Canada's Goods and Services Tax

A Guide for Foreign Investors

Canada

This document provides an overview of the main features of Canada's new Goods and Services Tax (GST) for potential investors considering Canada as an investment location.

It was prepared on behalf of Canada's Investment Development Program and its participating departments: *Investment Canada, External Affairs and International Trade Canada* and *Industry, Science and Technology Canada.*

Although every attempt has been made to ensure accuracy, if you require more specific information, please contact the nearest Canadian Embassy, Consulate or High Commission, or Investment Canada, P.O. Box 2800, Station D, Ottawa, Ontario, K1P 6A5 Telephone (613-995-0465) FAX (613-996-2515).

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On January 1, 1991 the Government of Canada introduced a value-added Goods and Services Tax (GST) of seven per cent covering the sale of most goods and services in Canada.

Similar to value-added taxes applied by nearly 50 other nations, the GST significantly improves the competitiveness of firms based in Canada by replacing the former federal sales tax on business inputs with a tax on consumption. It should also be noted that since the GST is a tax on consumption rather than production, it is paid ultimately, not by businesses, but by the consumer at the retail level. Furthermore, every dollar of GST paid by a commercial enterprise on business inputs is recoverable in full. And all exports are GST-free.

All businesses operating in Canada that have annual sales of more than $30,000 are required to register for GST and must collect and remit this tax in respect of taxable goods and services sold in Canada.

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HOW THE GST WORKS

The GST works like this:

- Businesses are required to charge GST at the rate of seven per cent of the purchase price of taxable goods and services they sell in Canada. Most businesses are able to claim a full credit (called an "input tax credit") for the GST that they pay on the goods and services they purchase to operate their businesses.

- At specified intervals (as detailed below), the company adds up the amount of GST it has paid to its suppliers in that period. It subtracts this amount from the total amount of GST it has collected from its own customers. If it has collected more than it paid, the difference is remitted to the government. If more tax was paid than was collected, a refund can be claimed from the government. The government is required to provide this refund within 21 days, or pay interest beyond that point.

WHAT'S TAXED AND WHAT ISN'T

The GST is paid on most, but not all, goods and services consumed in Canada. The exceptions fall into two main categories: "zero-rated" and "tax-exempt".

Zero-rated Goods and Services

Certain categories of goods and services are "zero-rated". This means, effectively, that they are GST-free on sale, or that tax is collectible at a rate of zero per cent. Nevertheless, the seller of these zero-rated items can still recover, through input tax credits, all the GST paid on business purchases related to the sale of the zero-rated supply. It is important to note that all exported goods and services are zero-rated for GST. Zero-rated items also include most basic groceries, prescription drugs and medical devices.

Tax-exempt Goods and Services

Goods and services in this category are not subject to GST – meaning that no tax is payable by the customer.

The difference between this category and "zero rated" items is that the seller may not claim any input tax credits for the GST paid to provide these tax-exempt goods and services.

Included in the "tax exempt" category is a wide range of social and health services and most basic financial services, for instance, loans, deposits, mortgages, life insurance and automobile insurance and brokerage commissions.

Certain other services provided by financial institutions including debt counselling, financial planning, safety deposit boxes and sales of blank cheques are subject to GST.

Of particular interest to foreign investors is the fact that financial services provided to a Canadian branch of a foreign company are considered to be made in Canada and are tax-exempt. And financial services provided to a foreign branch of a Canadian company are zero-rated.

Salaries, Wages and Commissions

Salaries and wages of employees are not regarded as fees for services so GST is neither charged nor collected on them. Nor are commissions paid to staff employees such as department store salespeople.

However, payments to self-employed people working on commission or contract are subject to GST. In these cases, businesses pay GST for these services and may claim input tax credits for the amounts paid.

Employee Benefits

Certain employee benefits are not subject to GST. These include pension payments and contributions, deferred compensation and profit-sharing plans, group life insurance, interest-free loans and tuition fees.

Allowances and Reimbursements

Employers may claim input tax credits on expense allowances paid to employees for charges incurred in Canada to the extent that the allowance is deductible for income tax purposes in determining the employer's income.

Buildings and Land

A GST-registered business may claim an input tax credit for GST paid on the purchase of land and buildings in proportion to the extent that the land or building is used for commercial activities.

GST applies to sales and leases of commercial properties such as hotels, shopping malls and office buildings. It also applies to sales of new and substantially-renovated residential housing, including rental properties and owner-occupied homes. The GST does not apply to used residential housing.

Also taxable are sales and leases of land that occur in the course of doing business – and this includes the sale of property previously used by the vendor for business purposes.

Capital Goods

Businesses may claim input tax credits for the GST they pay when they purchase capital goods – for instance tools, machinery, furniture and personal computers. To be eligible for credits, these goods must be used primarily (more than 50 per cent) for business use.

Leased Capital Equipment

Businesses and self-employed people who lease capital equipment primarily for commercial use can claim a full input tax credit for the GST paid on the lease payment.

Meals and Entertainment Expenses

Businesses may claim input tax credits for 80 per cent of the GST paid for meal and entertainment expenses incurred as a cost of doing business – this is consistent with Canadian income tax law which allows businesses to claim 80 per cent of these expenses.

Provincial Taxes

All but one of Canada's provinces operate a retail sales tax. Generally, GST is applied by the federal government to the purchase price of goods and services before application of the provincial retail sales tax. In some provinces the GST then forms the part of the value on which the province levies its own retail sales tax. Other provinces base their sales taxes on a value which does not include the GST.

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EXPORTS ARE GST-FREE

Generally, under the GST, both goods and services exported by Canada-based companies are "zero-rated" – in other words the exporting companies do not charge tax to their customers abroad.

Nevertheless, these companies are eligible for input tax credits on the goods and services they purchased in order to produce the exported items. Consequently, the GST return of a company which exports most of its goods and services will probably show an entitlement to a refund since input tax credits earned will likely exceed GST collected on sales.

Also zero-rated are services supplied in Canada but destined exclusively for use abroad. An example would be architectural fees paid by a Canadian company to a Canadian architect for work on a foreign project.

Exported intellectual property (such as copyrights, patents, trade secrets, scientific know-how and industrial design) is also zero-rated. So are goods bought in Canada for immediate export . In other words the buying company will not pay any GST on the goods.

Freight and Transportation for Export

GST does not apply to freight transportation costs within Canada for goods shipped directly to destinations abroad. The tax does apply if the goods are being shipped to a Canadian destination for further processing or handling before shipment abroad. In this case, of course, the exporter would be able to recover the GST in the form of input tax credits.

Export Broker Fees

Self-employed sales agents or export brokers who sell to foreign customers on behalf of Canadian firms also charge GST on their commissions or their fees. However, their clients (the exporter companies), if registered, may recover these costs as input tax credits.

The sales agents and brokers, if registered, for their part, will also be able to claim input tax credits for GST paid on their business purchases.

IMPORTS

Under the GST, most imported goods are taxed at the time of importation or, if applicable, when the goods are removed from a bonded warehouse, based on the duty-paid value of the goods.

Services and intangible or intellectual property imported into Canada by GST-registered companies are not subject to GST, provided they are for use exclusively in the commercial activities of the importer.

Direct-mail importers generally do not have to apply to register. However, they may voluntarily do so in order to claim input tax credits on business inputs.

In the case of direct-mail importers of books, periodicals and other printed publications, the non-resident supplier who has registered will charge GST to Canadian recipients; GST will not, therefore, apply to the printed materials at time of importation, thus avoiding possible delays at the border. Foreign publications are therefore taxed in the same way as Canadian-produced publications.

Meals and Entertainment Expenses

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TRAVEL

Within Canada

The GST applies to fares for travel by most modes of commercial transportation in Canada (i.e. taxi, bus, train, ship, aircraft, etc.). However, transit service fares and bridge, road and ferry tolls are exempt from GST.

Beyond Canada

No GST is charged for fares covering international air travel except for travel to and from the continental U.S. (i.e. exclusive of Hawaii) and the islands of St-Pierre and Miquelon.

For transborder air travel to and from the continental U.S., and St-Pierre and Miquelon, GST will apply to all tickets purchased in Canada. But tickets purchased outside Canada are taxed only if the first flight originates in Canada.

Domestic (in-Canada) legs of international trips are not subject to GST. For example, a train trip from Windsor to Toronto to connect with a flight to Paris qualifies as completely tax-free if it is part of a continuous journey.

Visitors' Rebates

Foreign visitors to Canada may claim a rebate of GST paid on short-term (30 days or less) accommodation and on goods (other than alcohol, tobacco or motor fuels) they buy to take home. The rebate applies to taxable purchases of goods valued at $100 and above. These rebates will be available from duty-free shops at the time the visitor leaves Canada, or they may be applied for within one year of purchasing the goods or accommodation. Proof of purchase is required and the government reserves the right to require proof that the goods were exported. A simplified rebate mechanism also exists for non-resident and non-registered foreign companies.

Convention Expenses

The accommodation rebate will be made available to non-resident convention and conference organizers on charges paid for rooms and exhibition space at conventions in Canada.

REQUIREMENTS

Registration

All companies engaged in a commercial activity in Canada with annual sales in Canada of more than $30,000 are required to register for GST. This includes all non-resident persons who carry on a business. This excludes persons whose only commercial activity is the sale of real property otherwise than in the course of a business.

Once registered, these companies will be on a completely equal footing with Canadian businesses in terms of the operation of the GST. Specifically, they must charge GST on their taxable sales, and they may claim input tax credits for GST paid on their business purchases.

Reporting Periods

The filing requirements for GST (the intervals at which taxes must be remitted and credits claimed) are flexible enough to match the needs of businesses of different sizes and requirements.

Filing periods are as follows:

- Businesses with revenues from taxable goods and services over C$6 million per year: monthly.

- Businesses with revenues from taxable goods and services of C$6 million or less per year: every three months, although they, too, may file monthly if they prefer.

- Companies which earn under C$500,000 per year from taxable goods and services have the option of filing annually (but must make quarterly installments).

Invoice Information

To be eligible to claim an input tax credit for the GST paid on a purchase, a business must be able to provide sufficient evidence to allow the amount of the credit to be determined. This would normally be in the form of an invoice from the supplier containing information of the kind that normally appears on invoices, as well as specific GST-related information such as, for supplies over C$30, the supplier's GST registration number.

Record-keeping

For the most part businesses will be able to use the same books and records they keep for income tax purposes to keep track of the GST they pay and collect.

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- ***Excise Tax Act*** *as amended by Bill C-62.*