

GST/HST Info Sheet

Applying the GST/HST Rate Reduction to Allowances and Reimbursements

May 2006

This info sheet explains how the proposed reduction in the rate of the goods and services tax (GST) and the federal component of the harmonized sales tax (HST) will apply to amounts as allowances or reimbursements for transactions that straddle the date the reduced rates come into effect, which is July 1, 2006.

In this info sheet, “taxable” means subject to the GST/HST at the rates of 7% and 15%, or at the reduced rates of 6% and 14%. “Participating province” refers to the provinces of Nova Scotia, New Brunswick, and Newfoundland and Labrador.

The HST applies only to supplies made in or imported into a participating province. The GST applies to supplies made in or imported into the rest of Canada. If you are uncertain as to whether a supply is made in a participating province, refer to the Technical Information Bulletin B-078, *Place of Supply Rules under the HST*, available from any Canada Revenue Agency (CRA) tax services office.

Note: The CRA has introduced new factors of 5/105 and 13/113, which may be used by registrants to calculate deemed tax paid in respect of reimbursements paid on or after July 1, 2006. See page 4 of this info sheet.

Background

Effective July 1, 2006, the rates of the GST and the HST will be reduced. The rate of the GST will be reduced from 7% to 6%. The rate of the HST will be reduced from 15% to 14%. The Minister of Finance is introducing legislative amendments to implement these changes (see Bill C-13, the *Budget Implementation Act, 2006*).

General transitional rule

Generally, the new rates of tax apply to the supply of taxable (other than zero-rated) goods and services in the following circumstances:

- If the GST/HST becomes payable on or after July 1, 2006, without having been paid before that day, the rate of 6% GST or 14% HST will apply.
- If the GST/HST is paid on or after July 1, 2006, without having become payable before that day, the rate of 6% GST or 14% HST will apply.

If the GST/HST becomes payable or is paid without having become payable before July 1, 2006, the rate of 7% GST or 15% HST will continue to apply.

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Transitional provisions for deemed supplies

Current legislation deems the GST/HST to have been paid, or collected, in certain circumstances. Under the proposed legislative amendments, the rates of 6% and 14% will be used to determine the GST/HST that is deemed to have been paid or collected, on or after July 1, 2006.

The current legislation concerning allowances and reimbursements paid by employers to employees, by partnerships to partners, or by public institutions and charities to their volunteers deems the GST/HST to be paid by these persons at specific times. As long as all the criteria outlined below are met, and as long as these allowances or reimbursements do not result in taxable benefits to the individuals receiving them, the person who pays these allowances or reimbursements is deemed to have paid the GST/HST, and may be entitled to claim an input tax credit (ITC) or rebate for the deemed tax paid.

Whether the reduced rates of tax apply to these allowances and reimbursements depend on the date the allowance or reimbursement is paid.

Allowances

A person is deemed to have paid the GST/HST on an allowance paid to:

- an employee of the person,
- where the person is a partnership, a member of the partnership, or
- where the person is a charity or public institution, a volunteer who gives services to the charity or public institution,

as long as the conditions listed below are met.

1. The allowance is used to pay for supplies of property or services all or substantially all (90% or more) of which are taxable supplies, and are acquired in Canada by the employee, partner, or volunteer in relation to the activities engaged in by the person.
2. The allowance is deductible in computing the income of the person paying the allowance for

purposes of the *Income Tax Act*, or would be deductible if the person were a taxpayer under that Act and the activity was a business (note that the full amount of the allowance does not have to be deductible for income tax purposes, but some of the amount must be deductible).

3. If the allowance is for the use in Canada of a motor vehicle in relation to the activities of the person, it must be considered to be a reasonable allowance for income tax purposes.

When these conditions are met, the person paying the allowance is considered to have received the property or services, and any consumption or use of the property or services by the employee, partner or volunteer is considered to be consumption or use only by the person. In addition, the person is considered to have paid, at the time the allowance is paid to the employee, partner, or volunteer, the GST/HST in respect of the property or services.

The GST/HST deemed to have been paid on the allowance is calculated by the formula

$$A \times B$$

where

A is the amount of the allowance and

B is

- for an allowance paid before July 1, 2006:
 - (i) 15/115, where 90% or more of the supplies for which the allowance is paid were made in participating provinces, or if the allowance is paid for the use of a motor vehicle in participating provinces, and
 - (ii) in any other case, 7/107.
- for an allowance paid on or after July 1, 2006:
 - (iii) 14/114, where 90% or more of the supplies for which the allowance is paid were made in participating provinces, or if the allowance is paid for the use of a motor vehicle in the participating provinces, and
 - (iv) in any other case, 6/106.

On June 29, 2006, an employer pays an allowance to an employee to attend a business meeting that is to be held in Vancouver, British Columbia, from July 12 to July 15, 2006. The allowance is intended to cover supplies of property or services of which 90% or more are taxable, and that are acquired in Canada.

Since the employer pays the allowance to the employee before July 1, 2006, to cover the taxable supplies of property or services made in a non-participating province, the employer is deemed to have paid tax equal to 7/107 of the amount of the allowance.

On September 15, 2006, a partnership pays a partner a reasonable allowance to cover motor vehicle travel within Nova Scotia. As the partnership pays this allowance after July 1, 2006, for travel within a participating province, the partnership is deemed to have paid tax equal to 14/114 of the amount of the allowance.

Reimbursements

A person is deemed to have paid the GST/HST on a reimbursement paid to:

- an employee of the person,
- where the person is a partnership, a member of the partnership, or
- where the person is a charity or public institution, a volunteer who gives services to the charity or public institution,

as long as the conditions listed below are met.

1. The employee, partner or volunteer must have paid the GST/HST on the taxable property or services acquired, imported, or brought into a participating province.
2. The employee, partner or volunteer must have consumed or used the property or services in relation to the activities of the person.

When these criteria are met, the person is deemed to receive a supply of the property or service, and to have consumed or used the property or service. The person is also deemed, on the day the reimbursement is paid, to have paid tax in respect of the supply of the property or service.

The deemed tax paid on the reimbursement is equal to the amount determined by the formula

$$A \times B$$

where

A is the tax paid by the employee, partner or volunteer in respect of that person's acquisition, importation or bringing into a participating province of the property or service; and

B is the lesser of

- (i) the percentage of the cost to the employee, partner or volunteer of the property or service that is reimbursed, and
- (ii) the extent (expressed as a percentage) to which the property or service was acquired, imported or brought into the province, as the case may be, by the employee, partner or volunteer for consumption or use in relation to the activities of the employer, partnership, charity or public institution.

Registrants may choose one of the following two methods to calculate the deemed tax paid in relation to reimbursements for expenses incurred in Canada:

- use a factor of 6/106 or 14/114 of the total amount reimbursed, or
- use the exact calculation method as shown above.

Documentary requirements

Registrants who use the factor of 6/106 or 14/114 for reimbursements are exempt from the general documentary and information requirements for claiming ITCs if they maintain books and records (including all documentation currently required to substantiate such deductions under the *Income Tax Act*) that contain the following information:

- the name and GST/HST registration number of the registrant who paid the reimbursement;
- the name of the employee, partner or volunteer who received a reimbursement;
- the total amount of the reimbursement paid to each employee, partner or volunteer;

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- the total GST or HST deemed to have been paid for the reimbursement (6/106 or 14/114 of the total amount);
- the reporting period in which the reimbursement was made; and
- the nature of the supply or expense.

Effective for reimbursements paid on or after July 1, 2006 a registrant will be allowed the option of multiplying the total amount reimbursed for expenses by the factor of 5/105, if 90% or more of these expenses are taxable at 6% GST, or by the factor of 13/113, if 90% or more of these expenses are taxable at 14% HST.

The calculation method chosen must be used consistently within each category of reimbursed amounts (e.g., airfare, hotel accommodation, food, beverages, and entertainment) throughout the fiscal year.

On September 15, 2006, an employer reimburses a sales employee \$74.40 for the cost of meals (including taxes and tips) incurred during a one-day trip exclusively in relation to the employer's activities. The employee paid \$3.60 GST on the cost of the meals. The employer is deemed to have paid \$3.60 GST ($\$3.60 \times 100\%$) on the reimbursed amount, since the employer is using the exact calculation method.

On September 15, 2006, an employer reimburses a sales employee \$74.40 for the cost of meals (including taxes and tips) incurred during a one-day trip exclusively in relation to the employer's activities. The employer consistently used the factor of 6/106 to determine the deemed tax paid on meal reimbursements paid to its employees before July 1, 2006. Since the employer reimburses the employee after July 1, 2006, it may use the factor 5/105 to determine the deemed tax paid. Consequently, the employer is deemed to have paid \$3.54 GST ($5/105 \times \74.40) on the reimbursed amount.

This info sheet does not replace the law found in *the Excise Tax Act* (the Act) and its Regulations. It is provided for your reference. As it may not completely address your particular operation, you may wish to refer to the Act or appropriate regulation, or contact any CRA GST/HST Rulings Centre for additional information. These centres are listed in GST/HST Memorandum 1.2, *Canada Revenue Agency GST/HST Rulings Centres*. If you wish to make a technical enquiry on the GST/HST by telephone, please call the toll-free number 1-800-959-8287. A ruling should be requested for certainty in respect of any particular GST/HST matter.

This info sheet reflects changes to the Act announced by the Minister of Finance on May 2, 2006, and included in Bill C-13, the *Budget Implementation Act, 2006*, which received first reading on May 11, 2006. Any commentary in this info sheet should not be taken as a statement by the CRA that these amendments will be enacted in their current form.

If you are located in the province of Quebec and wish to make a technical enquiry or request a ruling related to the GST/HST, please contact Revenue Québec by calling the toll-free number 1-800-567-4692.

All GST/HST publications are available on the Internet at the CRA site at www.cra-arc.gc.ca/tax/technical/gsthst-e.html.