Implementation of GST Rate Reduction and More on Harmonization

In the October Economic Statement, the Harper government dropped the other shoe, and announced the reduction in the rate of GST to 5% effective January 1, 2008. As with the previous reduction to 6% effective July 1, 2006, there is a series of implementation rules intended to smooth the transition to the new rate. But first, selling the tax to the provinces…

Harmonization

The federal government has recently increased its marketing of the GST in an attempt to persuade more provinces to harmonize their commodity tax structures with the GST. The rate cuts may make the overall combined rate that would result from harmonization more palatable, but several obstacles remain. Provinces must deal with the political fallout from making more goods and services taxable than are currently subject to retail sales tax, and some compensation must be paid to the provinces that would lose revenues from businesses that could now recover the tax fully on their inputs. Whether the federal government's efforts will succeed remains to be seen, but it is gratifying to see the federal government begin to exert more pressure on its provincial counterparts, particularly after several years of promoting the benefits of harmonization by business lobby groups such as FEI.

Rate Cut Implementation

As with the last rate cut, the GST credit is maintained at current levels for low- and modest-income Canadians and existing GST rebate rates for new housing continue unchanged. The rebate percentages used to calculate rebates of the otherwise unrecoverable GST claimed by charities, qualifying non-profit organizations and selected public service bodies (including municipalities, universities, public colleges, schools and hospitals) will not change. In line with the Government's promotion of health and wellness, tobacco (but, this time, not alcohol) excise duties will increase to offset the impact of the GST rate reduction, beginning January 1, 2008. The increases will also capture inventories on hand at January 1, 2008, excluding only retail inventories of 30,000 units or less.

Air Transportation Security Charge rates are structured to include, where applicable, the GST/HST. The new rates are $4.90 for a domestic one-way trip, $9.80 for a round-trip and $8.34 for a cross-border flight. The rate for other international, zero-rated flights remains the same, at $17.00. The new rates will apply to tickets purchased on or after January 1, 2008.

Transitional rules will determine the GST rate applicable to transactions that straddle the January 1, 2008 implementation date. They operate in the same way as those in effect for the July 1, 2006 rate cut. The tax content of allowances under section 174 of the *Excise Tax Act*, becomes 5/105 (or 13/113 for the harmonized zone) where the allowance is paid on or after January 1, 2008, and the simplified factor for use on expense reports becomes 4/104 (or 12/112 for the harmonized zone) where the expense is *reimbursed* (i.e., expense report is paid) on or after January 1, 2008.

Transitional Rules

The general transitional rule is as follows:

- If GST becomes payable, or is paid without having become payable, before January 1, 2008, the rate of 6% will apply.

- If GST becomes payable on or after January 1, 2008, without having been paid before that day, the rate of 5% will apply.

- If GST is paid on or after January 1, 2008, without having become payable before that day, the rate of 5% will apply.

(a) Sales of Real Property

Ownership or Possession Transferred before January 1, 2008: The 6% rate will apply to all of the consideration for a *sale* of real property if ownership, or possession, of the property under the agreement of purchase and sale, is transferred to the buyer before January 1, 2008.

Ownership and Possession Transferred on or after January 1, 2008: The 5% rate will apply to all of the consideration for a *sale* of real property if, under an agreement of purchase and sale entered into after October 30, 2007, both ownership and possession of the property under the agreement, are transferred to the buyer on or after January 1, 2008.

Written Agreement Entered Into on or before October 30, 2007 Where Both Ownership and Possession are Transferred on or after January 1, 2008: For *sales* of houses, apartment buildings and other residential complexes, made pursuant to a written agreement entered into on or before October 30, 2007 but after May 2, 2006, GST will apply at the rate of 6%. For sales of houses, apartment buildings and other residential complexes made pursuant to a written agreement entered into on or before May 2, 2006, the rate of 7% will apply. In these circumstances, where transfer of ownership and possession both take place on or after January 1, 2008, the purchaser will be entitled to file a claim with the Canada Revenue Agency to be paid a Transitional Rebate that reflects the GST rate reduction to 5% net of any corresponding rebate adjustment.

(b) Deemed Supplies

The *Excise Tax Act* provides for deemed supplies in a number of circumstances. Under the proposed rules, the rate of 5% will generally be used to determine GST that is deemed under the *Excise Tax Act* to be paid, or collected, on or after January 1, 2008.

(c) Imported Goods and Imported Taxable Services and Intangibles

Imported Goods: GST at the rate of 5% will apply to goods that are either imported on or after January 1, 2008, or released from Customs' control on or after January 1, 2008.

Imported Taxable Services and Intangibles: GST on imported taxable services and intangibles is usually payable on the earlier of the day the consideration is paid and the day that consideration becomes due. The general transitional rule outlined above will determine the rate of tax to be applied in these circumstances.

Financial Institutions: Under draft legislation released January 26, 2007, financial institutions will be required to self-assess GST on certain cross-border transactions using a special set of rules. GST on these transactions will be determined on an annual basis and, in general, will become payable six months after the end of the financial institution's taxation year.

If a financial institution's taxation year begins before January 1, 2008, and ends on or after that day, the financial institution will be required to apportion the total amount of qualifying consideration for the taxation year on which it is required to self-assess GST under the proposed measure. The apportionment will be based upon the ratio of the number of days in the taxation year that occur before January 1, 2008, to the total days in the taxation year. GST on the amount allocated to the period before January 1, 2008, will be calculated at the rate of 6% and GST on the remaining amount of qualifying consideration will apply at the rate of 5%.

(d) Taxable Benefits

The determination of the GST on certain taxable benefits for employees and shareholders is calculated based on amounts determined for income tax purposes.

In these cases, the GST is calculated by multiplying the amount determined for income tax purposes by a factor specified in the *Excise Tax Act* or a rate prescribed in the related regulations. These factors and rates will be adjusted to reflect the January 1, 2008 GST rate reduction. In particular, the prescribed rate for calculating the GST on the automobile operating expense benefit, which is currently 4%, will be 3% for the 2008 and subsequent taxation years, and for calculating the HST, the prescribed rate, which is currently 10%, will be 9% for the 2008 and subsequent years. The GST factor applicable to benefits other than automobile operating expenses will be 4/104 for 2008 and subsequent years, while the HST factor will be 12/112 for these years.

(e) Anti-Avoidance Provision

New rules will be implemented to maintain the integrity of the GST system through the transition period. These rules are intended to prevent inappropriate tax savings in cases where transactions are undertaken between non-arm's length parties to obtain the benefit of the rate reduction, rather than primarily for commercial purposes.

Housing Rebates

Individuals who purchase or construct a new home, or substantially renovate an existing home, for use as their primary place of residence are generally entitled to a rebate of part of the GST that they pay in the course of the purchase, construction or substantial renovation. The maximum amount of the rebate is equal to the lesser of 36 per cent of the GST paid and $7,560. For homes that cost more than $350,000, the rebate is phased out so that no rebate is available for homes valued at more than $450,000. The maximum dollar value of the rebate, which is currently set at $7,560, will be adjusted to $6,300 (i.e., 36 per cent of the GST paid at the 5 per cent rate on a $350,000 home). The maximum dollar amount will be also adjusted for other similarly structured housing rebate provisions in the *Excise Tax Act*.

The GST-included upper and lower phase-out values of the "Rebate for Purchasers of Shares in a Cooperative Housing Corporation" and the "New Housing Rebate for Building Only" will also be adjusted to reflect the lower rate of GST.

Streamlined Accounting Methods

Small businesses, as well as eligible public service bodies, can use a Quick or Special Quick Method of Accounting to simplify compliance. Under these methods, taxpayers multiply eligible

GST/HST-included sales by a reduced percentage and remit that amount to the government in lieu of tracking and claiming input tax credits for most of the tax they pay. The percentages used are specified in the *Streamlined Accounting (GST/HST) Regulations*.

As a result of the proposed rate reduction, the specified percentages will change. A series of charts is provided in the Supplementary Information that provides those new rates. The new percentages will apply to reporting periods that begin on or after January 1, 2008. For reporting periods that straddle January 1, 2008, the existing percentages will apply to consideration that becomes due, or is paid without having become being due, before January 1, 2008, and the new percentages will apply to the remaining consideration.