Cross-border Shopping and Sales Taxes
How it affects Nova Scotians

Fall 2010

Introduction

Most retail sales in Nova Scotia are subject to a harmonized sales tax (HST). This tax is administered by the federal government and applies to all goods and services, with some exceptions. It combines the federal goods and services tax (GST) of 5% and Nova Scotia's value-added tax (10%). Although the HST differs from retail sales taxes in some provinces, it is similarly applied in neighbouring New Brunswick.

Nova Scotia's restoration of the harmonized sales tax (HST) rate to 15% has created a price differential for many goods and services between this province and New Brunswick, where the HST rate is 13%.

This paper examines cross-border tax differences in several areas of Canada and the United States, considers the impact on retailers and consumers, and identifies how other jurisdictions are managing the situation.

Cross-border price differences created by sales taxes are not uncommon across Canada and the northern United States. As the tax gap increases, near international or interprovincial borders, retailers in the higher tax areas are more likely to feel the impact of consumers choosing to make purchases in the lower tax area.

Nova Scotia at a Glance

In Nova Scotia in August 2010 retail sales increased 3.4% from July to $1.1 billion and increased 4.1% over August 2009.

In Canada in August 2010 retail sales increased 0.5% from July 2010 to $36.1 billion and increased 3.5% over August 2009.

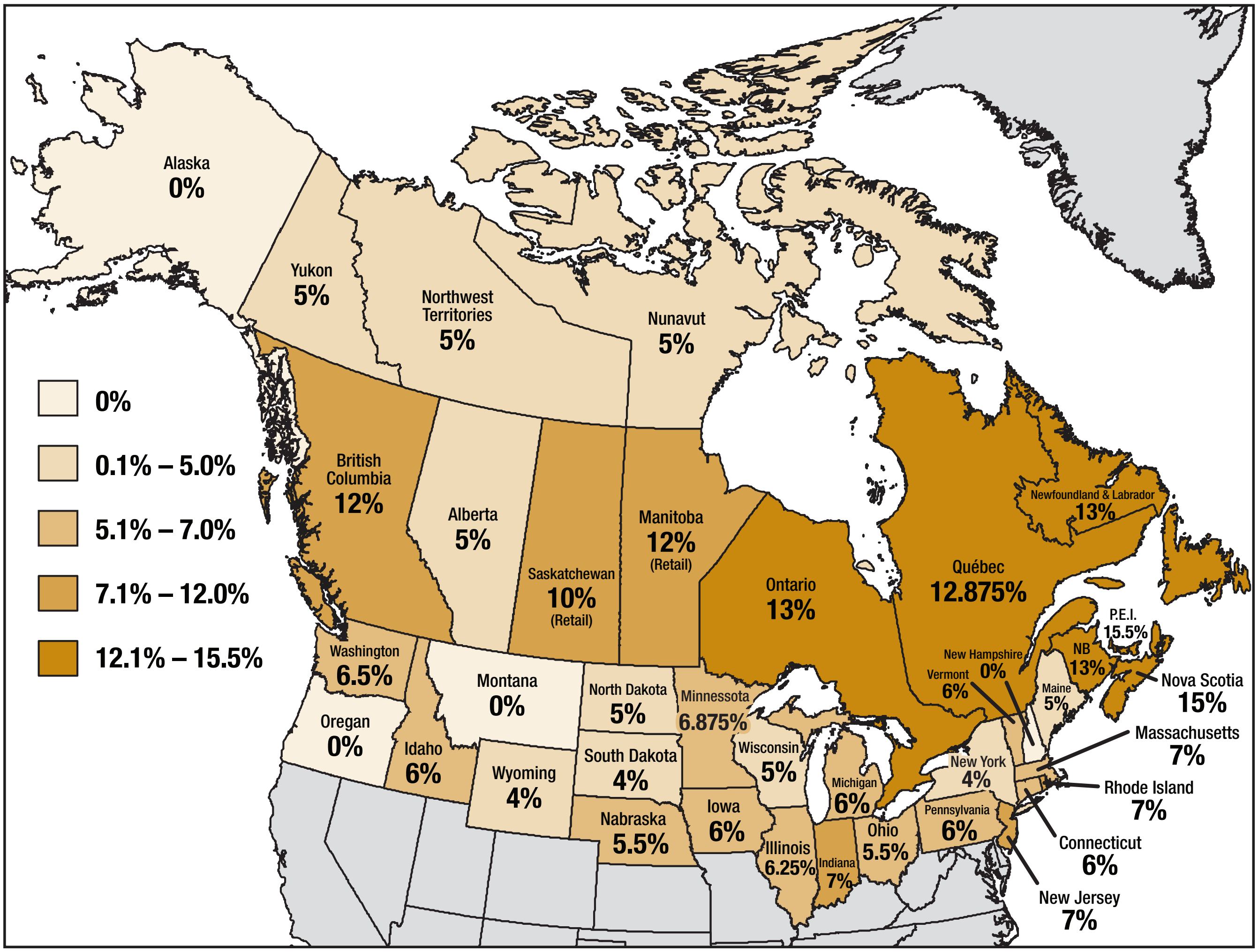
Nova Scotia's consumer price index (CPI) increased 0.1 percent in September from August 2010.

Nova Scotia's CPI increased 1.8 percent over September 2009. In July 2010, consumer prices were affected by the change in the HST in Nova Scotia.

Annual Retail Sales in Nova Scotia:

2004	$10,296,814
2005	$10,526,918
2006	$11,162,523
2007	$11,636,088
2008	$12,130,757

Figure 1 *Sales Tax Rates by Jurisdiction*



Where are the cross-border tax differences?

There are many instances of price differences created by sales taxes across provincial and state boundaries. As shown in **Figure 1**, a 2% difference is common in the retail sales taxes across Canada and the northern United States. The differences can be much higher for provinces and states that border an area where there is no sales tax.

Many Canadians who live close to an international boundary are used to dealing with a major cross-border price differential. Communities in the United States enjoy lower sales tax rates because there is no national sales tax. In addition, the Canadian–U.S. dollar exchange rate changes more often than goods and inventory are repriced. This creates opportunities for Canadians to buy products and services from American retailers at a lower cost than in Canada.

Seen by itself, a sales tax difference might appear to provide a lower-tax jurisdiction with advantages over a higher-tax jurisdiction. However, sales taxes cannot be viewed in isolation from other aspects of the economy, such as retail margins, consumer spending patterns, and other tax rates.

What are the effects on retailers?

Cross-border sales increase

Cross-border shopping happens between all provinces, regardless of whether there are differences in the sales tax rates.

When a resident of Nova Scotia shops across the border, they generate economic activity outside their province.

For example, if a Nova Scotia family buys a $100 jacket in Moncton, they are generating $100 worth of income in New Brunswick.

However, if the jacket (like most retail goods) was manufactured outside New Brunswick, then the act of importing it sends income to the place where it was made. Let's say the jacket cost the retailer $75.90 to purchase and ship from a manufacturer in Quebec. This generates income in Quebec.

In this case, $24.10 worth of income remains in New Brunswick as a result of the spending by a Nova Scotia family. This is the "retail margin" from which the New Brunswick store must pay wages, depreciation, rent, profits, etc.

Statistics Canada measures the value of retail margins generated by cross border shopping activities in Canada.

Statistics Canada reports the value of retail margins that are "exported" between provinces—that is, how much profit a retailer earns in one province from the spending of cross-border shoppers who come from elsewhere.

Between 2002 and 2006 there was no difference in sales tax between Nova Scotia and New Brunswick. Yet Statistics Canada reports that Nova Scotia retailers earned an annual average of $3 million more than New Brunswick retailers in cross-border retail trade. Essentially, New Brunswickers spent more in Nova Scotia over that four year period.

By contrast, over the same time period Saskatchewan and Alberta had a 5-7% tax difference. In that case, Alberta retailers earned an annual average of $37 million more than Saskatchewan retailers from cross-border retail trade.

When retailers in one province must charge higher sales taxes than their peers in another, it is not always the case that the additional sales tax is passed through to customers. Some retailers absorb the additional sales tax by reducing their own retail margins. Instead of passing through the additional costs of higher taxes, some retailers reduce their profits, wages for employees, and/or prices paid to suppliers. On the other hand, retailers in the lower tax jurisdiction have incentives to raise margins, which would result in higher costs to consumers and greater profit for the retailer. Adjusting any one of these components of retail margin could offset some of the after-tax price differential.

> *In a higher-tax jurisdiction, a retail business can be less valuable than a similar business operating where taxes are lower. This could be caused by selling fewer goods, but passing the tax through to customers in higher prices. On the other hand, a business in a higher-tax jurisdiction could absorb the higher taxes by reducing wages or profits. This would maintain the same sales volumes, but reduce the expected returns of the overall business.*

Nova Scotia retail margins exceed those of New Brunswick, giving Nova Scotia retailers more flexibility to reduce margins to equalize after-tax prices between the provinces.

What are the effects on consumers?

Lower sales taxes increases purchasing power

HST is a value-added tax. Although HST is collected at every step of the supply chain, producers can claim input tax credits that effectively negate the sales tax they pay on input costs. This means that the tax is largely borne by the customers or "final" consumers of a product. The effect of HST on consumers determines how the sales tax affects the whole economy.

Residents in Nova Scotia's border communities who save money by shopping in New Brunswick may have more disposable income left to spend in Nova Scotia on non-taxed goods and services, such as housing, energy, and basic groceries.

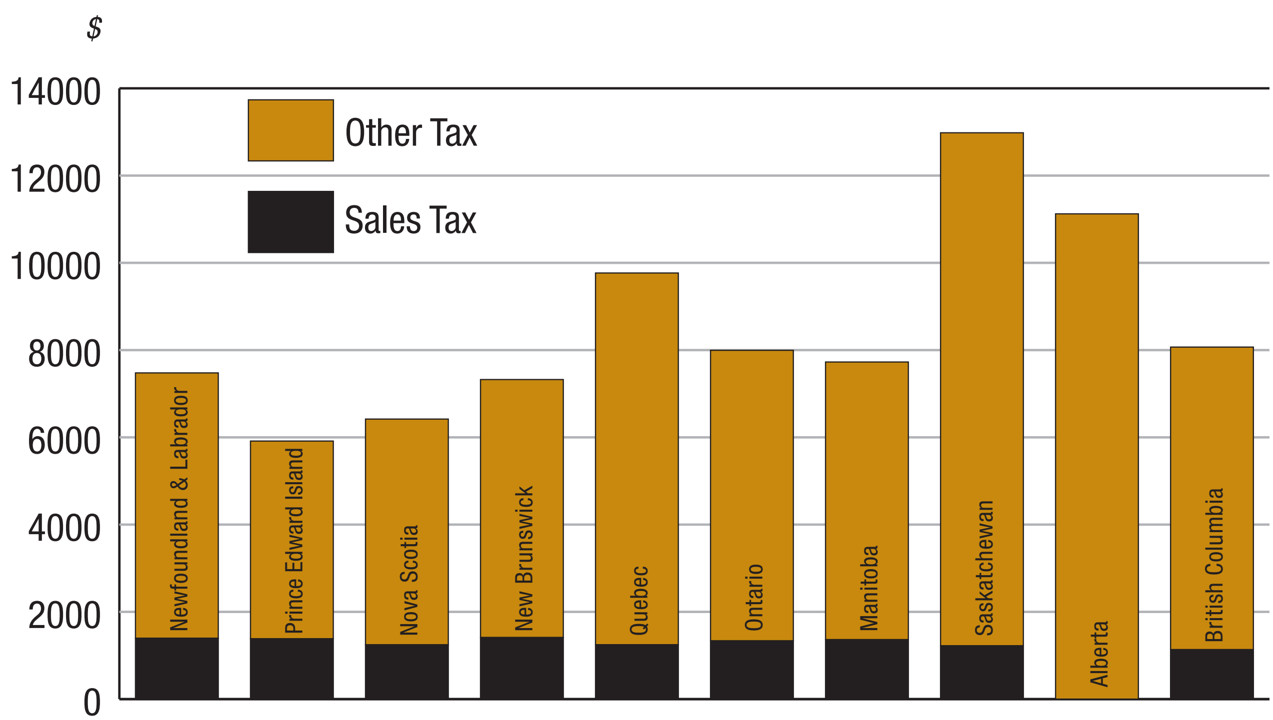
Lower sales taxes are offset by other taxes

Provincial governments set tax rates to pay for public goods and services. This need for revenue is balanced against the effects on business and quality of life for individual households.

In Canada, the revenue streams for provincial governments is made up of a broad range of both sales tax revenues and other taxes, such as income tax, property tax, and licensing fees. Nova Scotia's higher returns from sales taxes is somewhat offset by lower returns on licence fees, property taxes, and other taxes than are found in other provinces. By comparison, Alberta has high energy revenues that eliminate the need for sales tax. **See Figure 2**.

The situation is the same across the United States, where a wide range of tax mix makes up state revenues. For Atlantic Canada, the state taxes in New England are particularly relevant for cross border shopping.

Figure 2 *Per Capita Provincial Taxes*



How do other jurisdictions manage cross-border tax differences?

Many jurisdictions do nothing to correct for cross-border tax differences.

One exception is the Town of Lloydminister, which straddles provincial boundaries of both Saskatchewan and Alberta. Since this situation divides retail districts even on the same street, the city has established a provincial sales tax exemption that ensures one consistent rate is applied on goods and services within the city boundaries.

One other exception is Saskatchewan's Gasoline Competition Assistance Program. This program was introduced in 2000 to address the gasoline tax differential between Saskatchewan and neighbouring Alberta and Manitoba border towns, where gasoline taxes are lower. The program provides compensation to bulk fuel dealers and service station owners for their gasoline, propane, and ethanol-blended gasoline sales only; aviation and diesel fuel are excluded. The premise of the program is that if business is compensated for the difference, they will adjust their prices to competitive levels, thereby benefiting consumers.

Washington state, which borders BC, exempts retail sales tax on purchases by residents of other U.S. states or Canadian provinces when the purchasers' home jurisdiction has no retail sales tax or has a retail sales tax of less than 3%. Washington is bordered by two states (Oregon and Montana) that have no sales tax.

Currently 19 states have annual sales tax holidays. The majority of states with tax holidays do not border a state with lower or no sales tax. Of the states with no sales tax—Delaware, New Hampshire, Montana, Alaska and Oregon—only the New England states bordering New Hampshire create a "border land" of sales tax holidays.

The practice began in 1980 with Ohio and Michigan initiating sales tax holidays on automobile sales. New York started the recent (since the late 1990s) trend in 1997. New York's objective was to address cross-border shopping into states with lower or no sales tax, notably New Hampshire and Delaware.

The border community of St. Stephen, located on the New Brunswick border adjacent to Calais, Maine has approached the issue of cross-border shopping and competitiveness by developing a cooperative relationship with Calais. The two towns co-host an annual homecoming festival, the St. Stephen Chamber of Commerce promotes its relationship with Calais as a competitive advantage for residents and business, and residents consider the two towns as one community.

St. Stephen's most recent strategic plan (fall 2008) focuses on the three strategic areas of economic development, infrastructure, and finances. Specific initiatives include downtown revitalization efforts, waterfront development, focus on federal stimulus funding, and emphasizing better fiscal planning and debt management. The major issues St. Stephen identified as needing to be addressed to help it compete with other small towns in the Maritimes and New England were increasing the tax base, improving the town street infrastructure, addressing the collapse of local industry, and the need to brand the town as a centre for international commerce and travel. There were no specific comments on the need to address the flow of labour or retail trade across the border.

Conclusion

Sales tax differences are common across Canada and the United Sates. While the gap created by the difference in tax rates has some effect on retail trade, in no jurisdiction is there a single solution to manage the situation.

In Canada, Saskatchewan has the most active interventions to accommodate tax differences with neighbouring communities in Alberta and Manitoba. Separate provincial sales tax administration makes these options possible.

Some provinces allow the economy to adapt to cross-border tax differences through other adjustments, such as through retail profit margins and other tax rates, in order to make up for sales tax differentials.

Nova Scotia's retail margins are higher than those in New Brunswick as well as those in other Atlantic and Prairie provinces. And while Nova Scotia does have higher sales tax, it also has lower property tax, licensing fees, and other taxes than all other provinces except Prince Edward Island. These differences may provide retailers with flexibility to reduce margins in order to close the price gap created by the tax differential.

Gas prices are of particular concern to cross-border jurisdictions. Saskatchewan is the only province to implement a Gasoline Competition Assistance Program to compensate bulk fuel dealers and service station owners.

Case Study

Saskatchewan: Gasoline Competition Assistance Program

The Gasoline Competition Assistance Program applies to the entire Alberta border, which is divided into three zones that are determined by the distance between Saskatchewan communities and their nearest Alberta competitor. The program does not apply to the entire Saskatchewan–Manitoba border, but to three specific Manitoba areas.

Saskatchewan currently charges 15 cents per litre gas tax. Manitoba charges 11.5 cents (a differential of 3.5 cents), and Alberta charges 9 cents (a differential of 6 cents).

To date, the Saskatchewan government has not undertaken an official program review; however, informal feedback to the Saskatchewan Department of Finance indicates that the program is working well, given the original policy intent—to compensate bulk fuel dealers and service station owners—and is well received by industry. Saskatchewan Finance collects monthly statistics on how much money is reimbursed to dealers and service stations.

NOVA SCOTIA