

# A FINER FOCUS



Welch & Company LLP  
Lévesque Marchand, Chartered Accountants

## *GST Related Issues*

*The GST as promised by the last  
budget is set to drop from 7% - 6%*

**June '06**

*The Federal Budget of May 2, 2006 promised to reduce the GST rate by one percentage point effective July 1, 2006. The GST rate has remained unchanged since its introduction on January 1, 1991 – fifteen and one-half years ago! Here, then, is a primer as to the various considerations that will need to be made in switching to the new rate structure.*

### ***Transitional Issues***

One of the biggest considerations will be how to deal with supplies being made that straddle the implementation date of July 1. The transitional rules will not always lead to the 6% rate applying when consumption of the supply is made after June 30. In some instances, the 7% rate will still apply, depending on when the arrangements for the supply were negotiated and/or paid for.

#### ***Services and Tangible Personal Property***

The general transitional rule is based on the time at which the GST becomes payable:

- If GST becomes payable, or is paid without having become payable, before July 1, 2006, then the old 7% rate will apply.
- If GST becomes payable on or after July 1, 2006, without having been paid before that date, then the 6% rate will apply.
- If GST is paid on or after July 1, 2006, without having become payable before that day, then the 6% rate will apply.

Existing GST provisions dictate that GST becomes payable on the earlier of the date an invoice is issued, or the date of that invoice, or if no invoice is issued, then on the date payment is called for in a written contract.

#### ***Examples of Application of the General Transitional Rules***

- 1** If you buy a new appliance and are invoiced for it on June 30, but don't take delivery of the appliance until July 1, the rate of GST would be 7%.
- 2** If a national member organization invoices its members for the 2006/07 membership fee that covers the period from July 1, 2006 to June 30, 2007 and the invoice is issued prior to July 1, 2006, then the rate of tax is 7%.
- 3** A landlord invoices a tenant for property tax escalations for the calendar year 2006. The invoice is issued January 1, 2007, and the tenant has not paid for any of the escalations prior to the issuance of the invoice, then the rate of tax is 6% notwithstanding the fact that one half of the escalation charges relate to a point in time prior to July 1, 2006.
- 4** If you buy an airline ticket or concert ticket before July 1 for travel or a concert after June 30, the 7% rate will still apply.
- 5** For accounting or legal services provided before July 1, but not invoiced until after June 30th, the entire bill will be subject to GST at the reduced rate of 6%.

### ***Real Property***

There are two factors that dictate which rate will apply to the sale of real property (land and buildings, including commercial space and new homes). The first factor is the date that the agreement of purchase and sale was entered into. The second factor is the date on which ownership or possession of the property is transferred.

Ownership or Possession transferred before July 1, 2006 = 7%  
Ownership and Possession transferred on or after July 1, 2006 and agreement entered into after May 2, 2006 = 6%

Ownership and Possession transferred on or after July 1, 2006 and agreement entered into on or before May 2, 2006 = 7% for residential properties and = 6% for commercial properties.

### ***New Housing Transitional Rebate***

For new houses, condos and other new residential units where ownership and possession transfers on or after July 1, 2006 and the agreement was entered into on or before May 2, 2006, the 7% rate will apply, but the purchaser will be entitled to file a claim with CRA to be paid a Transitional Adjustment that effectively reduces the rate from 7% to 6%, taking into account the GST new-housing rebate that would already have been paid.

This rate reduction rebate is not available with respect to commercial space. The Transitional Rebate cannot be assigned to the builder.

### ***Other Factors to Consider Resulting from Rate Reduction***

#### ***GST to remit on Auto Benefits***

Employers who provide a company vehicle to an employee are required to calculate a taxable benefit with respect to the personal use of that vehicle. The benefit amount includes a GST component. For 2005 and prior years, the employer was required to remit GST at the rate of 6/106 of the standby charge portion of the benefit and at the rate of 5% of the operating cost benefit. These remittance rates are reduced to 5.5/105.5 and 4.5% respectively for 2006 and are further reduced to 5/105 and 4% respectively for 2007 and subsequent years.

#### ***GST New Housing Rebates***

Purchasers of new homes are currently entitled to a rebate equal to the lesser of 36% of the GST paid and \$8,750. The rebate begins to be reduced when the price of the purchased

eliminated for homes costing \$450,000 or more. With the GST rate reduction from 7% to 6%, the rebate percentage of 36% and the value thresholds of \$350,000 and \$450,000 remain unchanged. The maximum rebate available drops, however from \$8,750 to \$7,560.

#### ***Public Service Body Rebate Percentages***

The rebate percentages used by charities, NPO's, Municipalities, School Boards, Universities, and Hospitals will not change. For example, the rebate for charities remains at 50% of the amount of GST paid.

#### ***Quick Method Remittance Rates***

New Quick Method remittance percentages will apply to reporting periods that begin on or after July 1, 2006. For reporting periods that straddle July 1, 2006, the existing percentages will apply to consideration that becomes due, or is paid without becoming due, before July 1, 2006 and the new remittance rates will apply to the balance of the consideration. Therefore, unless the registrant has a reporting period ending on June 30th (as all monthly filers and most quarterly filers would) then two different rates will apply to the reporting period. As a result, all annual filers that do not have a June 30 reporting year end will have to do an extra calculation for 2006.

For service-based businesses located in Ontario, the old rates were 4% of the first \$30,000 of GST-included sales per year and 5% on the balance. The new rates will be 3.3% on the first \$30,000 and 4.3% on the balance.

For remittance rates for businesses that mainly purchase goods for resale, and for supplies made in participating provinces, other percentages apply.

#### ***Employee Allowances***

GST registrants can usually claim ITC's for reasonable expense allowances paid to employees (eg mileage allowances, meal allowances etc.). Prior to the rate change, the ITC was calculated as 7/107 of the amount of the allowance. The new calculation will be 6/106 (14/114 for HST) for allowances paid on or after July 1.

#### ***Employee Expense Reimbursements***

ITC's for GST paid on employee expense reimbursements will be claimed based on the actual amount of GST being reimbursed – regardless of the date on which the reimbursement takes place.

If, however, the company uses the 6/106 factor to claim ITC's for certain categories of expenses reimbursed to employees, then the new factors will be 5/105 for GST and 13/113 for HST, and will apply to all reimbursements paid to the employee on or after July 1, 2006 regardless of when the underlying expense was incurred or the expense report was submitted.

### ***Employee and Partner Rebates***

When preparing the personal income tax return for employees or partners, a GST rebate is available with respect to employment or partner expenses that are deductible for income tax purposes. The amount of the rebate is currently 7/107 of the tax-paid expenditures. For 2006, the rebate percentage drops to 6.5/106.5 and for 2007 and subsequent years, the rebate percentage is 6/106.

### ***Coin Operated Devices***

The amount of GST that must be remitted in respect of sales made through coin-operated devices is based on the date the money is removed from the machine. For money removed prior to July 1, the rate of tax is 7/107. For money removed after June 30, the rate of tax is 6/106.

### ***Anti-Avoidance Rules***

Rules have been introduced to deem the tax rate to be 7% where an agreement has been modified or annulled and replaced with a new agreement prior to July 1, 2006 where the purpose of the new agreements was to take advantage of the new 6% tax rate. These anti-avoidance rules apply only where the parties to the agreement are not dealing with each other at arm's length.

### ***Tips and Traps***

#### ***Automatic Calculations of GST paid to claim ITC's***

Many software programs automatically calculate the GST input tax credit assuming that the rate of tax paid is 7%. These software programs will have to be modified to reflect the lower GST rate. Once the modification is made, it will still be necessary to over-ride the calculation, for example, when an old invoice on which GST is paid at 7% is entered in the system after the system has been updated to the new 6% rate. Businesses will have to be careful to maximize their ITC claims.

#### ***System Changes – Effective Date versus Transaction Date***

Many computer systems will have to be modified, not only to take into account the rate reduction from 7% to 6%, but

also to take into account the date the transaction is posted into the system. If, for example, an invoice is dated in June, but entered in the system in July, the rate of tax is likely 7%, but the system may automatically (in error) default to a 6% entry rate.

### ***Employee Expense Claims***

Pay employee allowances prior to July 1 to obtain an ITC at the rate of 7/107 instead of 6/106. The factor to apply is based on when the allowance is paid, and not on the date that the underlying expenses relate to, or the date on which the expense claim is submitted to the employer.

If using the simplified method to claim ITC's for employee reimbursements, pay the reimbursements prior to July 1 to be able to claim the ITC at the rate of 6/106 instead of the new rate of 5/105 (13/113 for HST).

### ***Purchasing Real Property***

If you can't claim an ITC for the GST paid when acquiring land or a building, consider working with the vendor to enter into a new agreement that delays the closing until after June 30 to obtain the lower 6% rate.

### ***Bad Debts and Price Adjustments***

Businesses that claim relief from GST on bad debts will be able to claim back the actual amount of GST that has become uncollectible. This will be 7/107 for supplies made before July 30 and 6/106 for supplies made after June 30.

Similar logic will apply to price adjustments after June 30 for original sales made prior to July 1.