

Proposed Employer Health Tax Hurts the Health of BC's Businesses

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In its February budget, the BC Government proposed a new \$1.9 billion per year Employer Health Tax (EHT), effective January 1, 2019, to replace the revenues lost from the elimination of the Medical Service Plan (MSP) premiums for individuals and businesses.

As proposed, the EHT is a non-graduated payroll tax which exempts payrolls up to \$500,000, has increasing tax rates on payrolls between \$500,000 and \$1.5 million, and reaches 1.95 per cent on payrolls over \$1.5 million.

The government has made several claims about the cost, impact and scope of the new payroll tax. This policy paper tests these assertions and provides better accuracy and clarity where needed. For instance:

- **Government assertion:** The new tax will impact a small number of businesses
 - **REALITY:** It will impact over **60,000 businesses**, mostly small ones
- **Government assertion:** The tax will mainly affect big businesses
 - **REALITY:** It will cost the average small business owner \$15,429 (based on CFIB survey data)
 - **REALITY:** 44 per cent of small businesses with a payroll will be impacted (based on CFIB survey data)

This report draws on government data, as well as a CFIB member survey conducted on the proposed EHT from April 12 to 23 completed by 768 small business owners across BC. The findings show the EHT will:

- Create negative incentives for businesses to grow;
- Hurt employees and BC's economy through reduced wages and jobs;
- Result in price increases and increases in other taxes (e.g. property tax increases); and
- Impose a totally new payroll tax on many small business owners.

As structured, the proposed payroll tax will be punitive for business owners, and is a significant new tax at a time when many other business costs (i.e. EI and CPP premiums, carbon tax, minimum wage, etc) are increasing. As a result, 80 per cent of business owners surveyed want the government to drop their EHT proposal.

However, if the BC Government is determined to move ahead with its tax proposal, it is critical it be improved and made much more palatable for small and medium-sized businesses. To this end, there are at least seven ways to fix this flawed tax proposal:

- Increase the small business exemption (e.g. from \$500,000 to at least \$1.25 million);
- Make the tax graduated (i.e. rather than applying the tax rate on the entire payroll, pay the tax rate on the payroll within that range - 0 per cent on the first \$500,000, 0.98 per cent on payroll between \$500,000 to \$1,000,000, etc);
- Create a more even split on revenue replacement between businesses and individuals, such that businesses are not having to absorb the majority of the cost to replace MSP revenues;
- Tie the payroll thresholds subject to the Employer Health Tax to inflation;
- Ensure the tax is as easy as possible to administer;
- Exempt employees 18 and under from the EHT calculation of a business' payroll; and
- Phase in the Employer Health Tax only when the MSP has been fully eliminated (Jan 1, 2020).

This policy paper will review the preliminary recommendations made by the MSP Task Force, analyse the impact on small businesses in BC, and consider the other unintended impacts such as price increases, disincentives to hire, and potential municipal/provincial tax increases. These factors and the survey results provide the basis for the CFIB recommendations to fix the EHT.

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1. Recommendations by the MSP Task Force

The BC government appointed a MSP Task Force to provide non-partisan recommendations, informed by research and meetings with stakeholders, on the best method to replace MSP revenues. Before examining some issues with the tax, it is worth reflecting on what the Task Force recommended.

The Task Force made preliminary recommendations on February 1, 2018, with the promise to provide full recommendations to government by March 31. At the time of creating the EHT, the BC government had not yet received the final recommendations of the Task Force. As of April 26, the final recommendations have not been made public.

The two key preliminary recommendations made to the BC government were to¹:

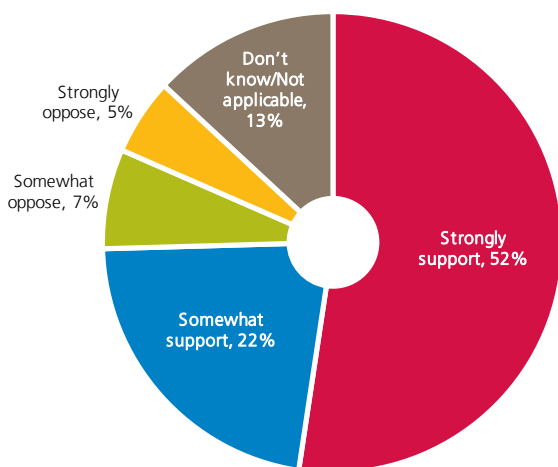
- Implement new taxes only when the MSP was fully eliminated;
- Implement a mix of taxes (e.g. personal income tax; payroll tax; excise taxes on unhealthy products) to replace the forgone revenue from the elimination of the MSP premiums.

Unfortunately, both of these recommendations were ignored in the BC government's 2018 budget.

The Task Force felt "strongly that there should not be any phase-in of the new measures and phase-out of MSP"². Despite this, in 2019 both the MSP premiums on businesses and families and the new EHT will be active.

To ensure there is no double taxation in any fiscal year, the BC government should follow the Task Force's recommendation and only implement any new tax in 2020 once the MSP is fully eliminated. Small businesses strongly support this (see Figure 1).

Figure 1:
Introduce the Employer Health Tax only when the MSP has been fully eliminated (e.g. Jan 1, 2020).



Source: CFIB, Municipal Election and New Provincial Employer Health Tax Survey, April 12-23, n = 768. Preliminary results.

¹ See MSP Task Force, Preliminary Recommendations, <https://engage.gov.bc.ca/app/uploads/sites/247/2018/02/MSP-Task-Force-Interim-Report-Final.pdf>

² MSP Task Force, Preliminary Recommendations. February 1, 2018. <https://engage.gov.bc.ca/app/uploads/sites/247/2018/02/MSP-Task-Force-Interim-Report-Final.pdf>

"The MSP Task Force provided an interim report earlier this month. This is not the direction we were going."

Dr. Lindsey Tedds
Chair, MSP Task Force responding to questions about the BC Government's EHT proposal

The second key recommendation, to implement a suite of tax measures instead of focusing on one, was also seemingly ignored. The Task Force was explicit in its preliminary recommendations that revenues to replace the MSP should come from a mix of sources to ensure the burden was not put on any one group. The Task Force correctly notes that a payroll tax will hurt the competitiveness of BC businesses during a time when they already face other increases to their costs (i.e. minimum wage increases, carbon tax increases, etc).

As it stands now, only a payroll tax on businesses (i.e. the EHT) has been proposed to replace MSP revenues. The MSP raised about \$2.6 billion in 2016-2017. The new payroll tax is estimated to raise about \$1.9 billion, or nearly 75 per cent of the lost revenue from eliminating the MSP. This certainly does not appear to strike the balance recommended by the Task Force.

In light of the fact the majority of the Task Force's preliminary recommendations are not reflected in the design of the EHT, it is important the BC government rethinks how it is proposing to replace the MSP revenues.

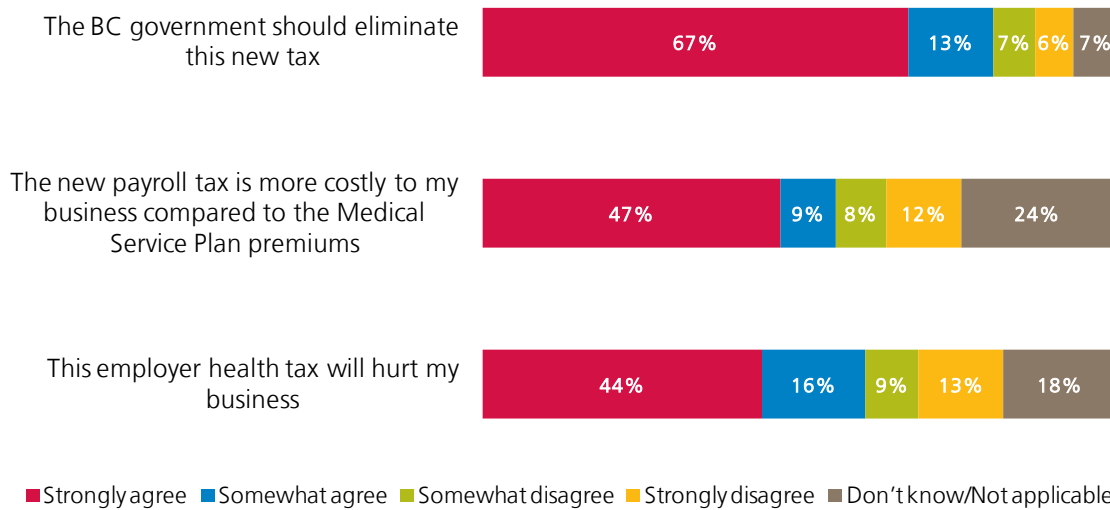
2. Impact on the small business community

In announcing the EHT, the BC government argued the proposed payroll tax would only impact a small number of small business owners, and for many businesses impacted the new payroll tax would simply replace the cost of covering employees' MSP.

On both counts, the case seems to be far more complicated. A majority of small business owners agree this tax will hurt their business, and is worse for their business than the MSP system (see Figure 2). As such, they also say the tax should be eliminated. The following section will examine why that is the case.

Figure 2:

For each of the following statements about the new Employer Health Tax, please indicate the extent to which you agree or disagree.



Source: CFIB, Municipal Election and New Provincial Employer Health Tax Survey, April 12-23, n = 768. Preliminary results.

Number of businesses paying the new payroll tax

The BC government exempted businesses with \$500,000 and under in payroll from the EHT. In response to criticism that \$500,000 in payroll was too low of an exemption, the government argued this was adequate as their research showed 85 per cent of businesses in BC fall under that level³. No additional research has been published at this time showing a profile of those who will be impacted.

³ Pamela Fayerman, *Vancouver Sun*, Feb 21, 2018. *BC Budget 2018: Business community outraged over payroll health tax*. "Finance Minister Carole James responded that the government's research shows that 85 per cent of businesses in B.C. are so small (under \$500,000 in payroll) that they will be exempt from the payroll tax"

However, taking this number at face-value, it is understandable why the government picked this statistic to show how many businesses would be impacted. In 2016, British Columbia was home to 319,000 businesses with fewer than 5 employees, representing 79 per cent of all BC business. These micro businesses will overwhelmingly be exempt from the proposed EHT, as they should be. But by using the 85 per cent number, this encapsulates these micro businesses, many without employees or payroll. When only looking at businesses with employees (i.e. those with an actual payroll), it is clear a much smaller percentage of businesses would be exempt from the Employer Health Tax.

A more important question is how many small businesses with employees will be required to pay the new payroll tax. And on that front, the data above shows thousands of businesses with 5 to 20 employees will be impacted. By any definition, these businesses are small, yet most of their payrolls sit above the \$500,000 threshold.

Table 1:

Breakdown of Businesses in British Columbia, 2016

	Number of businesses	Per cent of total
Businesses with 0 to 4 employees	319,000	79%
Businesses with 5 to 9 employees	37,900	9%
Businesses with 10 to 19 employees	24,200	6%
Businesses with 20 to 49 employees	14,900	4%
Businesses with over 50 employees	7,900	2%
Total BC Businesses	404,000	100%

Source: Ministry of Jobs Trade and Technology, Small Business Profile 2017

Using the BC government's figure, which states that 15 per cent of BC businesses will be impacted, **60,600** businesses in 2016 would have had to pay the EHT (see Table 1). And the majority who will be affected will be small, with up to 37,800 businesses with under 20 employees required to pay the new payroll tax⁴.

Table 2:

Breakdown of BC Small Business Payroll

Payroll	Per cent of total
Under \$300,000	38.1%
\$300,000 to \$450,000	13.5%
\$450,001 to \$500,000	4.3%
\$500,001 to \$750,000	14.8%
\$750,001 to \$900,000	6.6%
\$900,001 to \$999,999	2.4%
\$1 million to under \$1.25 million	5.2%
\$1.25 million to \$1.5 million	2.6%
Over \$1.5 million	12.5%

Source: CFIB, Municipal Election and New Provincial Employer Health Tax Survey, April 12-23, n = 768. Preliminary results.

A CFIB survey conducted in April, 2018 revealed when you exclude businesses without a payroll, the per cent of businesses impacted by the EHT far exceeds the number the BC government is citing. The survey found **44 per cent** of businesses had a payroll exceeding \$500,000, meaning they will pay the EHT (see Table 2 for a breakdown of payrolls in the survey). 83 per cent of business owners in the survey had fewer than 20 employees, and the average size of business in this survey sample was 13.7.

In order to exempt a greater percentage of the small business community from the EHT, the BC government will need to increase the threshold beyond \$500,000. For example, if the government increased the exemption to \$1.25 million in payroll, 85 per cent of BC's small business with a payroll will be excluded from paying the EHT – a far better scenario than what is proposed and one strongly supported by BC's small business community (see Figure 2).

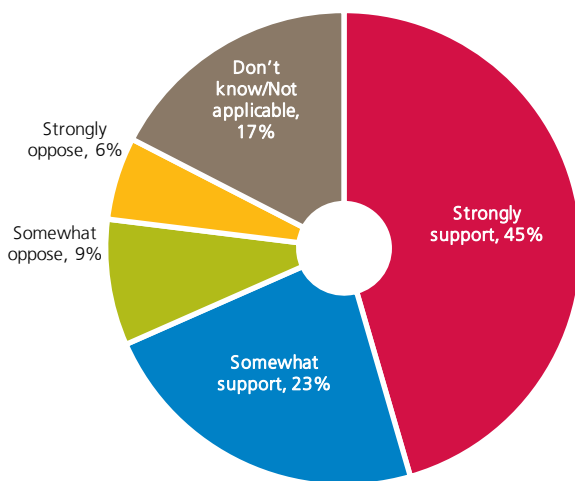
⁴ This figure is an estimate calculated as follows: 60,600 businesses minus 22,800 (businesses over 20 employees). It assumes that the vast majority of micro businesses (5 employees or less) fall below the \$500,000 threshold and that those businesses with over 20 employees exceed the \$500,000 threshold.

Cost of the new tax for BC's small business community

To make matters worse, this will be a new payroll cost for a large number of small businesses. The survey also found 21 per cent of the small, independent businesses surveyed currently pay MSP premiums for their employees.

Figure 2:

Please indicate the extent to which you support or oppose increasing the business payroll exemption for the Employer Health Tax (e.g. up to \$1.25 million, from \$500,000).



Source: CFIB, Municipal Election and New Provincial Employer Health Tax Survey, April 12-23, n = 768. Preliminary results.

\$30,528. While this is a rough estimate as the government has not released full details on the plan and its impact, it nonetheless shows that this tax is a significant burden on BC business.

Negative incentives created by the EHT

As currently designed, the EHT has several significant flaws in its structure beyond the inadequate small business exemption.

One of the proposal's biggest flaws is that once a payroll threshold is crossed, the higher rate applies to the entire payroll (see Table 3). This is fundamentally different than how many other taxes function. For example, with personal income taxes an individual pays the higher marginal rate only on the marginal income above each

Taking the difference between those who will be required to pay the EHT (44 per cent) compared to those that currently pay MSP for their employees (21 per cent), approximately 23 per cent of those small businesses surveyed will have a completely new cost imposed on them as of January 1, 2019 while many others will see an increase in costs. This new cost comes at a time when they will already be absorbing additional costs through a rapidly increased minimum wage, higher carbon taxes, increased EI contributions, and the CPP rate starting to increase in 2019.

The cost of this new Employer Health Tax is not trivial. On average, the small business owners surveyed who are eligible for the tax would pay approximately \$15,429 annually⁵.

More broadly, the average cost for *all* BC businesses (including large businesses) can be calculated. The tax is projected to raise \$1.85 billion in revenue in 2019-2020. With estimated 60,600 businesses being subject for the EHT, the average tax level clocks in at

Table 3:

Proposed Employer Health Tax Threshold Breakdown

Annual BC Payroll	Proposed Tax	Tax as a per cent of payroll
\$500,000 or less	\$0	0.00%
\$500,001	\$4,900	0.98%
\$750,000	\$7,350	0.98%
\$1,000,000	\$14,600	1.46%
\$1,250,000	\$22,000	1.76%
\$1,500,000	\$29,250	1.95%
Over \$1,500,000	1.95% of total payroll	1.95%

Source: BC Budget 2018, CFIB calculations.

⁵ This is an estimate based on payroll responses in the survey and data released by the government on the tax rates at each payroll threshold. The calculation takes the frequency of business owners in each threshold and calculates what tax is due, then calculates the weighted tax level of respondents.

threshold. As designed, this tax creates important negative incentives for business owners.

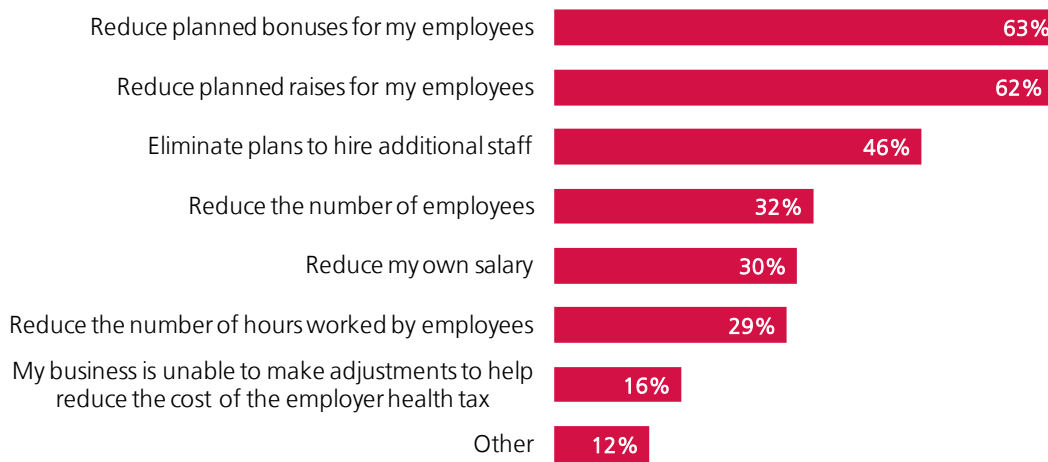
As a business nears a threshold, decisions on hiring, giving bonuses or raises, increasing benefits, and determining employee hours will all come under scrutiny. If a business crosses a threshold, it will see an increase in its EHT bill for their entire payroll, not just the amount above the threshold.

To illustrate, imagine a business with a payroll of \$475,000. This business would be exempt from the EHT as currently designed, since they fall below the \$500,000 threshold. If this business were to hire an additional employee with a salary of \$25,001, their total payroll would be \$500,001 and push the business above the threshold. The result would be a brand new annual tax bill of \$4,900. This clearly creates a significant disincentive to hire an additional employee.

To avoid having to pay for the tax, or increase the rate they are paying by exceeding a higher payroll threshold, business owners have said they will have to make some tough choices. Figure 3 shows what actions they will take, such as reducing bonuses, lowering wage increases, and hiring less.

Figure 3:

Will your business take any of following actions to help reduce the cost of the Employer Health Tax? (Select as many as apply)



Source: CFIB, Municipal Election and New Provincial Employer Health Tax Survey, April 12-23, n = 768. Preliminary results. Respondents with a payroll of over \$450,000.

As currently proposed, as soon as a business exceeds a threshold the higher tax rate applies to all payroll. In contrast, if the BC government made this tax graduated, it would greatly reduce the negative incentives in the proposed EHT.

If it were graduated, rather than applying the tax rate on the entire payroll, the tax rate would be applied only on the payroll within that range – 0 per cent on the first \$500,000, 0.98 per cent on payroll between \$500,001 to \$1,000,000, etc.

Table 3 shows how a graduated tax works as compared to as it is currently proposed. Consider the earlier scenario where a business owner is considering hiring someone who would bring their total payroll to \$500,001. As structured, the Employer Health Tax due for that business upon hitting \$500,001 is \$4,900. In contrast, with the graduated system only the \$1 of payroll that exceeds the threshold would be eligible for the 0.98 per cent tax – a tax of just about a penny. The difference to a small business running on thin margins is considerable.

Table 3:

Comparison of Proposed EHT versus Graduated EHT

Annual BC Payroll	EHT Annual tax as Proposed	EHT Annual Tax with Graduated Structure	Difference (Proposal minus graduated system)
\$500,000 or less	\$0	\$0	\$0
\$500,001	\$4,900	\$0	\$4,900
\$750,000	\$7,350	\$2,450	\$4,900
\$1,000,000	\$14,600	\$6,100	\$8,500
\$1,250,000	\$22,000	\$10,500	\$11,500
\$1,500,000	\$29,250	\$14,900	\$14,350
Over \$1,500,000	variable	variable	variable

Source: Source: BC Budget 2018, CFIB calculations.

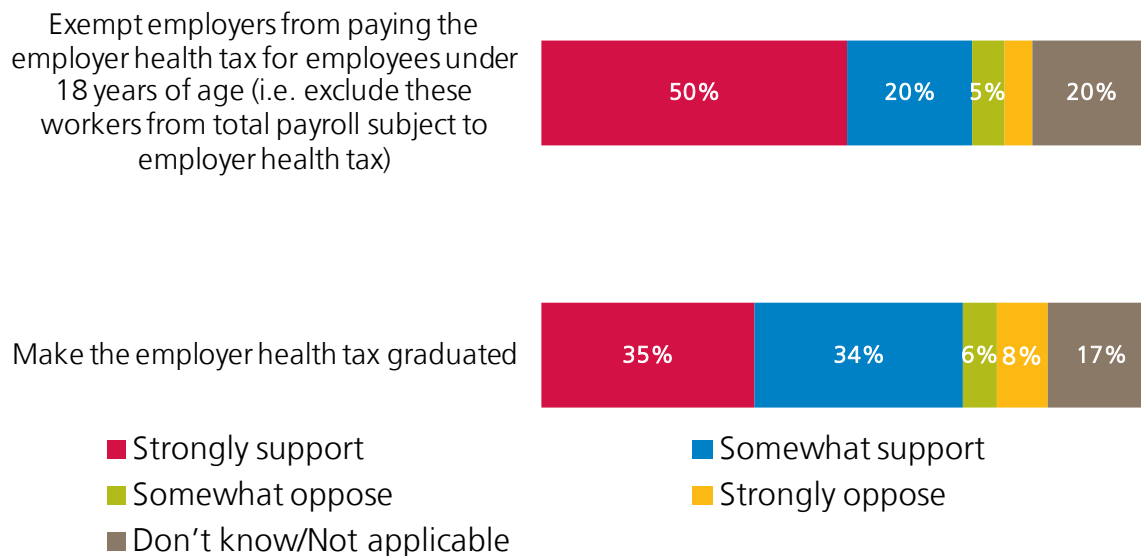
However, as a small business looks to grow, the graduated system would mitigate much of the negative incentives on wages and employment that the proposed EHT creates. Making the Employer Health Tax graduated resonates with the small business community: **69 per cent** support modifying the tax to make it graduated, with only 14 per cent opposing the change (see Figure 4).

An additional change the BC government needs to address is how the payroll thresholds subject to the Employer Health Tax increase over time. Currently, there is no mechanism to ensure the thresholds increase along with payroll costs. This will help ensure the tax does not become more costly for business owners over time.

Finally, the BC government needs to ensure that youth hiring remains as viable as under the MSP system. Under the MSP, employees 18 and under were often covered under their parents' plan. However, with the proposed Employer Health Tax, employees including those 18 and under will be included in total payroll and employers will be taxed on that too. There is also large support to change the EHT to exempt those 18 and under from the payroll considerations of the EHT (see Figure 4).

Figure 4:

To what extent do you support or oppose the following changes to the Employer Health Tax



Source: CFIB, Municipal Election and New Provincial Employer Health Tax Survey, April 12-23, n = 768. Preliminary results.

3. Other impacts on the economy and employees

As illustrated above, the proposed EHT will hit thousands of businesses and be a major new expense for BC's small business community.

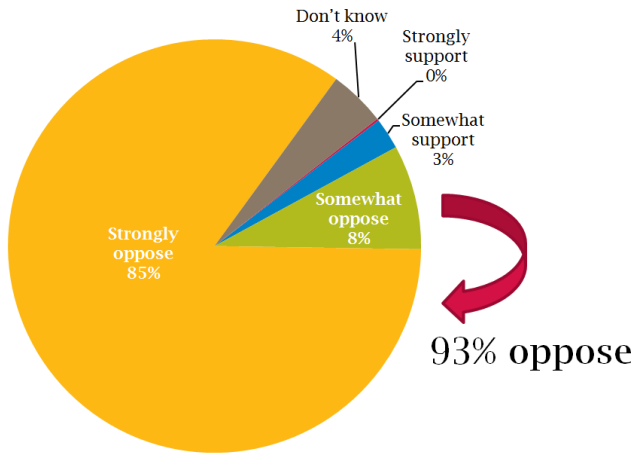
However, the impacts will ripple throughout the economy. Businesses will pass on some of the cost increases through price increases, less hiring, and reduced wages and benefits for employees. And other employers, such as the provincial government, municipal government, crown corporations (e.g. BC Hydro, ICBC, BC Transit), statutory authorities (e.g. TransLink, WorkSafeBC) and school districts will also have their payroll costs increased and be required to pass the costs down through tax, fee and rate increases.

"My business payroll is under the thresholds but with the increase to minimum wage I will reduce full time staff and hire more part time employees. Minimize staff on stat holidays, stop raises where I can and curtail the amount of bonuses."

**CFIB Member,
Restaurant in Kamloops, BC**

Figure 5:

Some have suggested the BC government replace the lost revenues with a new employer-paid payroll tax. To what extent do you support or oppose introducing a mandatory payroll tax?



Source: CFIB, BC Provincial and Municipal Survey, January 2018. n = 692. Preliminary results.

- **Smaller Bonuses:** 63 per cent will reduce employees' bonuses;
- **Fewer Positions:** 32 per cent will reduce the current number of staff;
- **Fewer Hours:** 29 per cent will reduce employees' hours.

Price increases, wage/benefit losses, and job losses

When surveyed in January about the potential of a new payroll tax to replace MSP revenues, small business owners voiced serious concern: **93 per cent** opposed the idea (see Figure 5).

In January and April surveys on a new payroll tax, entrepreneurs offered some of the reasons why it would be harmful. BC's business owners say the tax will be damaging for their business, employees and the economy in general.

The January survey asked what actions small businesses would take in response to a payroll tax (see Figure 6). In addition, Figure 3 shows how businesses most affected by the tax are planning to cope with the EHT as proposed. Here are some of the lowlights:

Impact on employees:

- **Lower Wages:** 62 per cent will reduce planned wage increases;

- **Lower Benefits:** 43 per cent said they would consider reducing other benefits (e.g. extended healthcare).

BC Budget 2018:

“Employer-paid payroll taxes and employer-paid health care premiums are generally reflected in reduced wages.”

Source: BC Government, 2018 Budget and Fiscal Plan, pg 128

Impact on the economy:

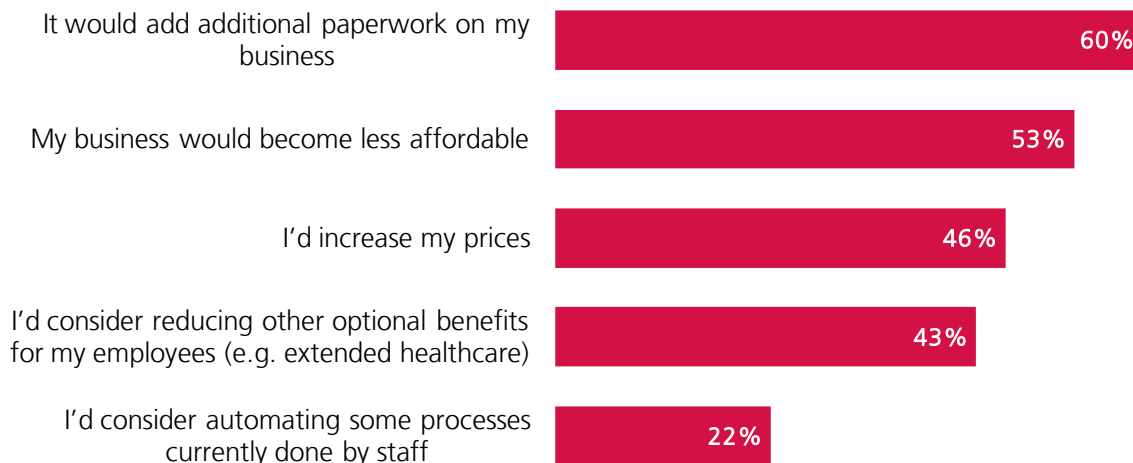
- **Fewer Jobs:** 46 per cent will eliminate plans to hire additional staff;
- **Higher Prices:** 46 per cent of entrepreneurs would increase their prices if a payroll tax was introduced.

Impact on business owners:

- **Lower Salary:** 30 per cent said they will reduce their own salary;
- **More Paperwork:** 60 per cent expected an increase in paperwork as a result of a payroll tax;
- **Less Affordability:** the same survey found 53 per cent believed a payroll tax would hurt the affordability of running their business²;
- **More Automation:** 22 per cent would consider automating some jobs.

Figure 6:

If the provincial government chooses to introduce an employer-paid payroll tax to offset lost revenues from eliminating MSP premiums, which of the following statements would apply for your business? (Select as many as apply)



Source: CFIB, BC Provincial and Municipal Survey, January 2018. n = 692. Preliminary results.

Potential Tax increases

Government and crown corporations are large employers and will tend to be taxed at the EHT's top tax rate of 1.95 per cent of payroll. The result will be increased fees and/or taxes at the local level, increased rates when considering WorkSafeBC, ICBC and BC Hydro, and increased taxes and/or fees from the provincial government.

Labour costs make up a significant component of overall costs for these organizations. For example, the City of Vancouver's payroll accounts for 57 per cent of its total operating expenditures⁶. The City noted in their 2017 Budget that each 1 per cent increase to wages city-wide requires property taxes to increase by 1.1 per cent⁷.

This means the EHT's 1.95 per cent tax on total payroll would translate into a roughly 2.1 per cent increase in property taxes.

The City of Vancouver has estimated the payroll tax will cost about \$13 million. On a per resident basis, that's a new cost of \$20. For a family of four, the additional cost equates to \$79 (see Table 4). For business owners, who pay over 4.5x the taxes as a resident on the same assessed property value, this tax increase will be difficult to absorb. Municipalities will be forced to raise taxes, increase fees, cut services, or a combination of the three.

And that's just at the municipal level. Any provincial employer with over \$500,000 in payroll under the proposed EHT will be hit by the tax.

Table 4:

Annual Payroll Increase from EHT, by Municipality

Municipality	Payroll tax	Payroll tax per resident	Payroll tax for a family of four
Vancouver	\$13,000,000	\$20	\$79
Abbotsford	\$1,700,000	\$12	\$47
Mission	\$356,000	\$9	\$36
Maple Ridge	\$700,000	\$8	\$32
Kamloops	\$700,000	\$8	\$30
Surrey	\$3,400,000	\$6	\$24
Coquitlam	\$600,000	\$4	\$16
Langley	\$236,000	\$2	\$7

Source: Vancouver Sun, CFIB calculations.

"B.C. Teachers' Federation president Glen Hansman this week estimated that the tax, collected at two per cent of employee payrolls, could add \$70 million in costs to the 60 provincial school districts."

Vaughn Palmer, Vancouver Sun
"NDP cannot afford retreat on payroll health tax". Mar 8, 2018

For illustration, an estimate for the 60 provincial school districts pegged the payroll tax cost at \$70 million⁸.

Adding in all the other provincial government and agencies like ICBC, WorkSafeBC, BC Hydro, BC Assessment etc and the costs quickly add up.

This is all money that will need to come from somewhere, whether through increased taxes or fees.

⁶ City of Vancouver, 2017. Budget and Fire-Year Financial Plan, pg 79

⁷ City of Vancouver, 2017. Budget and Fire-Year Financial Plan, pg 80

⁸ Vaughn Palmer, Vancouver Sun. Mar 8, 2018. NDP cannot afford retreat on payroll health tax

4. Conclusion and Recommendations

Overall, there are a series of serious flaws with the Employer Health Tax as proposed and will cause hardship for business owners during a period where they most already cope with several other increasing business costs (e.g. EI, CPP, carbon tax, minimum wage). It will also have a detrimental effect on employees and the economy in general.

Currently, there is not enough clarity on the proposed tax. There has been limited data released on the structure of the tax, the average cost for a business owner, and how the tax will be applied (e.g. what's included in payroll). When any new tax is implemented, business owners need to know how the tax functions in order to prepare. The government should release all information it has on its proposed tax so stakeholders can better understand the implications. In the interim, this research report attempts to dive into those unanswered questions.

CFIB was pleased to hear Premier Horgan say he was studying the consequences of the proposed EHT, and that he will be consulting certain groups. CFIB strongly encourages the BC government to include the input of BC small business owners in the consultation, as they will bear a large portion of the tax bill.

As proposed, the tax does not take into account the input provided by the business community and its own MSP Task Force. The tax will impact over 60,000 businesses, many of them small businesses. It discourages growth as it is structured by creating large jumps in tax rates on a business' entire payroll. And it will impact the province beyond just its business community: school districts, crown corporations, and the municipal and provincial governments will have their payroll costs increased and will pass down the costs to taxpayers.

Business owners will pass down whatever they can in price increases. However, small business owners typically operate in highly competitive markets on thin profit margins and there is only so much they can do to adjust prices. They will also need to make changes to their business structure, for example by hiring less, cutting benefits and reducing planned wage increases. This is why the vast majority of business owners in BC are calling on the government to eliminate the tax.

However, if the government is going to go forward with an EHT, they need to go back to the drawing board. To help reform the tax, CFIB is providing seven recommendations to fix the EHT. These recommendations have been informed through research and surveying the small business community in BC.

- Increase the small business exemption (e.g. from \$500,000 to at least \$1.25 million);
- Make the tax graduated (e.g. rather than applying the tax rate on the entire payroll, pay the tax rate on the payroll within that range - 0 per cent on the first \$500,000, 0.98 per cent on payroll between \$500,000 to \$1,000,000, etc);
- Create a more even split between businesses and individuals, such that businesses are not having to absorb the majority of the cost to replace MSP revenues;
- Tie the payroll thresholds subject to the Employer Health Tax to inflation;
- Ensure the tax is as easy as possible to administer;

- Exempt employees 18 and under from the EHT calculation of a business' payroll;
- Phase in the Employer Health Tax *only* when the MSP has been fully eliminated (Jan 1, 2020).

Sources

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