

The Employer Health Tax: Room for Remedy

A guide to reforming the new payroll tax to better reflect the needs of small business and support economic growth

Richard Truscott, Vice-President, BC and Alberta
Aaron Aerts, Western Economist
Muriel Protzer, Policy Analyst

© Canadian Federation of Independent Business, 2018

Executive summary

In its 2018 February budget, the BC Government proposed a new \$2 billion per year Employer Health Tax (EHT), effective January 1, 2019, to help replace lost revenues from the elimination of Medical Service Plan (MSP) premiums for individuals and businesses. As currently structured, the new tax has a series of flaws which will have negative consequences for the BC economy and small businesses. By making a few adjustments to the structure of the tax, the provincial government has the opportunity to lift some of the burden off local businesses in communities across BC. This report examines areas of improvement while providing recommendations based on analysis and survey data.

Reforming the
**Employer
Health Tax**
to better support small businesses
and economic growth



Introduction

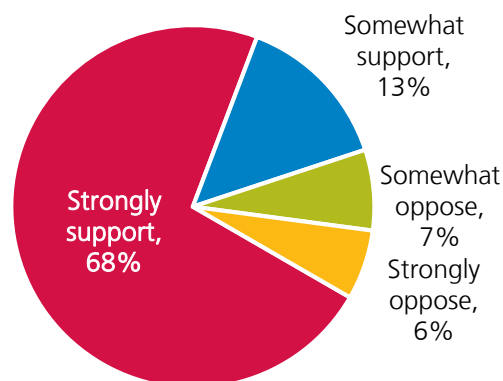
The government has made several claims about the cost, impact, and scope of the new Employers Health Tax (EHT). This policy paper tests these assertions and provides better accuracy and clarity where needed. Drawing upon government data, as well as a CFIB survey data of small business owners across BC, findings show this new payroll tax will:

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

As structured, the employer health tax will be punitive for business owners, and is a significant new tax at a time when many other business costs (e.g. EI and CPP premiums, carbon tax, minimum wage) are increasing. As a result, the majority of business owners surveyed in 2018 want the government to eliminate the EHT (Figure 1). This comes as no surprise; payroll taxes are the most difficult form of taxes for small businesses to absorb, making the nature of this analysis imperative (see Figure 2).

Figure 1:

The BC government should eliminate this new tax (the Employer Health Tax)



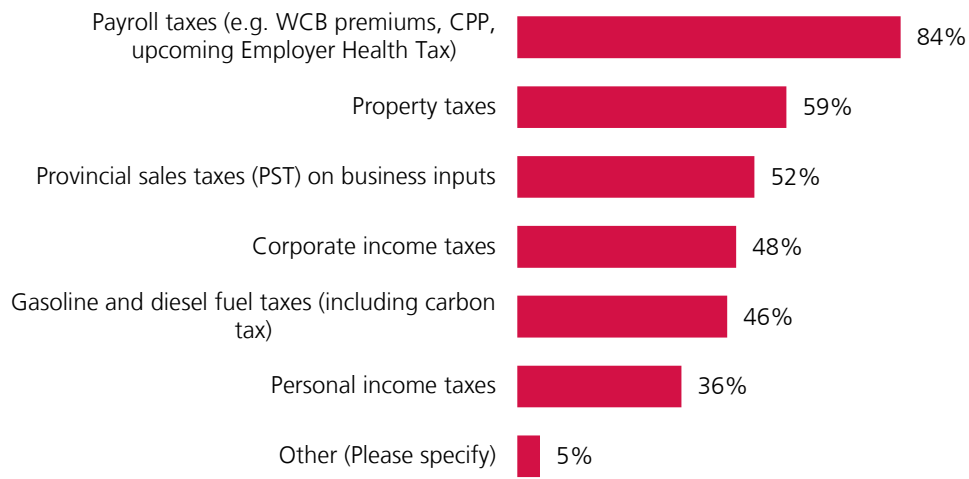
Source: CFIB, *Municipal Election and New Provincial Payroll Tax Survey*. April 12 – June 5, 2018, n=783

At this juncture, the BC Government has moved ahead with the EHT. If it is to stay, it is critical improvements are implemented in the short and long-term to make the tax much more palatable for small and medium-sized businesses and better protect the province's economy. To this end, CFIB has identified at least seven ways to fix the flawed Employers Health Tax:

- 1) Increase the small business exemption (e.g. from \$500,000 to at least \$1.25 million);
- 2) Ensure the tax is fully graduated (i.e. keep the tax calculation the same at all payroll thresholds: $1.95\% \times [\text{payroll} - \$500,000]$);
- 3) Ensure the tax is as easy as possible to administer;
- 4) Tie the payroll thresholds subject to the tax to inflation;
- 5) Exempt employees 18 and under from the calculation of a businesses' payroll; and
- 6) 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.

Figure 2:

Which types of taxes are the most difficult for your business to absorb? (Select as many as apply)



Source: CFIB, BC Provincial Issues Survey, Nov 22 – Dec 17, 2018, n=734

The following sections examine the realities of the EHT while debunking several government assertions, make suggestions on how to improve the tax, and ultimately put forward seven specific recommendations (as summarized above) the BC government should take action on.

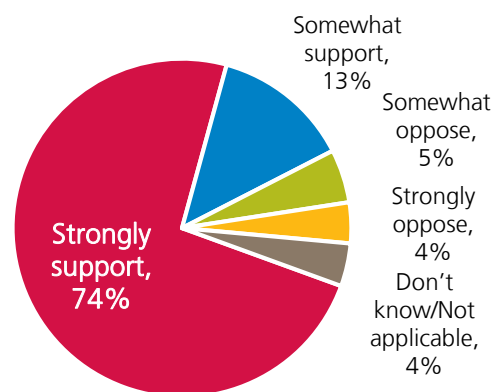
1. Wake up call: realities of the EHT

In announcing the EHT in its February 2018 Budget, the BC government argued the proposed payroll tax would only impact a small number of small business owners, and for many businesses it would simply replace the cost of covering employees' MSP. On both counts, the issue is actually far more complicated.

Overall, the majority of small business owners believe the provincial government should seek other ways to pay for healthcare **instead of** implementing the new

Figure 3:

The provincial government should seek other ways to help pay for healthcare instead of implementing the new employer health tax



Source: CFIB, Municipal Election and New Provincial Payroll Tax Survey. April 12 – June 5, 2018. n=783

Employer Health Tax (see Figure 3).

The following chapter will further investigate why the EHT is so detrimental and opposed by small businesses, specifically.

To set the tone, it is important to note the following findings: small business owners overwhelmingly believe that the EHT is costlier to their business than the MSP was, and the EHT is not fair to BC employers (see Figures 4 and 5).

Figure 4:

The EHT is costlier for my business compared to the Medical Services Plan

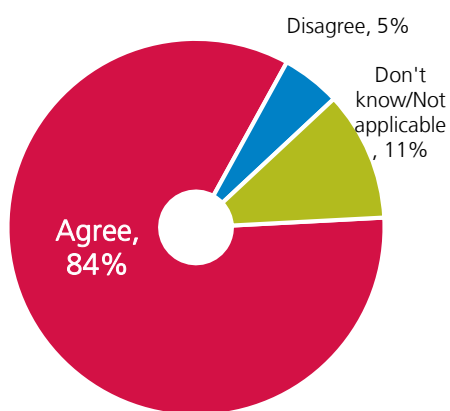
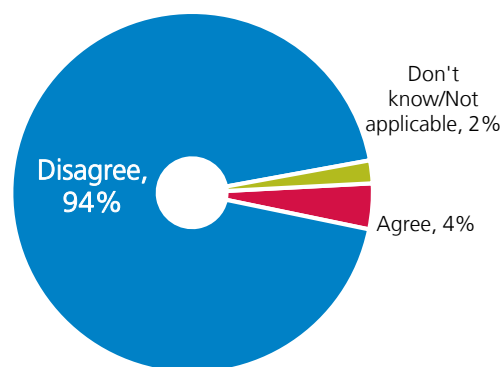


Figure 5:

The EHT is fair to BC employers



Source: CFIB, BC Provincial Issues Survey, Nov 22 – Dec 17, 2018, n=734

Government assertion: the Employer Health Tax will impact a small number of businesses

The BC government exempted businesses with annual payroll of \$500,000 and under from the EHT. In response to criticism that a \$500,000 threshold is too low, the government argued it was adequate; their research showed 85 per cent of businesses in BC fall under that level¹ and would be exempt from paying the EHT

When taking the research at face-value (that 85 per cent of businesses fall under a payroll of \$500,000), it is understandable why the government picked it to calculate how many businesses would be impacted - but it is not accurate. In 2017, British Columbia was home to 414,300 businesses with fewer than 5 employees, representing 83 per cent of all BC business. These very small businesses will overwhelmingly be exempt from the proposed EHT, as they should

¹ 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"

be. But by assuming 85 per cent fall under a \$500,000 payroll, micro businesses are included, of which are many without employees or payroll.

In fact, the government’s own research shows 60% of businesses are self-employed without any paid help.² When only looking at businesses with employees (i.e. those with an actual payroll), it is clear a **much smaller** percentage of small businesses would be exempt from the Employer Health Tax. The following analysis tackles a more accurate estimate of who the EHT hits.

Government assertion: The tax will mainly affect big business

The data shows thousands of businesses with 5 to 20 employees will be required to pay the new payroll tax. By any definition, these businesses are small, yet many of their payrolls sit above the \$500,000 threshold. Using the BC government’s figure, which states that 15 per cent of BC businesses will be impacted, calculations show that **75,195³** businesses in 2017 would have had to pay the EHT (see Table 1). And, the majority affected will be small, with up to 51,895 businesses who have under 20 employees required to pay the new payroll tax⁴.

A CFIB survey conducted in April, 2018 revealed when excluding businesses without a payroll, the proportion of businesses impacted by the EHT far exceeds the number the BC government is citing. The survey found **44 per cent** of small to medium-sized businesses had a payroll exceeding \$500,000, meaning they will pay the EHT (see Table 2 for a breakdown of payrolls in the survey). Eighty-three per cent of business

Table 1:
Breakdown of Businesses in British Columbia, 2017

	Number of businesses	Per cent of total
Businesses with 0 to 4 employees	414,300	83%
Self-employed without paid help	302,700	60%
Businesses with 1 to 4 employees	111,600	22%
Businesses with 5 to 9 employees	38,600	8%
Businesses with 10 to 19 employees	25,100	5%
Businesses with 20 to 49 employees	15,100	3%
Businesses with over 50 employees	8,200	2%
Total BC Businesses	501,300	100%

Source: Ministry of Jobs Trade and Technology, *Small Business Profile 2018*

REALITY:
The EHT will impact over **75,000** businesses, mostly **small ones**.

² BCStats, British Columbia, Ministry of Jobs, Trade and Technology. 2018 Small Business Profile, page 1.

³ The previous iteration of this report calculated that 60,600 businesses would pay the EHT in 2016. Using the BC government’s figures, the number of businesses impacted by the tax in 2017 rose significantly due to a large increase in total number of businesses. This resulted in a substantial increase in the number of businesses that will be impacted, reaching 75,195 in 2017. See [BC government 2018 Small Business Profile](#) for more detail.

⁴ This figure (51,895) is an estimate calculated as follows: 75,195 businesses minus 23,300 (businesses over 20 employees). This calculation assumes the vast majority of micro businesses (5 employees or less) fall below the \$500,000 threshold and businesses with over 20 employees would exceed the \$500,000 exemption threshold.

owners in the survey had fewer than 20 employees, and the average size of business in this survey sample was 13.7 employees.

Government assertion: the EHT is not a new cost, as many employers were paying MSP previously

Survey findings from April, 2018, found that 21 per cent of small, independent businesses currently pay MSP premiums for their employees. In other words, to make matters worse, the EHT will be an entirely new payroll cost for a large number of small businesses.

Taking the difference between those who will be required to pay the EHT (44 per cent) and those that currently pay MSP for their employees (21 per cent), it is estimated that approximately 23 per cent of those small businesses surveyed will see the EHT as a completely new cost imposed on them (as of January 1, 2019). This new cost comes at a time when they will already be absorbing a series of other additional cost increases: a rapidly increasing minimum wage, higher carbon taxes, increased EI contributions, and increased CPP rates (starting January 2019). The cost of the new Employer Health Tax is not trivial.

REALITY:
The EHT will cost the average small business owner \$15,326 annually.

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.

On average, those business subject to the new tax would pay approximately \$15,326 annually⁵.

The tax is projected to raise \$1.85 billion in revenue in 2019-2020. While this is a rough estimate, as the government has not released full details on the plan and its impact, it nonetheless shows this tax is a significant burden on BC business.

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.

How to improve the EHT

As currently designed, the EHT has several significant flaws in its structure. The following sections look at solutions to improve the EHT and better suit small businesses, employees, and the economy more generally.

Exemption Threshold

Survey research shows that 44 per cent of small business employers in the province will have to pay the new EHT. In order to exempt a greater percentage 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, a larger percentage of BC small businesses will be excluded from paying the EHT.

Solution: Increase the exemption threshold from \$500,000 to \$1.25 million.

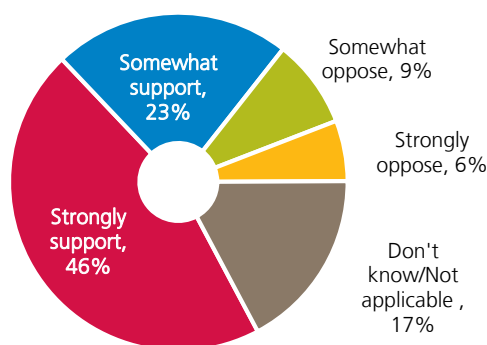
Double Taxation

The BC government appointed a MSP Task Force in November, 2017 to provide policy recommendations, informed by research and meetings with stakeholders, on the best method to replace MSP revenues.

One of the preliminary recommendations to the BC government was to implement new taxes only when the MSP was fully eliminated. The Task Force felt “strongly that there should not be any phase-in of the new measures and

Figure 6:

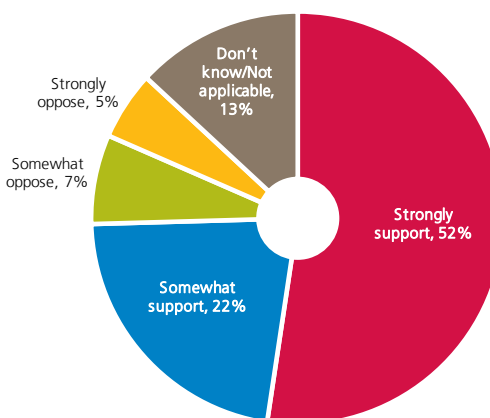
Please indicate the extent to which you support or oppose increasing the business payroll exemption for the Employer Health Tax (e.g. up to \$1.25 million, from \$500,000).



Source: CFIB, Municipal Election and New Provincial Employer Health Tax Survey, April 12 – June 5, 2018, n = 768.

Figure 7:

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 – June 5, 2018, n = 768.

phase-out of MSP⁶. 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 7).



I do not approve of the implementation of the EHT prior to the elimination of the MSP premiums, as we, like many other small and medium employers are already paying the MSP premiums for our staff as a benefit. Now we have to pay said in addition to paying for the premium, and even have to pay tax on the premium, as it is a benefit.

- BC business owner

Solution: Fully eliminate the MSP premiums before businesses are charged the EHT (i.e. do not make businesses pay twice for health care costs in 2019).

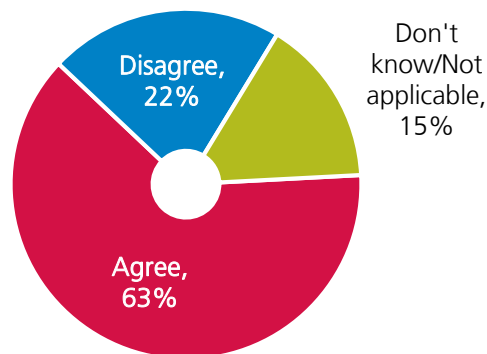
Youth Exemption

Ensuring that youth hiring remains viable under the new EHT system is essential. Under MSP premiums, employees 18 and under were often covered under their parents’ plan.

As structured, this will not be the case for the EHT - instead, it will effectively increase the cost of hiring and employing youth. Younger people are typically at the start of their careers, and have not yet developed many important workplace skills. Their first job represents an important step in expanding their life experience, and the individual responsibility that comes along with having a job.

Figure 8:

Younger employees (e.g. 19 and under) should be exempt from the EHT payroll calculations



Source: CFIB, BC Provincial Issues Survey, Nov 22 – Dec 17, 2018, n=734

⁶ 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>

Youth often look to local, independent businesses for their initial working opportunities. Employers are able to provide youth with critical entry-level experience through employment. These positions should not be made more expensive, as it will discourage employers to continue hiring and training youth.

There is wide-spread support among employers to change the EHT to exempt those 19 and under from the payroll considerations of the EHT to better reflect the reality under the MSP system (see Figure 8). Doing so would further protect employment opportunities for youth, making it easier for new generations to develop crucial skills in the workplace.

Solution: Exempt youth from the Employer Health Tax calculation.

Graduated Calculation

As currently structured, the tax calculation on payroll is two-tiered. In other words, businesses with a payroll of \$1.5 million or more are subject to a completely different tax calculation. See the following:

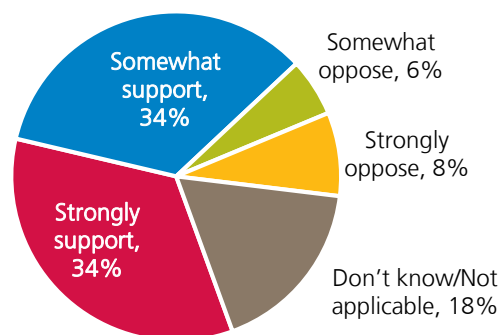
- Businesses with payroll of \$500,000 or less do not pay employer health tax
- Businesses with payroll between \$500,000.01 and \$1,500,000 (notch rate amount) pay the reduced tax amount as calculated: **2.925% x (B.C. remuneration - \$500,000)**
- Businesses with payroll greater than \$1,500,000 pay the tax on their total B.C. remuneration as calculated: **1.95% x total B.C. Remuneration**

While businesses with payrolls exceeding \$1.5 million pay a lower tax rate, they are not granted the \$500,000 deduction. As it stands now, there has been no justification by the BC government as to why the EHT has two separate rates depending on payroll, and why businesses with payrolls exceeding \$1.5 million are not granted the \$500,000 deduction.

Solution: ensure all thresholds are fully graduated (i.e. do not use a two-tiered system on the payroll tax calculation)

Figure 9:

Make the employer health tax graduated



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

Treat Each Business Separately

Some business owners own multiple businesses, completely independent of each other. As the EHT is currently structured, business owners will pay a tax calculated on the **sum of their businesses' total payroll**. See example below:

Bob owns two businesses. Business A has a total payroll of \$250,000 a year, and Business B has total payroll of \$300,000.

Scenario 1

The EHT is calculated based on each business' total payroll separately.

Because Business A is under the exemption threshold, the EHT does not apply. Because Business B is under the exemption threshold, the EHT does not apply. Bob does not pay the EHT.

Scenario 2

The EHT is calculated based on the sum of the business' total payroll.

Business 'A' total payroll + Business 'B' total payroll = \$550,000.

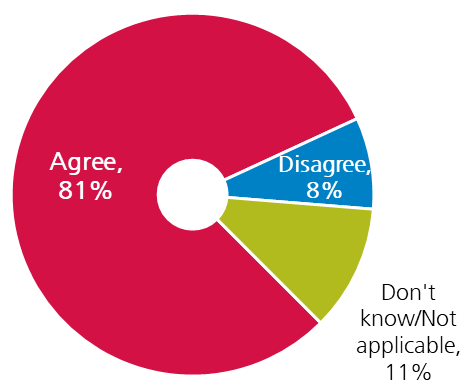
Because the combined payroll for Businesses A and B is over the exemption threshold, the EHT applies. Bob pays the EHT.

Currently, the EHT is structured to produce the outcome seen in Scenario 2 where it is calculated on the sum of the business' payrolls. Despite the businesses being entirely different entities, Bob is taxed as if they were one.

This is exactly what will happen unless the EHT is improved to produce the outcome seen in Scenario 1. Treating separate businesses as one is grossly unfair, and discourages business owners from growing and pursuing new entrepreneurial endeavours. In fact, 81 per cent of business owners agree that multiple businesses should be treated separately for the EHT (see Figure 10).

Figure 10:

If a business owner owns multiple businesses, payroll of these businesses should be treated separately for the EHT (i.e. EHT should not be charged based on the total payroll of all businesses under the same business owner, but instead should be considered separately for the EHT)



Source: CFIB, BC Provincial Issues Survey, Nov 22 – Dec 17, 2018, n=734

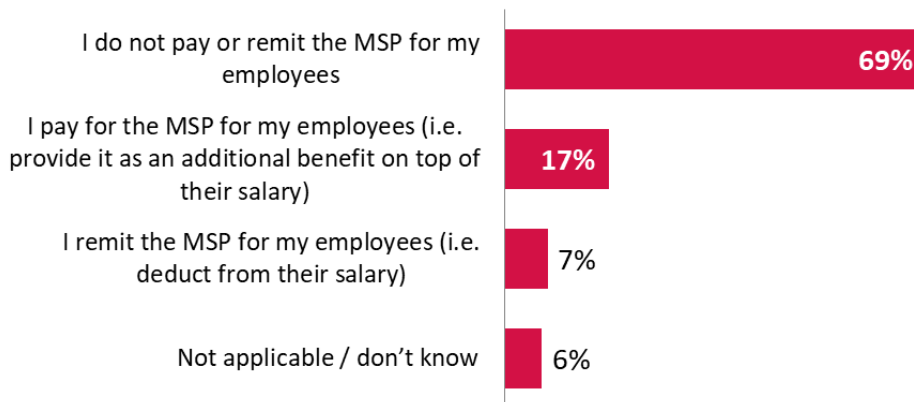
Solution: if a business owners own multiple businesses, their payrolls should be treated separately when calculating the EHT

Fair Split of who pays Health Care Costs

Under the MSP, BC residents were responsible for paying their premiums for coverage; the premiums were based on family size and income. As a benefit to their employees, some businesses offer to cover those MSP premiums.

Figure 11:

Out of the following statements, please indicate which best represents how the MSP is accounted for in your business. (Select one answer only)



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

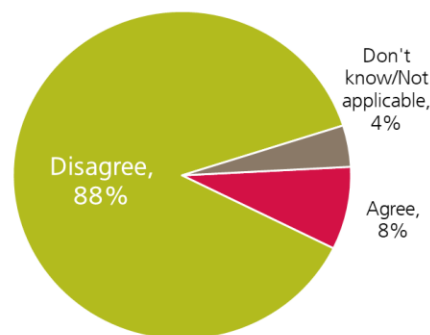
When surveyed, 24 per cent of business owners indicated that their either paid for the MSP for their employees, or remitted the MSP on their behalf (see Figure 11). In other words, approximately a quarter of small businesses covered these health care costs for employees under the MSP. Now that the new EHT has been introduced, the picture of who pays for health care costs is dramatically different.

Under the EHT, employers are **entirely responsible for paying for health care costs** totalling \$2 billion annually.

This expectation is unfair, and burdens business owners with a cost that should be split more evenly with BC residents, as was recommended by the Government's own MSP Task Force. Health care is something all residents understand the importance of, and is a vital service to British Columbians.

Figure 11:

It is fair for the provincial government to shift the cost of paying for healthcare from all BC residents (i.e. through MSP premiums) to employers (i.e. through the new EHT)



Source: CFIB, BC Provincial Issues Survey, Nov 22 – Dec 17, 2018, n=734

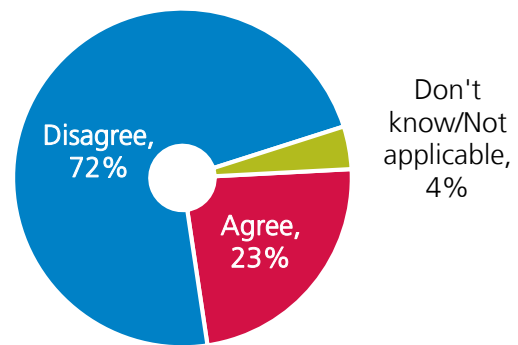
Eighty-eight per cent of business owners think it is **unfair** for the provincial government to shift the cost of paying for healthcare from all BC residents to just employers. The province should look to create a more even split of responsibility between BC citizens and businesses to cover provincial health care costs.

3. Economic Impacts

As illustrated, the EHT will hit thousands of businesses and be a major new expense for BC’s small business community. Furthermore, the impacts will ripple throughout the economy. Findings show that businesses will pass on some of the cost increases through price increases, less hiring, and reduced wages and benefits for employees.

When surveyed (twice) during 2018, entrepreneurs offered several reasons why a payroll tax would be harmful for their business, employees, and the economy (see Figures 12 and 13).

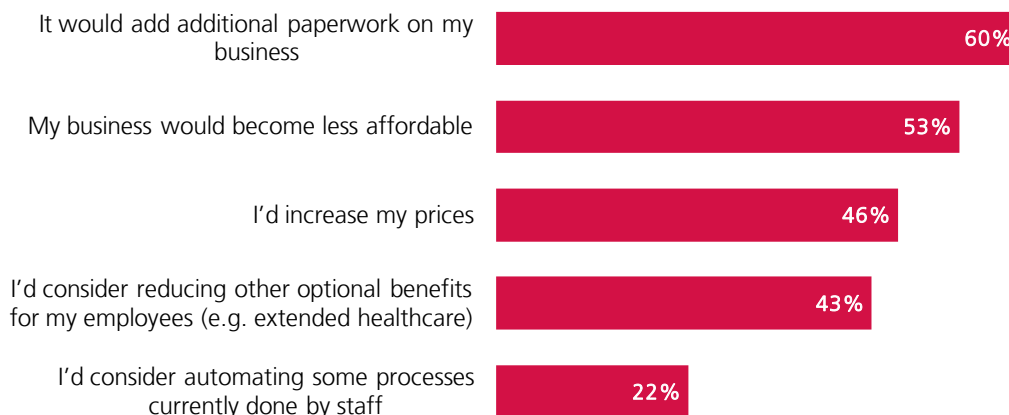
Figure 12:
The EHT will have no impact on my hiring intentions



Source: CFIB, BC Provincial Issues Survey, Nov 22 – Dec 17, n=752.

Figure 13:

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.

Impact on the economy and jobs:

- **Less Hiring:** 72 per cent of business owners say the EHT will have a negative impact on their hiring intentions;
- **Lower Benefits:** 43 per cent said they would consider reducing other benefits (e.g. extended healthcare).
- **More Paperwork:** 60 per cent say it will add paperwork to their business
- **Higher Prices:** 46 per cent of entrepreneurs would increase their prices

4. Conclusion and Recommendations

Overall, there are a series of serious flaws with the Employer Health Tax as currently designed and structured, which will cause hardship for business owners during a period where they already cope with several other major cost increases (e.g. EI, CPP, carbon tax, minimum wage).

Business owners will pass through some of the cost increases, if they can, in the form of price increases. However, it is important to remember that small business owners typically operate in highly competitive markets and on thin profit margins - there is only so much they can do to increase prices. They will also need to make changes to their business structure, for example, by hiring less, cutting benefits, and reducing planned wage increases.

To help reform the tax, CFIB is putting forward seven recommendations that have been informed through research and surveying the small business community in BC.

- 1) Increase the small business exemption (e.g. from \$500,000 to at least \$1.25 million);
- 2) Ensure the tax is fully graduated (i.e. keep the tax calculation the same at all payroll thresholds: $2.925\% \times [\text{payroll} - \$500,000]$, and apply the small business exemption to all payroll thresholds);
- 3) Ensure the tax is as easy as possible to administer;
- 4) Tie the payroll thresholds subject to the Employer Health Tax to inflation;
- 5) Exempt employees 18 and under from the EHT calculation of a business' payroll; and
- 6) 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.

Sources

BC Stats, and Ministry of Jobs, Trade, and Technology. "Small Business 2018 Profile." *Government of British Columbia*, 2018, www2.gov.bc.ca/assets/gov/employment-business-and-economic-development/business-management/small-business/sb_profile.pdf.

Tedds, Lindsay, et al. "MSP Task Force Tax Reform Proposals." *Province of British Columbia*, Mar. 2018,

engage.gov.bc.ca/app/uploads/sites/121/2018/07/MSP_Task_Force_Final_Report_March_2018.pdf.

City of Vancouver. “2017 Budget and Fire-Year Financial Plan”, 2018, http://bcbudget.gov.bc.ca/2018/bfp/2018_Budget_and_Fiscal_Plan.pdf

Vaughn Palmer, “NDP cannot afford retreat on payroll health tax”. *Vancouver Sun*, March 8, 2018, <http://vancouversun.com/opinion/columnists/vaughn-palmer-ndp-cannot-afford-retreat-on-payroll-health-tax>

Government of British Columbia. “2018 Budget and Fiscal Plan”, http://bcbudget.gov.bc.ca/2018/bfp/2018_Budget_and_Fiscal_Plan.pdf

Pamela Fayerman, “BC Budget 2018: Business community outraged over payroll health tax.”. *Vancouver Sun*, February 21, 2018, <http://vancouversun.com/health/local-health/b-c-budget-2018-business-community-outraged-over-payroll-health-tax>
