TOWARDS REPLACING THE GOODS AND SERVICES TAX

Canada

Towards Replacing The Goods and Services Tax

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Overview

The government of Canada has put forward a set of measures that makes significant progress towards replacement of the Goods and Services Tax.

The signing of the Memoranda of Agreement between the federal government and the governments of Nova Scotia, New Brunswick and Newfoundland and Labrador marks a significant first step towards an integrated, federal-provincial sales tax. With the province of Quebec concluding the harmonization process this year, the government is committed to work with the remaining provinces to make this a national system.

The government is also introducing over 100 measures to streamline and simplify the operation of Canada's sales tax. These measures are an essential part of the new architecture of a much-improved system.

Taken together, this package constitutes a major advance in responsible sales tax reform. Consumers, taxpayers and business – particularly small business – will benefit.

House of Commons Standing Committee on Finance

In 1994, the House of Commons Standing Committee on Finance conducted an extensive review of sales tax reform options. During the review, the Committee heard from nearly 500 witnesses and received more than 700 briefs. The Finance Committee considered a wide range of alternative sources of

revenue for the federal government and rejected all of them[1]. In its June 1994 report, the Committee concluded that a harmonized value-added tax was the best option. As the Committee noted, the harmonization of federal and provincial sales taxes offers key benefits to Canadians, including simplified tax compliance for business, lower administration costs through the elimination of existing overlap and duplication, and increased economic efficiency and competitiveness.

In addition, the Committee recommended a two-level approach to tax-included pricing. Under this approach, goods and services would be priced for public consumption on a tax-included basis, while receipts and invoices would show the amount of value-added tax payable or the rate at which value-added tax was charged.

Sales tax harmonization discussions with the provinces

Since the release of the Finance Committee's report, the federal government has been actively seeking agreement with provinces interested in harmonization. The harmonization agreements announced today represent a significant step towards the goal of a harmonized federal-provincial sales tax system.

Benefits of harmonization using a value-added tax model

Harmonizing federal and provincial sales taxes on the basis of a value-added tax model offers important benefits for Canadians, including:

- benefits to consumers;

[1] See Annex A for a list of the alternatives considered.

- economic benefits resulting from the improved competitiveness of Canadian businesses;
- lower compliance costs for Canadian businesses;
- more efficient tax administration and the elimination of government overlap and duplication; and
- the opportunity to implement a two-level approach to tax-included pricing.

Benefits to consumers

Value-added taxes largely eliminate the hidden taxes on business inputs (i.e. the items that businesses buy in order to make their products, deliver their services, and keep their businesses running), which increase consumer prices for many goods.

Replacing the current federal and provincial sales taxes with a harmonized value-added tax will:

- remove distortions which increase the price of certain goods;
- reduce compliance costs, thereby contributing to lower prices; and
- make both the final price of a good or service and the total sales tax applied to that good or service more transparent.

Economic benefits

The key economic advantage of the value-added tax model is the improved competitiveness resulting from the reduction of indirect taxes on business inputs and lower business compliance costs. The reduction in taxes on business inputs will:

- eliminate tax cascading inherent in current provincial retail sales tax systems; and
- minimize distortions in investment decisions associated with the taxation of business investment in capital stock.

Elimination of sales tax cascading

Tax cascading occurs when businesses pay sales tax on goods and services used at each stage of the production and distribution chain (e.g., heat, office supplies, etc.). Businesses account for the tax paid on their inputs by increasing their price to the next buyer in the production and distribution chain. Therefore, tax cascading effectively increases prices at each stage from production to final sale to the consumer. A value-added tax removes tax on business inputs and eliminates sales tax cascading through the input tax credit (ITC) mechanism. Therefore, federal-provincial sales tax harmonization using a value-added tax model will greatly improve the productivity and competitiveness of the Canadian economy by:

- lowering the tax embedded in the prices of Canadian exports, thereby increasing the competitiveness of Canadian products in international markets;
- increasing the competitiveness of Canadian-produced goods vis-à-vis imports;
- eliminating price distortions between products that use a high percentage of taxable inputs and those that do not; and
- eliminating locational distortions, where businesses seek to locate in low-tax rate jurisdictions to minimize costs and selling prices.

Elimination of distortions in investment decisions

Nationally, over one-third of provincial retail sales tax revenues are raised through the taxation of business inputs (the actual share of provincial retail sales tax paid by business varies from province to province). In addition to contributing to the problems associated with tax cascading, the taxation of business capital investment under provincial retail sales taxes hampers Canadian economic growth by making investment in Canadian industries more costly to both domestic and foreign investors. It also distorts investment choices by introducing an artificial, taxation-based variable into the decision of which

province and what industry to invest in. This can lead to an allocation of capital investment based in part upon relative taxation liabilities, and may produce less than optimal gains in terms of increased employment and national wealth.

The elimination of the sales tax burden on capital investment under the harmonized federal-provincial value-added tax will ensure that the allocation of capital in Canada is optimized, resulting in a higher and more productive utilization of the country's capital resources.

Lower compliance costs for Canadian businesses

In addition to these economic benefits, federal-provincial sales tax harmonization offers other equally important benefits. In particular, the implementation of a fully harmonized federal-provincial sales tax system will represent a major simplification of the tax system for Canadian businesses. For example, businesses operating under a harmonized sales tax system would use a single set of operating rules for sales tax purposes and would be required to fill out fewer forms.

Additionally, a single tax administrator will significantly reduce the costs to business associated with complying with two or more separate sales tax systems on a daily basis. These costs are disproportionately borne by small- and medium-sized firms, which typically do not have the accounting capacity to easily cope with this additional burden.

More efficient administration/reduced overlap and duplication

Canadians are demanding that their governments become more efficient in the administration and collection of taxes. Sales tax harmonization will enable Canadian governments to greatly reduce tax administration costs by consolidating sales tax bureaucracies. The consolidation of federal and provincial sales tax administrations eliminates the costly duplication

of sales tax collection and enforcement functions within governments.

More efficient administration also creates the potential for further simplifications in the tax system. For example, a fully harmonized sales tax with a single rate and a common base facilitates the development of new sales tax accounting systems, which could eliminate most of the current compliance burden on small business. Under such a system, businesses could file for all federal and provincial sales taxes and income taxes using a consolidated return.

Other benefits

A harmonized federal-provincial value-added tax will also minimize transition costs for businesses, and provide a stable and reliable source of revenue for all governments.

Measures to simplify and improve the fairness of the federal sales tax

The federal government is taking steps to make significant changes to the operation of Canada's value-added tax system to improve the fairness and efficiency of the tax and to facilitate federal-provincial sales tax harmonization. Many of these proposed changes were developed in response to concerns raised by businesses and other organizations during consultations over the last two years. The package of over 100 legislative proposals can be categorized as follows:

- measures to simplify the operation of the tax for many businesses, charities and non-profit organizations;
- measures to improve the fairness of the federal sales tax for businesses and consumers; and
- clarifications and measures to ease compliance.

In addition, as part of the government's ongoing changes to simplify the operation of the federal sales tax for Canadian

taxpayers, Revenue Canada is reducing the number of forms required to calculate sales tax in certain circumstances and is studying the harmonization of administrative measures for all federal taxes.

Simplification measures

One of the government's key priorities is to simplify the federal sales tax system. Well over one-third of the proposed modifications are aimed at achieving this goal. Extensive consultations were undertaken with businesses and public sector organizations to find ways to substantially simplify the tax as it applies to businesses and public sector bodies. The proposed measures include:

- a simplified treatment of used goods;
- streamlining the tax treatment of charities and non-profit organizations – fewer charities and non-profit organizations will be required to register and administer the federal sales tax; and
- simplifying the calculation of employee benefits – enabling businesses to make a one-step calculation of tax using the same information generated for income tax purposes.

Fairness measures

The government is committed to restructuring the federal sales tax system to make it fairer for Canadians. The proposed measures will accomplish this by ensuring competitive equity between businesses and increasing the fairness of the tax for consumers. Proposals included in this category are:

- a variety of measures to enhance the international competitiveness of Canadian service providers;
- changes in the tax treatment of certain health care services; and
- fairer application of housing rebates.

Clarifications and measures to ease compliance

The package of changes to the federal sales tax also includes proposals to clarify the application of the tax and to ease compliance for businesses. These changes will ensure that the federal sales tax is clear in its application and does not contain measures that unnecessarily complicate administration. The proposed measures include:

- clarifications of certain educational services – e.g., the definitions of "public college", "vocational school", and the tax treatment of university meal plans;
- streamlining the administration of tourist rebates and extending the eligibility for rebates to businesses; and
- clarification of the application of the federal sales tax to trustee services, personal trusts, trustee liabilities and obligations and estates as well as changes to existing partnership rules.

Harmonized administrative measures

During the next year, the Minister of Finance and the Minister of National Revenue will work together to develop legislative proposals to harmonize accounting, interest, penalty and related administrative and enforcement provisions of the various federal taxing statutes, including the *Excise Tax Act*, *Excise Act*, *Income Tax Act*, *Customs Act*, *Customs Tariff* and *Special Import Measures Act*. The purpose of this initiative is to simplify the payment of taxes and the processing of returns for taxpayers and Revenue Canada.

Measures to Simplify and Improve the Fairness of the Federal Sales Tax

Charities and other public sector bodies

The *Excise Tax Act* sets out special rules pertaining to public sector bodies, which include government and public service bodies. Public service bodies are comprised of charities, non-profit organizations, municipalities, school authorities, hospital authorities, public colleges and universities.

The government proposes to introduce a number of measures applicable to charities and other public sector bodies. These include:

Simplified rules for all charities, including:

- a reduction in the number of charities required to be registered; and
- simpler rules relating to fund-raising.

Simplified rules for smaller charities, including:

- an expanded range of exempt activities;
- a new streamlined accounting method; and
- simplified rules for filing returns and claiming rebates.

Simplified rules for other public sector bodies, including:

- a reduction in the number of public service entities required to be registered;
- streamlined rebate application requirements;
- changes in the tax treatment of memberships in public sector bodies; and
- changes in the tax treatment of certain fund-raising events.

Charities

The *Excise Tax Act* contains special rules for supplies by charities that are registered under the *Income Tax Act*. In general, a charity's supplies are exempt unless specifically excluded from the general exemption. In addition, those supplies by charities that fall outside the general exemption may be exempt or zero-rated under another provision of the *Excise Tax Act*. For example, otherwise taxable supplies of goods by charities may be exempt if sold for less than direct cost.

Certain rules for charities were originally developed to address the activities of the largest charities. Many smaller charities have found these rules difficult to comply with.

New simpler rules for all charities are proposed. In addition, new rules specifically designed for smaller charities will greatly simplify compliance with the federal sales tax for that group. To facilitate the introduction of these new rules, the government proposes to distinguish larger charities, comprised of public colleges, universities, school authorities, hospital authorities and certain local authorities, from the broader

group of charities. This new group of charities will be called "public institutions".

As a result of these proposed changes, significantly fewer charities will be required to register for federal sales tax purposes. For those that do remain registered – 10-12 per cent of all charities – the rules will be much simpler, particularly with respect to fund-raising activities, filing returns and claiming rebates.

Simpler rules for all charities

The following proposed measures will apply to all charities. Unless otherwise indicated, these measures apply after 1996.

- Effective immediately, the small supplier thresholds applicable to the registration of charities – currently $30,000 annually based on taxable supplies and $175,000 annually based on gross revenues – will be increased to $50,000 and $250,000, respectively. Charities with taxable supplies or gross revenues below these thresholds will not be required to be registered for federal sales tax purposes.

- Consequently, about 10,000 fewer charities will be required to be registered. Charities that are now registered and that choose to de-register under the new rules within the next two-year period (from ANNOUNCEMENT DATE) will not be subject to any self-assessment of tax as a consequence of de-registration on property held at the time of de-registration.

- A new provision dealing with fund-raising activities will replace the volunteer exemption, which requires various complicated determinations to be made in respect of each fund-raising activity. Under the new measure, most supplies made in the course of a fund-raising activity will be exempt, provided that such supplies are not made on a regular or continuous basis throughout the year or a significant portion of the year by the charity, and do not entitle the recipients to receive property or services from the charity throughout the year or a significant portion of the year.

■ The full price of admission to a fund-raising event (e.g., a dinner or dance) will be exempt where part of the price of admission qualifies as a charitable donation for income tax purposes. Currently, only the donation component of the price of admission is not subject to federal sales tax.

■ The definition of "direct cost" will be simplified and supplies made by charities will be treated as exempt when made for less than "direct cost". For example, where charities re-supply goods for less than the tax-included purchase price, these supplies will be exempt from federal sales tax. Supplies of goods and certain services by charities are currently exempt when made for consideration equal to or less than "direct cost". This rule is, however, difficult to apply because of the complex nature of the existing definition of "direct cost".

Simpler rules for charities other than public institutions

New proposed rules will further simplify compliance for those charities, other than public institutions, that remain registered or are required to register. These simplifying measures will apply to supplies made on or after January 1, 1997, or to fiscal years of charities beginning on or after that day.

These proposed measures are:

■ Charities will be able to make more supplies on an exempt basis. Catering services, short-term leases and licenses of real property, including any goods supplied with such real property (e.g., rentals of meeting rooms and audio-visual equipment when rented with a meeting room) and parking will be exempt when supplied by charities.

■ Charities will no longer be required to apportion their inputs between taxable and exempt supplies. Under a new streamlined accounting method for charities, charities registered for federal sales tax purposes will continue to collect the tax on all of their taxable supplies but remit only 60 per cent of the tax charged on specified supplies. In turn, charities will receive a 50 per cent rebate of federal sales tax paid in respect of inputs used in making both taxable and exempt supplies.

■ However, charities will continue to be eligible for full input tax credits on qualifying purchases of real property and capital personal property and will continue to remit 100 per cent of the federal sales tax collected in respect of taxable supplies of such property. They will be able to elect not to follow the new streamlined accounting method where all or substantially all of their supplies are taxable or where a charity, in the ordinary course of a business, makes zero-rated supplies.

■ The requirements related to filing returns and claiming rebates will be streamlined to reduce the cost and complexity for a large number of charities. Charities registered for purposes of the federal sales tax will no longer be subject to a taxable supplies threshold test for the purposes of determining their reporting periods. They will be able to elect to report on an annual, quarterly or monthly basis, regardless of their size.

■ New federal sales tax registrants will automatically have an annual reporting period for purposes of filing returns and an annual claim period for rebate purposes but will have the option of reporting quarterly or monthly. Existing registrants who wish to change their reporting period (e.g., from quarterly to annually) will be able to do so regardless of their size. Existing registrants who have made an election and who want to maintain their current reporting periods may do so without filing new elections.

Other non-profit and public sector entities

Several new rules are proposed for other non-profit and public sector entities.

Small supplier threshold

For public service bodies other than charities and public institutions, the small supplier threshold, based on annual taxable supplies, will be raised to $50,000 in annual taxable supplies from the current level of $30,000.

As a result of this measure, a larger number of public service bodies will no longer be required to be registered for federal sales tax purposes. This means that they will not be

required to collect tax on their supplies or to apportion inputs. If eligible, they will be able to claim the partial rebate available to qualifying non-profit organizations, hospital authorities, school authorities, universities, public colleges and municipalities. Public service bodies that are now registered and that choose to de-register within the next two-year period (from ANNOUNCEMENT DATE) will not, as a consequence of de-registration, be subject to any self-assessment of tax on property held at the time of de-registration.

This measure will be effective as of ANNOUNCEMENT DATE.

New definition of direct cost

The proposed new simplified "direct cost" exemption applicable to charities and public institutions will also apply to other public service bodies. This measure will become effective January 1, 1997 and applies to supplies for which payment is made on or after that day.

Simplifying the application for rebates

The rebate application requirements for non-registered public service bodies will be streamlined. This will reduce the cost and complexity of administration and compliance for a large number of smaller public service bodies. The rebate claim period for these organizations will now be semi-annual. This measure will apply to claim periods in fiscal years beginning on or after January 1, 1997.

Rebate apportionment rules

The rules for specific rebate apportionment by selected public service bodies, charities and qualifying non-profit organizations will be clarified. The apportionment of rebates is required when a hospital authority, school authority, university, public college or municipality engages in activities that are separate from the activities undertaken in its capacity as such an entity.

The new rules clarify that these organizations must apportion inputs related to their exempt activities for purposes of determining the amount of their rebate. They are entitled to recover at least 50 per cent of the tax paid on these inputs. However, to the extent that inputs relate to the operation of their respective facilities – e.g., a hospital or a public college – a charity may apply the higher rebate rate applicable to the selected public service body category in which it falls. For example, if a religious order, as a charity, operates a hospital and a public college and undertakes other activities that are unrelated to operating either the hospital or the public college, the religious order is entitled to an 83 per cent rebate for inputs into exempt activities relating to the operation of the hospital, a 67 per cent rebate for inputs into exempt activities relating to the operation of the public college and a 50 per cent rebate in relation to other exempt charitable activities.

For persons designated to be municipalities for the purposes of claiming a partial rebate, these rules apply as of January 1, 1991. In all other cases, these new rules apply for the purpose of determining rebates for which applications are filed after ANNOUNCEMENT DATE.

Memberships and fund-raising events

Measures are proposed to simplify the tax treatment of memberships in public sector bodies and of certain fund-raising events.

Currently, memberships in most public sector bodies are exempt provided that members do not receive any material benefit by virtue of their membership, and the public sector body does not elect to treat the memberships as taxable.

It is proposed that memberships in public sector bodies (other than charities, public institutions, and registered political parties) be taxable. Accordingly, input tax credits will be available to bodies supplying these memberships. Memberships in charities and public institutions will continue to be exempt, except for memberships that entitle members to

supervision or instruction in certain recreational or athletic activities or that entitle members to otherwise taxable admissions for no extra charge or for significant discounts to members.

New rules will apply to registered political parties. Memberships in registered political parties will be exempt from federal sales tax. In addition, a supply made by a registered political party in respect of which the purchaser can claim a political contribution tax credit for federal or provincial income tax purposes will be exempt. This includes admissions to fund-raising events such as dinners and dances. These measures are consistent with the proposed rules applicable to fund-raising events for charities and public institutions.

The proposed measure regarding memberships will be effective after ANNOUNCEMENT DATE. The measure regarding admissions to fund-raising events applies to supplies made after 1996 but does not apply to supplies of admissions to events for which any admissions have been supplied before 1997.

The health care sector

A number of changes are proposed to make the federal sales tax system fairer in its application to the health care sector.

Health care practitioners

Changes will be made in the tax treatment of health care services provided by health care practitioners who are not medical doctors or dentists. Certain health care practitioners who are specifically listed in the legislation are not required to charge tax on their health care services. Also, services provided by other health care practitioners not listed are exempt in a province where they are fully or partially covered by that province's health care plan.

Many health care professionals who are not on the list of exempt health care practitioners have expressed dissatisfaction

with the lack of clear criteria for determining which professions should qualify to be listed as exempt health care practitioners. In order to ensure fairness in the exemption of services provided by health care practitioners, the list of health care practitioners qualifying to provide their services exempt of tax will be based on the following criteria:

- the service must be covered by a provincial health care plan in two or more provinces; or
- if the service is not covered by a provincial health care plan, the service must be provided in the practice of a profession that is regulated as a health care profession in five or more provinces.

Accordingly, the list of exempt health care practitioners will be extended to include dieticians, who are regulated as health care professionals in five provinces. As a result, dieticians will be able to provide their services exempt of federal sales tax to individuals, health care facilities and public sector bodies as of January 1, 1997. In addition, services provided by other health care professionals who do not meet these criteria (psychoanalysts, osteopaths and speech therapists) will become taxable after the end of 1997 unless, at that time, they satisfy the new criteria.

Linking the federal sales tax exemptions to provincial policies recognizes the provinces' major role in the health care field.

Medical devices

A number of changes are proposed to extend or clarify the zero-rating provisions as they apply to certain medical devices and associated services. These are:

- the zero-rating of hospital beds will be extended to purchases by all health care facilities, including long-term care facilities. Currently, sales of hospital beds are zero-rated only when purchased by a hospital, or by an individual on the written order of a medical practitioner. This measure will be

effective for supplies for which payment becomes due after ANNOUNCEMENT DATE;

- the zero-rating of a service (as well as goods supplied in conjunction with the service) of modifying a vehicle to meet the needs of an individual using a wheelchair will be expanded. Currently, such adaptations are zero-rated only when the vehicle is owned by an individual. This restriction will be eliminated and the zero-rating will be extended to other owners, such as corporations, associations, or municipal or governmental organizations. This measure will be effective for supplies for which payment becomes due after ANNOUNCEMENT DATE;

- orthotic or orthopaedic devices will be zero-rated when they are made to order for an individual, or when they are supplied under a prescription issued by a medical practitioner to a consumer. Currently, the provisions for orthotic devices and orthopaedic braces have different zero-rating conditions and are contained in two different sections of the legislation. This measure will be effective for supplies for which payment becomes due on or after the day that is 21 days after ANNOUNCEMENT DATE;

- a supply of footwear will be zero-rated if it is specially designed to be used by an individual with a crippled or deformed foot and it is supplied on the written order of a medical practitioner. The requirement for a written order from a medical practitioner has been added for greater certainty. This measure applies to supplies for which all of the payment becomes due on or after January 1, 1997.

The municipal sector

A number of changes will be introduced to simplify the federal sales tax treatment of the municipal sector. These include:

- broadening the scope of exempt municipal services;

- ensuring consistency in the treatment of supplies by public utilities;

- clarifying the tax status of the collection of recyclable materials; and
- clarifying the tax status of municipal non-optional services.

Exempt municipal services

Most municipal services are provided on an exempt basis. That is, no tax is charged on the services provided by the municipality, and the municipality is not entitled to claim input tax credits for tax paid on the inputs purchased in relation to these services.

Under the existing legislation, basic municipal services, which are generally provided on an exempt basis, may also be taxable in certain circumstances. This has led to administrative difficulties. For example, optional services supplied to individual households on a fee-for-service basis are generally taxable. Thus, garbage collection services provided by a municipality as part of a weekly service are exempt, but the special pick-up of a refrigerator for a homeowner, for example, is taxable.

To streamline and simplify the application of the tax in the municipal sector, the collection of garbage and the supply of information or documents regarding titles or assessments in respect of property or the zoning of real property will always be exempt when provided by a municipality or government, or by a board or commission established by a government or municipality. Also, the following services will always be exempt when provided by a municipality or a board, commission or other body established by a municipality:

- removal of snow, ice, or water;
- installation, repair, maintenance or interruption of the operation of a water distribution, sewerage or drainage system;
- installation, replacement, removal or maintenance of street or road signs, barriers, lights and similar property;
- repair or maintenance of roads, streets, sidewalks or similar or adjacent property; and

- removal, cutting, pruning, treating or planting of vegetation.

These changes will simplify the rules in many cases by eliminating the need for municipalities to distinguish between taxable and exempt supplies and to apportion their inputs accordingly. It is proposed that the measures apply to services performed on or after January 1, 1997 or for which any payment becomes due on or after that day except in the case of supplies of information or documents regarding titles or assessments where the amendment applies to supplies for which all of the payment becomes due or is paid without becoming due on or after January 1, 1997.

In addition, an amendment is proposed to clarify that municipal transit services are exempt only when supplied directly to the public. For example, if an organization contracts with a municipality to provide transit services on behalf of the municipality, the charges for the transit service to the public are exempt. However, any charges from the organization to the transit authority for these services are taxable. The amendment will apply to supplies for which all of the payment becomes due or is paid without becoming due after ANNOUNCEMENT DATE.

Finally, certain supplies of unbottled water are currently exempt when made by a person other than a government or by a government designated as a municipality. The rules will be clarified by providing that the service of delivering unbottled water is also exempt only where the delivery is made by the supplier of the water, and that supply of water is exempt. The amendment will apply to supplies for which all of the payment becomes due or is paid without becoming due after ANNOUNCEMENT DATE.

Supplies by public utilities

Under the current rules, special provisions exempt many transactions between municipalities and their para-municipal organizations. As a result, municipalities that own or control public utilities are able to purchase electricity, gas, steam or

telecommunication services on an exempt basis, while municipalities that do not own or control public utilities must pay tax on these supplies.

In order to ensure consistent tax treatment of supplies by public utilities, it is proposed that a supply of electricity, gas, steam or telecommunication services made by a public utility be excluded from the special exempting rules and, therefore, be taxable. However, supplies by a municipality to a public utility that it owns or controls will continue to qualify for the exemption. For example, a municipality will continue to be able to provide services, such as legal or accounting services, on an exempt basis to the public utilities that it owns or controls.

The proposed measure will apply to supplies of electricity, gas, steam or telecommunication services for which payment becomes due after ANNOUNCEMENT DATE.

Municipal recycling programs

There has been some uncertainty about whether the curbside pick-up of recyclables is included in the exempting provision for garbage collection. To remove this uncertainty, the government proposes that the collection of recyclable materials be included in the exempting provision for the collection of garbage. This exemption will include the collection of recyclables as part of a curbside or neighbourhood collection program as well as the delivery of such recyclables to a recycling facility.

The measure will be effective as of January 1, 1991.

Tax status of non-optional municipal services

The tax status of services performed by a municipality or government as a result of an owner's or occupant's failure to comply with an obligation imposed under a law will be clarified. Such services are non-optional services and are therefore exempt. For example, if an individual fails to control

the growth of weeds on his or her property, thereby violating a municipal by-law, and the municipality cuts the weeds and charges for the service, the service is exempt. The amendment will apply to supplies for which payment becomes due after ANNOUNCEMENT DATE.

The education sector

A number of clarifications will be made to the federal sales tax treatment of the education sector.

Public college

It is proposed that the definition of public college be amended to clarify the basis on which such an organization is eligible for the exempting provisions. Under the current legislation, a public college is defined as an organization that operates a post-secondary college or technical institute:

- that is funded by a government or a municipality; and
- the primary purpose of which is to provide instruction in vocational fields or general education.

It is proposed that, in order to qualify as a public college, an organization be required to receive funding from a government or municipality to support the ongoing delivery of educational services by the organization to the general public. This contrasts with funding paid under a special agreement between an organization and a government or municipality for the provision of training to a particular group of students. The amendment will apply for the purpose of determining any rebate for which an application is received at a Revenue Canada office on or after ANNOUNCEMENT DATE. For all other purposes the amendment applies after 1996.

In addition, it is proposed that an amendment be made to clarify that, in order to claim a partial rebate of the federal sales tax paid on its inputs used in providing exempt services, a public college must operate on a non-profit basis. This is

consistent with the existing eligibility criterion applicable to school authorities and universities. This amendment will apply for the purpose of determining rebates for claim periods beginning after ANNOUNCEMENT DATE.

Vocational school

It is proposed that the existing definition of vocational school be amended to remove the reference to organizations certified for purposes of the tuition tax credit under the *Income Tax Act*. Currently, an organization must meet one of two conditions to be a vocational school and eligible for the related exemptions. The organization must be:

- established and operated primarily to provide courses that develop or enhance students' occupational skills; or
- certified by the Minister of Employment and Immigration (now Human Resources Development) for the purposes of the tuition tax credit.

Removing the certification criterion from the definition will mean that an institution will have to be established and operated primarily to provide courses that develop or enhance students' occupational skills. A number of organizations that are currently certified, while providing one or more occupational courses, are not established primarily to provide students with courses that develop occupational skills and, in some cases, are not primarily educational institutions. These organizations will no longer qualify as vocational schools for federal sales tax purposes. The amendment will apply in relation to supplies made on or after January 1, 1997.

Meal plans offered by universities and public colleges

The circumstances in which meal plans offered by universities and public colleges are exempt will be clarified. A meal plan that is sold to students will be exempt if the amount paid for the plan is sufficient to provide a student with at least ten

meals per week for the period of the plan, which must not be less than one month.

The amendment will ensure that meal plans sold to students in the form of a decreasing balance debit card or meal vouchers are eligible for the exemption. The amendment applies to supplies for which all of the payment becomes due or is paid without becoming due on or after July 1, 1996.

The used goods sector

It is proposed that the current treatment of used goods be substantially reformed.

The treatment of used goods under the current federal sales tax includes a special mechanism – the notional input tax credit – which was designed to remove the embedded tax in used goods when they are resold. This mechanism enables a registrant to claim an input tax credit equal to 7/107ths of the price paid for a good when the good is purchased from someone who is not required to charge tax. However, the system has proved to be complex due to the number of special rules required to make it work. The following changes will be introduced to simplify the federal sales tax treatment of used goods while at the same time limiting tax cascading:

- notional input tax credits will be eliminated for most transactions;
- a trade-in approach will be introduced;
- the special rules for the sales tax treatment of appreciating used goods (e.g., certain works of art and jewellery) will be eliminated; and
- new rules will be introduced for sales by agents and auctioneers.

However, notional input tax credits will be retained in certain areas:

- property acquired through seizures or repossessions by creditors;
- property acquired by insurers following the settlement of claims; and
- returnable containers.

Notional input tax credits

Under the current rules, sales of used goods by a person who is not required to collect tax, such as a non-registrant (e.g., an individual consumer or small supplier) or a registrant who used the goods in exempt activities (e.g., a public sector body or a financial institution), are not subject to tax. On the other hand, sales of used goods by most registrants (e.g., used goods dealers) are subject to tax. Since a person who is not required to collect tax is unable to claim an input tax credit for the tax paid on the good, some tax will remain embedded in the price of the good. To remove the tax embedded in the price of a good, a registrant who acquires a used good from an individual consumer, or another person who is not required to collect tax, may claim a notional input tax credit equal to 7/107ths of the price the registrant paid for the good.

This notional input tax credit system is complex and has not been well understood. Consumers often mistakenly believe that there is an element of double taxation when they trade in or purchase used goods from dealers. Those who are aware of the notional input tax credit system object to the manner in which notional input credits are administered, i.e. that the federal sales tax is calculated on the full price of the new good with no allowance for the good traded in. Many have expressed a preference for paying tax on the net price, as is the current practice with most provincial sales taxes.

In response to this criticism, and to simplify the federal sales tax system, it is proposed that notional input tax credits be eliminated. In order to limit the tax cascading that would result from eliminating notional input tax credits, two consequential changes are proposed: the introduction of a

trade-in approach and the elimination of the special rules for appreciating used goods. In addition, changes to the rules for agents and auctioneers are also proposed.

This measure will apply to supplies made after ANNOUNCEMENT DATE.

Trade-in approach for calculating sales tax on used goods

In order to avoid tax cascading when a person who is not required to collect tax (e.g., a consumer) trades in a good as full or partial payment for another good, a new trade-in approach will be introduced. As a result, where a person who is required to collect tax (e.g., a dealer) accepts a used good as full or partial consideration for another good, that person will collect federal sales tax only on the difference between the price of the new good and the trade-in amount. A car dealer who accepts a trade-in from a consumer as partial consideration for a new car will charge tax only on the selling price net of the value of the car accepted as a trade-in. The following example illustrates the current system and the proposed trade-in approach.

Current approach

Currently, when an individual trades in a used good to a dealer, the value of the trade-in is subtracted from the price of the good after the calculation of federal sales tax on the new good price:

Selling price before tax	$11,000
Federal sales tax	770
Total price	11,770
Less trade-in	(5,350)
Price paid by consumer	$6,420

Note: The trade-in price represents $5,000 for the used good and $350 for the notional input tax credit available to the dealer (7/107ths of $5,350), assuming that the full value of the credit is passed on to the consumer.

Trade-in approach

Under the trade-in approach, the federal sales tax will be calculated only on the difference in price between the dealer's selling price of the new good and the value of the used good accepted as a trade-in:

Selling price before tax	11,000
Less trade-in	(5,000)
Price of good net of trade-in	6,000
Federal sales tax	420
Price paid by consumer	6,420

Note: The trade-in price of $5,000 assumes that the dealer would offer less money for the trade-in because a notional input tax credit would no longer be available.

Provincial sales taxes are not taken into account for the purposes of these illustrations.

Current rules will continue to apply to trade-ins by persons who are required to collect tax. In this case, a sale involving a trade-in will continue to be treated as two transactions: a sale by the person who is required to collect tax on a used good and a sale by the dealer of a new good. This will simplify the tracking of federal sales tax paid on goods in the event there is a recapture of tax due to a change in use.

This measure will apply to supplies made after ANNOUNCEMENT DATE.

Appreciating used goods

The proposed elimination of notional input tax credits removes the need for special rules for supplies of appreciating used goods, such as certain works of art and jewellery. These rules, which currently require the recapture of input tax credits on appreciating used goods acquired for export or otherwise supplied on a zero-rated basis, will be eliminated. As a result, appreciating used goods will receive the same tax treatment as other goods. For example, a registrant purchasing a work of art from a dealer for an office will be able to claim an input tax credit to the extent that it is for use in a commercial activity. If the artwork is subsequently resold, it will be taxable.

This measure will apply to supplies made after ANNOUNCEMENT DATE.

Property acquired through seizures, repossessions and property insurance settlement claims

The special rules for claiming notional input tax credits for goods that were seized or repossessed by creditors will be maintained. Similarly, the treatment of goods that were acquired by insurance companies following the settlement of a claim will also be maintained. Under the current rules, a creditor that seizes or repossesses a good from a person not required to collect tax, or an insurance company that acquires a good from a person not required to collect tax as a result of the settlement of an insurance claim, is able to claim a notional input tax credit on the good when the good is resold on a taxable basis. Maintaining these rules will prevent tax cascading in these circumstances.

Returnable containers

The notional input tax credit system will generally be maintained for returnable containers. These rules allow registrants to claim notional input tax credits for returnable

containers that are purchased from a person that is not required to collect tax (e.g., where an individual returns used soft drink bottles to a retailer in exchange for a deposit refund).

Agents and auctioneers

The current federal sales tax treatment of agents depends on whether they act on behalf of a disclosed or undisclosed principal. If the agent discloses the identity of the principal to the purchaser, the normal rules apply:

- the supply is considered to be made directly from the principal to the buyer; and
- tax is not charged if the principal is a non-registrant.

However, when the agent does not disclose the identity of the principal to the buyer, the following rules apply:

- the agent is deemed to buy directly from the principal for the selling price net of commission;
- the agent is deemed to sell to the buyer for the actual selling price;
- the agent may claim an input tax credit (if the principal is a registrant), or a notional input tax credit (if the principal is not a registrant), equal to 7/107ths of the tax-included selling price net of the tax-included commission;
- the registered principal remits tax on the selling price net of commission; and
- the agent remits an amount equal to the tax on the commission.

These rules are complex and, as a result, agents and their principals may have difficulty accounting for tax correctly. In addition, the existing provisions do not permit a principal to claim bad-debt relief in cases where sales are made through an agent because it is the agent, not the principal, who is deemed to have made the supply.

The current rules for sales by auctioneers are also complex. Under the current federal sales tax, auctioneers charge tax on all of their sales and all of their commissions. The auctioneer is deemed to have purchased each item from the principal for the bid price. The auctioneer may also claim an input tax credit (or a notional input tax credit if the principal is a non-registrant) on the tax charged to the buyer at the auction. The auctioneer then remits a net amount equivalent to the tax on the commission.

In order to ensure that the notional input tax credit does not result in a windfall to auctioneers, the existing rules require that the tax paid by the purchaser be passed on to the principal. The benefit is passed on to the principal in that the auctioneer turns over the tax-inclusive bid price less the tax-inclusive commission to the unregistered principal.

Proposed measures for agents and auctioneers

The current federal sales tax rules governing sales of goods by agents and auctioneers will be simplified through the introduction of a single set of rules for both agents and auctioneers which will have the effect of charging tax on all sales made through agents and auctioneers. In cases where the principal does not invoice the purchaser directly, a regulatory amendment is proposed to allow the purchaser to use an invoice issued by the agent, auctioneer or intermediary for input tax credit purposes. These measures will apply to all supplies made after ANNOUNCEMENT DATE.

Sales on behalf of registered principals required to collect tax

It is proposed that the existing deeming provisions be eliminated, and that the general federal sales tax rules be applied to goods supplied by agents and auctioneers acting on behalf of persons who are required to collect tax on the supply. In general, this means that the principal will be required to account for tax on the supply made through the agent or

auctioneer, and the agent or auctioneer will be required to collect tax on the commission charged to the principal.

The new approach will allow an agent or auctioneer to issue an invoice for input tax credit purposes in situations where the principal and agent or auctioneer do not wish to disclose their relationship to the purchaser. Principals will be allowed to claim bad debt relief as they will be accounting for the tax. These proposed measures will better reflect normal business practice and will achieve the intended result with simpler rules.

Sales on behalf of persons not required to collect tax

As a consequential change to the elimination of notional input tax credits in the used goods sector, changes are proposed to the treatment of sales of goods by agents and auctioneers on behalf of principals who are not required to collect the federal sales tax on the supply (i.e. non-registrants, small suppliers or registrants engaged in exempt activities). This will simplify the federal sales tax rules and more closely conform with provincial sales tax rules in this area.

The deemed supply from the principal to the agent or auctioneer as well as the notional input tax credit will be eliminated. Tax will be applied on the full consideration charged on the supply of the goods (other than exempt or zero-rated supplies) sold by an agent or auctioneer, and tax will not apply to the commission charged to the principal (other than for exempt or zero-rated supplies). In general, the agent or auctioneer will remit the tax charged on the sale.

An exception to these general rules will apply where the principal is a registrant who would not normally be required to collect tax on the supply (e.g., the good was used in an exempt activity of the registrant). In these circumstances, the principal and the agent will be permitted to elect to have the principal account for the tax. This will simplify accounting for tax where the agent has supplied some goods on which the principal would otherwise be required to remit the tax and

other supplies for which the agent is required to account for tax. In these cases, the agent would charge tax on his commission, while the principal would remit the tax charged on the sale and claim an input tax credit for the tax paid on the commission. The principal would continue to be denied input tax credits on other costs incurred in making the supply.

International transactions

Since the federal sales tax applies uniformly to imports and domestic goods regardless of the stages at which production and distribution costs are incurred, it does not favour imports over domestically produced goods. This feature, combined with the removal of tax on business inputs through the input tax credit mechanism and the zero-rating of exported goods and services, strengthens the competitiveness of Canadian businesses in domestic and international markets.

A number of changes are proposed to further improve the international competitive position of Canadian businesses. In addition, other proposed changes to the tax treatment of international transactions will improve the fairness, simplicity and administrative efficiency of the tax.

The following changes are being proposed to improve the competitiveness of Canadian businesses:

- services provided by Canadian sales and purchasing representatives to non-resident businesses will be zero-rated;
- a rebate will be provided for federal sales tax charged on installation services supplied to certain non-resident businesses;
- a broader range of goods and services relating to international transportation will be zero-rated;
- the zero-rating provision for goods delivered abroad will be expanded;
- parts supplied with services relating to temporarily imported goods will be zero-rated; and

- double tax on certain imports, such as foreign publications, will be relieved.

In addition, it is proposed that zero-rating be extended to emergency repairs provided to non-resident owners of railway rolling stock by businesses that are not carriers. This will ensure equity between businesses in Canada. Also, it is proposed that the eligibility criteria for voluntary registration by non-resident businesses transacting with businesses in Canada be expanded.

Further, a change is proposed to simplify the general rule for exported services. The tax treatment of supplies on board vessels on international voyages will also be simplified.

Finally, it is proposed that the place of supply rules for intangible personal property supplied to unregistered non-residents and the drop-shipment rules be clarified and that the non-resident security provisions be tightened.

Details of these proposed changes are outlined below.

Sales and purchasing representatives

Under the present system, Canadian sales and purchasing representatives that are not agents must collect the federal sales tax on services provided to their unregistered non-resident clients. This places Canadian sales and purchasing representatives that are not agents at a competitive disadvantage relative to non-resident representatives that do not charge the tax, and may increase the cost of both exports from, and imports to, Canada.

It is proposed that services supplied to a non-resident of arranging for, procuring or soliciting orders for supplies by or to the non-resident be zero-rated. To be relieved of the tax, the services must be in respect of zero-rated export supplies to the non-resident or supplies made outside Canada by or to the non-resident.

Zero-rating intermediary services will improve the competitive position of Canadian sales and purchasing representatives who deal with non-resident clients. This amendment will be effective as of January 1, 1991.

Rebate for installation services

Under the current rules, Canadian installers must collect, from unregistered non-residents, the federal sales tax on services of installing equipment in real property situated in Canada. This has the effect of placing Canadian installers at a competitive disadvantage relative to non-resident unregistered suppliers that do not charge the tax.

A rebate will be introduced for the federal sales tax paid on installation services provided to unregistered non-residents in certain specified circumstances. The rebate will be available to unregistered non-resident recipients of taxable installation services. The installation services must be in respect of goods supplied on an installed basis by an unregistered non-resident to a registered person. Also, the goods must be installed in real property located in Canada for the use of a registered person who credits the amount of the rebate to the non-resident at the time payment for the service is made.

The unregistered non-resident recipient of the installation service may submit a rebate application to the Minister of National Revenue within one year after the completion of the service. Alternatively, rules will be put in place to allow the unregistered non-resident recipient of the installation service to assign payment of the rebate to a registered installer who credits the amount of the rebate to the non-resident at the time payment for the service is made.

Availability of the rebate will improve the competitiveness of Canadian installers, and Canadian businesses may benefit from lower prices for goods acquired on an installed basis from unregistered non-residents. This proposed measure will apply to supplies made after ANNOUNCEMENT DATE.

Air ambulances

In order to maintain competitive equity between the Canadian air ambulance industry and foreign suppliers of air ambulance services, it is proposed that the supply of international air ambulance services be zero-rated. This will make the tax treatment of international air ambulance services consistent with the treatment of other exported services. The provision of air ambulance services in Canada will continue to be exempt of tax. This measure will be effective as of January 1, 1991.

Storage and emergency repair of cargo containers

Under the existing legislation, storage of, and emergency repair services to, cargo containers used for the international transportation of freight are subject to the federal sales tax when supplied by cargo container storage facilities to foreign businesses that are not carriers (e.g., owners of the containers who lease the containers to carriers). If these services were provided to an unregistered non-resident carrier, they would be zero-rated.

As a result, Canadian container storage and repair facilities are currently at a competitive disadvantage relative to foreign facilities. Also, the cost of international freight transportation services includes embedded federal sales tax, which increases the cost of exports from, and imports to, Canada.

It is proposed that the supply to unregistered non-residents of storage and emergency repair services relating to empty cargo containers used for international freight transportation and classified under specific tariff items be zero-rated. Goods, such as repair parts, provided in conjunction with the emergency repairs will also be zero-rated. This measure will apply to supplies made after ANNOUNCEMENT DATE.

Supplies to international carriers

The current rules zero-rate goods and services supplied to unregistered non-resident carriers and supplies of fuel to registered carriers, provided the supplies are for use in

transporting passengers or freight to or from Canada. It is proposed that the legislation be amended to clarify that tax relief also applies where the carrier transports passengers or freight through Canada. An example is where a carrier makes a stop-over in Gander, Newfoundland solely for refuelling in the course of a flight beginning and terminating outside Canada.

The amendment promotes the competitiveness of Canadian suppliers of goods and services, including suppliers of fuel and Canadian airports and seaports. This measure will apply to supplies made after ANNOUNCEMENT DATE.

Goods mailed abroad

Under the existing legislation, sales of goods to consumers may be zero-rated if the goods are mailed or shipped abroad by the vendor to the purchaser, for example, where a non-resident tourist purchases an article in a department store and arranges for the store to ship it directly to the tourist's home.

However, items mailed or shipped abroad by the vendor to a third party cannot be zero-rated. Under the current rules, if the non-resident tourist or a Canadian resident buys an article and arranges for the vendor to mail or ship it to a relative of the purchaser living outside Canada, the federal sales tax would apply. In addition, if the purchaser is a resident of Canada, there would be no eligibility for the tourist rebate. The effect is to discourage purchases in Canada by consumers for export.

It is proposed that the rules be expanded to zero-rate goods mailed or shipped abroad to a third party. This measure will be beneficial to many Canadian retailers. This amendment will apply to supplies made after ANNOUNCEMENT DATE.

Parts supplied with exported services

The existing legislation zero-rates services (other than transportation services) performed on goods temporarily imported into Canada in order to have the services performed.

Goods, such as parts, supplied with the zero-rated services are not expressly zero-rated.

To enhance the competitive position of Canadian service providers and to simplify compliance, it is proposed that the legislation be amended to clarify that goods supplied in conjunction with zero-rated services on goods temporarily imported into Canada (e.g., goods imported into Canada for repair) will also be zero-rated. This measure will apply to supplies made after ANNOUNCEMENT DATE.

Double tax on certain imported goods

The existing drop-shipment rules for supplies to unregistered non-residents may result in unrecoverable federal sales tax applying twice on the value of certain imported goods. For example, the federal sales tax is imposed twice on the same imported goods in cases where a registered foreign publisher has a contract with an unregistered non-resident business for mailing house services (e.g., labelling, wrapping and affixing postage), and the unregistered non-resident in turn subcontracts the services to a registered mailing house in Canada. In this case, the current drop shipment rules require the Canadian registered mailing house to collect tax from the unregistered non-resident on the fair market value of the imported publications, even though the foreign publisher is required to collect the federal sales tax on the price of the publications to Canadian subscribers.

It is proposed that these situations be excluded from the charging provision in the drop-shipment rules. This measure will help to maintain the competitiveness of Canadian businesses providing services relating to goods drop-shipped in Canada on behalf of registered non-residents. In addition, Canadian purchasers will not incur the cost of the federal sales tax twice on the same good. This measure will be effective as of January 1, 1991.

Emergency repairs to railway rolling stock

The current provision which zero rates emergency repair services supplied to non-resident owners, other than carriers, of railway rolling stock requires that the services be supplied by a carrier. However, there are businesses supplying emergency repair services that are not carriers. This places these service providers at a competitive disadvantage relative to carriers.

It is proposed that the legislation be amended to zero-rate emergency repairs provided to unregistered non-residents, whether the services are supplied by a carrier or a business that is not a carrier. In addition, goods, such as repair parts, provided in conjunction with the service will be zero-rated.

This measure will ensure that Canadian railway rolling stock repair facilities are not at a competitive disadvantage relative to carriers, and will apply to supplies made after ANNOUNCEMENT DATE.

Voluntary registration of non-resident businesses

The current voluntary registration rules for non-resident businesses are deficient in two respects:

- non-resident businesses providing services or intangibles in Canada are eligible to register voluntarily for the federal sales tax only in very restrictive circumstances. Consequently, they are generally unable to recover, by way of the input tax credit mechanism, the federal sales tax they pay on taxable business expenses incurred in Canada; and
- there is some uncertainty respecting the circumstances in which non-resident suppliers of goods may apply to be registered.

It is proposed that the legislation be amended to allow non-resident businesses to register voluntarily for the federal sales tax where they have entered into an agreement to provide services or intangible personal property in Canada. These

non-resident businesses will then be eligible for input tax credits for their taxable expenses, while collecting the federal sales tax on their sales in Canada. This measure will make the federal sales tax fairer. Also, it will provide increased sales opportunities for Canadian businesses, as non-resident businesses will be able to recover the federal sales tax paid on their purchases in Canada.

It is also proposed that the legislation be amended to clarify that non-resident suppliers of goods may apply to be registered for the federal sales tax if the goods are for export to or delivery in Canada. This amendment is consistent with Revenue Canada's current administrative policy.

These measures will apply after ANNOUNCEMENT DATE.

Simplification of the rules for export services

The general zero-rating provision for export services includes a test that is difficult to apply in practice. The test requires that the supplier determine whether a service is consumed, used or enjoyed primarily in or outside Canada. The complexity of the test causes uncertainty and increases compliance costs of Canadian service providers.

To simplify the tax administration and compliance in this area, it is proposed that the general zero-rating provision for export services be amended by repealing the current test relating to where services are primarily consumed, used or enjoyed. A new test based on whether the service is rendered to an individual in Canada will be introduced.

This measure will provide greater certainty and simplify compliance for Canadian service providers. This amendment will apply to supplies for which all the payment is due or is paid without becoming due on or after July 1, 1996.

Supplies on-board vessels during international voyages

Goods and services provided to passengers on international flights are currently not subject to the federal sales tax. It is proposed to extend similar tax relief to goods and services provided to passengers on board vessels on international voyages.

This proposal will simplify compliance for operators of ships on international voyages while in Canadian waters. Under the new rules, registered operators, as well as other registered on-board suppliers of goods and services, will not have to distinguish between supplies made to passengers while the vessel is within or outside Canadian waters. Passengers will also benefit from this simplification as they will no longer be required to pay federal sales tax on their on-board purchases unless they import these items into Canada. This measure will apply to supplies made after ANNOUNCEMENT DATE.

Place of supply of intangibles supplied to non-residents

There is some uncertainty concerning the current place-of-supply rule for intangible personal property, such as a ticket to a sporting event in Canada, when supplied to an unregistered non-resident. It is proposed that the legislation be amended to ensure that supplies to unregistered non-residents of intangible personal property for use in Canada are considered to be supplied in Canada.

In addition to ensuring that the tax applies fairly in all circumstances, the proposed clarification of the place-of-supply rule for intangible personal property supplied to non-residents will resolve uncertainty for suppliers and purchasers. This measure will apply to supplies made after ANNOUNCEMENT DATE.

Drop-shipment rules relating to storage and shipping services

The drop-shipment rules may, in some cases, relieve the federal sales tax on storage and shipping services. The supply of a service of storing or shipping goods is intended to be taxable in all cases unless it qualifies for specific zero-rated treatment.

It is proposed that the legislation be amended to ensure that the use of the drop-shipment rules will not relieve the tax on storing and shipping services. This measure will apply to supplies made after ANNOUNCEMENT DATE.

Security requirement for non-resident registered businesses

The provision requiring security from non-resident registered businesses that do not have permanent establishments in Canada is deficient in two respects:

- security is not required if a non-resident has a permanent establishment in Canada solely by virtue of making supplies through an agent in Canada; and
- the security is not required for payments to non-residents for credit returns.

It is proposed that the non-resident security provision be amended to require that security be posted in the case of a non-resident that has a permanent establishment in Canada only by virtue of another person's fixed place of business in Canada and by expanding the scope of the security provision to cover payments to the non-resident.

These measures will ensure that appropriate security is in place for registered non-residents that do not maintain assets in Canada, and will apply on Royal Assent.

The tourism sector

Under the current federal sales tax system, rebates are available to non-resident visitors to Canada for federal sales tax paid on certain accommodation and on goods exported within 60 days of purchase. The minimum amount of taxable expenditures in respect of which a claim may be made is $100 (or $7 of tax) for each claim. This threshold applies to both goods and accommodation. Accommodation rebates are available for federal sales tax paid on most short-term accommodation whether purchased separately or as part of a tour package.

Two changes are proposed to the goods rebate to make it more efficient while maintaining the competitive benefits of this program for the tourism industry. These measures will apply to any rebate for which an application is received at a Revenue Canada office on or after the first day of the third calendar month beginning after ANNOUNCEMENT DATE.

The proposed measures are:

- the minimum claim threshold will be increased to $200 (or $14 of tax) per claim; and
- the total amount of tax on each receipt for goods that accompanies the rebate claim must be at least $3.50.

Other eligibility requirements for the rebate (i.e. that the goods must be exported within 60 days of purchase and that all claims must be made within one year of purchase) remain unchanged.

With respect to the accommodation rebate, this will be extended to non-resident businesses so that they will have the same treatment as non-resident tourists. This measure will help make Canada a more attractive place to do business. This measure applies to any rebate for which an application is received at a Revenue Canada office after ANNOUNCEMENT DATE.

Financial services

The federal sales tax system generally exempts financial services provided to residents of Canada and generally zero-rates financial services rendered to non-residents. With respect to their exempt services, financial institutions are not required to collect tax, and they are not entitled to claim input tax credits to the extent that the inputs are used in providing the exempt services. Since financial institutions provide a mixture of taxable and exempt services, they must apportion inputs among these activities in order to determine their input tax credit entitlements.

The federal sales tax treatment of financial institutions is therefore different from that of most other businesses. The majority of other businesses are collectors of federal sales tax whereas financial institutions are payers of federal sales tax.

The exempt treatment of financial services was adopted because of the difficulty of measuring the charges for financial services that are implicit in the margin that a financial institution earns. Canada's exempt treatment of financial services is similar to most other countries that have value-added tax systems.

The complexities associated with financial services and the frequent changes occurring in the financial markets lead to significant difficulties in applying a sales tax in this sector. The government therefore consulted with the various financial industry groups prior to the introduction of the federal sales tax, and issued numerous technical and administrative publications which detailed how the tax was to be applied. As a result, financial institutions have in general complied well with the policy and rules governing the exempt treatment of financial services.

In spite of the general understanding of the government's underlying policy objectives, there have recently been several instances of aggressive tax interpretations, for example, some financial institutions have filed substantial refund claims to

recover federal sales tax as far back as 1991. This has the potential to create serious inequities between those who would realize windfall gains if their claims were accepted and the vast majority of financial institutions, who continue to comply with the policy intent. If their claims were accepted, they would also result in a substantial loss in revenue.

To address this issue, a press release in 1994 announced proposed amendments relating to apportionment of input tax credits as well as the application of tax to management and administrative services. This press release proposed that the amendments apply to future transactions and to additional claims in respect of past transactions, but not to existing refund claims or to transactions on which tax had not been charged. The release of these amendments, however, gave rise to other interpretations and the continuation of claims for refunds of federal sales tax previously paid. The scope of the challenges now also encompasses trustee fees.

To address these concerns, it is proposed that the amendments that were proposed in 1994 dealing with apportionment of input tax credits and with management and administrative services be reintroduced with modifications. In addition, a new amendment dealing with trustees' fees is proposed. In general, these measures will be effective as of January 1, 1991. This approach ensures that the measures will apply in a manner that treats all taxpayers equally and is consistent with the criteria for retroactive amendments outlined by the government in its response to the Seventh Report of the Public Accounts Committee on managing tax risks.

Apportionment of input tax credits

Under the federal sales tax, tax paid on business inputs can be recovered only to the extent that the inputs are attributable to the making of taxable supplies. Therefore, the tax payable on any input used exclusively in making an exempt supply cannot be claimed as an input tax credit. Similarly, tax on any input used partially in making an exempt supply can only be partially claimed as an input tax credit. This means that

financial institutions are required to apportion their inputs according to their ultimate use.

Where inputs are acquired for the purpose of making a supply for nominal or no charge (for example, where the input is used as a promotional tool to attract customers), input tax credits are available only to the extent that the promotional supply is made to promote or facilitate taxable supplies. Thus, if a promotional gift were given to promote an exempt service, an input tax credit would not be available for the gift.

In December 1994, an amendment was proposed to reinforce these basic apportionment rules for businesses that make exempt supplies by specifying that "taxable supplies" refers to supplies made "for consideration", meaning that businesses must look to the taxable and exempt output of their business in determining their input tax credit entitlement.

It is proposed to reintroduce this amendment effective January 1, 1991. Accordingly, an amendment is also proposed to ensure that the basic rules relating to supplies made for nominal or no consideration apply as of that day as well. A consequential amendment is also proposed to ensure that the receipt of grants and subsidies continues to have no effect on a registrant's input tax credit entitlement.

Management and administrative services

Under the federal sales tax, the provision of management or administrative services to a corporation, partnership or trust whose principal activity is the investing of funds is explicitly excluded from the definition of "financial service". An amendment was proposed in December 1994 in order to clarify that these services are taxable and to ensure that the application of the tax is not circumvented by an "unbundling" of services. Therefore, the amendment makes explicit reference to "any service" provided by a person who provides management or administrative services to the corporation, partnership or trust. This amendment will be reintroduced with the clarification that this measure does not apply to any sale of

a financial instrument, which, in all cases, remains exempt unless it is zero-rated under the export provisions.

It is proposed that the amendment relating to management and administrative services apply to services for which any payment becomes due or is paid without becoming due after December 7, 1994. It also applies to amounts that became due or were paid on or before that day unless the supplier neither charged nor collected tax on those amounts. In other words, refund claims will not be allowed in respect of transactions on or before that day, however, if the supplier treated the services as exempt, the amendment will not apply.

Trustee services

In some cases, a person providing management or administrative services to a trust whose principal activity is the investing of funds (e.g., a mutual fund trust) also acts in the capacity of a trustee. In keeping with the taxable status of management and administrative services, it is proposed to clarify that where a person is in the business of providing services as a trustee, those services are taxable.

It is proposed that this amendment apply as of January 1, 1991.

Managing future risks

To reduce the government's exposure to risks in the future, other measures affecting financial institutions and large federal sales tax registrants are also proposed. These include:

- measures to reduce the time period for claiming input tax credits and certain rebates from four years to two years (see discussion under **Limitation Period – Two-Year Rule**); and

- rules mirroring income tax provisions that require that the issues in dispute, the amount of relief sought, and the relevant facts and reasons for objecting to an assessment be specified in

a notice of objection relating to the federal sales tax (see discussion under **Objections and Appeals)**.

To maintain an equitable and operational tax system, the government remains committed to continuing its ongoing process of consultation with the financial sector and its representatives.

Imported taxable supplies

The *Excise Tax Act* sets out rules that entitle two corporations that are members of the same closely related group that includes a "listed financial institution" (e.g., a bank or insurance company) to make an election to treat certain supplies of property and services between them as exempt supplies of financial services. The effect is that the supplying member bears the tax on any inputs attributable to the provision of the property or services to the related member. The supplying member is not entitled to claim input tax credits in respect of those inputs and does not charge tax to the related member.

This exemption for supplies between members of a closely related group does not apply to supplies between a resident member and a non-resident branch of another member of the group. In that case, the resident member is required to pay tax on a self-assessment basis to the extent that the imported supply is not for consumption or use in a commercial activity of the member or for re-supply on a taxable basis. In the absence of this exception, the election would result in avoidance of tax altogether, thereby creating a bias in favour of importing inputs over acquiring them domestically.

While the supply received by such an importer is not itself exempt, if the importer re-supplies an imported service to another party to the election, the re-supply is exempt. Since the importer will have acquired the service for re-supply on an exempt basis, as opposed to a taxable basis, the importer is thereby subject to the self-assessment rules.

It is proposed to reintroduce an amendment announced in December 1994 that clarifies this treatment of imported taxable supplies. This amendment will apply to payments for imported taxable supplies made after December 7, 1994, the date of the announcement.

Other changes relating to financial services

Five additional changes are proposed to streamline and clarify the application of federal sales tax to financial institutions and financial services. In particular, these proposals will:

- modify the *de minimis* financial institution rules;
- extend input tax credits to warrantors in respect of reimbursements to warranty holders;
- broaden the scope of exempt insurance adjuster services;
- clarify the scope of exempt insurance appraisal services; and
- clarify that the definition of "insurance policy" includes construction bonds.

De minimis financial institution rules

The *Excise Tax Act* defines and sets out special rules for two types of financial institutions, listed financial institutions and *de minimis* financial institutions:

- listed financial institutions include the types of businesses that are traditionally considered as financial institutions or providers of financial services, such as banks, trust companies, insurance companies, investment dealers and credit unions; and
- *de minimis* financial institutions include any business that earns a significant amount of income (either in excess of $10 million or 10 per cent of total revenue) from the provision of financial services.

Rules pertaining to listed financial institutions also apply to *de minimis* financial institutions in order to maintain

competitive equity between businesses competing with listed financial institutions in the financial markets.

The current rules defining *de minimis* financial institutions, however, capture businesses (e.g., certain funeral service providers) that do not in practice compete with listed financial institutions. Therefore, a better targeted two-tier test is proposed for purposes of defining *de minimis* financial institutions. Specifically, businesses whose income from dividends, interest and separate fees and charges for financial services exceeds $10 million and 10 per cent of total income in the preceding year, will be considered financial institutions and will be subject to the same rules as are listed financial institutions.

Businesses that do not satisfy this first test may nevertheless be treated as a special type of *de minimis* financial institution if they earn in excess of $1 million annually from interest and separate fees or charges with respect to credit cards issued by them and the granting of loans or credit. However, in the case of these *de minimis* financial institutions, only their credit card and lending activities will affect their input tax credit entitlements. Other financial services they provide that relate to their commercial activities will be considered part of those commercial activities.

The new *de minimis* financial institution rules will apply for the purpose of determining whether a person is a financial institution in taxation years beginning after ANNOUNCEMENT DATE.

Input tax credits in respect of reimbursements to warranty holders

Under the existing legislation, a warranty is not considered to be insurance or an exempt financial service. Consequently, the sale of a warranty for tangible property (for example a car) is a taxable supply, and warrantors may claim input tax credits for the tax paid for goods and services used in the provision of the warranties and services performed in honouring them.

The legislation does not, however, address situations where a warrantor reimburses a warranty holder for services supplied by a third party. In automotive cases, where warrantors reimburse the car owner (warranty holder) for repair expenses and federal sales tax that the owner paid to a third party, the warrantor is unable to claim input tax credits.

To remove this inequity, it is proposed that the legislation be amended to permit the warrantor to claim input tax credits where the warrantor reimburses a warranty holder for expenses paid to a third party who performed the warranty services. This measure will apply to reimbursements paid by warrantors after ANNOUNCEMENT DATE.

Insurance adjuster services

The existing definition of "financial service" under the *Excise Tax Act* includes the service of investigating and recommending compensation in satisfaction of a claim under an insurance policy when it is provided either by a provincially licensed adjuster or an insurer. This excludes other comparable service providers who supply the same type of services but are not required by a province to hold an adjuster's licence. In these cases, their services are treated as taxable.

To provide equitable treatment of similar services, it is proposed that the legislation be amended to include in the definition of "financial service" adjuster services supplied by persons who would be required to be licensed but for the fact that they are relieved of that requirement under the laws of a province.

This change applies to supplies of services for which any payment becomes due after ANNOUNCEMENT DATE.

Insurance appraisal services

The *Excise Tax Act* currently exempts property damage appraisal services supplied to insurance claims adjusters. However, the legislation does not address situations where an

appraiser may supply services directly to the insurance company that uses its own in-house adjuster.

To clarify the treatment of appraisal services and to ensure equitable treatment, it is proposed that the legislation be amended to provide that an appraisal service supplied directly to an insurance company be exempt.

This amendment applies to any supply for which payment becomes due after ANNOUNCEMENT DATE. It also applies to any supply for which all of the payment becomes due or is paid on or before ANNOUNCEMENT DATE if the supply was treated as exempt, that is, where the supplier did not charge tax, or the recipient paid an amount as tax and filed an application for a refund that was received at a Revenue Canada office before ANNOUNCEMENT DATE.

The definition of "insurance policy"

Construction bonds are three-party contracts between a surety company, an owner of a project, and a contractor who has provided a bid on the owner's project. Generally, construction bonds constitute a promise from the surety company to the owner that if the contractor defaults in the performance of a specific contract that the surety company will be obliged to guarantee that the project is completed or will pay all outstanding obligations, depending on the type of bond. Although construction bonds are unique, they do have many features that strongly resemble insurance, so much so that issuers of construction bonds are normally required to be licensed under the same legislation as insurers. Therefore, there is a strong rationale for treating construction bonds as insurance under the federal sales tax.

The government's policy and administrative practice has consistently been to treat the supply of construction bonds as exempt. This position has been communicated to the construction bond industry through meetings as well as published material. Accordingly, this practice is consistent with the manner in which the majority of businesses have

treated construction bonds since the introduction of the tax. However, there has been some uncertainty in the industry regarding the application of federal sales tax on construction bonds.

It is therefore proposed that the legislation be amended, effective January 1, 1991, to clarify that construction bonds are encompassed within the definition of "insurance policy", and are therefore exempt.

Limitation period – two-year rule

As part of the government's efforts to manage the risks to the federal sales tax system and government revenues arising from new interpretations of the legislation, new limitation periods are proposed for certain input tax credit and rebate claims.

The periods for claiming input tax credits are being reduced from four years to two years for all listed financial institutions as well as for registrants with more than $6 million in annual taxable supplies in each of the two preceding fiscal years. The reduced limitation period will not apply to persons who are registered charities, other than large municipalities, hospital authorities, schools, colleges, and universities whose annual taxable supplies exceed the $6 million threshold. Other registrants will continue to have four years to claim input tax credits.

Under the new rules, affected registrants will be permitted to claim input tax credits in a return for any reporting period ending within two years after the beginning of the reporting period in which the tax became payable. The return in which the input tax credit is claimed will have to be filed on or before the due date of the return for the last reporting period for which the input tax credit may be claimed.

Changes are also proposed to certain other limitation periods, which will affect all persons who have paid tax. Limitation periods will be reduced to two years from the

current four years for rebates of tax paid in error, new housing and other special real property rebates and imported goods subject to abatement or refund. In addition, the period within which a registrant may refund or provide a credit for tax that has been collected in error from a customer and the limitation periods for claiming deductions in respect of price adjustments, bad debts and exclusive products of a direct seller will be reduced to two years. Limitation periods for other credits, rebates and deductions remain unchanged.

Special rules will apply to taxpayers affected by these limitations to ensure that a taxpayer will neither be disadvantaged nor enjoy any advantage relative to other taxpayers in the case of assessments or reassessments. Where an affected taxpayer has failed to claim an input tax credit within the time limits, in assessing the person, the Minister of National Revenue will be generally authorized to allow the credit in determining net tax for the period in which the credit arose. Where the credit results in an overpayment for the period, the Minister will be authorized to offset the overpayment against any outstanding federal sales tax liability that arose before or during the two-year period for claiming the credit. The Minister will be authorized to refund any part of the overpayment that the Minister has not applied against outstanding liabilities only where the assessment is issued within the two-year period. These rules will also apply to other unclaimed input tax credits, deductions and rebates, but will take into account longer or shorter limitation periods that may apply to particular claims.

In the course of an assessment, the restrictions on applying or refunding an overpayment of net tax that arose from allowing an unclaimed input tax credit will not apply in certain cases where bona fide errors have occurred. Where the Minister assesses another person for failing to charge and remit tax that was collectible from the registrant or for claiming an input tax credit that the registrant should have claimed, the Minister may allow the input tax credit claim on an assessment of the registrant, and may apply or refund any resulting overpayment after the two-year period has expired,

provided that the registrant has paid the applicable tax and the other person has paid the assessment.

All of these measures will take effect on the first day of the third calendar month that begins after ANNOUNCEMENT DATE but the four-year limitation period will generally continue to apply to refund and deduction entitlements that arose before that time.

Input tax credits for reporting periods ending before the effective date of the measures, and any rebates or vendor adjustment of tax paid in error before that date, will generally continue to be subject to the previous rules, but must be claimed in a return or rebate application filed within two years of the effective date of the measures. This restriction only applies, in the case of input tax credits, to listed financial institutions and registrants who exceed the $6 million threshold.

Objections and appeals

Under current federal sales tax legislation, a person may ask Revenue Canada to reconsider an assessment by filing a notice of objection to the assessment. If the person is not satisfied with the outcome, the person can appeal to the Tax Court of Canada.

As part of the government's efforts to manage the risks to the sales tax system and government revenues, new rules are being proposed with respect to the filing of notices of objection. The proposed changes apply to all listed financial institutions and those registrants with annual taxable supplies in excess of $6 million in each of the preceding two fiscal years. The new objection requirements will not apply to persons who are registered charities, other than large municipalities, hospital authorities, schools, colleges and universities whose annual taxable supplies exceed this threshold.

The new rules require that each issue under dispute, the amount of relief sought and the relevant facts and reasons for objecting to a federal sales tax assessment or denial of a federal sales tax rebate claim be specified in the notice of objection. Only the issues and related relief specified in valid notices of objection or new issues raised by Revenue Canada on a reconsideration of an assessment may be taken before the courts.

These changes will assist the government in better understanding the reasons for disputes, and will parallel existing income tax provisions that apply in similar circumstances. These rules apply to objections to assessments where the notice of assessment is issued after the end of the month in which the measure is announced.

A related change, applicable to all registrants, confirms that no objection to, or appeal from, an assessment can be made by a person who has waived these rights in writing. This particular change applies, in the case of objections, after ANNOUNCEMENT DATE and, in the case of appeals, after Royal Assent, to waivers signed at any time.

Real property

A number of modifications are proposed to the real property rules. These measures will:

- broaden the exemptions for inherited real property;
- extend the filing period for the new housing rebates on certain owner-built homes by two years;
- broaden the entitlement to a rebate for owner-built residential condominiums and residential condominiums built on leased land;
- limit the eligibility for the new housing rebate to situations where the tax is required to be paid; and
- expand the definition of mobile homes.

Other measures will limit the exemption for sales of subdivided land and address self-assessment issues for builders of subsidized housing and for communal organizations that build residential complexes.

Exempt status of inherited real property

Under the existing federal sales tax legislation, an inequity exists between the tax treatment of personal-use real property (e.g., land of an individual that is not used for commercial or other business purposes) disposed of under a will versus the same property sold by an individual:

- Personal-use real property sold by an individual is exempt from tax, regardless of who is the purchaser.
- However, personal-use real property sold by a deceased individual's estate or distributed to beneficiaries of the estate may be taxable if any of the beneficiaries are not individuals.

It is proposed that this inequity be corrected by removing the requirement relating to all beneficiaries of the estate being individuals in order for the exemption to apply to supplies of the deceased's personal-use property.

This measure will be effective as of January 1, 1991, except for any supplies of personal-use real property made on or before ANNOUNCEMENT DATE where the federal sales tax was charged, or an amount was collected on account of the tax.

Rebate claim period for owner-built homes

An individual who constructs or substantially renovates a house for the individual's own use may apply for the new housing rebate within two years after the construction or renovation work is substantially completed. However, where the individual occupies the house before construction or renovation work is substantially completed, the limitation period expires two years after the home is first occupied, even if the work takes longer to complete.

It is proposed that the period for claiming the new housing rebate on these homes that are occupied before completion be extended. In cases where the construction is substantially completed within two years after first occupancy, the limitation period will be extended to allow the individual to apply for the rebate within two years after substantial completion. Where the construction lasts for a longer period, the refund must be claimed within four years after first occupancy.

Although the period for claiming the rebate is being extended, the rebate will continue to be limited to costs that are incurred before or during the two-year period following first occupancy.

This measure applies to rebates for which an application is received at a Revenue Canada office on or after ANNOUNCEMENT DATE except where the applicant substantially completed or occupied the residential complex before ANNOUNCEMENT DATE or transferred ownership of the residential complex to a purchaser before ANNOUNCEMENT DATE.

New housing rebates for condominiums

To provide equitable treatment across the housing market two measures are proposed concerning the availability of the new housing rebate for condominium units.

The rebate will be made available for owner-built and substantially renovated residential condominium units. This measure applies to rebates for which an application is received at a Revenue Canada office on or after ANNOUNCEMENT DATE except where the applicant substantially completed or occupied the residential complex before ANNOUNCEMENT DATE or transferred ownership of the residential complex to a purchaser before ANNOUNCEMENT DATE.

It is also proposed that the legislation be amended to confirm that residential condominium units built on leased land are eligible for the new housing rebate. This measure applies to

rebates for which an application is received at a Revenue Canada office on or after ANNOUNCEMENT DATE.

Eligibility for rebate where tax not paid

Currently, where an individual acquires a new home on leased land from a builder who is not required to self-assess federal sales tax because of another Act of Parliament or any other law, the individual may be entitled to claim a new housing rebate even though no federal sales tax has been paid on the construction of the home.

It is proposed that the application of the housing rebate be denied in situations where the builder is not required to self-assess and remit the tax because of another Act of Parliament or any other law. This measure will be effective as of January 1, 1991, but does not apply to an application for a rebate received at a Revenue Canada office before ANNOUNCEMENT DATE.

Mobile homes

It is proposed that the definition of mobile homes be broadened to encompass most types of mobile homes, including mini homes. This will enable purchasers of mobile homes to assign their new housing rebate to the vendor to offset the purchase price. In addition, builders of these homes will be subject to the same rules as builders of other types of residential property, such as the self-supply rules.

The change to the definition of mobile home is effective after ANNOUNCEMENT DATE and also applies to mobile homes sold on or before ANNOUNCEMENT DATE where any payment becomes due after that day or is paid after that day without having become due.

Taxable status of subdivided land

To ensure competitive equity between developers and individuals selling subdivided land, it is proposed to tax certain

sales of subdivided land by individuals. Under the current rules, individuals may in some circumstances subdivide and sell land on an exempt basis, while developers cannot. If the subdivision activities are not extensive or not part of a regular course of conduct, the sale is not considered to have been made in the course of a business. Accordingly, the sale is exempt, unless it constitutes an adventure or concern in the nature of trade and the individual elects for taxable status. As a result, those who buy a lot from individuals are able to construct homes without paying tax on the land.

In order to provide equivalent treatment between individuals and developers selling subdivided lots, it is proposed that the legislation be amended to clarify that the sale of subdivided land by an individual will be taxable, except where the subdivision creates no more than two lots and the person did not previously subdivide or sever it from another parcel of land, or the individual is transferring property to related individuals. The term subdivision will also include severances. A rebate will be available for the tax paid in relation to land purchases and improvements made on subdivided land that is subsequently sold on a taxable basis by a non-registrant.

This measure applies to supplies of land made after ANNOUNCEMENT DATE.

Subsidized residential housing

Changes are proposed to the existing rules for builders of subsidized residential complexes to ensure equitable and consistent treatment between builders of non-subsidized housing and builders of subsidized housing.

For federal sales tax purposes, builders of subsidized rental residential complexes are currently required, at time of first rental, to self-assess on the fair market value of the complex. In the case of subsidized residential complexes, however, questions have been raised over the actual fair market value of subsidized housing. Valuations below cost of construction can give rise to the inequitable situation whereby less federal sales

tax is being paid by subsidized residential builders than by other residential builders.

Consequently, it is proposed that residential builders of subsidized housing be required to self-assess and pay tax equal to the greater of the federal sales tax payable on the fair market value of the complex or the total of input tax credits or real property rebates claimed in relation to construction of the real property that forms part of the complex or addition or improvement to the real property. As is currently the case, government subsidized residential builders may still be entitled (as designated municipalities) to claim a partial rebate of federal sales tax paid on their ongoing expenses relating to subsidized residential housing.

This measure will generally be effective after ANNOUNCEMENT DATE but does not apply where the construction or substantial renovation of the complex or addition began on or before ANNOUNCEMENT DATE and is substantially completed before the day that is two years after ANNOUNCEMENT DATE and the builder, on or before that day, received government funding or has a reasonable expectation of receiving government funding in respect of the complex.

Communal organizations – new housing

Under the existing rules, the construction of residential complexes or additions to residential complexes by members of a communal organization for the exclusive use of the organization's members are treated in the same manner as complexes constructed by any builder of rental property.

In recognition of the fact that this provision currently requires that the labour provided by members of the communal organization for the benefit of the members be included in the self assessment, communal organizations will be excluded from the requirement to self assess. This measure will apply only to a religious communal organization whose members live or work together, does not permit any of its members to own

property in their own right, and requires that its members devote their working lives to the activities of the organization.

These organizations would not, however, be able to claim input tax credits on the cost of constructing the residences. This measure will be effective as of January 1, 1991.

Trusts and estates

Several changes are proposed to clarify the application of the federal sales tax in the area of trusts and estates. More specifically, the proposed changes deal with:

- the supply of the service of acting as a trustee or executor;
- the tax treatment of personal trusts;
- the obligations and liabilities of a trustee with respect to trust activities;
- the activities continued by an individual's estate and the continuation of registration status; and
- the disposition of taxable assets from an estate.

Trustee services

Under the existing federal sales tax system, trusts are treated as persons separate from the trustee and beneficiaries of the trust. As such, a trust through which a commercial activity is carried on is required to register for the purposes of the tax and has the legal liability for tax on property and services acquired for consumption, use or supply in the course of the trust's activities. The same rules apply to estates of deceased individuals. Among the services provided to trusts and estates are the services of the trustee, executor or administrator. These are similar to other types of professional services except for the fact that there is a unique legal relationship between the trust and its trustee or the estate and its executor or administrator.

For greater certainty, it is proposed to confirm that the services of acting as trustee, executor or administrator provided by persons who are in the business of supplying these services are taxable to the trust or estate.

Activities of a personal trust

For federal sales tax purposes, in order for an individual to be entitled to register and claim input tax credits in respect of a business or adventure or concern in the nature of trade, the individual must be engaged in that activity with a view to profit. Individuals are not entitled to register and recover tax in respect of activities that are carried out essentially as hobbies. In some cases, activities of an individual are carried out through an *inter vivos* trust or are continued after the death of the individual through a testamentary trust.

These personal trusts, in contrast to business or charitable trusts, are created by and for the benefit of individuals, and beneficial interests in the trusts are not sold by the trust or its settlor. In a personal trust, for purposes of the *Excise Tax Act*, the beneficiaries must be individuals, and contingent beneficiaries must all be individuals or charities.

Although the activities carried out through a personal trust may be identical to those carried out by an individual in the absence of such a trust, existing provisions do not apply a profit test to personal trusts in determining the trust's entitlement to input tax credits.

It is proposed to apply the same profit test to personal trusts as applies to individuals in order to ensure consistent treatment between individuals and personal trusts.

Joint and several liability of trustees

Under existing federal sales tax provisions, there is some uncertainty as to the extent to which enforcement provisions can be applied to a trustee of a trust for the collection of taxes owing by the trust. This uncertainty also arises with administrators and executors of estates.

It is proposed that the federal sales tax legislation specifically provide that trustees are jointly and severally liable with the trust for the trust's federal sales tax liabilities. The liability of the trustee will be for all amounts that become payable or remittable by the trust while the trustee acts as a trustee for the trust. The trustee will also be liable for all amounts that become payable or remittable before the trustee's appointment, but only to the extent of the property and money in the trust. This rule is consistent with the obligations that trustees otherwise have at law and ensures that the Minister of National Revenue may assess trustees and, as a result, apply the same collection provisions to trustees as apply to registrants. This rule is also proposed for executors and administrators of estates.

A change is also proposed to clarify the liability of trustees (as well as executors and administrators of estates) for all other obligations for which the trust is liable, such as filing returns.

All of the above proposed changes in the area of trusts (other than the change to apply a profit test to personal trusts) will be effective as of January 1, 1991 as they are consistent with existing administrative practice and generally accepted interpretations adopted by taxpayers in complying with the law. The change to personal trusts applies the day after ANNOUNCEMENT DATE.

Distributions from trusts

The value on which federal sales tax applies when business assets of a trust are transferred to persons who are not beneficiaries of the trust will be clarified. It is proposed that, in this circumstance, the trust will be required to account for tax on the proceeds of disposition as determined for income tax purposes. This measure applies to distributions made after ANNOUNCEMENT DATE.

Activities continued by an estate

The federal sales tax rules in the area of estates are intended to treat the activities continued by the estate of a deceased individual in the same way as they would have been treated had they been carried out by the individual before the individual's death. The existing rules address the treatment of property, but there is uncertainty, for federal sales tax purposes, as to whether certain attributes of an individual such as registration, entitlements to rebates, etc., continue following the death of the individual.

Changes are proposed to clarify that, for federal sales tax purposes, all rights and obligations of the individual that arose during an individual's lifetime flow through to the individual's estate. In addition, the proposed changes will clarify that administrative actions taken during the lifetime of the individual (such as registration and the filing of elections) continue to apply to the estate. These proposed measures codify existing administrative practice and will be effective as of January 1, 1991.

The determination of reporting periods of the estate of a deceased individual will also be clarified. This amendment applies to estates created on the death of an individual after ANNOUNCEMENT DATE.

Partnerships

A number of changes are proposed to the federal sales tax partnership rules. The proposed changes are designed to increase fairness, clarify the rules for partnerships in certain situations and protect revenues. More specifically, the proposed changes deal with:

- the obligations and liabilities of a partner with respect to the partnership's federal sales tax debts;
- the application of the federal sales tax to transactions between a partnership and its partners;

- changes in the membership of a partnership; and
- the availability of input tax credits.

Liability of partners

Under existing rules, where the assets of a partnership are insufficient to satisfy the partnership's tax liabilities, Revenue Canada must sue the partners to recover the taxes on the basis of the partners' joint and several liability under provincial law. The proposed measure will authorize Revenue Canada to assess partners for partnership debts. This measure will apply on Royal Assent.

It is also proposed that the legislation be amended to specifically provide that partners and former partners are jointly and severally liable with the partnership for the partnership's federal sales tax debts. Liability will exist for all amounts that became payable or remittable by the partnership before or during the period in which the person is a member of the partnership. The liability of a partner for amounts owing before the person became a partner will be limited to the property and money of the partnership. Partners and former partners will be liable for all other obligations for which the partnership is liable, such as filing returns.

This proposed measure applies to amounts that become payable or remittable after ANNOUNCEMENT DATE and to all other amounts and obligations outstanding after that day.

Supplies from partners to partnerships and from partnerships to partners

There is currently some uncertainty as to the consideration applicable to a supply from a partner to a partnership where the supply is not made in the course of partnership activities. Specifically, it is unclear whether a partner should charge the full amount of tax or deduct a *pro rata* portion to represent the interest that the partner has retained in the asset.

It is proposed that the consideration be deemed to be equal to the amount the partnership agrees to pay or credit to the partner for the supply where the relevant property or service is intended to be used exclusively in commercial activities of the partnership. Where the intended use is not exclusively commercial, the consideration for the supply will be the fair market value of the property or service determined as if the partner were dealing with the partnership at arm's length.

Similarly, where a partnership asset is transferred to a partner, the transfer will be treated as a supply for consideration equal to the full fair market value of the asset (including the fair market value of the partner's interest in the property).

These measures will apply to supplies made after ANNOUNCEMENT DATE, although transitional rules will apply to supplies made on or before that day. Under transitional rules, the existing provisions of the Act will apply for the purpose of assessing underpayments of tax, but the proposed rules will apply for the purpose of determining any overpayment. Nevertheless, the existing rules will continue to apply to rebate applications received at a Revenue Canada office before ANNOUNCEMENT DATE.

Changes in the membership of a partnership

Currently, where a partner leaves a partnership or a new partner is admitted, partnership law in some provinces provides that the partnership ceases to exist and a new partnership is created unless the partnership agreement provides for its continued existence. Technically, where a new partnership is created, the assets of the old partnership are supplied to the new partnership and tax applies. In addition, the new partnership must apply for a new registration.

It is proposed that, where under provincial law a partnership ceases to exist because of a change in its membership, the new partnership be treated as a continuation of the old partnership if the business and membership remain substantially the same.

The membership of the new partnership generally will be regarded as substantially the same where at least 50 per cent of the assets of the old partnership are transferred to the new partnership, and a majority of the partners of the old partnership comprise a majority of the new partnership. The proposed rule will not apply if the new partnership requests a new registration.

It is also proposed that, for federal sales tax purposes, a dormant partnership be deemed to continue until it is deregistered. This measure clarifies that Revenue Canada may assess the partnership for partnership debts until the partnership is deregistered.

These measures will apply after ANNOUNCEMENT DATE.

Availability of input tax credits

Under the current federal sales tax provisions, certain partners (e.g., trusts, other partnerships, unregistered corporations) cannot claim input tax credits for expenses incurred on behalf of the partnership. They can receive tax relief only if they are reimbursed by the partnership (which may then claim the input tax credit where applicable). Some partnership agreements require partners to provide property or services to the partnership as part of their contribution. Partners who are individuals are eligible for a rebate for an expense that is not reimbursed, while registered corporate partners may claim input tax credits for such expenses.

Changes are proposed to permit all partners that are not individuals to claim input tax credits for expenses directly incurred on behalf of the partnership. The requirement that partners be registered for an outside activity in order to claim input tax credits for partnership expenses will also be removed.

It is also proposed that changes be made to ensure that a partner's input tax credit in respect of an expense incurred on behalf of a partnership is reduced by any amount that the partnership reimburses to the partner for the expense. These

measures apply after ANNOUNCEMENT DATE and apply to input tax credits claimed in a return for reporting periods that began on or before ANNOUNCEMENT DATE where the return is received at a Revenue Canada office on or after that day.

Under existing provisions, there is uncertainty as to whether a partner or a partnership can claim an input tax credit where a partner, who is eligible for input tax credits, purchases partnership property. It is also proposed to clarify that, where a partner purchases property or services for the partnership, the partnership may claim an input tax credit only if the purchase was made on the account of the partnership, or if the partnership has reimbursed the partner for the expense. This measure applies to input tax credits claimed in a return received at a Revenue Canada office on or after ANNOUNCEMENT DATE.

Forfeitures and damage payments

To make the federal sales tax simpler and fairer, three changes are proposed to the tax treatment of forfeitures and damage payments. These are:

- a clarification of the status of damage payments;
- an extension of input tax credit entitlement to the original recipient of a supply where a third party makes a damage payment; and
- a simplification of the rules for reductions and extinguishments of debts and other obligations.

These measures will apply after ANNOUNCEMENT DATE.

Tax status of damage payments

The current federal sales tax legislation does not specify the circumstances in which the federal sales tax applies to damage payments and forfeited amounts. For example, in certain

circumstances, there is uncertainty as to how the place of supply is to be determined, or whether the payment or forfeited amount may be zero-rated.

It is proposed that damage payments and forfeited amounts be treated as amounts paid for the original supply. As a result, the tax status of damage payments and forfeited amounts will be based on the characteristics of the original supply.

Input tax credit entitlement to recipient where third party payment

There is some uncertainty respecting input tax credit eligibility when a third party makes a damage payment.

It is proposed that the legislation be clarified to ensure that, if there is a third party payment, the original recipient of the supply is the person eligible for an input tax credit. As a result**,** eligibility for the input tax credit will be based on the registration status of the recipient and whether the original supply was for use in the recipient's commercial activities.

Treatment of reductions and extinguishments of debts and other obligations

The current rules for reductions and extinguishments of debts and other obligations as a result of a breach, modification or termination of an agreement are inconsistent with the rules for damage payments and forfeited amounts. The rules for reductions and extinguishments apply whether the agreement for the supply was made by or to the registrant, while the rules for damage payments and forfeited amounts apply only where there is a supply by the registrant. This difference adds complexity to the federal sales tax.

It is proposed that the rule for reductions and extinguishments of debts and other obligations exclude situations where the debt or obligation is that of the person who is the recipient under the agreement that was terminated.

Bad debts

Currently, recovery of the portion of a bad debt relating to the federal sales tax is available when an account receivable is written off by a business as a bad debt in the business' books of account. The existing bad-debt rules will be changed to make them both fairer and simpler for businesses.

The rules will be made fairer by extending bad-debt relief to *de minimis* financial institutions that purchase the accounts receivable of a closely related corporation. In addition, the rules will be made simpler for all businesses by specifying how the deduction from net tax is to be calculated when partial payment is made on an account.

Relief for de minimis financial institutions

Under the existing provisions, *de minimis* financial institutions are not allowed the same bad debt relief afforded to listed financial institutions for accounts receivable. Listed financial institutions are not only allowed the relief as the original vendor of the taxable supply but also where certain accounts receivable are purchased by a listed financial institution that is closely related to the vendor.

It is proposed that the legislation be amended to extend the same treatment to *de minimis* financial institutions as is currently available to listed financial institutions. Bad debt write-offs will therefore be allowed for *de minimis* financial institutions where the *de minimis* financial institution is a member of a closely related group and is purchasing qualifying accounts receivable from another member of the group.

These measures will apply to any amounts written off as bad debts after ANNOUNCEMENT DATE.

Clarifying the application of bad-debt relief

Currently, there is some uncertainty as to how bad-debt relief should be calculated in cases where only partial payment is made. It is proposed that the manner of calculating the bad-debt deduction be specified. The deduction will be equal to the tax payable in respect of the supply multiplied by the ratio of the total amount remaining unpaid (including federal sales tax and provincial taxes) to the total amount paid or payable (including federal sales tax and provincial taxes).

This clarification applies to bad-debt deductions claimed in returns filed after ANNOUNCEMENT DATE.

Telecommunication services

Measures will be introduced to simplify and clarify the application of the federal sales tax to telecommunication services and to make the tax system fairer. These include:

- introducing definitions for "telecommunication service" and "telecommunications facility";
- clarifying the place-of-supply rules for telecommunication services; and
- lowering the zero-rated threshold for pay-phone calls paid for by coin from 70 cents to 25 cents.

Define the terms "telecommunication service" and "telecommunications facility"

Special rules apply to the treatment of telecommunication services under the federal sales tax. However, the legislation does not define the terms "telecommunication service" or "telecommunications facility".

To provide more certainty for the industry, it is proposed that a definition of "telecommunication service" be introduced that will include services such as:

- local and long-distance telephone services;
- cable and pay television;
- facsimiles and electronic mail;
- video, audio and computer link-ups;
- data transmission; and
- providing access to a telecommunications facility, such as a dedicated line.

The definition also distinguishes between telecommunication services and services delivered by means of telecommunications. The following are not considered telecommunication services:

- translation services;
- charges for the relocation of services;
- 1-900 numbers;
- wire news services; or
- directory assistance.

For example, an individual seeking directory assistance is billed for the service of receiving the requested information, not for a telecommunication service. The provider of the information service is using the telecommunication service as a means of delivering the information.

The new definition "telecommunications facility" is relevant for purposes of the new definition "telecommunication service". A telecommunications facility is defined as any facility, apparatus or other thing that is used or is capable of being used for telecommunications. The definition is broad in scope, including items such as satellites, downlink and uplink earth stations, fibre-optic transmission systems, telephones and fax machines.

The definitions apply in relation to supplies made after ANNOUNCEMENT DATE.

Clarification of place-of-supply rules

The existing rules that establish whether a supply of a telecommunication service is considered to be made in Canada have created some uncertainty. It is proposed that new rules be implemented to clarify when a supply of a telecommunication service will be considered to be made in Canada.

The following rules will be introduced to clarify how the rules apply to cases where the charge for the supply is determined on a per-use basis (e.g., long-distance telephone calls). The place of supply of a telecommunication service will be considered to be in Canada when one of the following tests is met:

1. The transmission originates and terminates in Canada.

   For example, a telephone call from one location in Canada to another location in Canada is a supply made in Canada, even if the telecommunications facility used to make the call is normally located outside Canada (such as a cellular phone with a non-Canadian billing location).

2. The transmission either originates or terminates in Canada and the billing location for the service is located in Canada.

   The billing location for a telecommunication service is considered to be in Canada if the fee for the service relates to a telecommunications facility ordinarily located in Canada. It is not necessarily the place where the invoice is sent. For example, if a business traveller made a long-distance call from a telephone in the United States to a place in Canada and used a calling card to have the call charged to the business' number in Canada, the billing location would be considered to be in Canada, even if the business had arranged to have its telephone billings sent to its U.S. branch office for processing.

This measure applies to supplies made after ANNOUNCEMENT DATE.

In addition, the federal sales tax legislation currently zero-rates supplies in respect of a telecommunication service made by a registrant who carries on the business of supplying telecommunication services to a non-resident who is not a registrant and who carries on such a business.

It is proposed that this zero-rating provision apply only where the service is supplied outside Canada. The zero-rating provision will not include the supply of a telecommunication service where the telecommunication originates and terminates in Canada.

This amendment applies to supplies made after ANNOUNCEMENT DATE. It also applies to any supplies made on or before ANNOUNCEMENT DATE unless the supply was treated as zero-rated (i.e. the supplier did not charge any amount as tax, or the recipient paid an amount as tax and filed an application for a refund of the amount which was received at a Revenue Canada office before ANNOUNCEMENT DATE).

Tax-free threshold for pay-phone calls

The current treatment of pay-phone calls raises a fairness issue in relation to the tax treatment of coin-operated machines in general. Currently, there is no tax charged on a pay-phone call costing less than 70 cents and paid for in coins, while other registered vendors using coin-operated machines generally account for tax on their supplies regardless of the value.

To make the sales tax system more equitable, it is proposed that the threshold be reduced to 25 cents. As a result, no tax will be charged on pay-phone calls costing 25 cents or less.

This measure applies to calls made after ANNOUNCEMENT DATE where payment is made by depositing coins in the pay phone.

Employee and shareholder benefits

Three changes aimed at simplifying the federal sales tax treatment of employee and shareholder benefits for businesses are proposed:

- a simplified calculation of employee and shareholder benefits including those associated with the availability of an automobile (standby charge);
- extension of the application of the election for non-commercial-use automobiles; and
- simplification of the treatment of reimbursements.

Calculation of employee and shareholder benefits

Under existing rules, determining the amount of the automobile standby charge for income tax purposes is complex because of the many calculations required to determine the related federal sales tax benefit to be included in the employee's or shareholder's income.

Equally complex is calculating the amount of federal sales tax that the employer or corporation is required to remit on account of the benefit, as determining this amount currently requires businesses to remove the provincial sales tax from the capital cost, while the determination of the pre-federal sales tax income tax benefit is made on a provincial sales tax-inclusive basis.

The calculations will be simplified, by requiring that the automobile standby charge benefit and non-automobile benefits be calculated for income tax purposes on a provincial sales tax and federal sales tax-included basis.

It is also proposed that the federal sales tax remittance on the benefit be calculated as 6/106ths (5.66 per cent) of the total income tax benefit before reimbursements by the employee or shareholder are deducted. This proposal will

reduce slightly the amount of federal sales tax otherwise required to be remitted.

The federal sales tax remittance and income tax inclusion calculations for automobile operating cost benefits will remain the same.

This measure applies to the 1996 and subsequent taxation years.

Election for non-commercial use

An election is currently available to financial institutions and other registrants in relation to passenger vehicles and aircraft acquired by them primarily for non-commercial use. Where an election is made, the federal sales tax calculated on the employee or shareholder benefit is not remittable. However, the registrant is not entitled to claim an input tax credit with respect to the passenger vehicle or aircraft.

Currently the election does not extend to automobile operating costs. This creates complexity because the employer must calculate and remit federal sales tax on the operating cost benefit and can claim input tax credits on the operating costs.

The election will be extended to automobile operating costs to simplify the calculations and facilitate compliance. Existing elections will automatically be extended to include operating costs for the 1996 and subsequent taxation years.

Treatment of reimbursements

The current treatment of reimbursements by a person receiving an employee or shareholder benefit is complex and requires detailed record-keeping and adjustments for relatively small amounts of tax.

Currently, where an employee reimburses an employer for a supply that gives rise to an employee benefit, the reimbursement is considered to be a tax-included payment. The

employer must then remit the tax in its return for the period in which the reimbursement is received. This amount is subsequently deducted from the tax remittance on the benefits for the reporting period that includes the last day of February. Similar rules apply to reimbursements by shareholders.

The treatment of reimbursements will be simplified. Amounts reimbursed by employees and shareholders will be aggregated throughout the year. For employees, the tax considered to have been collected on the reimbursement as well as the federal sales tax calculated on the benefit will both become payable at the end of February of the following year or, in the case of shareholders, at the end of the taxation year of the corporation.

This measure is effective for the 1996 and subsequent taxation years.

Seizures and repossessions

Seizures and repossessions under federal or provincial laws

The existing seizure and repossession provisions do not outline the specific treatment to be applied where a seizure or repossession is exercised under federal or provincial laws. This would include, for example, circumstances where a municipality seizes real property from a debtor for unpaid municipal taxes.

It is proposed that the general rules be amended to confirm that seizures and repossessions made, for example, by federal, provincial or municipal bodies as creditors will be subject to the same treatment as seizures and repossessions by non-governmental creditors. This will ensure equality, irrespective of whether the creditor's right stems from a debt security or a federal or provincial law.

This measure applies to supplies made after ANNOUNCEMENT DATE. It also applies to supplies made

on or before ANNOUNCEMENT DATE unless the supply was treated as non-taxable, that is, where no amount was charged or collected as tax or an amount was charged or collected as tax but, before that day, an application for a rebate was received at a Revenue Canada office.

Treatment of redemptions

There are circumstances, after a seizure or repossession of real property has occurred (e.g., for non-payment of municipal taxes), where a debtor may redeem property sold to a third party at auction. Where this occurs, full title passes back to the original debtor.

Measures are proposed to ensure that, where a redemption occurs, the parties can be placed in the same situation as if the sale by the creditor had never occurred. When redeeming property, the debtor will not be required to pay federal sales tax a second time. However, to the extent that the debtor reimburses the third party purchaser for tax paid by the third party upon acquiring the property, the debtor will be permitted to recover the reimbursed tax as tax paid in error. The debtor will, however, be prevented from claiming certain input tax credits and rebates unless and until the time limit for redeeming the property has expired without the debtor exercising the right. A third party purchaser will not be entitled to claim input tax credits or rebates in respect of the property after the property is redeemed.

These measures will apply to redemptions after ANNOUNCEMENT DATE.

Deemed sales by municipalities

Under existing rules, there are circumstances where sales of real property that would otherwise have been taxable (if the sale had been made by the debtor) become exempt because they are deemed to have been made by a municipality following a seizure or repossession.

Legislative changes are proposed that will ensure that, in such circumstances, even though the sale is deemed to have been made by a municipality, it will remain taxable.

This measure applies to supplies made after ANNOUNCEMENT DATE. It also applies to supplies made on or before ANNOUNCEMENT DATE unless no amount of tax was, on or before that day, charged or collected, or, if an amount was charged or collected before that day, an application for a rebate was received at a Revenue Canada office before that day.

Agriculture

It is proposed that the list of zero-rated farming equipment and other related items be expanded and that the tax treatment of grains and seeds, and compost, be clarified. These measures will make the federal sales tax fairer and more administratively efficient.

Zero-rated farm equipment and feeds

Most supplies of farm equipment are zero-rated. The government proposes to add the following items to the list of zero-rated supplies set out in the agriculture and fishing regulations:

- automated and computerized farm livestock or poultry feeding systems (as well as individual components of such systems when supplied together);
- certain mulchers and crop shredders that exceed specified operational widths;
- certain transportable conveyors;
- transportable elevators, utility augers and farm grain augers; and
- certain agricultural wagons and trailers.

Amendments are also proposed to the agriculture and fishing regulations to zero-rate feed, packaged in large quantities, for ratites and bees. Zero-rated treatment will also extend to certain products that are packaged in large quantities and that are used as ingredients in feed for these animals. This measure will apply to supplies for which payment becomes due after ANNOUNCEMENT DATE.

Grains, seeds and compost

The existing legislation zero-rates grains or seeds in their natural state or when treated for seeding purposes. However, when grains or seeds are irradiated for storage purposes (to kill insects and prevent diseases) they are taxable. To simplify the application of the tax, it is proposed that the legislation be amended to zero-rate grains or seeds irradiated for storage purposes. This measure will apply to supplies for which payment becomes due after ANNOUNCEMENT DATE.

Similarly, under the existing legislation, bulk fertilizers are zero-rated. In practice, compost is sold as topsoil and bought by farmers and other consumers for use other than as a fertilizer, and should be treated as taxable. Accordingly, it is proposed that the legislation be amended to clarify that the supply of compost is taxable.

This measure applies to supplies made after ANNOUNCEMENT DATE.

Food

To make the federal sales tax fairer and more efficient to administer, the following minor changes are proposed to the federal sales tax treatment of food:

- a clarification of the tax treatment of salads and sandwiches;
- a clarification of the tax status of foods and beverages sold under a catering contract; and

- a change to the tax status of frozen juice bars and non-dairy frozen snacks.

These measures will apply to supplies for which all of the payment becomes due or is paid without becoming due on or after the day that is 21 days after ANNOUNCEMENT DATE.

Salads, sandwiches and catered food

The existing legislation does not clearly establish which types of salads are taxable and which are not taxable. It is proposed that the legislation be amended to clarify that fresh or perishable salads are taxable, and that salads are zero-rated when sold in cans or vacuum-sealed containers. In addition, all non-frozen sandwiches will be taxable, including those that are ready to be eaten or are warmed before being eaten. This change will not, however, result in items such as frozen hamburgers becoming taxable.

It is also proposed that the legislation be amended to clarify that food and beverages sold under a catering contract are taxable.

Juice bars and non-dairy frozen snacks

The administration of the tax will be streamlined by eliminating two minor borderlines between taxable and zero-rated food items. Juice bars will become taxable in order to ensure consistent tax treatment with items such as popsicles, which are currently taxed as sweetened ice waters. Similarly, non-dairy frozen snacks will be taxable as a non-dairy substitute to a frozen dairy snack (e.g., ice cream).

Administrative measures

Electronic filing and remitting

Under certain circumstances, businesses are now allowed to file and remit electronically for federal sales tax purposes.

Purchases of real property from persons not required to collect tax

The federal sales tax rules governing taxable purchases of real property from vendors not required to collect tax will be simplified. Currently, the purchaser is required to remit any tax payable on such purchases directly to the Receiver General and to file a separate return to account for that tax.

It is proposed that the requirement for a separate return where the purchaser is a registrant and the property is acquired for use or supply primarily in the purchaser's commercial activities be eliminated. In this case, tax will be reported in the registrant's regular return for the reporting period in which the tax becomes payable and will have to be paid by the filing-due date of that return. This measure will apply as of January 1, 1997.

Reporting period for non-registrants

The *Excise Tax Act* requires self-assessment of tax payable on imported taxable supplies. For non-registrants, such as a non-registered financial institution, the tax must be reported and remitted by the end of the month following the calendar quarter in which the tax becomes payable.

An amendment is proposed to require non-registrants to report and remit this tax by the end of the month following the calendar month in which the tax becomes payable. This measure will be effective as of January 1, 1997.

Other measures

Machines that can only accept a single coin

Vendors who make supplies through vending machines designed to accept only a single coin as payment cannot pass on the sales tax to the consumer.

It is proposed the tax on sales made through mechanical monoselector devices be rounded where the tax is less than 5 cents. If the tax amount comes to less than 2.5 cents, the tax payable will be zero; if the tax amounts to between 2.5 cents and 5 cents, the tax payable will be rounded to 5 cents. Tax will be rounded to the nearest cent when the tax otherwise determined is 5 cents or more. This measure applies to supplies made through mechanical monoselector devices after ANNOUNCEMENT DATE.

Coin-operated laundry facilities in residential buildings

Currently, tax must be charged for the use of a laundry machine located in a residential complex where the owner of the machine is a registrant. However, tax is not required to be charged if the machine is owned by a person not required to collect tax (e.g., a small supplier, a university residence, etc.).

It is proposed that the federal sales tax be made more equitable by exempting the use of laundry machines located in a common area of a residential complex. This measure applies to supplies made after ANNOUNCEMENT DATE.

Accommodation rebate and timeshare units

Under the existing rules, a non-resident consumer is entitled to claim a rebate of tax paid on short-term accommodation. The current definition of short-term accommodation may, however, unintentionally allow some accommodation supplied under a timeshare arrangement to qualify for a rebate.

As a result, in some cases, a non-resident acquiring an interest in timeshare property in Canada may be entitled to claim a rebate equal to the total tax payable on the acquisition. There is no recapture of the rebate where the non-resident subsequently sells the timeshare property or becomes a resident of Canada.

It is therefore proposed that the accommodation rebate be denied for the acquisition of timeshare properties. This

measure will be effective as of January 1, 1991 but does not apply to an application for a rebate that has been received at a Revenue Canada office before ANNOUNCEMENT DATE.

Sales made through vending machines at extracurricular events

It is proposed to clarify the provision that exempts supplies of food or beverages supplied by a school authority to students as part of an extracurricular activity by adding that the exemption does not extend to food or beverages that are supplied through vending machines. The amendment applies to supplies made after ANNOUNCEMENT DATE.

Deemed residents

Under the *Income Tax Act*, members of the Canadian Forces, public servants, ambassadors, ministers and high commissioners are deemed to be resident in Canada even when posted abroad.

It is proposed that these individuals be specifically treated as residents of Canada for the purposes of the federal sales tax.

This measure applies after ANNOUNCEMENT DATE.

Home office expenses

It is proposed that the federal sales tax rules for claiming input tax credits be made more consistent with the provisions dealing with home office expenses under the *Income Tax Act*.

For income tax purposes, home office expenses are deductible in computing an individual's business income only where the office is the individual's principal place of business, or is used exclusively for the purpose of earning income from the business and is used on a regular and continuous basis for meeting clients, customers or patients. The current federal sales tax rules do not restrict the claiming of input tax credits for home office expenses.

It is therefore proposed to limit input tax credits to the federal sales tax paid on those expenses deductible for qualifying home office expenses under the *Income Tax Act*. The *Income Tax Act* also limits the deduction of home office expenses to the individual's income for the year from the business. This income restriction, however, will not apply for federal sales tax purposes.

Generally, this measure applies to property imported after ANNOUNCEMENT DATE and to supplies for which all of the payment becomes due or is paid without becoming due after ANNOUNCEMENT DATE.

Sponsorship of public service activities

Existing sales tax rules provide that, where a public service body provides a promotional service in exchange for a sponsorship from a business, the provision of the service is not subject to federal sales tax. For example, a non-profit hockey club might agree to advertise on its team uniforms the name of a corporate sponsor. The federal sales tax would not apply to the transaction. However, where the payment by a sponsor may reasonably be regarded as being primarily for advertising on radio or television, or in a newspaper, magazine or periodical, the supply of that advertising service by the public service body is treated as a taxable supply.

It is proposed that the reference to a public service body be changed to a reference to a public sector body to ensure that a sponsorship provided to a government, which includes an agent of the Crown, is not subject to federal sales tax. This proposed measure will apply to supplies made after September 1992.

Including pre-collected taxes in the sales tax base

The current legislation provides that the consideration for a supply includes certain taxes, duties or fees imposed under federal and provincial legislation. It is proposed that the legislation specifically refer to taxes, duties and fees payable

or collectible by a supplier. This measure will be effective as of January 1, 1991.

Clarifying the availability of input tax credits

Under the existing federal sales tax rules, registrants are able to claim input tax credits for federal sales tax paid on property or services acquired for use or supply in the course of a commercial activity, whether or not that activity involves the making of supplies. It is proposed to clarify that persons whose activities do not involve the making of supplies are not entitled to claim input tax credits.

This measure will be effective the day after ANNOUNCEMENT DATE .

ANNEX A

GST Alternatives Considered by the House of Commons Standing Committee on Finance

In 1994, the House of Commons Standing Committee on Finance conducted an extensive review of sales tax reform options. The Committee considered twenty alternatives to the Goods and Services Tax (GST):

- abolish the GST – no replacement;
- cut government expenditures;
- reduce federal transfers to provinces;
- personal income surtax;
- corporate income tax rate increase;
- exchange tax bases with the provinces;
- a flat tax;
- additional personal income tax – flat tax "add-on";
- a turnover tax;
- a payroll tax;
- a wealth transfer tax;
- green taxes;
- the taxation of gambling and lottery winnings;
- a personal expenditure tax;
- a manufacturers tax;

- a wholesale tax;
- a retail sales tax;
- an addition-method value-added tax;
- an accounts method value-added tax (also known as a business transfer tax); and
- an invoice method value-added tax.

The Committee concluded that a national, invoice method value-added tax, replacing the GST and provincial sales taxes, was the best option for addressing the current shortcomings in the Canadian sales tax system.

ANNEX B

The Operation of the Goods and Services Tax

The Goods and Services Tax is a multi-stage value-added tax applied at each stage of the production and distribution process. Businesses are entitled to claim an "input tax credit" for the tax paid on their purchases. The tax is applied to a broad base of goods and services at a rate of 7 per cent. There are several exceptions to the tax base for social, economic and/or administrative reasons; these exceptions are either *zero-rated* or *exempt*.

Zero-rated goods

The federal sales tax applies a "zero rate" to several categories of goods. Purchasers of these products do not pay tax but vendors are entitled to claim input tax credits. The following goods are zero-rated:

- basic groceries;
- agriculture and fish products;
- prescription drugs;
- medical devices; and
- exports.

Exempt services

Several categories of services are tax-exempt under the federal sales tax. Purchasers of these services pay no tax, and vendors

are not entitled to claim input tax credits. The following services are exempt from tax:

- health care services;
- residential rents, used housing and recreational property, and condominium fees;
- educational services;
- financial services;
- day-care services; and
- legal-aid services.

Charities, qualifying non-profit organizations, municipalities, universities, schools and hospitals may claim a partial rebate for taxes paid with respect to exempt services. The federal rebate percentages are:

	(per cent)
Charities	50
Qualifying non-profit organizations	50
Municipalities	57.14
Universities and public colleges	67
School authorities	68
Hospital authorities	83