0 - $34,836	10.12		
	$34,836 - $69,673	15.48		
	$69,673 - $113,273	16.80		
	> $113,273	17.95		
Ontario	0 - $36,020	6.05	20	$4,162
	$36,020 - $72,041	9.15	36	$5,249
	> $72,041	11.16		
Quebec	0 - $37,500	16.00		
	$37,500 - $75,000	20.00		
	> $75,000	24.00		
Manitoba	0 - $30,544	10.90		
	$30,544 - $66,000	12.75		
	> $66,000	17.40		
Saskatchewan	0 - $39,135	11.00		
	$39,135 - $111,814	13.00		
	> $111,814	15.00		
Alberta	Taxable income	10.00		
British Columbia	0 - $35,016	5.24		
	$35,016 - $70,033	7.98		
	$70,033 - $80,406	10.50		
	$80,406 - $97,636	12.29		
	> $97,636	14.70		
Yukon	0 - $37,885	7.04	5	$6,000
	$37,885 - $75,769	9.68		
	$75,769 - $123,184	11.44		
	> $123,184	12.76		
Northwest Territories	0 - $35,986	5.90		
	$35,986 - $71,973	8.60		
	$71,973 - $117,011	12.20		
	> $117,011	14.05		
Nunavut	0 - $37,885	4.00		
	$37,885 - $75,770	7.00		
	$75,770 - $123,184	9.00		
	> $123,184	11.50		

Table A2 – Provincial and Territorial Tax Rates as at July 1, 2008

	Combined Top Marginal PIT Rate [(a)] (%)	Retail Sales Tax (%)	Fuel Tax [(b)] Gasoline (¢/ litre)	Fuel Tax [(b)] Diesel (¢/ litre)	Tobacco Tax on Cigarettes ($/ carton) [(c)]	Payroll Tax [(d)] (%)	Corporate Income Tax Small (%)	Corporate Income Tax Large (%)	Capital Tax [(e)] (%)
Northwest Territories	43.05	-	10.7	9.1	42.00	2.00	4.0	11.5	-
Nunavut	40.50	-	6.4	9.1	42.00	2.00	4.0	12.0	-
Yukon	42.40	-	6.2	7.2	42.00	-	4.0	15.0	-
British Columbia	43.70	7.0	14.5	15.0	35.80	-	3.5	11.0	0/ 3.0
Alberta	39.00	-	9.0	9.0	37.00	-	3.0	10.0	-
Saskatchewan	44.00	5.0	15.0	15.0	36.60	-	4.5	12.0	0/ 3.25
Manitoba	46.40	7.0	11.5	11.5	35.00	2.15	2.0	13.0	0.4/ 3.0
Ontario	46.41	8.0	14.7	14.3	24.70	1.95	5.5	14.0	0.285/ 0.855
Quebec	48.22	7.5	15.2	16.2	20.60	4.26	8.0	11.4	0.36/ 0.72
New Brunswick	46.95	8.0	10.7	16.9	23.50	-	5.0	13.0	0.10/ 3.0
Nova Scotia	48.25	8.0	15.5	15.4	33.04	-	5.0	16.0	0.225/ 4.0
Prince Edward Island	47.37	10.0	15.8	20.2	34.90	-	3.2	16.0	0/ 5.0
Newfoundland	45.00	8.0	16.5	16.5	36.00	2.00	5.0	14.0	0/ 4.0
Weighted average [(f)]	45.65	6.8	14.1	14.3	27.72	1.86	5.4	12.5	

Notes:
(a) Combined federal-provincial/ territorial highest personal income tax rates in effect for the 2008 tax year.
(b) New Brunswick, Newfoundland, Nova Scotia and Quebec apply sales tax to fuel. The NWT's off-highway gasoline tax rate is 6.4 cents/ litre.
(c) Manitoba, New Brunswick, Newfoundland, Nova Scotia and Saskatchewan apply sales tax to tobacco products.
(d) The NWT and Nunavut levy payroll taxes on employees. Other provinces that levy payroll taxes provide exemptions for small business and/ or the rates vary depending on the payroll size.
(e) Capital tax rates are for large corporations and for financial institutions in the order shown. The tax bases are different for different types of companies.
(f) Average weighted by provincial/ territorial populations at July 1, 2007.

Table A3 – Selected European Carbon Taxes

	Coal	Diesel	Heavy fuel	Light fuel	Methane for stationary	Electricity consumption	Natural gas	Natural gas burned on petroleum platforms	Petroleum burned on petroleum platforms	Gasoline unleaded	Domestic aircraft
	CA$/ tonne	CA$/ litre	CA$/ kg	CA$/ litre	CA$/ GJ	CA$/ kWh	CA$/ nm3	CA$/ m3	CA$/ litre	CA$/ litre	CA$/ litre
Denmark	47.72	0.06	0.06	0.06		0.01	0.04				
Finland	63.94	0.07	0.09	0.07			0.029			0.06	
Norway		0.10	0.10	0.10			0.09	0.09	0.09	0.15	0.12
Sweden	87.88	0.72		0.57	8.87					0.84	

Examples of exemptions from tax:

Denmark	- Use in aviation, used in the production of electricity, used in commercial fishing vessels, exports of coal and oil.
Finland	- Waste oil, fuel used in electricity generation, fuel used as raw material or as an immediate input, used in fishing boats outside territorial waters.
Norway	- Fuels used in aviation, fishing boats, military vehicles, and products exported.
Sweden	- Fuels used in aviation, ships and boats, fuels sold in one litre containers, fuel used by trains, fuels used for the production of mineral oils, carbon fuels and petroleum coke, fuels used for the production of electricity.

Notes

1. Other fuel taxes are levied in addition to those listed.
2. Source of the data is the OECD/EEA database on instruments used for environmental policy and natural resources management last updated December 7, 2007.
3. Prices in Euros converted to the nearest cent in Canadian dollars at the Bank of Canada's average 2007 exchange rate CA$1.47/ €.