



CURRENT ANALYSIS

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Robert Hogue
Senior Economist
(416) 974-6192
robert.hogue@rbc.com

Quebec-Canada agreement on QST and GST harmonization

After nearly two years of negotiations, the federal and Quebec governments today announced a 'Memorandum of Agreement' that will see the federal government transferring \$2.2 billion to the Quebec government as compensation for Quebec harmonizing its sales tax (the Quebec Sales Tax or QST) with the federal government's Goods and Services Tax (GST). In return, the Quebec government will amend its QST so that its "tax base, as well as administrative, structural and definitional parameters... produce results that are identical to the results produced by the GST". The changes will take effect on January 1, 2013. While today's announcement comes with great fanfare – with both Prime Minister Stephen Harper and Quebec Premier Jean Charest on hand – this is an agreement in principle. A final, detailed accord (so-called Comprehensive Integrated Tax Coordination Agreement) is scheduled to be reached by April 1, 2012. Meanwhile, negotiations will continue to work out the "policy and administrative details".

A long time coming

In the early 1990s, Quebec had been among the first provinces to adopt a value-added sales tax but, unlike New Brunswick, Nova Scotia and Newfoundland and Labrador – the other early adopters – it had not fully blended it with the GST to form a federal-provincial Harmonized Sales Tax (HST). It, consequently, did not receive any federal compensation to ease the transition from the old provincial tax. The decisions by Ontario and British Columbia to harmonize their own provincial sales tax with the federal sales tax in July 2010 and, more importantly, the significant transition money they received – \$4.3 billion and \$1.6 billion, respectively – prompted Quebec to demand similar treatment. The negotiations that ensued focused primarily on finding enough common ground on the goods and services that would form the base of the provincial portion of a harmonized tax. The federal government felt confident enough about reaching a deal that it set aside \$2.2 billion in its June budget.

What will change?

As of January 1, 2013, the QST will be calculated on the selling price excluding the GST. Currently, the QST is applied to the selling price plus the GST – yes, Quebec is taxing the federal tax. The QST rate (presently 8.5% but scheduled to rise to 9.5% on January 1, 2012), however, will be increased slightly to 9.975%, which will maintain the effective rate constant once removing the effect of the 5% GST rate from its calculation. In other words, the impact on both the total prices paid (selling prices plus all taxes) and sales tax revenues will be neutral.

The refund of the QST paid to financial institutions will be eliminated but so will the compensatory tax on financial institutions (which was designed to partly offset the refund). On net, financial institutions will face higher taxes to the tune of \$345 million in 2013-14 (the first full year of implementation), and estimated to rise to \$310 million by 2020-21.

Large businesses will be allowed to obtain a refund for the QST they pay for all goods and services they purchase starting in 2018. Currently, large businesses cannot obtain a refund of the QST paid on such things as light vehicles, electricity, natural gas and telecommunications services. This change is estimated to save businesses \$945 million by 2020-21 and thereby lower government revenues by the same amount. Nonetheless, it will have no impact on the provincial government's current fiscal plan since the plan does not go beyond 2015-16.

Otherwise, the memorandum of agreement announced today does not foretell any particular modifications in the QST's tax base and exemptions. It states that "by maintaining all existing exemptions, the QST will differ by only 3%" from the GST base, which is well within the 5% difference accepted in agreements with other provinces.

\$2.2 billion in compensation going towards lowering the deficit

Quebec's Finance Minister Raymond Bachand indicated that the \$2.2 billion federal transfer to Quebec will go towards reducing the province's deficit (projected to be \$3.8 billion in fiscal 2011-12). The compensation will be paid in two installments: \$733 million in January 2013 and \$1.5 billion in January 2014. This windfall, along with higher revenues from the changes to the refund mechanism for financial institutions, will significantly raise the revenue profile for the Quebec government. The provincial government estimates that its revenues will be boosted by \$788 million in 2012-13, \$1.7 billion in 2013-14, \$255 million in 2014-15 and \$270 million in 2015-16. This would cut the deficit in half in 2012-13 from the current projection of \$1.5 billion to \$712 million, and produce budget surpluses in subsequent years, with the largest being \$1.7 billion in 2013-14. Prior to today's announcement, Quebec's fiscal plan was to balance its books by 2013-14 and show zero deficit thereafter.

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