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REPORT ON THE TECHNICAL PAPER ON THE GOODS AND SERVICES TAX

The Standing Committee on

Finance

November 1989

(reprint - January 1990)

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REPORT ON THE TECHNICAL PAPER ON THE GOODS AND SERVICES TAX

The Standing Committee on Finance

November 1989

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HOUSE OF COMMONS

Issue No. 85

Tuesday, June 27, 1989
Tuesday, August 15, 1989
Wednesday, September 20, 1989
Monday, October 30, 1989
Thursday, November 2, 1989
Monday, November 6, 1989
Tuesday, November 7, 1989
Wednesday, November 8, 1989
Thursday, November 9, 1989
Monday, November 20, 1989
Tuesday, November 21, 1989

Chairman: Don Blenkarn

Minutes of Proceedings and Evidence of the Standing Committee on

Finance

RESPECTING:

Pursuant to Standing Order 108(2), consideration of the Technical Paper on the Goods & Services Tax

INCLUDING:

The Second Report to the House

Second Session of the Thirty-fourth Parliament, 1989

CHAMBRE DES COMMUNES

Fascicule nº 85

Le mardi 27 juin 1989
Le mardi 15 août 1989
Le mercredi 20 septembre 1989
Le lundi 30 octobre 1989
Le jeudi 2 novembre 1989
Le lundi 6 novembre 1989
Le mardi 7 novembre 1989
Le mercredi 8 novembre 1989
Le jeudi 9 novembre 1989
Le lundi 20 novembre 1989
Le mardi 21 novembre 1989

Président: Don Blenkarn

Procès-verbaux et témoignages du Comité permanent des

Finances

CONCERNANT:

Conformément à l'article 108(2) du Règlement, étude du document technique relatif à la taxe sur les produits et services

Y COMPRIS:

Le Deuxième Rapport à la Chambre

Deuxième session de la trente-quatrième législature, 1989

STANDING COMMITTEE ON FINANCE

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Lee Richardson
Pat Sobeski
René Soetens
Douglas Young—(14)

(Quorum 8)

Marie Carrière
Clerk of the Committee

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Douglas Young—(14)

(Quorum 8)

Le greffier du comité
Marie Carrière

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ORDER OF REFERENCE

Extract from the Votes and Proceedings of the House of Commons on Thursday, September 28, 1989

By unanimous consent, it was ordered,—That the House hereby directs the following arrangements with respect to the consideration, by the Standing Committee on Finance, of the proposed Goods and Services Tax:

That the Committee be authorized to travel as follows:

a)A sub-committee of the said committee, composed of one Member from each recognized Party in the House, to travel to Whitehorse for hearings on September 30, 1989;

b)The full committee to travel for hearings in Vancouver (October 2 and 3), in Edmonton (October 4), in Regina (October 5), in Winnipeg (October 6), in St. John's (October 18), in Halifax (also on October 18), in Charlottetown (October 19), and Fredericton (also on October 19).

2. That the Committee make its report to the House no later than Tuesday, November 28, 1989.

3. That televised broadcasting of any or all public meetings of the Committee in Ottawa, subsequent to the adoption of this Order and until the Committee enters into preparing its report, be on the basis of the principles and practices now governing broadcast of the proceedings of the House of Commons.

4. That the Order for consideration by the House of second reading and committee referral of any Bill or Bills relating to the proposed Goods and Services Tax be for "Second Reading and referral to the Standing Committee on Finance."

5. That the Committee be authorized to travel to Mont Ste Marie, Quebec, from November 6 to November 9, 1989, inclusive for the purpose of drafting the report.

ATTEST

ROBERT MARLEAU

The Clerk of the House of Commons

ORDER OF REFERENCE

Extract from the Votes and Proceedings of the House of Commons on Tuesday, October 24, 1989

By unanimous cosnent, it was ordered,—That, a sub-committee of the Standing Committee on Finance composed of one member from each recognized party in the House, be authorized to travel to Yellowknife (Northwest Territories) on Thursday, October 26, 1989, for the purpose of hearing witnesses on the Committee's consideration of the Goods and Services Tax; and that, the necessary staff do accompany the Committee.

ATTEST

ROBERT MARLEAU

The Clerk of the House of Commons

The Standing Committee on Finance

has the honour to present its

SECOND REPORT

In accordance with its mandate under Standing Order 108(2), your Committee has examined the Technical Paper on the Goods and Services Tax issued by the Minister of Finance on Tuesday, August 8, 1989 and agreed to report the following:

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ACKNOWLEDGEMENT

The Finance Committee first became involved in value-added taxes when it became apparent that the government was considering such a tax proposal in the latter part of 1986 and in early 1987. On June 17, 1987 the government produced its White Paper on Tax Reform which was separated into two parts. The first part dealt with tax reform of the income tax system and the second part dealt with tax reform of the commodity tax system proposing a value-added tax.

It was the intention of the government to create a national sales tax on a value-added tax base and the White Paper report dealt with the possibilities and the base for such a tax.

The Finance Committee completed a study on Part I of the tax reform and made its report in the fall of 1987.

After completing this report the Finance Committee did preliminary work in connection with Part II of the suggested tax reform and, in the process, travelled to New Zealand and examined the Goods and Services Tax as it exists in that country.

The Finance Committee report on the goods and services tax was tabled with the House of Commons on March 16, 1988. In that reports the Finance Committee recommended the following:

"1. That in their discussions on sales tax reform, federal and provincial governments give consideration to the New Zealand experience. This experience indicates that the most efficient form of a value-added national sales tax is one which has a comprehensive base with as few exemptions as possible. The Committee makes no recommendations with respect to taxing such necessities as food. The Committee recommends, however, that if necessities are taxed, it should be only on condition that low and lower-middle income groups are fully and immediately compensated for the incremental burden they bear, and that such compensation is fully indexed.

2. That in its discussions with the provinces about sales tax reform and about the taxation of government operations the government give the highest priority to minimizing compliance cost for Canadian businesses collecting sales taxes.

3. That the government, given that financial transactions should not be treated exactly like other transactions, take special care in developing simple, practical rules for the application of the tax to financial transactions and institutions.

4. That, if the government proceeds with the tax, it establish a private sector advisory committee to develop practical rules for the new tax and to publicise the details of the new tax and the relevant social policy transfers."

In the budget of February 1988, the Minister of Finance attempted to make corrections to the existing federal sales tax by, in short, dealing with the marketing problem that is tearing away at the tax base.

In accordance with the respect of the Minister, the Committee held hearings with the entire business community concerning the Minister's February 1988 budget suggestion and reported to the Minister with respect to that suggestion and advised the Minister that he would be better off to raise any additional monies he needed by increasing existing sales taxes while he proceeded as expeditiously as possible to produce for the country a national value-added tax as it was the view of the Committee that the federal sales tax could not be amended, repaired or altered in any fashion that would be workable. In early 1989 the Minister announced that the federal government would go it alone on a value-added tax. In the budget of April 27, 1989, the Minister suggested the tax would be a Goods and Services Tax at a rate of 9%. Detail of this tax was presented by the Minsiter in a Technical Paper on August 8, 1989 and on August 15, 1989 the Committee commenced its hearings in connection with this Technical Paper.

In its hearings, the Committee has heard 274 sets of witnesses and has analyzed at over 1,100 briefs and other representations. A list, though perhaps not complete, of briefs and representations made to the Committee is appended to this report.

In its discussions, the Committee held hearings in all provinces and territories of Canada with the exception of the provinces of Ontario and Quebec. Groups in Ontario and Quebec were requested to appear before the Committee in its many hearings in Ottawa.

The Committee completed its public hearings on October 26, 1989.

The Committee has been ably assisted by Blake Murray, Barrister and Solicitor and partner in the firm Osler, Hoskin and Harcourt in Toronto, who has acted as General Counsel in this matter. Mr. Murray had also accompanied the Committee to New Zealand in 1988 as a representative of the Canadian Bar Association.

Also acting as a Counsel to the Committee was Mr. Michel Coderre, Barrister and Solicitor with the firm Stikeman Elliott in Montreal. Mr. Coderre is a member of both the Bars of Québec and Ontario and is also a chartered accountant.

The Committee also had the assistance of Michael Cassidy, former Member of Parliament for Ottawa Centre from 1986 to 1988, a former member of the Finance Committee and now President of an Ottawa public affairs consulting firm, The Ginger Group Consultants.

The Committee also had the specialized services of Cheryl Knebel. Ms. Knebel is a chartered accountant and a senior manager of Price Waterhouse in Edmonton, Alberta. She practices in commodity taxation and international trade.

The regular research staff of the Committee was fully employed. The Director of the Research staff, Basil Zafiriou, an economist, is from the Library of Parliament and is on assignment to the Committee. Also from the Library of Parliament is Richard Domingue, an economist, who has worked for the Committee in this Parliament as well as in the last Parliament.

The Committee was further assisted by Sean Aylward, Barrister and Solicitor. Mr. Aylward holds a Master of Laws degree in tax and trade law from the London School of Economics and is a Member of the Bar of Ontario. Mr. Aylward also worked as a Counsel to the Committee during its study in 1987 on Part I of tax reform.

All of the members of this Committee, even those members from political parties who would not perhaps on their own approve of a Goods and Services Tax, worked diligently to solve the problems presented in the Technical Paper. This report reflects the mature and considered judgment of all Committee members.

From the New Democratic Party, the Committee had the assistance of Lorne Nystrom, Member of Parliament for Yorkton-Melville, Saskatchewan. Mr. Nystrom is a House of Commons veteran and is the Finance critic for the New Democratic Party. Assisting him was Jack Whittaker, Member of Parliament for Okanagan-Similkameen-Merritt, British Columbia. Mr. Whittaker was, prior to being elected, a barrister and solicitor.

From the Liberal Party, the Committee had the services of Douglas Young, Member of Parliament for Gloucester, New Brunswick. Mr. Young is the associate Finance critic for the Liberal Party. He is the former Minister of Fisheries in the New Brunswick Legislature. Assisting Mr. Young was Jerry Pickard, Member of Parliament for Essex-Kent, Ontario. Mr. Pickard is a former school teacher. Also assisting was Diane Marleau, Member of Parliament for Sudbury, Ontario who made important representations regarding child care that were accepted by the Committee. Mrs. Marleau is a former Regional Chairman for the District of Sudbury. Alfonso Gagliano, Member of Parliament for Saint-Léonard, Québec, the Liberal critic for Small Business, also assisted. Mr. Gagliano was first elected to the House of Commons in the general election in 1984.

From time to time, the Liberal Party had the services of John Manley, Member of Parliament for Ottawa South, Ontario. Mr. Manley is a lawyer and he added considerably to the Committee's deliberations.

From the Progressive Conservative Party, the Committee had the service of Murray Dorin, Member of Parliament for Edmonton Northwest, Alberta. Mr. Dorin has been a member of the Committee since 1984 and is the Committee's Vice-Chairman. Mr. Dorin is a chartered accountant with extensive business experience.

In addition, the P.C. Party had the assistance of William Attewell, Member of Parliament for Markham, Ontario. Mr. Attewell has been a member of the Committee since 1984. He is a former executive with Guaranty Trust in Toronto.

Also representing the Conservative Party was René Soetens, Member of Parliament for the riding of Ontario. Mr. Soetens is a former business executive with Co-Steel in Whitby;

Pat Sobeski, Member of Parliament for Cambridge, Ontario is a former officer with Canada Trust;

Clément Couture, Member of Parliament for Saint Jean, Quebec is a former business development officer with the City of Saint Jean;

Yvon Côté, Member of Parliament for Richmond-Wolfe, Quebec is a former teacher; and Lee Richardson, Member of Parliament for Calgary Southeast, Alberta, who has been active for a long time in political affairs is a former businessman.

Assisting the Progressive Conservatives from time to time as a substitute was Fernand Jourdenais, Member of Parliament for La Prairie, Québec. Mr. Jourdenais is a former businessman.

The Clerk of the Finance Committee, Marie Carrière, organized a very considerable work force to assist the Committee both in the preparation of the documentation and the briefs and organized all of the meetings and attendances. Ms. Carrière is certainly one of the most competent Committee Clerks in the House of Commons Committee Service, and the Finance Committee is fortunate to have her as its Clerk.

Appended to this report are minority views of both the Liberal and New Democratic Parties.

It is the Committee's view that the Committee would like to see provincial participation in the tax. During the Committee's deliberations, as Chairman I was at times able to discuss the matter with provincial treasurers. Clearly, it would be best if we could have one national sales tax; one central administration with the same tax right across the country. Unfortunately, that does not seem to be possible. In the absence of agreement, a federal only Goods and Services Tax is a viable alternative.

In this report we have dealt with as many of the issues as possible. It is the Committee's view that a Goods and Services Tax form of multi-stage sales tax is the best form of taxation to replace the existing federal sales tax and that the tax ought to be legislated in accordance with the viewsof the Committee as determined by the evidence before the Committee and set out in this report.

A number of people coming before the Committee and making representations to Parliamentarians have complained about the high cost of government and have demanded that government tailor its expenses to its revenue. In this regard, the enormity of the federal deficit was brought to our attention time and again.

It is the view of the Committee that effort must be made to bring revenues into line with expenditures and therefore there must be expenditure cuts and it is the Committee's view that any monies realized from the Goods and Services Tax over and above the monies required to replace the existing federal sales tax ought to be applied in reduction of the deficit and/or the public debt.

All of this is respectfully submitted.

Don Blenkarn, M.P.
Chairman

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All of this is respectfully submitted.

Don Blenkarn, M.P.
Chairman

The Committee wishes to thank the following persons who have assisted in the preparation of this report

Committee Clerks	Maija Adamsons Djénane Boulad Carole Chafe Richard Chevrier Richard Dupuis Christine Fisher Diane Tremblay
Administrative Assistants	Hélène Cousineau Carole Lachapelle Diane Lefebvre
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Centralized Support and Publications Service	
Ryder Group	Manon Martel
Support Staff — House of Commons	Sylvie Bednar Diane Harper Michelle Parent Julie Parent Chantal Proulx Micheline Simoneau **AND** all the others who assisted the Committee from time to time

LIST OF RESOLUTIONS AND RECOMMENDATIONS

RESOLUTIONS

PART A: APPROACHES TO SALES TAX REFORM

Chapter 2: Alternatives to the Existing Federal Sales Tax

The Committee resolves to conduct an inquiry to hold hearings early in 1990 into the question of government spending and measures to control its growth.

PART B: ECONOMIC AND DISTRIBUTION ASPECTS

Chapter 3: GST Credits

The Committee therefore resolves to conduct an inquiry into Canada's tax and social benefits systems, the interrelationship between the two, appropriate methods of indexing them to price changes, their respective purposes, efficacy, and implications for economic performance; and to report its findings to the House of Commons before the end of 1990.

RECOMMENDATIONS

PART A: APPROACHES TO SALES TAX REFORM

Chapter 1: The Need for Sales Tax Reform

1. That the existing Federal Sales Tax be abolished.

Chapter 2: Alternatives to the Existing Federal Sales Tax

2. That, as a means of replacing the revenue forgone by the elimination of the Federal Sales Tax, a broadly based consumption tax is a superior option to higher imcome taxes.

3. That a value added tax, such as the goods and services tax, is preferable to a retail sales tax as a substitute for the existing federal sales tax.

Chapter 3: Administrative issues

4. That, the federal government reiterate its support for a national sales tax and offer to establish the National Sales Tax on a partial basis as soon as three or four provinces, with a substantial population, are prepared to take part.

5. That, the design of the Goods and Services Tax should continue to be structured to make it relatively easy for the provinces to take part.

6. That, the federal government should maintain its target of January 1, 1991 for the introduction of the Goods and Services Tax.

7. That the federal government and the provinces should explore all possible means to reduce sales tax collection costs and paper burden through joint collection of tax and auditing, through delegation of collection from one level of taxing authority to another, and through other forms of co-operation.

8. That, the federal government should begin developing plans, with the assistance of any interested provinces, for the creation and operation of a joint national sales tax collection agency to be responsible for collection of a National Sales Tax at such time that a substantial number of provinces had joined in a national sales tax.

9. That, no attempt should be made by the federal government to have the provinces change their present practice, whereby provincial sales tax is computed on top of the price of goods and services, including the federal sales tax or Goods and Services Tax.

10. That, the provinces should, however, be encouraged to develop a uniform standard for how Provincial Sales Tax should be applied to the price of goods and services which are also subject to Goods and Services Tax.

11. That, retailers should be required to inform consumers by signs and other means as to whether prices of goods or services in a retail establishment are quoted including or excluding Goods and Services Tax, but there should be no requirement that prices be quoted pre-tax with Goods and Services Tax added separately.

12. That, the federal government should continue efforts to get the provinces to join in a national sales tax, as this is the ultimate means of resolving the issues of double-taxation and of lack of visibility of the Goods and Services Tax.

PART B: ECONOMIC AND DISTRIBUTION ASPECTS

Chapter 1: Economic Aspects

13. That the government not proceed with the proposed middle income tax rate reduction and that the savings be used instead to bring about a lower GST rate.

Chapter 2: Alternative GST Option

14. That any revenues from sales tax reform in excess of revenues required to finance replacement of the existing FST and associated sales tax credit increases and indexation payments should be used to reduce the government deficit.

15. That the general GST rate be lowered from the proposed 9% to 7%.

16. That excise taxes on alcohol and tobacco products be raised sufficiently to recoup the revenue losses that would otherwise result from the substitution of GST at 7% for the existing FST.

Chapter 3: GST Credits

17. That the single person's credit be eliminated and that it be replaced by a higher basic GST credit for the first adult in any household.

18. That the amounts for the GST credit be set as follows: $250 for the first adult in the household, $175 for the second adult, and $100 per child.

PART C: The Design of the GST

Chapter 2: Basic Operation

19. That full GST input tax credit be allowed for meal and entertainment expenses, and for passenger vehicles purchased or leased, including those purchased or leased by self-employed individuals, partners and persons meeting the criteria of paragraph 8(1)(f) of the Income Tax Act. If the Minister deems it advisable to make appropriate adjustments because of the personal consumption component, the changes should be made by amending the Income Tax Act. The Income Tax complications should not be added to the legislation implementing the GST.

20. That a simplified method to eliminate the provincial sales tax component prior to determining input tax credits be allowed. The optional simplified method could involve use of a reciprocal tax factor to determine the GST input tax credit on the gross selling price including provincial sales tax and GST. An adjusted reciprocal factor to reflect an assumed tax status and value combination could be used where a business is supplying goods with a different tax status for provincial sales tax and GST purposes.

21. That the government cooperate with the provinces to ensure GST input tax credits are treated as a price adjustment for PST purposes.

22. That businesses be allowed to claim a standard percentage on GST tax included (invoiced and non-invoiced) purchases as a GST credit when information as to actual amounts may be inadequate and the risk of revenue loss from error is not significant. The input credit could simply be calculated by applying an appropriate reciprocal factor. Satisfactory documentary evidence should be maintained by the registrant.

23. That on transactions where both parties are registrants and goods, other than inventory and commercial properties exceeding $1 million, are supplied, GST be collected by the vendor and the input tax claimed by the purchaser on a notional basis only. That is, GST should be deemed collected and the corresponding input tax credit deemed claimed where the vendor and purchaser complete and file a prescribed form, containing details of the transaction, and Revenue Canada, Customs and Excise approves the notational collection and claim. Submission of satisfactory evidence that the proposed use will entitle the purchaser to a full input tax credit should be required, and the procedure should be allowed only in respect of purchases of goods (other than inventory) greater than $100,000, where a registered vendor has annual taxable sales greater than $500,000, and of purchases greater than $30,000, where a business has annual taxable sales less than or equal to $500,000.

24. That certain related groups be allowed to elect to be treated as a single entity for GST filing purposes only. The related group given the option of group registration would be a related group as defined in Section 251 of the Income Tax Act, except that control would be deemed to mean 100% ownership. A member company could be designated as being responsible for accounting for the GST for the entire group. Although individual member companies would thereby be relieved of responsibilities to file returns, they would still be required to issue tax invoices and keep records. Also, although only one registration number could be given the group of companies, for control purposes individual member companies could be required to register as part of the group.

Chapter 3: Defining the Tax Base

25. That tax by the nature of the establishment be adopted by the Government for incorporating restaurant meals and take out prepared food into the tax base.

26. That, the Government review the list of zero-rated medical devices in consultation with representatives of the disabled on a regular basis.

27. That, health care service provided by psychologists who are registered under the Canadian Register of Health Service Providers in Psychology be exempt under the

GST. The Committee further recommends that non-diagnostic psychological services provided on an elective basis continue to be taxable. For greater certainty, the Committee recommends that the Regulations to the Excise Tax Act provide that only those psychological services billed under codes A1-A2-A3 or T1-T2-T3 as diagnostic health care under the fee schedule of the Council of Provincial Associations of Psychologists be treated as exempt.

28. That, all provincially licensed commercial day care services be entitled to a rebate of 50% of all GST paid.

29. That, the provision of legal aid services be made fully taxable and that a full rebate of tax be paid to all provincial legal aid societies.

Chapter 4: the GST and Small Business

30. That a small business collection fee be paid, equal to the lesser of $600 or 5% of the net remittance of the registrant. In accordance with the Technical Paper proposals, the fee should be available only to registrants who are carrying on a business and have revenue from taxable and zero-rated supplies of $2 million or less in a full fiscal period.

31. That the government consider use of general simplification methods for various types of small businesses, and not just registrants selling a combination of taxable and zero-rated food products at the retail level. Since a second threshold limit could ease the transition to the GST for businesses exceeding the $30,000 threshold, the government should consider especially simplifying procedures for small businesses in particular industries that have supplies of goods and services between the $30,000 exemption limit and a $500,000 limit. In all cases where additional methods are developed, the use of the method should be optional only. Small business fees should not be paid to those using simplified accounting methods, and businesses using the methods should not be allowed to adjust the net remittance calculated under the method if a lower net remittance is later calculated under the regular method. However, businesses should have the option to change the method of calculation the following year.

That the government should allow the following simplifying methods when the GST system is implemented:

(a) a reduced rate option similar to Japan. Use of the option would have to be approved by the Minister;

(b) a de minimis rule similar to Japan. This revenue test would be in addition to the use test outlined in Section 108 of the Draft Legislation; and

(c) a direct seller option which provides that where all or substantially all of the goods supplied by a particular person (the "Supplier") are ultimately

sold to consumers by itinerant vendors (i.e. persons selling from no fixed place of business) at prices not exceeding the suggested retail selling prices established by the Supplier, and the Supplier and all persons purchasing such goods for resale (the "Vendors") enter into a collection agreement, in prescribed form, with the Minister of National Revenue, for the purpose of the collection and remittance requirements, the Vendors shall be deemed to be employees of the Supplier. Under the terms of the Collection Agreement the Supplier will be deemed to have collected GST in respect of all goods sold by it on an amount equal to the value of the consideration for which the goods are offered for sale at retail. The value of the consideration for which the goods are offered for sale at retail shall be deemed to be not less than the suggested retail selling prices established by the Supplier.

Chapter 6: Transportation and Travel

33. That the claiming process for the foreign tourist rebate be simple and visible. At any point of entrance into Canada, information explaining the rebate system should be available to foreign visitors. The tourist sales tax rebate must be refundable, in Canadian dollars, through mail or refundable immediately at designated points of departure from Canada. The government should remit the GST, through the Duty Free Shops so that tourists can get their rebate instantly and in cash as they leave the country.

34. That, if prepaid by the foreign shipper and as long as a declaration specifies that the transportation services is part of an international continuous movement of goods, the domestic segment of inbound international freight movements be zero-rated, whether there is a second bill of lading or not.

35. That once its financial position is more balanced, the government should consider the advisability of integrating the excise tax on fuel into the GST through the input tax credit system, in order to eliminate the distortions associated with the excise tax.

Chapter 7: Real Property

36. That rebates not be paid to charities, non-profit organizations and selected public sector organizations for taxes paid on real property acquisitions or by application of the self-supply rule.

37. That per diem rentals of residential units at a cost of $20 or less be exempt supplies.

38. That, where the value of a commercial property exceeds $1 million, the purchaser, rather than the vendor be required to remit the tax. The vendor should, in these cases, be required to notify Revenue Canada of the sale by sending a form to this effect.

39. That a tax rate of 5% be apply to all taxable supplies of real property.

40. That all supplies of real property (except supplies of land used in a farming business by an individual to a related individual, or supplies of land used in a farming business as part of the transfer of a going concern) be taxable at 5%.

41. That the taxable amount of a supply of non-commercial property (new and existing housing, new and existing personal-use properties and new and existing residential rental properties) be computed in accordance with the trade-up approach, generally meaning that a purchaser of a non-commercial real property will only be liable for tax to the extent of the difference in price between the property sold and the price of the property purchased.

42. That the trade-up approach not apply to the purchase of commercial real property, meaning real property used or sold in the course of a commercial activity.

Chapter 8: Charities and Non-profit Organizations

43. That, as proposed in the Technical Paper, charities and qualifying non-profit organizations should get special treatment under the Goods and Services Tax in recognition of their important services to the community. In the form of a 50% rebate on Goods and Services Tax paid on their purchases.

44. That, the Department of Finance review the proposed 50% rate of rebate with affected charities and non-profit organizations to ensure that it is equitable and that the overall federal sales tax burden of this sector does not increase with the introduction of the Goods and Services Tax.

45. That, in general, relief from Goods and Services Tax which is given to charities, to qualifying non-profit organizations and to public-sector organizations in Canada should be provided through a rebate system as proposed in the Technical Paper rather than through zero-rating or by providing tax-free status on purchases. The affected organizations should therefore pay the Goods and Services Tax on their purchases and get relief through rebates rather then buying goods and services free of tax.

46. That non-profit organizations should be eligible to receive a 50% rebate of the GST paid on their purchases if they are 25% or more funded by government in a given year, not 50% as proposed in the Technical Paper. For non-profit organizations falling short of the 25% test, the 50% rebate should be reduced by one-fifth for each percentage point that the organization's funding from government falls below 25% of its revenues.

47. That for the purposes of GST, provincial sports federations should be treated on the same basis as registered amateur sports organizations in order that they automatically qualify for 50% rebate of GST paid on their purchases.

48. That a non-profit organization which qualifies for the 50% rebate of GST paid on purchases because it is substantially funded by government should be able to continue claiming the rebate on a monthly or quarterly basis rather than wait to the end of each fiscal year, as proposed in the Technical Paper, provided that it has met the qualifying test for the 12 preceding months.

49. That the government should pay interest on rebates of GST to charities, to qualifying non-profit organizations and to the MUSH sector starting 21 days after filing, rather than starting after 60 days as proposed in the Technical Paper.

50. That commercial supply by charities and non-profit organizations should generally be liable to GST, subject to exemptions such as those which are provided in the Technical Paper.

51. That the Departments of Finance and National Revenue work with charities and non-profit organizations to develop a streamlined approach that would simplify their accounting for taxable supplies under the GST and reduce the related complexity and administrative costs.

52. That the government should issue an interpretation bulletin to clarify that non-profit organizations will not lose their exemption from tax under the Income Tax Act by virtue of engaging in "commercial activity" as defined for the purposes of the GST.

53. That the volunteer exemption proposed in the Technical Paper be amended and clarified to specify that charities will be exempt from charging GST on supplies where all or substantially all (i.e., 90% or more) of the time worked in day-to-day administration and operation of the activity providing the supply is carried out by unpaid volunteers. Alternatively, Revenue Canada should issue an interpretation bulletin to clarify that this is what the volunteer exemption provided under the GST means.

54. That the "volunteer exemption" applied to charities should also be extended to those non-profit organizations which qualify, because of their level of government funding, for a 50% rebate of GST paid on their inputs.

55. That membership fees in non-profit organizations should be exempt from GST where they have a direct cash value that does not exceed $25 and is less than 50% of the cost of the membership.

56. That the exemption from GST for supplies at nominal consideration provided by charities and non-profit organizations should remain as proposed in the Technical Paper.

57. That the federal government should develop information packages with private sector suppliers and with associations in the charitable and non-profit sectors to help ensure that make-or-buy decisions in public-sector organizations are not distorted by lack of knowledge about the GST and rebate systems.

58. That recreation programs provided by public sector bodies should be exempt from GST for teenagers as well as for children, and for this purpose the qualifying age should be 18 and under, rather than under 14 as proposed in the Technical Paper.

59. That the federal government should cooperate closely with sports federations and other sports organizations to resolve administrative and compliance problems created by the introduction of the GST.

60. That federal support for national sports organizations should be increased in the early 1990s if it appears this is needed to maintain the standard of Canada's national sport program under the GST.

61. That revenue Canada should clarify through an interpretation bulletin the status of sponsorships by business of sports and cultural activity. The charging of GST on sponsorships should be optional unless they provide the sponsor with a substantial and direct commercial benefit.

62. That where services are provided to a group of charities or non-profit organizations by a related organization, or an umbrella organization that is set up for that purpose and certified by the Minister of National Revenue, these supplies should be exempt from GST.

63. That the federal government make special grants to the Canada Council and other agencies supporting the arts beginning in 1991, to the extent that this may be needed to offset any serious problems created for arts organizations through the introduction of the GST.

64. That to simplify the administration of GST in relation to contracts with artists and performers, the government permit producers and arts organizations to deduct GST that is payable on these contracts at source in a manner similar to the deduction at source of income tax.

Chapter 9: The Public Sector

65. That the Department of Finance proceed immediately to determine rebate rates for the MUSH sectors in close consultation with the affected institutions and their respective associations.

66. That, as proposed in the Technical Paper, there should be only one rate of rebate of GST paid on inputs for each of the four major areas in the MUSH sector.

67. That the Departments of Finance and of National Revenue work with MUSH institutions to develop a streamlined accounting system that will simplify their accounting for the net amounts of GST payable on their taxable supplies.

68. That, as proposed in the Technical Paper, rebates of GST paid on purchases be paid directly to MUSH institutions rather than being paid through provincial governments.

Chapter 11: Financial Services

69. That the Department of Finance give consideration to the appropriate means by which input tax credits on business inputs supplied to registered vendors pursuant to a property and casualty insurance policy could be allowed.

70. That the definition of investment quality precious metal be amended to include gold and silver coins with a purity level of at least 90%.

71. That the 10% rule should be rescinded and a revenue test should apply to persons whose annual revenue in the immediately preceding taxation year, in the form of interest and dividends received from unrelated persons and required to be included in income from a business for Canadian income tax purposes, exceeded $10 million, or a pro-rata amount for a short taxation year.

72. That, unless substantially all (i.e., 90%) of a taxable supply purchased by a financial institution is used by it in the course of making a taxable supply, the input tax credit entitlement of such financial institution be limited to the portion of the purchased taxable supply that can reasonably be considered to have been used by it in making zero-rated supplies described in Part IX of Schedule II.

73. That the Minister of National Revenue be permitted to grant group relief to particular named corporations with respect to specified types of transactions with financial institutions (including data processing, management, accounting and administrative services).

74. That, if group relief is provided for transactions between financial institutions and related corporations, comparable relief should be extended to transactions

between *caisses populaires* and credit unions with like institutions that form part of a federation.

75. That no self-supply rule be enacted for financial institutions.

76. That all supplies made by a property and casualty appraiser or adjuster who performs all of his or her services for one or more property and casualty insurance companies be treated as an exempt supply.

77. That supplies of financial services made under contracts entered into before January 1, 1991 not be zero-rated.

Chapter 12: Transition

78. That the Government allow as an option an actual physical stock taking within a reasonable period, perhaps 3 to 6 months, before or after the implementation date, with reliance on normal books and records (or previous year's averages) to estimate physical inventory as of December 31, 1990. In claiming rebates of federal sales tax in inventory, a business be allowed:

(a) to reduce its net GST remittances for periods ending on or before April 30, 1991 by an aggregate amount not exceeding its federal sales tax rebate entitlement: and

(b) after April 30, 1991, to claim a cash refund for the balance, if any, of the federal sales tax rebate, with interest on such amount to be paid on any amount not paid within 21 days from the date the rebate claim is received.

79. That registrants who on January 1, 1991 hold inventories of non-commercial properties (including unregistered condominiums, and properties subject to an agreement of purchase and sale) receive a rebate of federal sales tax, based on their work in progress records and the estimated federal sales tax content per square foot, allowable only against net GST remittances under the new system.

80. That the lease of goods that were subject to federal sales tax pursuant to a lease entered into before January 1, 1991, be treated as an exempt supply until December 31, 1993.

Chapter 13: Other Operational Aspects

81. That individual partners be permitted to claim input tax credits with respect to partnership expenses on either a monthly or quarterly basis.

82. That individuals, who in the course of their employment earn commission income and who meet all the conditions of application of paragraph 8(1)(f) of the *Income Tax Act*, be treated as independent agents for the purpose of their entitlement to input tax credits for taxes paid on the purchase of any property

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acquired to enable them to earn their commission income. The input tax credits should only be available to the extent that all expenditures or outlays in a given year do not exceed the commission income for the year.

83. That full GST input tax credit be allowed for meal and entertainment expenses, and for passenger vehicles purchased or leased, including those purchased or leased by self-employed individuals, partners and persons meeting the criteria of paragraph 8(1)(f) of the *Income Tax Act*. If the Minister deems it advisable to make appropriate adjustments because of the personal consumption component, the changes should be made by amending the *Income Tax Act*. The Income Tax complications should not be added to the legislation implementing the Goods and Services Tax.

84. That the GST not apply to pari-mutuel betting.

85. That GST not apply to provincial lotteries.

86. That a notional input tax credit be allowed to registrants for the purchase from non-registrants of used appreciating goods as defined in paragraph 54(e) of the *Income Tax Act*, such as coins, stamps, art and other collectibles, or as may be prescribed. The Committee further recommends that notional input tax credits be payable only upon the registrant establishing through sales documentation or other evidence satisfactory to Revenue Canada that the tax remitted by the registrant on the sale of the used appreciating good is equal to or greater than the notional input tax credit in respect of the same used appreciating good.

PART A

APPROACHES TO SALES TAX REFORM

1. THE NEED FOR SALES TAX REFORM

On August 8, 1989, the Minister of Finance issued the "Goods and Services Tax Technical Paper" (the "Technical Paper") setting forth the government's proposal for replacement of the existing federal sales tax ("FST") with a goods and services tax ("GST"). On October 13, 1989, the Minister issued a document "Goods and Services Tax Draft Legislation" ("Draft Legislation") to be read in conjunction with the Technical Paper.

Attempts at sales tax reform in Canada have a history that is even longer than attempts at constitutional reform. We've had a manufacturer's sales tax at the federal level since 1924. Calls to abandon that tax came almost immediately following its introduction - and not from self-interested parties only. The Rowell-Sirois report in 1940, the Carter Commission on Taxation in 1966, the Macdonald Royal Commission in 1985, and various task forces and study groups in-between, unanimously condemned the manufacturers sales tax as a poor tax that ought to go.

Even groups that oppose the proposed Goods and Services Tax recognize that the manufacturers sales tax is inimical to Canada's interests. As stated by the United Steelworkers of America in their submission to the Committee:

> In a country whose manufacturing economy is under constant pressure, it makes no sense to have a tax system that biases the internal economy in favour of service providers. And in an economy as heavily dependent on trade as Canada's, it makes no sense to impose what amounts to a tax on exports of manufactured goods.

The present federal sales tax applies to all goods sold by manufacturers in Canada and to finished goods imported into Canada, except those that are specifically exempted. The range of exemptions is wide: it includes food, clothing, footwear, pharmaceuticals, and equipment used in commercial transportation, construction, agriculture and manufacturing. Most services are also exempt. The one exception is the 11% telecommunication services tax introduced in 1987.

The tax is generally levied on the manufacturer's selling price of domestically produced goods and on the duty paid value of imports. For some products, including cosmetics, vehicles, gasoline, microwave ovens, televisions and video recorders and players, the tax is levied at the wholesale level. The general rate at which most goods are taxed is 13.5%. Alcohol and tobacco are taxed at 19% and building materials at 8% (9% effective January 1, 1990).

As already noted, the FST has been studied extensively and its many shortcomings are well-known. A brief review of the problems associated with this tax may nevertheless be

useful in explaining the wide consensus among tax specialists that the FST ought to be abolished.

A) Narrow Base

To begin with, the FST is very narrowly based. It applies to barely 1/3 of total consumer spending on goods and services. About 40% of revenues from the tax are accounted for by five commodity groups only: tobacco, alcohol, gasoline, automobiles and automobile parts. The tax, therefore, distorts consumer choices, by favouring some commodities over others, and discriminates against households with greater preference for the taxed commodities relative to households with stronger preferences for commodities that are not taxed.

The narrow tax base also implies that the tax rate must be high to achieve the government's revenue objectives. High rates do not only compound the inequities between taxed and tax-free commodities, they increase incentives for efforts to avoid or evade the tax. Administration of the tax system by the tax authorities thereby becomes more difficult and compliance by taxpayers more costly.

To a large extent, the narrow base of the FST reflects deliberate policy decisions to leave certain items out of the base as a means of improving the distributional impact of the tax. The exclusion of food, clothing and footwear can probably be explained on this basis. Exclusion of most services from the base, however, cannot be so explained. Services are disproportionately consumed by higher income households, and their exclusion from the tax base makes the tax more regressive. Since services, however, are sold directly to consumers, a tax imposed prior to the retail level obviously cannot cover most services. The exclusion of services, therefore, is an inherent feature of the FST.

B) Wide Variation in Effective Tax Rates

The application of the tax at an early stage in the production and distribution process creates a host of other problems as well. As already explained, for most goods the FST is generally levied at the manufacturer's or importer's level. Consequently, it does not generally apply to the wholesale and retail margins that go into the determination of the final selling price. The effective tax rate at the retail level, therefore, will vary depending on the size of these margins, or the mark-up from the manufacturing to the retail level. A product where the post-manufacturing level mark-up is low will be taxed more heavily than one where the mark-up is high. As a result, the tax on finished products can be highly variable, even among competing products. A 1984 survey conducted for the Department of Finance found that the range between the lowest and highest effective tax rates exceeded 500%, i.e. items taxed at the highest rate bore a tax rate more than four times the rate borne by the most lightly taxed items. Effective tax rates varied widely even among similar products. Among autoparts, for example, effective tax rates varied by more than three times; similarly for cosmetics and for office supplies. Thus the FST favours — in arbitrary and unpredictable ways — some manufacturers over others, and brings about a pattern of final selling prices which differs

markedly from the pattern of relative costs of the different items that ought to guide consumer choices.

An additional complication with the present FST system arises from the fact that the economy is not neatly divided into manufacturing, wholesale and retail sectors, with goods flowing smoothly through each sector before reaching final users. A large portion of manufactured goods today is sold directly by manufacturers to retailers or end users. In this light, a strict application of the requirement that the tax be imposed on the "selling price" of the manufacturer would create serious inequities: sales made directly to retailers or final consumers would be taxed on a much higher base than sales of the same product to wholesalers. To prevent this from happening, Revenue Canada allows manufacturers to establish discount "notional values" on which the FST is levied. While these arrangements have helped to make the system fairer, they are far from a fully satisfactory solution to the inequities inherent in a manufacturers' form of tax. The notional values are largely arbitrary and difficult to monitor. In addition, they lack legal sanction and, hence, are not subject to judicial review. They are the result of private, confidential arrangements, so that a manufacturer may be taxed at a different rate from his competitors and not even be aware of it.

Also, as the 1975 Green Paper on sales and excise taxation pointed out, since "notional values" always involve discounts from actual selling prices, "they are ineffective when removal of competitive distortions would require an increase in the taxable value of certain goods."([1])

This is often the case with imports, because marketing, warranty, and distribution costs, which are normally included in the taxable value of domestically produced goods, are usually not included in the duty-paid value on which the FST on imports is levied. As a result, the effective tax on imports is lower than on domestic products. The difference is considerable. According to the 1984 survey already cited, on average the effective tax rate on domestic products is one-third higher than on competing imports.

C) Taxation of Business Inputs

Approximately one-half of total revenues from the FST is derived from business inputs. Since these business inputs are used in the production of both taxable and tax exempt commodities, the latter also bear the tax. According to estimates by the Department of Finance, food, though statutorily tax-exempt, is in fact taxed at an effective rate of 1.6% owing to the FST embedded in commodities used in food production. More generally, goods produced by taxed inputs may be taxed again, resulting in tax cascading, or compounding of tax on tax. The resulting tax burden on finished consumer products is consequently both arbitrary and unknown.

As well, the tax on business inputs amounts to a serious handicap for Canadian exporters. Although GATT regulations do permit remission of indirect taxes paid on goods that are exported, full offset of the FST is difficult because of the difficulty of accurately calculating the FST content in the price of exports. On average, the FST content in exports is

slightly more than 1% of the value of the goods exported. Given the low margins in international sales, this amounts to a significant cost disadvantage for Canadian exporters.

D) Unrealiable Source of Revenue

The narrow base of the FST and the fact that the tax is levied at an early stage in the production and distribution process provide opportunities to shift manufactured products outside the base to avoid the tax. An increasingly popular method of avoidance in recent years has been the establishment of marketing and distribution subsidiaries to which manufacturing firms are able to register sale of their goods, thereby reducing the value on which the FST applies. A 1986 ruling by the Federal Court of Canada confirmed the right of manufacturers to establish such related marketing and distribution companies, endorsing in the process a major tax loophole. Attempts by the government to deal with this problem, by shifting the tax to the wholesale level, have proved unworkable.

Beyond efforts by producers to push forward as many functions as possible so as to minimize the base on which taxes are applied, another way of avoiding the tax is to claim that one's product falls within one of the numerous exempt categories provided for under the *Excise Tax Act*. Higher tax rates encourage greater tax avoidance efforts. As these efforts collide against attempts by Revenue Canada to prevent erosion of the sales tax base, the predictable result is a higher dose of administrative rulings, legal challenges and ad hoc patching up of an increasingly unsalvageable system. There are only 75,000 taxpayers under the FST, but 22,000 special provisions and administrative interpretations of the *Excise Tax Act* have proved necessary to keep the system operating. As of last August, there were 227 outstanding court cases relating to product classification under the tax (i.e. whether a product is taxable or non-taxable), compared to 186 two years earlier. Yet, the leaks in the system grow wider. According to estimates provided to the Committee by the Department of Finance, continuation with the present system would lead to revenue losses, through tax avoidance efforts, of some $2 billion a year, or more than 10% of total annual revenues from the FST (estimated at about $17 billion in the current fiscal year).

In short, the FST is a tax broken beyond repair. The question is not whether to keep it, but how best to replace it.

Therefore the Committee recommends:

1. That the existing Federal Sales Tax be abolished.

2. ALTERNATIVES TO THE EXISTING FEDERAL SALES TAX

Current projections show that by 1991 the FST will be generating approximately $18.5 billion for the federal treasury. If this tax source is abolished, something will have to be done about the consequent revenue shortfall. What is that something to be?

We have heard arguments that the resulting loss of revenue need not be made up through other taxes: one alternative is to continue reducing government spending. We strongly support the view that public spending must be most carefully controlled and that government activities must be curtailed whenever their value no longer justifies the resources that they absorb. In order to help identify areas where savings might be made, the Committee intends to hold hearings early in 1990 to provide the many witnesses who proposed spending cuts with an opportunity to elaborate on their proposals.

> **The Committee therefore resolves to conduct an inquiry and hold hearings early in 1990 into the question of government spending and measures to control its growth.**

Program evaluation and tax reform, however, are separate exercises — and at this time we are engaged in the latter. At any rate, particularly in the present fiscal context, spending restraint cannot substitute for the FST. The current federal government deficit is roughly $30 billion a year, and will grow larger if the economy turns sluggish or goes into recession. At a time when government finances are in such straits, to remove a major source of revenue without replacing it would be not only unrealistic but irresponsible. The markets would not find such an option credible, and to attempt it would lead to a loss of confidence in the Canadian economy that would exacerbate our financial difficulties.

Realistically, then, elimination of the FST implies that we must find alternative revenues for the revenues forgone. There are three main alternatives: increases in the income tax, a federal retail sales tax (RST) or a value added tax (VAT).

A) Income vs. Consumption Taxes

A large number of the submissions that we received and many of the witnesses that appeared before us, particularly witnesses representing organized labour and anti-poverty organizations, expressed support for a shift in government revenue sources towards greater reliance on income taxes. They drew attention to the fact that the trend since the early 1980s has been in the opposite direction. Between fiscal year 1984 and fiscal year 1989, federal revenues from sales and excise taxes rose from $12 billion to over $23 billion. In 1984, sales and excise taxes accounted for less than 19% of all federal revenues; today that share is 23% and climbing(2). By contrast, the share of income taxes has remained constant over this

period, at 2/3 of total revenues. In dollar terms, income tax revenues amounted to $70.6 billion in fiscal year 1989 compared to $42.2 billion in fiscal year 1984.

The main source of opposition to consumption taxes is the perception that they are inherently regressive. Since consumption as a percent of income generally falls as income rises — i.e. the savings rate rises with income — consumption taxes tend to tax a greater proportion of the incomes of the poor than of the affluent. An increased reliance on consumption taxes, therefore, tends to erode the progressivity of the tax system, shifting a greater portion of the overall tax burden towards lower income groups. Income, it is argued, is a better measure of one's ability to pay; and the ability to pay ought to be the central principle on which an equitable tax system is based.

This is a powerful argument, but not without challenge. Against the position that income ought to be the basis of taxation is the view that what people take out of the economy through consumption is a fairer basis of taxation than what they contribute to it in the form of income. As Professor Robert Clark pointed out in a comprehensive submission to the Committee, this view, whose pedigree can be traced back for centuries, was more recently endorsed by the U.K. Committee on tax reform, chaired by Nobel-laureate economist James E. Meade. In the words of that Committee:

> A strong case can be made for this [consumption] base in that it levies a tax on the claims which a taxpayer makes at any one time on the community's resources which he uses up for his own consumption purposes. If he saves his income instead of consuming it, he is putting resources back into the productive pool; if he dissaves, he is taking resources out of the productive pool in addition to his other income. His relatively low consumption in the case of savings and his relatively high consumption in the case of dissavings are measures of what he is appropriating at any one time for his own personal use.([3])

A basic principle of equity in taxation is that individuals of similar economic capacity should be taxed similarly. Income taxes fail to satisfy this principle. They tax more heavily persons who save than persons with the same income but a higher propensity to spend. This is because income taxes tax savings twice, once when income is first received and then again when savings from that after-tax income yield a return. Thus, for instance, two individuals with the same initial endowments would pay the same income tax the first period, but the individual with a stronger preference for savings would bear a higher tax burden in later periods. The stronger the preference for savings, the heavier the additional burden.

The burden of consumption taxes, on the other hand, is independent of the time path of consumption. Of two individuals with the same income, the one who saves more is taxed less at first, but more in later periods when he spends his savings. On a present value basis, the tax burden is equal for both individuals.

In addition to being fairer than income taxes in this respect, consumption taxes are also more efficient. The double taxation of savings under an income tax system reduces the rate of return to savings below the yield of the investment financed by those savings. This

tends to encourage consumption over saving, resulting in lower savings, investment and economic growth. Consumption taxes, by contrast, tax present and future consumption equally. Their effect on choices of whether to consume or save is therefore neutral.

It is also important to make the point that the measured regressivity of consumption taxes is largely a function of the accounting period over which the incidence of tax burdens is assessed. The longer the period, the less regressive is the measured impact. The reason is simple. For most people, savings represent postponed consumption. Measured over a lifetime, one's savings tend to be small, and savings rates differ little across income groups. The lifetime incidence of consumption taxes, therefore, is nearly proportional rather than regressive. Their impact on lower income households can be made progressive by exempting basic necessities from the tax or, more directly, by providing low income households with tax credits to compensate them for taxes paid.

On balance, therefore, we do not believe that equity-based considerations preclude an important role for consumption taxes in our fiscal system. On the contrary, as the Green Paper on *Federal Sales and Excise Taxation* stressed fourteen years ago, "The presence of commodity taxes enhances the equity of the overall tax structure by supplementing income as a measure of ability to pay. Individual circumstances differ in ways which cannot be fully recognized by any single index of taxable capacity or by any single tax. The greater the reliance upon any single tax, the greater the likelihood of unacceptably large strains and distortions. These are best avoided by the adoption of a "balanced" tax system; i.e., one where the burden of raising revenues is divided among several revenue sources so that no single source is utilized to the point of generating severe and unacceptable distortions." [4]

Canada's income tax system underwent a major overhaul barely two years ago, under Phase I of tax reform. The thrust of that reform was to widen the tax base and reduce tax rates for both the corporate and personal income tax systems. A prime motivation behind those changes was the need to make the tax system more efficient and to improve the competitive position of Canadian industry in a world that is increasingly interlinked. Higher surtaxes on individual incomes introduced earlier this year have partially offset the benefits of tax reform under Phase I. Additional increases in income taxes would further undermine those benefits, and risk alienating domestic capital and high-skilled labour to more genial jurisdictions abroad. In short, they could be self-defeating. A broadly based consumption tax would avoid that risk and retain a finer balance between direct and indirect taxation in Canada. In the Committee's view, it is a better option.

Therefore the Committee recommends:

2. That, as a means of replacing the revenues forgone by the elimination of the Federal Sales Tax, a broadly based consumption tax is a superior option to higher income taxes.

B) **RST vs. VAT**

A consumption tax is a tax levied on consumption, or spending, rather than income. Thus the current FST is itself a consumption tax. So are the various retail sales taxes levied by provincial governments.

The characteristic feature of consumption taxes is that they are levied on consumption, or spending, rather than income. Of the many varieties possible, there are two principal contenders: a retail sales tax or a value-added tax ("VAT"). The retail sales tax is imposed on abroad range of goods and services when they are sold at the retail level or to the final consumer. The VAT is levied at every stage in the production and distribution process, or more precisely, every time that a sale is made in that process until the commodity reaches the final consumer. Every business that pays the tax, however, receives a corresponding credit, so that in the end only the final consumer pays the tax. The GST is a form of VAT.

The retail sales tax and the VAT are equivalent in their economic impact, differing only in their method of collection. As already noted, both are taxes on final consumption. Applied on the same base and at the same rate, they would yield the same revenue and have the same distributional impact. The choice between them, therefore, hinges on practical considerations concerning the operational aspects of these two forms of tax.

A retail sales tax is probably easier to administer and to comply with. It requires registration by fewer companies, since only sellers at the end of the production and distribution chain collect the tax. Record-keeping requirements under a retail sales tax would also be less onerous: registered traders need keep track of tax collections on their sales only. Under a VAT, by contrast, each trader is required to keep full records in respect of both purchases and sales to substantiate taxes collected and tax credits for taxes paid. In many cases, taxes paid will exceed liabilities, and tax authorities will have to process tax refunds. Operating costs for a VAT are probably higher than for a retail sales tax.

The VAT has two significant advantages over a retail sales tax: it is more difficult to evade and more effective in exempting producer goods from taxation. Both advantages stem from the relatively heavier record-keeping requirements entailed in a VAT. The tax credit system of the VAT helps reduce the incidence of tax evasion, since every tax-payer along the production and distribution chain has an incentive to ensure that his predecessor has correctly invoiced the amounts of taxes paid so that he can in turn reduce the net tax liabilities on his sales. A VAT system therefore is largely self-enforcing. Generally, the higher the tax rate, the greater the incentive to evade the tax, and the greater the advantage of the VAT over a retail sales tax.

The tax credit system under a VAT also makes it easier to relieve business inputs from tax. Every purchaser under such a system pays the tax, but registered traders qualify for an offsetting credit. Relief of tax on business inputs is thus automatic and total. Under a retail sales tax system, two means are used to avoid taxing business inputs. One is to exempt producer goods from the tax; the other is to exempt certain purchasers from the tax. The first

approach is inadequate in dealing with mixed-use goods (goods that are used by both producers and final consumers). The second places an onus on the seller to determine whether the purchaser is eligible for a tax exemption, a task that sellers will often be in poor position to accomplish. In practice, therefore, retail sales tax systems tend to tax producer goods to a much greater extent than VAT systems do. ([5])

On the whole, the net advantages of a VAT seem to exceed those of a retail sales tax. Certainly, worldwide the VAT is the consumption tax of preference by far. Within the OECD, 19 of the 24 member countries have a VAT. This experience in itself is a strong argument in favour of this form of tax over a retail sales tax. Therefore, the Committee supports implementation of a VAT, such as the GST, in place of the existing FST.

Therefore the Committee recommends:

3. That a value added tax, such as the goods and services tax, is preferable to a retail sales tax as a substitute for the existing federal sales tax.

REFERENCES

(1) Department of Finance, Discussion Paper: Federal Sales and Excise Taxation, Ottawa, June 23, 1975, p. 17.

(2) These shares are net of energy taxes. The share of sales and excise taxes inclusive of energy taxes fell marginally over this period, from 25.3% in fiscal year 1984 to 24.8% in fiscal year 1989, owing to a reduction in petroleum sector taxes.

(3) The Institute for Fiscal Studies, The Structure and Reform of Direct Taxation, Report of a Committee chaired by Professor J.E. Meade, George Allen and Unwin, London, 1978, p. 33.

(4) Op. cit. p. 13.

(5) OECD, Taxing Consumption, Paris, 1988, p.106

3. ADMINISTRATIVE ISSUES

A) A National Sales Tax

Many witnesses were concerned at the complexity and the cascading of taxes that would result from bringing in a Goods and Services Tax while retaining existing provincial sales taxes, and therefore urged that there be one national sales tax in Canada. Some suggested that the introduction of the GST be deferred from January 1, 1991, in order to allow sufficient time to put a national sales tax in place.

The Committee met with a number of provincial Ministers of Finance to explore provincial concerns about the GST. It also inquired into the series of meetings which were held between federal and provincial officials to try to develop a national tax before negotiations came to an end soon after the meeting of Finance Ministers in April, 1989.

Although the provinces have now expressed strong opposition to the GST, they participated actively in the technical discussions aimed at designing a national tax. According to Department of Finance officials, most of the features of the GST as proposed in the Technical Paper are based on that design for a national tax.

This view was supported in an address delivered to the Canadian Institute of Chartered Accountants (C.I.C.A.) in October 1989 by Mr. L.R. Leonard, who served as Ontario's Assistant Deputy Minister for the tax reform process from October 1987 to June 1989. As he describes it, the National Sales Tax Working Group of officials, which was set up in late 1986 to explore the idea of a joint tax, met regularly over an 18-month period.

> "These meetings were characterized by a level of goodwill, energy and constructive advice that certainly was superior to anything else I saw in twenty years on the federal-provincial scene.
>
> For all issues, either solutions were hammered out, or at the very least, a narrow range of options was agreed to. The end result was a straight technical report for consideration by Treasurers and Ministers of Finance...
>
> ... I do not agree that the process was a failure. The National Sales Tax Working Group got very close [to getting an agreement]."

Mr. Leonard blamed "time or the shortage of it" for the failure to agree.

> "First, the federal election put ... a 90-day hole in the schedule. Second, to create full NST, it would have been necessary to somehow cause nine provincial legislatures and the House of Commons to move at the same pace towards the same

legislation at the same time. Given varying pressures and priorities, this would have been very difficult, although not impossible.

Third, there was the matter of the federal schedule, calling for implementation in 1991 ... by April of 1989, there was no more time to wait in the face of the uncertainties of federal-provincial negotiations."

The Committee does not believe that this failure means an end to the prospects of a national sales tax. The design of the GST does make it possible to include the provinces at a later date, and it does not require that all provinces join in the GST at once. One can therefore foresee a scenario where three or four provinces, representing a substantial number of Canadians, joined in the GST after the tax had become established and the remaining provinces joined a short time later.

The province of Quebec or of Ontario would have to be part of the first group for this scenario of a partial national sales tax to work. The transition would obviously create some further complexity, but there would also be benefits to the provinces that joined because their industries would not be subject to cascading of PST on business inputs.

In a joint GST or national sales tax, the provinces would be free to maintain their own rate of tax just as they do now under the shared collection of income tax. As with the federal income tax, however, the tax base of the GST would be maintained on a uniform basis and could not be varied from one province to another.

The Committee does not support the idea that the tax base of a national sales tax might vary in different provinces, even though this would give more flexibility to the provinces in fiscal policy. Under this approach, Quebec could join in a national sales tax but could continue to exempt furniture purchases from the provincial portion of the NST. Another province might choose to exempt the first $5 worth of restaurant meals and another might reduce its share of the national tax on hotel rooms in order to encourage tourism.

As these examples indicate, a national sales tax would quickly become more complicated if provinces were free to vary the tax base, and the NST would lose the simplicity which is one of its major assets. The Committee believes that the federal government should continue to insist on a uniform tax base as a precondition for a national sales tax.

A national tax would be simpler for consumers to use than the dual system that is now emerging because almost all of their purchases would be in one province, and at the same rate of sales tax. However, the dual system of GST and PST will be not unlike the present system at the retail level: goods will likely bear GST in the retail price, just as they now bear FST, with provincial sales tax applied at the time of sale. Services to final consumers, which are not currently taxed either for FST or PST, will have to bear GST even if they are not taxed provincially.

For businesses, a national sales tax would be easier to administer than the dual system of sales tax that will be created under the GST, but will not be free of complexity. This is because the provincial portion of the NST will vary by province. Companies selling to

businesses or to final consumers in several provinces will have to charge NST at different rates on their sales depending on the location. On the same principle, inputs purchased in different provinces would bear different rates of tax depending on where they were purchased.

Under the dual system, companies selling to other businesses in several provinces will have to charge GST at one rate on their sales and calculate GST input credits at one rate on their purchases. They will also have to take account of differing rates of provincial sales tax, however, if they are dealing directly with final consumers or are selling business inputs which happen to be subject to PST. Hence, as at present, there will continue to be complications caused by dealing with differences in rate and base between different provincial sales tax systems.

The Committee considered recommending a national sales tax at a standard rate of 15%, with the proceeds shared among the participating governments. Some special measures such as additional equalization payments might be required to maintain revenues for the eastern provinces whose provincial sales tax rates are, for revenue reasons, generally higher than in central and western Canada. The advantages of such a truly national sales tax would be to simplify the system, wipe out the cascading of PST on Canadian exports, and substantially reduce the cost of administration and collection.

The Committee noted that the objective of a national sales tax at a common rate, while ideal, could pose another obstacle to provinces considering whether or not to join in a NST. It also noted that the technical discussions between the federal government and the provinces were generally based on the design of a national tax with differing rates rather than a common rate.

The European Economic Community is currently seeking to harmonize VAT rates among its member countries, 20 years after the VAT first began to be used in the Common Market. Even now, its goal is to reduce the number of VAT rates rather than move all EEC members onto a common rate. This experience in Europe also suggests that getting a NST at a single national rate should be considered as a desirable long-term objective, but that it is unlikely to be achieved at one jump.

An NST with different rates for each province would be more complex for registrants to administer than an NST with a common rate, but would nonetheless have some advantages. For example:

- Vendors now doing business in different provinces must accommodate both to different rates of PST and to differences in the tax base for PST between different provinces. Even if the rates differ by province, an NST would be based on a uniform tax base common to every participating province.

- The whole amount of NST would generate input tax credits, thus ending the cascading of PST that is now levied on business inputs and on export sales. Businesses in participating provinces would therefore have an economic advantage both in the Canadian market and in exports over companies

located in provinces that retained their own sales tax. Once some provinces join an NST, in other words, there will strong incentives, and pressures, for the remaining provinces to join as well.

- If the long-term economic benefits predicted for the GST materialize, then provinces that participated in the NST would be likely, over time, to receive more economic benefits than if they continued with a separate PST.

- Provinces could substantially expand their sales tax base by moving into the NST.

- Broadening the base of PST by folding it into an NST would simplify compliance for governments and for registrants.

The sales tax is one of the few areas where provinces still retain some flexibility in fiscal policy. By joining in a national sales tax, provinces will lose that flexibility. It was notable in the Committee's private meetings with Finance Ministers that several provinces brought up this issue, suggesting that the federal government should be prepared to give them the flexibility in structuring their income and corporation taxes to compensate for the flexibility they would lose if they joined in a national sales tax.

The Committee recognizes that it is now very late to try and bring some or all provinces into a joint GST or national tax with the federal government in time for the proposed implementation date of January 1, 1991. This also seems unlikely for political reasons.

While some witnesses urged that the launch of the GST be postponed to allow more time for the provinces and federal government to arrive at a national sales tax, there is no guarantee that this goal would be achieved through further delay. There is never a "right" time to introduce a new tax, and the objective of a national sales tax is more likely to be achieved by evolution than all at once. It should be made clear, however, that the federal government wants to move to a national sale tax as soon as possible and that, to that end, it is prepared to move to a partial NST as soon as enough provinces want to join in to make such a tax feasible.

Finally, given the different electoral calendars in play, the Committee believes that the best way available to ultimately create a national sales tax which combines both federal and provincial sales taxes on a common base, is for the federal government to begin the process now through adopting the GST.

Therefore, the Committee recommends:

4. That, the federal government reiterate its support for a national sales tax and offer to establish the National Sales Tax on a partial basis as soon as three or four provinces, with a substantial population, are prepared to take part.

5. That, the design of the Goods and Services Tax should continue to be structured to make it relatively easy for the provinces to take part.

6. That, the federal government should maintain its target of January 1, 1991 for the introduction of the Goods and Services Tax.

B) A Joint Agency to Collect Sales Tax

During the Committee's informal meetings with Finance Ministers, several provinces appeared favourable to the idea of a joint or national agency to collect sales tax for the federal and provincial governments. Such an agency would help to reduce the costs of administering the GST and provincial sales tax systems. Several witnesses urged that there be cooperation between the two levels of government in order to avoid duplication and extra expense in sales tax collection and auditing.

The prospects for such an agency in the immediate future are slight, given the provinces' opposition to GST and the lack of agreement on a national sales tax. Such an agency could also run into problems of political accountability. It could be difficult, for example, to determine which minister at which level of government was responsible for tax rulings made by officials. Regulations or legislation needed to plug tax loopholes could be delayed if they had to be passed by all participating governments before they could take effect. Procedures might be needed to resolve disputes in the event that all participating governments did not agree on the need for a particular regulation.

An alternative would be for the provinces and federal governments to share responsibility for collection, with some provincial collection delegated to federal officials (i.e., at customs points) and with Provincial Sales Tax administrations strenghtened to handle the bulk of GST collection in each province. This is similar to the present practice in a number of government activities where provincial or federal responsibilities are delegated to the other level of government.

One province expressed concern that the federal government may take the best sales tax collectors from the provinces when it starts recruiting its force of GST collectors, since it may offer better salaries and chances of promotion. Mr. Leonard, in his address to the Canadian Institute of Chartered Accountants (C.I.C.A.), estimated that excluding lawyers and specialists, there are about 1,000 officials collecting provincial sales taxes from a tax-roll of around 400,000 registrants. On the same basis, Revenue Canada had about 1,800 staff handling FST and related taxes and dealing with about 75,000 manufacturers. The net active tax-roll for the GST, based on work done for the NST, would be about 1.4 million businesses and agencies.

Tax administrations are already having difficulty recruiting in the face of a strong economy and salary constraints, according to Mr. Leonard. This coincides with the Committee's information: for example, sales tax audits are running several years in arrears in some provinces because of limited resources and staff. Thus, in Mr. Leonard's words, "it is difficult to see an easy solution to the staffing questions. Yet is must be solved at least at implementation since all computers in the country cannot answer a taxpayer's telephone or letter inquiry."

While recognizing that some duplication is inevitable, the Committee is concerned with the cost and complications of having sales tax collected by two levels of government. According to the Technical Paper, the added costs for federal sales tax administration will amount to $200 million. The Minister of National Revenue has informed Parliament that his department will require up to 3,900 additional employees to administer the GST.

The Committee believes that a joint collection agency for sales tax is not feasible until such time as the provinces join the federal government in a national sales tax. The provinces have most of the expertise in collecting sales tax in Canada, however, and there is every reason for the two levels of government to co-operate in sales tax collection, even under a dual sales tax system.

The Committee also believes that the provinces will be more likely to consider joining in a national sales tax if the tax is collected by a joint agency or through some other form of co-operation, rather than being collected exclusively by the federal government.

Therefore, the Committee recommends:

7. **That the federal government and the provinces should explore all possible means to reduce sales tax collection costs and paper burden through joint collection of tax and auditing, through delegation of collection from one level of taxing authority to another, and through other forms of co-operation.**

8. **That, the federal government should begin developing plans, with the assistance of any interested provinces, for the creation and operation of a joint national sales tax collection agency to be responsible for collection of a National Sales Tax at such time that a substantial number of provinces had joined in a national sales tax.**

C) The "Tax on Tax" Issue

A number of witnesses expressed concern about the question of double taxation under a dual system of GST and provincial sales tax and urged that it be avoided. This would mean changing the "tax on tax" situation which already exists under the present federal sales tax. When goods are sold at retail, the selling price includes the FST, which is normally not declared separately. Provincial sales tax is then levied on the FST-included selling price, and hence PST revenues are increased by means of a "tax on tax".

The provinces have not indicated to Ottawa whether they will charge PST on the price of goods and services before or after GST is applied. But there are legislative, economic and administrative reasons why they are likely to maintain the status quo and continue to impose PST on the retail selling price including federal sales taxes. These include:

<u>Legislative</u>: Although several provincial ministers told the Committee in private that they would not levy their PST on top of the GST, this is in fact the practice in every province which now has a provincial sales tax. The provincial statutes are uniform in requiring that PST be levied after all other relevant taxes have been calculated, i.e. on the tax-included value of taxable goods and services, and a

number refer specifically to federal excise and customs taxes in this category. One reason why the draft legislation is named the *Excise Tax Act* rather than the *Goods and Services Tax Act*, may have been to avoid requiring the provinces to amend their sales tax laws with the introduction of the GST.

The *Ontario Retail Sales Tax Act* imposes retail sales tax on the "fair value" of any purchase and defines fair value to include

"(b) the cost of, or charges for, customs, excise, mailing, handling, delivery or transportation, whether or not such are shown separately in the books of the vendor or on any invoices or in the computation of the sale price."

Quebec's sales tax is levied on the "purchase price" of any movable property and states that this price

"includes the charges for the installation of the thing sold, for service, for customs, for excise and for transportation, even when such are not shown separately on the invoice or in the vendor's books."

Newfoundland's sales tax is based on a "fair value" which includes

(v) customs and excise duties and sales tax payable to Her Majesty in right of Canada."

These statutes would have to be amended in order to avoid imposing PST in the respective province on top of the GST.

Economic: A province which decided to calculate PST on the price of goods and services before the GST had been added in would suffer a significant loss of tax revenues. The reason is that if, as is expected, producers and other businesses in the distribution chain pass on the elimination of the manufacturer's sales tax, their selling prices will be reduced substantially. This will reduce the taxable base for PST by an average of around 7 to 10 percent, depending on the type of good.

Hence if a province applies its sales tax before the GST has been added in, its PST revenues will fall by 7 to 10 percent on goods currently subject to the manufacturer's sales tax. Provincial governments would have to raise their rate of sales tax, raise other taxes, or cut spending in order to maintain their fiscal position. A likely response would be for a province to add one percentage point to its rate of sales tax, thus raising about the same amount of revenue as it would lose by leaving the GST out of its sales tax base.

The alternative is for a province to maintain its present system and apply provincial sales tax on top of the GST. In such a case, the province's revenue will tend to increase by a modest amount from the current situation. The province will have applied a "tax on tax" more visibly than under the present system, but the political cost of double-taxing is likely to be much less than that of raising the province's sales tax rate with no net benefit in return.

Administrative: The most compelling reasons why it is difficult to avoid double-taxing are the cost, complexity and annoyance entailed in charging GST and PST separately. A simple illustration shows the problems that could ensue:

> Jennifer Smith goes to the hardware store to buy a stepladder in April of 1991. The ladder she wants costs $49.95 before GST, a price which included federal sales tax of $3.92. If it was sold the old way, PST of $4.99 would be computed and added in to make a final price of $54.94.
>
> With a 9% GST, the price is still quoted as $49.95, GST included. But times have changed. At the sales counter the clerk writes the price on the invoice and then calculates the GST component, which is 9/109 times the selling price, or $4.12. Then he deducts that amount from the selling price in order to compute the the pre-GST selling price for the ladder of $45.83.
>
> Then, while people in the line-up get restless, he calculates PST of $4.58; adds it to the selling price pre-GST; adds the GST back in; and gives Ms. Smith a bill for $54.53. Much to the dismay of the people behind her, Ms. Smith is not sure that the calculation was correct and insists that it be done again before she finally takes her ladder away.

The possibilities for confusion and for acrimony in dealing with customers are obvious, particularly in smaller stores which are less likely to have sophisticated point of sale equipment. Restaurants already have problems in explaining their bills in provinces where liquor is taxed at a different rate of PST than food, and this problem could become universal.

The Committee believes, on the basis of these arguments, that it would be unwise and impracticable to try to avoid double-taxing by having GST and PST calculated independently on the basic price of goods and services. For retail sales, it will be more practical in most cases for prices to be quoted including GST, and for the provincial sales tax to be added in at the time of sale. This also leaves retailers with more flexibility in their pricing, so that the ladder, for example, can still be priced at $49.95 when a full 9% tax would take it to $50.17.

The Committee believes it would be useful to have uniformity in how the PST is to be applied, but that is not an issue which can be resolved by the federal government. It would be helpful if the provinces could be encouraged to meet and to decide on a common standard, i.e., at what point to calculate the PST, rather than have a decision imposed on them. In practice, however, there will be uniformity if the provinces simply leave their legislation unchanged.

A related issue is whether suppliers should be required to quote prices of goods pre-GST or with tax included. The Committee does not believe that this matter needs to be regulated, beyond the requirement of a visible sign at the cash register indicating whether prices are quoted including or excluding GST.

In the extent that prices were quoted pre-GST, this would avoid double taxation and ensure greater visibility for the GST because it would be computed on every sale. The problem that this entails is that quoting prices pre-tax may be confusing to shoppers. In the example of the hardware store mentioned above, for example, the stepladder price at $45.83 pre-tax will cost $54.53 after the provincial and federal sales taxes are added in - a difference of almost $10.00.

In European countries with VAT, merchants have generally had the freedom to quote prices either including or excluding the tax. The overwhelming choice now is to quote prices with VAT included. This seems to be simpler to administer and easier for customers to understand, but at the expense of possibly making the sales tax less visible.

The Committee shares the concern of witnesses on the issues of visibility and of double-taxing, but believes that some of the suggested solutions are too complex to be workable. It is satisfied that the GST will be a visible tax if customers are informed by signs in retail stores, and on invoices, as to how the GST is being applied by the particular vendor. This issues is also discussed in Part C, Chapters 2 and 5.

The Committee also notes that the ultimate solution to the problems of visibility and double-taxing lies in a national sales tax. Such a tax would be more visible than the FST or even than the new GST, and no double-taxing would be involved because is would be imposed in each province at a combined federal-provincial rate.

Therefore, the Committee recommends:

9. **That, no attempt should be made by the federal government to have the provinces change their present practice, whereby provincial sales tax is computed on top of the price of goods and services, including the federal sales tax or Goods and Services Tax.**

10. **That, the provinces should, however, be encouraged to develop a uniform standard for how Provincial Sales Tax should be applied to the price of goods and services which are also subject to Goods and Services Tax.**

11. **That, retailers should be required to inform consumers by signs and other means as to whether prices of goods or services in a retail establishment are quoted including or excluding Goods and Services Tax, but there should be no requirement that prices be quoted pre-tax with Goods and Services Tax added separately.**

12. **That, the federal government should continue efforts to get the provinces to join in a national sales tax, as this is the ultimate means of resolving the issues of double-taxation and of lack of visibility of the Goods and Services Tax.**

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12. That the government should continue efforts to get the provinces to join in a national sales tax, as the ultimate means of resolving the issues of double-taxation and visibility of the Goods and Services Tax.

PART B

ECONOMIC AND DISTRIBUTION ASPECTS

1. ECONOMIC ASPECTS

The GST as proposed in the Technical Paper will apply at a rate of 9% on a wide range of goods and services consumed in Canada. Unlike the existing FST, which is levied at one point only, the GST will apply to sales throughout the production and distribution chain. Sellers, however, will receive full credit for taxes paid on their purchases, so that in the end only the final consumer will pay the tax.

The coverage of the GST will be much broader than that of the existing FST, but still well short of being fully comprehensive. Basic groceries, prescription drugs and medical devices will be "zero-rated", or tax free. In addition, most health and dental care services, most supplies by charities, long-term residential rents, and most financial services will be tax exempt. (As explained later on in the report, tax exempt sales are not tax free: exemption means that the seller collects no tax on the supply of a commodity, but also cannot claim a credit for taxes paid on the inputs into that commodity.) On the whole, the FST will apply to about two-thirds of total consumer spending on goods and services. The existing FST applies to roughly one-third of total consumer spending, so that even with the proposed exclusions, implementation of the GST would result in considerable broadening of the federal sales tax base.

A) Fiscal Impact

At the proposed 9% rate, the Department of Finance estimates that the GST will yield $24 billion in 1991, its first year of operation. This amount is net of rebates to the public and non-profit sector (provided so as to ensure that the tax burden on this sector will not rise with implementation of the GST), to small business (to defray administration expenses), and to housing (to dampen the impact of the GST on house prices at the mid to lower-cost end of the housing market). Of this amount, $18.5 billion will replace revenues that would have been generated by the existing FST. The remaining $5.5 billion will be used to fund an enriched sales tax credit ($2.4 billion), a reduction in the middle income tax rate from 26% to 25% ($0.7 billion), indexation of transfer payments and income taxes resulting from the anticipated price impact of the GST ($2 billion), and increased tax administration costs ($0.2 billion). The net effect of substituting the GST for the existing FST is thus estimated to be fiscally neutral.

At the same time, and somewhat paradoxically, the government cites a reduction in the federal budget deficit as one of the main goals of the proposed GST. To understand this paradox it is necessary to be clear on the meaning of fiscal neutrality in this context. First, it refers only to the direct impact of the GST. It excludes therefore the fiscal dividend that will accrue to the government from the additional economic growth that is anticipated to result from the substitution of the GST for the existing FST.

Second, the fiscally neutral result is based on a "mature" system, with full adjustment for indexation of income taxes and transfer payments triggered by the price impact of the GST. Full adjustment for indexation, however, occurs with a three year lag. Thus in the first two years of the GST regime, indexation costs will be considerably lower than the $2 billion factored into the calculations that show no net yield from this new tax. Moreover, the indexation requirements are calculated on the basis of the initial price impact of the GST, rather than on its long-run price effect. Because the GST is expected to increase economic efficiency over time, its long-run effect on the price level will be lower than its short-run impact. Consequently, the permanent increase in indexation costs resulting from the implementation of the GST will be lower than the increase estimated on the basis of the GST's initial price impact.

Finally, fiscal neutrality assumes that the existing FST would in fact generate the increased revenues implied by the recent increases in federal sales tax rates. However, as the Technical Paper acknowledges, this is a dubious assumption. The FST system is so leaky that any projections of revenues from it that are based on the assumption that the sales tax base will remain intact are purely academic.

In short, viewing the proposed GST package more realistically and looking beyond its immediate impact reveals that it will have a significantly positive effect on the federal fiscal balance. Given the size of the federal deficit, this is not an undesirable result.

B) Price Effects

The Department of Finance estimates that introduction of the GST will result in a one-time increase in the CPI of 2.25%. The impact on the GDP deflator, the broadest measure of price changes in the economy, is estimated to be about half as large as for the CPI. The reason for the much larger increase in consumer prices is that the GST will be imposed entirely on consumption commodities, whereas under the current FST a large portion of all revenues is collected from levies on business inputs.

These official estimates of the price impact have been challenged as excessively optimistic because they assume that firms will pass on to consumers the full savings from the elimination of the FST. A less than full passthrough of the FST savings would of course imply a higher initial price impact, but estimates of a 9% impact or even higher that we heard from some witnesses are clearly alarmist. Since the GST will apply to roughly two-thirds of total consumer spending, even with the extreme assumptions of full forward shifting of the GST and no price reductions from the elimination of the FST, consumer prices would rise by about 6%.

But the assumption of no price reduction from the elimination of the FST is not a tenable one. For every configuration of demand and costs facing a firm, there is a price at which the firm can maximize its revenues or profits. That optimal price will change when either the cost or demand structure facing the firm changes. A firm that failed to lower prices in response to a reduction in its costs would fail to maximize profits. Out of self-interest,

therefore, sellers will want to lower their prices to reflect the removal of the FST: the more intense the competition in particular markets, the larger the price reduction will be.

The same argument applies for cost increases. Sellers will of course want to pass on fully the new GST levy but, depending on prevailing market conditions, they may not always be able to do so. Hence, while the assumption of full passthrough of the FST savings may be overly optimistic, the assumption that the GST will be fully shifted forward on to higher prices may be viewed as excessively pessimistic. On balance, there are no *a priori* grounds to question the reasonableness of the GST price impact estimates derived by Finance.

A more important and difficult question is whether the effect of the GST on prices will be limited to a one-time increase in the price level or whether it will lead to subsequent rounds of price increases, or higher rates of inflation. The answer will depend on many factors, including the state of the business cycle at the time that the GST is introduced, the response of labour to the initial price impact, and the monetary policy adopted by the Bank of Canada. In principle, there is no compelling reason for inflation to rise as a result of the introduction of the GST, and the evidence from international experience suggests that, in most countries, the introduction of VAT has had little or no effect on retail prices. (1)

There have been exceptions to this general experience however, and, depending on how the transition is handled, Canada may become one of them. All representatives of organized labour who appeared before us emphasized that unions will push to make up for the increase in prices through higher wages. The government may wish of course that labour sees through the initial price impact of the GST and accept the temporary loss in purchasing power that that entails, but it would be wishful thinking to expect that that will happen. The way to limit an inflationary response from labour is to limit the provocation: the GST-induced price impact. The GST package, as proposed, needlessly compounds that impact.

The package can be altered to reduce its attendant inflationary risk without affecting its fiscal integrity. As indicated in the Technical Paper, and as Finance officials stressed in testimony before the Committee, the direct impact of the GST on the CPI overstates the effect on the real purchasing power of consumers, for it fails to reflect the gains to consumers through an enriched sales tax credit and lower personal income taxes. On average, real disposable incomes will fall only about one percent. This one percent is the extent of the net transfer of resources from households to government resulting from the introduction of the GST. The remaining 1.25 point increase in the CPI represents the redistributive effect of the GST package. By reducing the magnitude of the redistribution, one can lower the price impact.

Some redistribution is necessary to protect lower income households from a higher tax burden as a result of the implementation of the GST. But the middle income tax rate reduction serves little purpose. It accrues entirely to middle and upper income households, and one may consequently be tempted into thinking that these households are thereby made better off. But as figures in the Technical Paper show, these are precisely the households that will have to pay for the additional revenues from the GST. Any savings they get from the income tax reduction will be fully offset by the increases in the GST required to pay for those

savings. These households, therefore, will derive no net benefit from the income tax reduction, but will have to bear an additional inflationary risk owing to the shift from income to sales taxation that that reduction entails. In the Committee's view, this does not amount to a good trade off, and the overwhelming evidence that we received suggests that it has few supporters.

Because of the interaction of the GST rate with the GST offsets (the sales tax credit and indexation of income taxes and transfer payments), the one point reduction in the middle income tax rate can have a much larger effect on the GST rate than one would expect on the basis of the revenues associated with that single income tax point. The $700 million involved are equivalent to a little more than one-quarter point of GST. A drop in the GST rate, however, together with a corresponding fall in the GST price impact, will generate savings in GST credit requirements and indexation payments. Taking these into account, withdrawal of the middle income tax reduction would allow the GST rate to be lowered by about two-thirds of a percentage point and still remain revenue neutral.

In addition to its favourable price impact, not proceeding with the middle income tax rate reduction would also have the advantage of leaving provincial revenues intact. Pursuant to agreements with nine of Canada's provinces, the federal government collects income taxes on behalf of all provinces except Quebec. These agreements require that the participating provinces have the same income tax as the federal government, so that provincial tax liabilities are determined as a percentage of the federal taxes payable. A reduction in federal income tax revenues therefore would imply a corresponding decrease in provincial revenues that the provinces would have to make up from other sources. Not proceeding with the proposed income tax reduction would eliminate this difficulty.

Therefore the Committee recommends:

13. **That the government not proceed with the proposed middle income tax rate reduction and that the savings be used instead to bring about a lower GST rate.**

To avoid misunderstanding, we hasten to add that our recommendation on this point should not be interpreted as reflecting a general opposition to income tax reductions for middle income households. It stems instead from concerns we have about any measures that may compound the price impact of substituting a GST for the existing FST and that may thereby complicate the transition into the new sales tax regime. In short, our opposition is related to the timing of the proposed income tax rate reduction, rather than to the reduction *per se*. The announced intent to reduce income taxes for middle income households should proceed at a later date, as circumstances permit.

C) Effect on Employment and Growth

The Committee heard evidence from four groups, in addition to the Department of Finance, that had analyzed the economic and fiscal implications of the GST through simulations of its effects by means of macroeconometric models of the economy:

— The Conference Board

— The Economic Council of Canada

— Informetrica

— University of Toronto Institute for Policy Analysis

There was agreement among all of these groups that implementation of the GST would be highly beneficial to the Canadian economy in the long-run, resulting in a more efficient allocation of resources, larger output and higher consumer welfare.

Benefits derive from three sources:

1. A reduction in the variation of effective tax rates across commodities, thereby resulting in prices that reflect more accurately the economic costs of production.

2. Elimination of the tax burden on business inputs, leading to increased capital accumulation, and thereby to higher labour productivity and larger output.

3. Improvements in the international competitiveness of Canadian producers through the removal of the tax on exports and the FST bias in favour of imports.

Estimates of the overall effects of the GST differ. Results derived by the Department of Finance using a general equilibrium model of the economy show that implementation of the GST will increase real output of the economy, over time, by 1.4%. Of this increase, 0.9% is due to enhanced efficiency and 0.5% to a larger capital stock. General equilibrium models involve many assumptions that one can disagree with and not everyone would accept these Finance estimates as the final word on the matter. Generally, however, the disagreement is over the magnitude of the long-term gains, not over whether there will be gains in the long-run.

The transition to this happy long-run, however, may be difficult. The Technical Paper indicates that the benefits from the implementation of the GST can begin almost immediately. It predicts 0.2% higher real output in 1991, rising to 0.7% by 1994. This higher output leads to 35,000 additional jobs in 1991 and to 60,000 additional jobs in the period 1992 to 1994. These results, however, hinge crucially on a major assumption: that there will be no wage response to the price impact of the GST, other than marginal increases resulting from indexation of wages through COLA clauses. If labour's response is not so benign, there may be serious adverse economic consequences during the early states of the GST. As the Technical Paper states:

> An inflationary price-wage response to the GST ... would delay realization of the benefits and result in less favourable employment and output effects during the transition. Unit labour costs of Canadian firms would rise relative to those of foreign producers, offsetting the direct competitive advantages brought about by replacing the FST with the GST. Instead of a net export gain, net export losses could occur in the transition period. Rising inflation would also induce upward

pressure on short-term interest rates, which would moderate aggregate demand. (p. 41)

In addition to the wage response, monetary policy is the other major factor in the determination of the effects of GST during the transition years. A strong wage response to the GST price impact would create a difficult policy dilemma for the Bank of Canada. Full accommodation by the Bank not only of the direct price impact of the GST but also of the indirect price effects stemming from wage increases would usher the economy into a prolonged wage-price spiral. Such an accommodative monetary policy stance is unlikely, given the emphasis that current Bank policy places on the goal of price stability.

A monetary policy that resisted wage increases would cause interest rates to rise, dampening aggregate demand and leading to lower output and to employment losses. The government deficit would also rise under the untoward combination of higher interest costs and reduced tax revenues.

An illustration of the unpleasant possibilities that may arise is shown in the following table which presents the results of an analysis by Toronto investment dealer Wood Gundy. Wood Gundy assumed that wages would rise by one-half the expected GST price impact and that, in order to dampen attendant inflationary pressures, the Bank of Canada would raise short-term interest rates by 200 basis points. Under this scenario, the CPI jumps by 3% in 1991, rather than by 2.25% projected by Finance. Real GDP declines by 0.6%, employment falls by 75,000 jobs, and the federal deficit rises by $2.9 billion.

Comparison of the Short-Run Economic Impact of GST:
Department of Finance and Wood Gundy Economics
(Percent change except where noted)

	Department of Finance	Wood Gundy
Real GDP	0.2	–0.6
Nominal GDP	1.5	1.1
CPI Inflation Rate (Percentage Points)	2.3	3.0
GDP Deflator	1.3	1.7
Employment (000s)	35	–75
Budgetary Balance ($billions)		–2.9

It is important to note that the adverse effect on economic growth, employment and the deficit projected by Wood Gundy derive from the assumed tightening in monetary policy, not from the introduction of the GST *per se*. There is nothing inherent in the GST itself that should cause the economy to become less stable. As argued by Professors Peter Dungan and Thomas Wilson in a submission to the Committee on the macroeconomic effects of the GST:

The allocative efficiency gains of sales tax reform are achieved if the relative tax burden is equalized across a broad range of consumer products. The dynamic gains from increased capital formation are achieved by eliminating direct and indirect sales tax burden on business fixed investment. Neither of these results, by itself, would trigger a price-wage spiral. A price-wage spiral is likely to develop because the present phase 2 reforms will increase the aggregate sales tax burden on consumption. If the reform package were modified to reduce or eliminate this increase, the macroeconomic adjustment problems would be attenuated or would largely disappear.

Of course, since we cannot know for certain the response of private agents or of the Bank of Canada to the introduction of the GST, there is no way to say for certain what the short-term effects of the GST are going to be. It stands to reason, however, that the greater the initial price impact of the GST, the greater is the risk that it will lead to an inflationary price-wage response and, hence, to other unfavourable economic consequences. Setting the GST at a rate that minimizes the initial price impact would reduce the likelihood of a wage-price spiral and avoid the transitional problems associated with the introduction of the GST.

At the same time, in light of the government's fiscal position, it is important that the reduction in the tax rate not be made at the expense of deficit reduction. A higher deficit, in addition to constraining the government's fiscal capacity to act, would have an inflationary effect that would tend to counteract the anti-inflation impact that a lower GST rate is intended to achieve. The revised GST package that we propose below balances both considerations: it eases the transition to the new sales tax regime without undermining the government's deficit-reduction efforts.

FOOTNOTES

(1) OECD, op. cit., p. 138.

2. ALTERNATIVE GST OPTION

The alternative GST package that we propose would amend the GST package proposed in the Technical Paper as follows:

- Lower general GST rate from 9% to 7%, except for real estate sales where the applicable rate will be 5%.

- Expand the GST base to include taxation of real estate trade-ups, as discussed in a later section of the report. At the proposed 5% rate, the estimated revenues from this base broadening is $1.6 billion.

- Withdraw the middle income tax rate reduction.

- Increase excise taxes on alcohol and tobacco products to recapture revenue losses that would otherwise result from the substitution of a 7% GST for the existing FST. These are estimated at about $500 million(1).

- Lower GST credit proportionate to the reduction in the GST tax burden on lower income households.

A) Price Impact

Our proposal to tax all real estate trade-ups is developed fully in Part C, Chapter 7 of the report, which deals with real property. Essentially, it entails application of GST to any net increases in the value of real estate acquired by a purchaser. To illustrate, a person who sells a property for $100,000 and acquires another property for $150,000 will be taxed at a GST rate of 5% on the $50,000 trade-up involved in the two transactions. As Chapter C-7 points out, this proposal removes some of the most serious problems associated with the Technical Paper proposal to confine the tax to new construction only, including significant distortions in the housing market as a result of taxing houses differently depending on whether they are new or used, rented or owner-occupied, moderately priced or expensive. From the perspective of the macroeconomic impact of the GST, however, the attraction of broadening the base in the way that we propose is that it can generate additional revenues without affecting price levels. The proposal makes it therefore possible to reduce the GST rate, and thereby lower the price impact of the GST, without sacrificing the fiscal goals of tax reform.

This point is sufficiently important to deserve some elaboration. Under the Technical Paper proposals, GST will apply to newly constructed houses at a rate of 9%, but a rebate of 4.5% will be provided to houses costing $310,000 or less. The rebate will be phased out beginning at houses costing $350,000 or more, and will be reduced to zero for houses priced above $400,000. To qualify for the rebate, the new house must be the purchaser's principal residence. Thus not only high-priced homes but also all new rental accommodation dwellings will bear a GST rate of 9%. On average, new dwellings will be taxed at about 6.9%.

According to estimates by the Department of Finance, the current effective FST rate on new dwellings is 4.2% of the selling price. Thus, under the Technical Paper proposals, taxation of new housing, both rented and owner-occupied, would rise by about 2.7 percentage points.

What effect will this tax increase have on housing prices? The answer depends on the sensitivity of the demand for and supply of new houses to price changes. On the assumption that neither demand nor supply is completely insensitive or infinitely sensitive to price changes (in the economists' jargon, neither has an elasticity of either zero or infinity), the tax increase will be split between buyers and sellers, i.e. some will be absorbed by the land-owners or builders in the form of lower returns and some will be passed on to buyers in the form of higher prices. New house prices therefore will increase under the Technical Paper proposals, the increase being greater the more price sensitive the supply of new housing is relative to demand.

In most analyses of this issue, the assumption made is that, within the relevant range, the cost of bringing new houses on stream is constant, which is equivalent to saying that the supply of new houses is infinitely elastic. Under this assumption, a tax on new houses is fully passed on to the purchasers. The tax has the effect of reducing the quantity of housing demanded, but since this reduction does not reduce the cost of new houses, it will not reduce the price of houses net of the tax. House prices, therefore, inclusive of the tax will rise by the amount of the tax increase. On this basis, the Technical Paper proposal will lead on average to a 2.7% increase in the price of new houses.

But the price effect of the proposed GST will not be confined to new houses only: it will spread to the existing housing stock as well. This follows from the fact that newly-constructed and existing houses are fairly close substitutes. Hence, an increase in the price of new houses will shift demand towards existing houses, pushing their prices higher. The upward pressure on existing houses will continue until the relative prices between old and new houses that existed prior to the tax increase is re-established. Prices of existing houses therefore will rise by the same proportion as those of newly constructed houses, even though GST will not apply to the former. Existing house-owners will reap a windfall gain.

Extending application of the GST to existing houses would not alter this price impact. The tax would shift some demand from the resale to the new house market. If the additional construction does not raise land or construction costs, as assumed, prices in the new housing market would remain unaffected. The demand shift would continue until prices in the resale and new house markets are again equalized. Compared to the situation where only new houses are taxed, there would be more residential construction and fewer house resales, but house prices would remain the same.

This result is illustrated in Figure 1 below. The supply of new houses is shown as a horizontal line, reflecting the assumption that the per unit cost of housing does not rise with the quantity of housing produced. The supply of existing houses is positively sloped on the premise that as housing prices rise the number of house owners willing to put their houses up for sale rises. The equilibrium situation in the absence of a tax is at point A, where the demand schedule for houses intersects supply. A quantity Q^1 of houses is bought and sold at

a price of P^1. Of the quantity Q^1, Q^{R1} consists of housing resales and $Q^{R1}Q^1$ of newly-constructed houses.

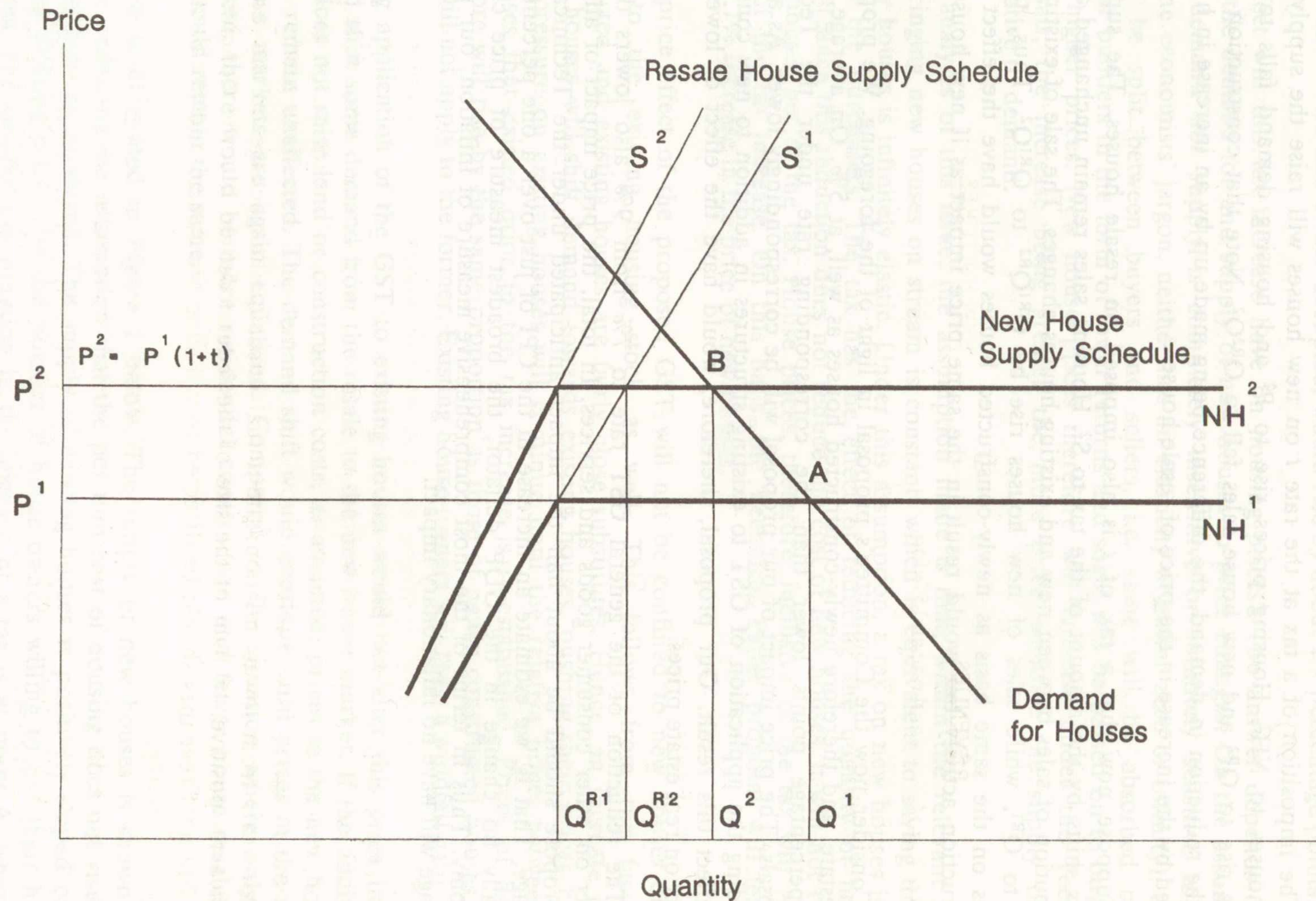
The imposition of a tax at the rate t on new houses will raise the supply schedule for new houses to NH^2. Housing prices rise to P^2 and housing demand falls to Q^2. Housing resales rise to Q^{R2} and new house sales fall to $Q^{R2}Q^2$. Note that construction falls by more than the reduction in demand, the difference being made up by an increase in housing resales induced by the increase in the price of resale houses.

Suppose now that a tax of t is also imposed on resale houses. The supply of resale houses shifts by the amount of the tax to S^2. Housing sales remain unchanged at Q^2, but the distribution of sales between new and existing houses changes. The sale of existing houses falls back to Q^{R1}, while sales of new houses rise by $Q^{R1}Q^{R2}$ to $Q^{R1}Q^2$. Thus, taxing existing houses on the same basis as newly-constructed houses would have the effect of increasing construction activity but would result in the same price impact as if new houses alone were taxed.

Consider now the Committee's proposal in light of the foregoing. We propose to tax all real estate, and therefore newly-constructed houses as well, at 5%. On average, this is nearly two percentage points lower than the corresponding rate under the Technical Paper proposals. The price impact of our proposal will be correspondingly lower. As already shown, extending the application of GST to existing structures in addition to new construction does not affect this result. Our proposal, therefore, would have the effect of lowering the GST impact on real estate prices.

The reduction of the general GST rate to 7% from 9% also lowers the GST price impact on other consumer goods and services. In total, the price impact of all the measures we propose should be about half the impact anticipated under the Technical Paper GST package. That is, we estimate an increase in the CPI of just over a one percentage point and virtually no change in the GDP deflator, the broadest measure of price changes in the economy. Thus in terms of the most comprehensive measure of inflation, our proposed GST package will have no inflationary impact.

Figure 1
The Effect on the Housing Market of Taxing Housing Sales



Research Branch, Library of Parliament.

B) Fiscal Implications

The direct fiscal implications of the revised package are summarized in Table B.2 below. The measures we propose are expected to generate $20.9 billion in 1991, net of the small business administration fee and rebates to the MUSH and non-profit sectors. As proposed in Chapter C-4 of the Report, the small business administration fee will be payable to registrants with annual sales from taxable and zero-rated supplies of under $2 million. It will be equal to 5% of the registrant's GST liability to a maximum of $600 annually, and is estimated to cost the government, in terms of revenues foregone, $300 million a year.

Fiscal Impact of 7% GST Option
($ billion)

REVENUES		EXPENDITURES	
GST at a 7% general rate and 5% for real estate transactions, TP base	18.8*	FST	18.5
		GST Credit	1.2
Real estate base expansion	1.6	Indexation	1.0
Alcohol and Tobacco	0.5	Administration	0.2
TOTAL:	20.9	TOTAL:	20.9

* Net of small business administration fee of $300 million and of rebates to MUSH and the non-profit sectors

The revenue losses of approximately $5 billion from the reduction of the general GST rate to 7% from 9% are made up through the expansion of the tax base ($1.6 billion), increased excise taxes on alcohol and tobacco ($0.5 billion), withdrawal of the middle income tax rate reduction ($0.7 billion), and reduced GST credit and indexation costs ($2.2 billion).

We measure fiscal neutrality on the same basis as the Technical Paper. In other words, we take into account only the direct impact of the GST on government revenues, assume full adjustment of indexation payments, and calculate indexation costs on the basis of the initial price impact, rather than the long-term effect on prices, which is lower. Accordingly, as discussed above in respect of the GST package proposed in the Technical Paper, when one takes into account the fiscal feedback from the impact of the package on the economy and adjusts indexation costs to incorporate savings in the early years from partial indexation and in later years from lower inflation, the actual effect of the package on the federal budget is significantly positive. In light of the size of the federal deficit, it is the Committee's view that the additional revenues should be directed to reducing the deficit, and not be diverted to new program spending.

Therefore the Committee recommends:

14. That any revenues from sales tax reform in excess of revenues required to finance replacement of the existing FST and associated sales tax credit increases and indexation payments should be used to reduce the government deficit.

C) Lower Adjustment Costs

In other respects, as well, the GST package we propose retains all of the advantages of the Technical Paper proposal and adds to them. The long-term efficiency gains expected to result from the elimination of the FST and its replacement by a more neutral tax will be fully captured. Indeed, the gains from the revised GST that we propose should be marginally greater. This is so for two reasons. First we broaden the GST base, thereby improving the neutrality of the tax. Second, and more important, by lowering the rate, we reduce the magnitude of the economic distortions inherent in every tax system (other than poll taxes).

The main advantage of our revised GST package, however, is that it can ease the transition to tax reform. At the 2.25 per cent price impact of a 9% GST rate, the risk of an adverse wage response leading to a painful price-wage spiral is very real. The economic costs of such an outcome, as already discussed, would be enormous. As indicated above, we estimate the price impact of our revised package to be less than half that of the GST at 9%, or a little over one percentage point increase in the CPI and virtually no change in the GDP deflator. This is a much smaller impact for the economy to absorb and the risk of provoking an inflationary spiral is thereby considerably lessened. As a result, the long-run benefits of tax reform can be more speedily attained and the short-term adjustment costs are substantially avoided.

Therefore the Committee recommends:

15. That the general GST rate be lowered from the proposed 9% to 7%.

16. That excise taxes on alcohol and tobacco products be raised sufficiently to recoup the revenue losses that would otherwise result from the substitution of GST at 7% for the existing FST.

FOOTNOTES

(1) The replacement of the existing 19% FST on alcohol and tobacco products by the proposed 9% GST would result in a loss of tax revenues from these products of about $200 million. (The revenue reduction, from about $1.4 billion to $1.2 billion, is proportionately much less than the rate reduction, owing to an offsetting increase in the tax base on which GST will apply.) An additional $300 million revenue loss would result from the GST rate reduction to 7% from 9%. There is no compelling reason of course to tie the replacement of the FST with lower taxation of alcohol and tobacco. A number of submissions to the Committee, including the one by the Canadian Medical Association, urged that offsetting measures be taken to ensure that implementation of the GST does not result in lower taxation of these products.

(6) The replacement of the existing 19% FST on alcohol and tobacco products by the proposed 9% GST would result in a loss of tax revenues from these products of about $200 million. (The revenue reduction, from about $1.4 billion to $1.2 billion, is proportionately much less than the rate reduction, owing to an offsetting increase in the tax base on which GST will apply.) An additional $300 million revenue loss would result from the GST rate reduction to 7% from 9%. There is no compelling reason of course to tie the replacement of the FST with lower taxation of alcohol and tobacco. A number of submissions to the Committee, including the one by the Canadian Medical Association, urged that offsetting measures be taken to ensure that implementation of the GST does not result in lower taxation of these products.

3. GST CREDITS

Canada has had a system of refundable sales tax credits since 1986. Currently, the maximum benefits are $100 per adult and $50 per child payable to families with net incomes of less than $16,000. In 1990 benefits will increase to $140 per adult and $70 per child, and the income threshold will rise to $18,000.

Under the Technical Paper proposals, a new GST credit will replace the existing federal sales tax credit. The benefits will be $275 per adult and $100 per child payable in full to families with net incomes of $24,800 or less, the same level as that of the refundable child tax credit. As with existing sales tax credits, benefits will be reduced at the rate of 5% of net income in excess of the $24,800 threshold. The GST credit will be paid quarterly; the existing credit is paid once a year. As many of our witnesses observed, these amounts represent a substantial enrichment of the present system of providing assistance to lower income households.

A) The Single Person's Credit

Two new features in the GST credit system are directed to single parents and single individuals. First, single parents will be entitled to claim a full adult credit for one dependant child. Second, single individuals, including single parents, will be able to claim an additional credit of up to $140. The reason for the single credit is to recognize the fact that there are economies of scale to maintaining a household and that therefore single-member households incur proportionately higher costs than larger households.

An unusual feature of the proposed single person's credit is that it rises with income. More specifically, this credit is payable at 2% of net income in excess of $6,175. Thus a single adult with a net income of $6,000 will qualify only for the standard credit of $275, while a single adult with a net income of $24,000 will be able to claim a credit for $415. The rationale provided in the Technical Paper for so designing this credit is to ensure that it is targeted to low-income "singles who maintain their own households and are not dependant on parents or other supporting persons." (Technical Paper, p. 15)

This particular feature of the credit was strongly criticized by a number of witnesses. The most obvious criticism is that, in the interest of excluding some non self-supporting individuals from the supplement, it denies benefits to the most needy households. For example, as the brief by the National Anti-Poverty Organization (NAPO) pointed out, "most minimum wage workers will not receive any benefit from this credit, and no minimum wage worker will receive the full benefit."

Another aspect of the single person's credit that is difficult to defend is that, over a fairly wide income range, the credit rises with income. Here, the question raised by the National Council of Welfare in their submission to the Committee is very pertinent: Why should a single person with an income up to $24,800 — $9,900 above the projected 1991

poverty line — receive the full $140 supplement, while someone with an income well under half the poverty line get no supplement?

One suggestion, made by the National Anti-Poverty Organization (NAPO), for correcting this anomaly in the GST credit is that the single person's supplement be abolished and that the savings be applied to an increase in the basic GST credit for the first adult in any household. This option has several advantages:

a) it simplifies the GST credit system;

b) it does not discriminate against the very poor; and

c) it recognizes that there are extra costs to maintaining a separate household.

Therefore, the Committee recommends:

17. That the single person's credit be eliminated and that it be replaced by a higher basic GST credit for the first adult in any household.

B) Income Thresholds

We also received suggestions from a number of witnesses that the the income threshold, or turning point at which credits begin to be phased out, should vary with the size of the household. According to data provided to the Committee by the National Council of Welfare, the $24,800 threshold proposed in the Technical Paper is about $10,000 above the projected poverty line in 1991 for single-member households, but nearly $5,000 below the poverty line for a family of four. Thus single-member households will be receiving the full credit at income levels far above the poverty line, while benefits to larger families will begin to decline at income levels substantially below the poverty line: the larger the family, the wider the gap between the turning point and the poverty line.

On the other hand, while under the TP proposals the turning point is the same for all households, the amount of benefits payable rises with household size. Because the 5% phase out formula applies to the aggregate of the benefits received, as household size increase, the income range over which <u>some</u> benefits are received also rises with family size. To illustrate, under the TP proposals, a family of four will be eligible for benefits up to an income level of $39,800, which is more than $10,000 above the projected poverty line in 1991.

In addition, the existing sales tax credit system is characterized by a single income threshold, and this too has a bearing on the choice between a single or variable threshold for the GST credit. While attractive in the abstract, a variable threshold based on poverty lines implies that many low-income single persons would be made worse off by the sales tax reform. This is because the projected low-income line for a single-member household in 1991 is $14,900, while the turning point for the current sales tax credit system will rise to $18,000 in 1990.

As a matter of principle, we do not think that the position of low-income households should be allowed to deteriorate as a result of the implementation of the GST. A turning

point at the $24,800 level proposed in the Technical Paper together with adequate credit amounts would accomplish this aim. We are not prepared at this point therefore to recommend any changes to this aspect of the GST credit.

At the same time, we think that the suggestion that income thresholds for GST benefits be related to family size has considerable merit. Indeed, the issue has relevance not only for the GST credit, but for other social benefits provided by the government as well. It can therefore best be examined within a comprehensive review of the relationship of taxation and social benefits policy.

It is the Committee's intention to undertake such a review before 1991. Among the areas that the Committee will examine at that time will be the appropriate pattern of income thresholds for the sales tax and child tax credits, the determination of the value of the credits and other personal transfer payments, indexation of these benefits to price changes, and the integration of social benefit payments with the income tax systems and its effects on individuals' incentives to work and save. It is not widely recognized, for instance, that although the maximum personal income tax rate is 29%, when the effect of the phase out of the sales tax and child tax credits is taken into account, the effective marginal tax rate for many middle income taxpayers is 36% for federal taxes only, and above 50% when provincial taxes are also included. In addition to the anomaly of having tax rates in middle income ranges much above rates applicable to the highest incomes, the disincentive effects of marginal tax rates at such high levels must also be significant.

C) Indexation

Another feature of the GST credit that was condemned by virtually every submission that addressed this matter is the provision limiting indexation of the credit amounts and the income thresholds to increases in the Consumer Price Index (CPI) in excess of 3%. An implication of this provision is that, as long as annual increases in the CPI exceed 3%, the real value of the credits and the income thresholds will decline by 3% a year, thereby reducing over time both the amount of the credit and the number of persons qualifying to receive it.

The explanation for the partial indexation provided to the Committee by officials of the Department of Finance is that it is part of a general formula, applicable to all aspects of the income tax system, that was introduced in the 1986 taxation year as a deficit reduction measure.

The connection between the income tax system and the sales tax credits, however, is only incidental. Credits are provided in order to reduce the sales tax burden of low income households. Income tax returns are simply used as a convenient means of establishing household income and therefore eligibility for credits.

We note, as well, statements made by the Minister of Finance expressing the government's intent to adjust the credits over time as required so that their value will not be eroded. If that is the intent, there will be no savings from the partial indexation of credits,

and it would be best to incorporate the intent into law and thereby remove the anxiety of those who count on these credits as part of their income.

In any event, if it is considered equitable or desirable to compensate lower income households at the levels proposed for the implementation of the GST, we see no reason for the compensation offered to be so designed that, in the absence of legislative intervention, its value erodes with time. As noted above, the Committee intends to revisit this question when we conduct an inquiry into the income tax and social benefits systems.

The Committee therefore resolves to conduct an inquiry into Canada's tax and social benefits systems, the interrelationship between the two, appropriate methods of indexing them to price changes, their respective purposes, efficacy, and implications for economic performance; and to report its findings to the House of Commons before the end of 1990.

D) Credit Benefits

At the lower GST rate of 7% proposed by the Committee, the sales tax burden on consumers will obviously be lower, and the requirements for GST credits are accordingly reduced. The credit levels proposed in the Technical Paper were designed with the aim of ensuring that sales tax reform does not increase the tax burden of middle to lower income households. In the absence of a thorough review of the social security system that might yield alternative criteria for establishing appropriate GST credit levels, the Committee feels that the principle adopted in the Technical Paper is a good one. The Committee accepted it therefore as the working principle for determining the levels of credits that it proposes below.

As noted earlier, having the same income threshold for the credits regardless of family size favours single person families over larger families. One way of compensating larger families for this disadvantage is to provide for relatively generous child credits. Accordingly, while the Committee proposes reductions in the amounts for adult credits proposed in the Technical Paper, the Committee would leave the child credit amounts intact. More specifically, the Committee recommends:

18. That the amounts for the GST credit be set as follows: $250 for the first adult in the household, $175 for the second adult, and $100 per child.

The distributional impact of the Committee's GST proposals is shown in Tables B.3 to B.8 below. Table B.3 sets out the credit entitlements for various household types at different income levels. The discrepancy in credit benefits between a four-member family with one earner and a four-member family with two earners at income levels above $25,000 results from an assumption that the two-earner family would have incurred $3,000 in child care expenses, which would be deductible from gross income to arrive at the net income level on which credits are payable.

Tables B.4 to B.8 show the overall impact of the Committee's proposals relative to the existing sales tax regime. While these tables are largely self-explanatory, a clarification is in order. Column (2) in each of these tables shows the change in sales tax burden resulting from

the substitution of the GST for the existing FST. The estimated changes in tax burdens shown in that column are based on a GST of 7% applied to a base that is the same as that proposed in the Technical Paper. In other words, these estimates do not reflect the Committee's proposal to reduce the GST rate on real property to 5% and expand the base to include real estate trade-ups. Time and resource constraints did not allow us to refine these estimates sufficiently to take the distributional effects of this proposal into account.

Had these effects been incorporated in the results shown in Tables B.4 to B.8, the improvement in the position of low-income households reflected in those results would probably be greater. The reduction in the GST rate from the 7% rate assumed in those tables to 5% for all real estate transactions implies that rental real estate, and therefore rental costs, would be reduced accordingly. Since a greater proportion of low income households than high income households are renters, any measure that reduces the cost of rental accommodation would tend to benefit low income households proportionately more.

The other aspect of the proposal, expansion of the GST base to include all real estate transactions, would have little impact on low income households. As illustrated in the previous chapter, expanding the GST base to include the existing housing market would have the effect of capturing some of the windfall gains that would accrue to existing home owners under the TP proposals. The higher the value of an existing home, the larger would be the windfall. Since investment in home ownership and household wealth are strongly correlated, the additional revenues that would be raised by expansion of the GST base along the lines that the Committee recommends would derive mainly from wealthier households. Low-income households would remain largely unaffected.

On the whole, therefore, the estimates of the overall distributional impact of the Committee's proposals shown in column (5) of Tables B.4 to B.8 probably underestimate the favourable impact that the proposals will have on lower-income families. Those estimates show that the Committee's proposals will improve the economic position of single-member households with incomes below $25,000 and of families with children and income levels below $35,000. Families with children, who benefited relatively less than other groups under Stage I of tax reform, will be the major beneficiaries under the Committee's proposals.

Figure 2 illustrates the incidence of the GST proposed by the Committee, net of the GST credits. As that figure shows, net GST payable as a proportion of family income rises steeply for incomes up to about $40,000 and falls marginally thereafter. For comparison purposes, Figure 2 also illustrates the tax incidence resulting under the Technical Paper proposals and under the current FST system. What emerges from that comparison is that, while the tax incidence under all three systems is virtually proportional at higher income levels, the incidence at lower incomes is much more progressive under the Committee's proposals than under either the current FST or the GST package proposed in the Technical Paper. In other words, Canada's poor would fare better under the Committee's proposals than they would under the Technical Paper proposals or than they do under the existing FST system.

As with the Tables B.4 to B.8, the illustration of the Committee's GST proposals in Figure 2 assumes a 7% GST rate on new residential construction only: it does not incorporate the effects of taxing real estate at 5% and expanding the tax to trade-ups of existing housing stock. Incorporation of these changes would result in a more progressive incidence of the effects of the Committee's proposals than that indicated in Figure 2.

TABLE B.3
VALUE OF GST CREDIT PER HOUSEHOLD

INCOME	SINGLE UNDER 65	SINGLE OVER 65	ONE EARNER TWO CHILDREN	TWO EARNER TWO CHILDREN	ONE PARENT TWO CHILDREN
12,500	250	250			525
15,000	250	250	625	625	525
20,000	250	250	625	625	525
25,000	240	240	615	625	525
30,000	0	0	365	515	415
35,000	0	0	115	265	165
40,000	0	0	0	65	0
45,000	0	0	0	0	0
50,000	0	0	0	0	0
60,000	0	0	0	0	0
75,000	0	0	0	0	0
100,000	0	0	0	0	0

IMPACT OF SALES TAX REFORM ON TYPICAL INDIVIDUALS AND FAMILIES

TABLE B.4
SINGLE WAGE-EARNER UNDER 65

(1) HOUSEHOLD INCOME	(2) CHANGE IN SALES TAX PAYABLE GST - FST	(3) INDEXING	(4) GST CREDIT LESS FST CREDIT	(5) AGGREGATE CHANGE IN TAX: GST - FST
			(in dollars)	
12,500	95	–20	–110	–35
15,000	120	–23	–110	–13
20,000	164	–23	–210	–69
25,000	202	–23	–240	–61
30,000	236	–76	0	161
35,000	263	–58	0	205
40,000	281	–58	0	224
45,000	328	–58	0	270
50,000	357	–58	0	300
60,000	464	–97	0	367
75,000	676	–99	0	578
100,000	917	–99	0	818

IMPACT OF SALES TAX REFORM ON TYPICAL INDIVIDUALS AND FAMILIES

TABLE B.5
SINGLE OVER 65

(1) HOUSEHOLD INCOME	(2) CHANGE IN SALES TAX PAYABLE GST - FST	(3) INDEXING	(4) GST CREDIT LESS FST CREDIT	(5) AGGREGATE CHANGE IN TAX: GST - FST
		(in dollars)		
12,500	102	–114	–110	–122
15,000	108	–66	–110	–68
20,000	135	–66	–210	–141
25,000	179	–66	–240	–127
30,000	191	–110	0	81
35,000	181	–95	0	87
40,000	276	–95	0	182
45,000	312	–95	0	218
50,000	351	–95	0	257
60,000	412	–172	0	240
75,000	412	–172	0	241
100,000	637	–109	0	529

IMPACT OF SALES TAX REFORM ON TYPICAL INDIVIDUALS AND FAMILIES

TABLE B.6
ONE EARNER COUPLE WITH TWO CHILDREN

(1) HOUSEHOLD INCOME	(2) CHANGE IN SALES TAX PAYABLE GST - FST	(3) INDEXING	(4) GST CREDIT LESS FST CREDIT	(5) AGGREGATE CHANGE IN TAX: GST - FST
		(in dollars)		
15,000	86	–63	–205	–181
20,000	89	–63	–305	–279
25,000	99	–63	–545	–509
30,000	129	–127	–365	–363
35,000	143	–127	–115	–98
40,000	184	–127	0	58
45,000	200	–106	0	95
50,000	206	–106	0	101
60,000	283	–115	0	168
75,000	419	–115	0	305
100,000	477	–117	0	360

IMPACT OF SALES TAX REFORM ON TYPICAL INDIVIDUALS AND FAMILIES

TABLE B.7
TWO-EARNER COUPLE WITH TWO CHILDREN

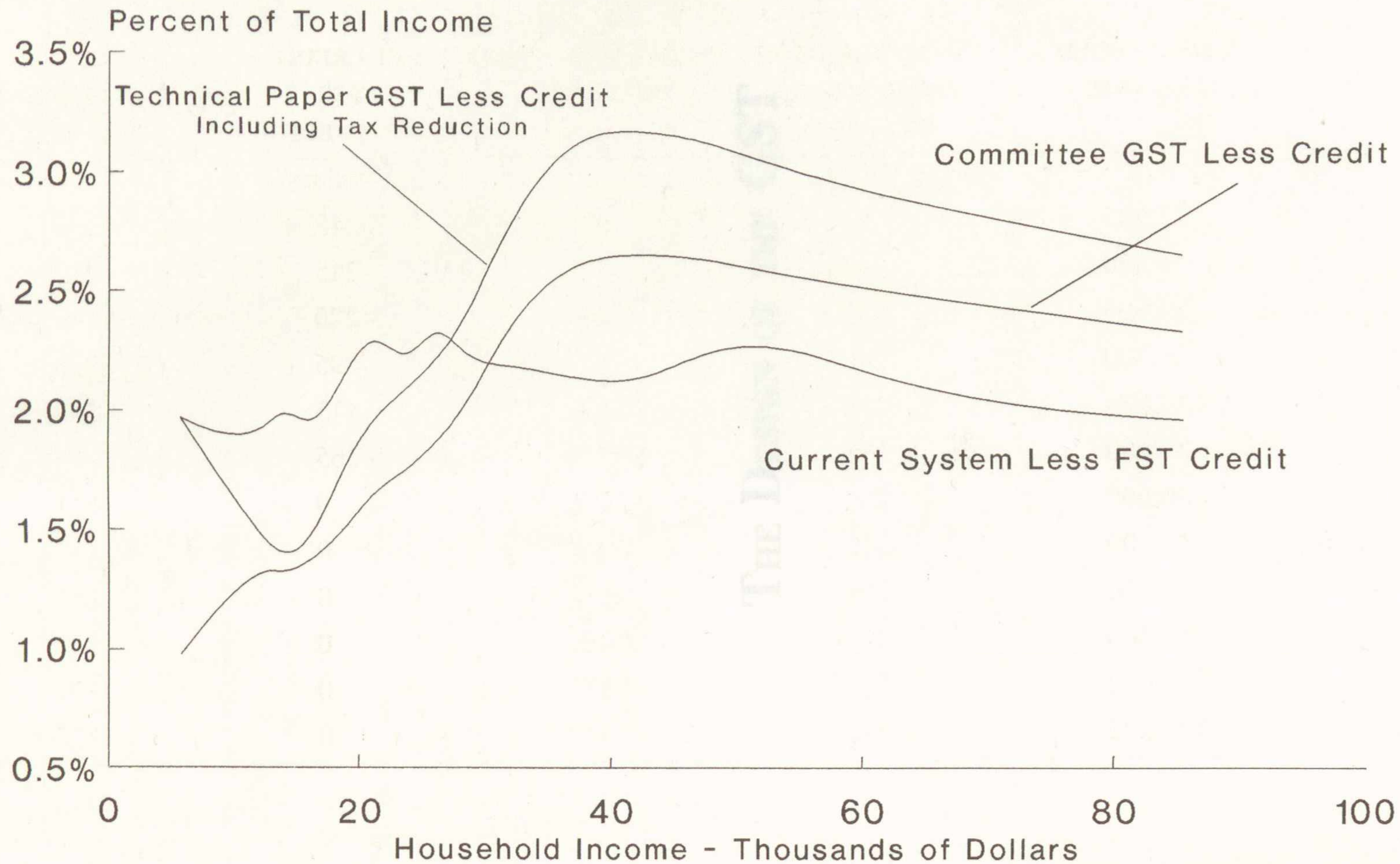
(1) HOUSEHOLD INCOME	(2) CHANGE IN SALES TAX PAYABLE GST - FST	(3) INDEXING	(4) GST CREDIT LESS FST CREDIT	(5) AGGREGATE CHANGE IN TAX: GST - FST
		(in dollars)		
15,000	73	–64	–205	–196
20,000	74	–48	–230	–203
25,000	114	–66	–455	–407
30,000	182	–92	–515	–425
35,000	171	–92	–265	–186
40,000	167	–92	–65	11
45,000	207	–71	0	136
50,000	257	–109	0	148
60,000	341	–83	0	258
75,000	461	–83	0	378
100,000	595	–157	0	439

IMPACT OF SALES TAX REFORM ON TYPICAL INDIVIDUALS AND FAMILIES

TABLE B.8
SINGLE PARENT WITH TWO CHILDREN

(1) HOUSEHOLD INCOME	(2) CHANGE IN SALES TAX PAYABLE GST - FST	(3) INDEXING	(4) GST CREDIT LESS FST CREDIT	(5) AGGREGATE CHANGE IN TAX: GST - FST
			(in dollars)	
12,500	94	–63	–245	–214
15,000	115	–63	–245	–193
20,000	149	–63	–270	–183
25,000	204	–63	–495	–353
30,000	216	–89	–415	–287
35,000	198	–127	–165	–93
40,000	239	–127	0	113
45,000	312	–125	0	187
50,000	358	–105	0	253
60,000	490	–128	0	362
75,000	503	–114	0	389
100,000	435	–116	0	320

Figure 2 **Federal Sales Taxes Net of Credits as a Percentage of Total Income for all Canadian Families**



Research Branch, Library of Parliament.

PART C

THE DESIGN OF THE GST

1. OVERVIEW OF THE GST

The Goods and Services Tax or GST is a tax on final domestic consumption by Canadians. It will be levied at every stage in the production and distribution process, or more precisely every time that a sale is made in that process until the commodity reaches the final consumer. Double taxation will be avoided, however, by allowing sellers to claim a refundable sales tax credit for taxes paid on purchases used in the course of doing business. In effect, therefore, only the value added at each stage where a sale occurs is taxed. Thus the GST is a form of value added tax, similar to value added taxes operated in some 50 other countries around the globe.

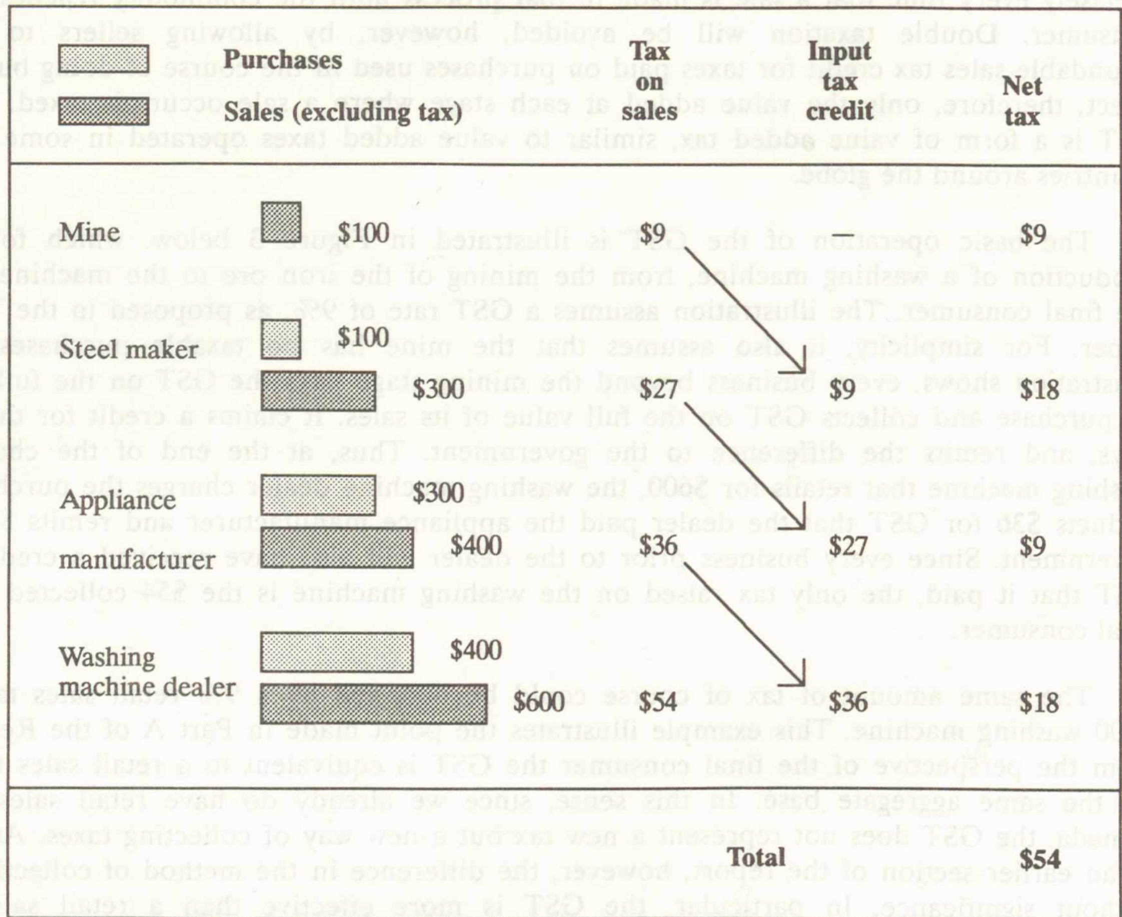
The basic operation of the GST is illustrated in Figure 3 below, which follows the production of a washing machine, from the mining of the iron ore to the machine's sale to the final consumer. The illustration assumes a GST rate of 9%, as proposed in the Technical Paper. For simplicity, it also assumes that the mine has no taxable purchases. As the illustration shows, every business beyond the mining stage pays the GST on the full value of its purchase and collects GST on the full value of its sales. It claims a credit for the taxes it pays, and remits the difference to the government. Thus, at the end of the chain, on a washing machine that retails for $600, the washing machine dealer charges the purchaser $54, deducts $36 for GST that the dealer paid the appliance manufacturer and remits $18 to the government. Since every business prior to the dealer will also have received a credit for the GST that it paid, the only tax raised on the washing machine is the $54 collected from the final consumer.

The same amount of tax of course could be obtained by a 9% retail sales tax on the $600 washing machine. This example illustrates the point made in Part A of the Report that, from the perspective of the final consumer the GST is equivalent to a retail sales tax levied on the same aggregate base. In this sense, since we already do have retail sales taxes in Canada, the GST does not represent a new tax but a new way of collecting taxes. As we note in an earlier section of the report, however, the difference in the method of collection is not without significance. In particular, the GST is more effective than a retail sales tax in ensuring that business inputs are relieved from tax and in minimizing losses to the treasury from tax evasion.

While conceptually the GST is fairly simple, its application in particular areas does raise complicating factors. These are discussed in subsequent sections of the Report.

Figure 3

Goods and Services Tax
Basic Operation



Source : Department of Finance, *Goods and Services Tax* : *Technical Paper*, Ottawa, August 1989

2. BASIC OPERATION

The basic rules governing the operation of the proposed GST, including the definitions of various terms, are set out in Part C2 of the Technical Paper. This Chapter first sets out a general description of these basic rules and terms and then goes on to examine, in detail, the input tax credit mechanism, documentation requirements and operational aspects. After referral from the House of Commons of the Bill to enact the proposed GST, a detailed technical review of these rules will be carried out.

A) General

Legal liability for payment of the GST is imposed on the purchaser under the Technical Paper proposals. Generally a purchaser of a "taxable supply" of "property" or "services" will be liable to pay GST at the rate of 9% on the "value of the consideration" paid or payable for the "supply".

Under the recommendations proposed by the Committee in this Report, the general rate of tax would fall to 7%.

A "registered vendor" will be obliged, as agent for the federal Crown, to collect and remit the tax on behalf of the purchaser. The importer of record of taxable goods will be liable to pay the tax on such goods at the time of importation.

As a general rule, most property and services supplied by a business for consideration (i.e. money or money's worth) will be taxable under the GST. Exceptions to this rule are most health and dental services, day-care services, most educational services, most supplies by charities, most domestic financial services and certain supplies by non-profit organizations, governments, and other selected public sector organizations which will be "exempt" supplies; basic groceries, prescription drugs and medical devices which will be "zero rated" goods.

B) Timing

Liability for payment of GST on the value of the consideration for a supply will arise on the earlier of (i) the date payment is made or (ii) payment for the supply becomes "due" determined under specific rules. In addition, there is an "override rule". For most suppliers, payment is considered to become due on the date an invoice for the supply is issued, or the date of the invoice, whichever is earlier. Specific rules are contemplated for, among other things, continuous supplies, progress payments and deposits.

No tax is exigible on deposits in respect of a subsequent supply except to the extent the deposit is credited towards payment or forfeited.

The "override rule" provides that liability for GST in respect of a supply (of goods or services) can never go beyond the end of the month following the month in which the supply is completed (e.g., if a service was completed January 1, liability cannot be postponed beyond February 28). For most services, the Technical Paper states a service is completed when it is substantially completed.

C) Filing Requirement

Registered vendors will be subject to a monthly, quarterly, or annual reporting period depending upon sales volume as follows:

- Registrants with annual revenue from taxable and zero-rated supplies of $6 million or more must file monthly.

- Registrants with annual revenue from taxable and zero-rated supplies of $6 million or less must file quarterly but may elect to file monthly.

- Registrants with annual revenue from taxable and zero-rated supplies of $500,000 or less have the further option of annual filing with quarterly installments.

The fiscal year chosen for computing the reporting period may be the registrant's calendar year or its taxation year for income tax purposes, at its option. A return, together with remittance of any net GST due, will have to be filed one month after the end of the registrant's reporting period. Refund claims, where applicable, are also to be made in the return; interest on refund claims will be paid from 21 days after the registrant's return is received by Revenue Canada.

D) GST Terminology

The following terms used in the Technical Paper and Draft Legislation are also used throughout this Report.

(i) Persons

The term person will include an individual, partnership, corporation, trust, estate, society, union, club, association, organization and any other body of any kind whatever. Notably a partnership is a person and therefore the partnership (and not the partners) will be required to become registered as a vendor and file returns for GST purposes.

(ii) Commercial Activity

The term "commercial activity" will be defined to include generally any business carried on by a person and the supply of real property but will exclude employment and any activity of a person that relates to the making of an exempt supply by that person and any activity without a reasonable expectation of profit.

This is a key concept for the purposes of the GST as characterization of an activity as a commercial activity will determine both a person's obligation to register as a vendor and collect taxes and the person's entitlement to input tax credits in respect of the activity.

(iii) Goods

The term "goods" is to have the meaning assigned in the Customs Act. Generally this will include all tangible personal property (personal property you can touch, etc.) and animals.

(iv) Property

The term "property" will mean property of any kind whatever but does not include money.

(v) Real Property

The term "real property" will, in addition to, its usual meaning include in Quebec immovable property and a lease in respect of such property in Quebec and elsewhere in Canada include any estate or interest in respect of real property. Finally, the term will also include a right to explore or exploit mineral deposits and other natural resources and generally any production royalty with respect to a mineral resource.

(vi) Personal Property

The term "personal property" will mean any property that is not real property.

(vii) Services

The term "service" will mean anything other than property, money and anything supplied to an employer by an employee in the course of his employment.

(viii) Supply

The term "supply" will generally mean the provision of property or service in any manner and includes sale, transfer, lease or disposition of property and any provision of service and any agreement to provide any property or service.

(ix) Supply Made in Canada

Special rules are set out in the Draft Legislation to determine whether a particular type of supply is made in Canada. For most services (i.e. other than a service in respect of real property, or a telecommunications service), the supply will be considered to be made in Canada if the service is performed in whole or in part in Canada.

(x) Taxable Supply

A "taxable supply" will mean any supply other than an exempt supply made in the course of a commercial activity.

(xi) Exempt Supply

An "exempt supply" will be defined by Schedule, as discussed further below in Chapter 4, to include specifically defined categories of supplies including most health and dental services, day-care services, most educational services, most supplies by charities, most domestic financial services and certain supplies by non-profit organizations, governments, and other selected public sector organizations.

No tax is levied on the purchase of exempt supplies but a person making exempt supplies is not entitled to an input tax credit for the taxes it pays on the property and services it purchases to make such supplies. In effect a person making exempt supplies is treated as the consumer of the property and service it purchases. The effect of exempt treatment is to tax the inputs but exclude the value added in or exempt supply.

(xii) Zero Rated Supply

The term zero-rated supply refers to supplies of properties or services on which a zero-rate of tax is applied but which entitle the registered vendor supply if such services in the course of a commercial activity to full input tax credits. In effect, these supplies are taxable at a zero rate; therefore no tax is chargeable to the purchaser but the supplier is entitled to a full input tax credit. The supply of services related to the export of goods and of services will be zero-rated. Specifically defined categories of goods including basic groceries, prescription drugs and medical devices will be zero rated.

(xiii) Input Tax Credit

Subject to certain restrictions and requirements, the term "input tax" credit refers to a mechanism to allow a "registered vendor" to recover the GST paid or payable by it on its

(i) purchase of taxable property and services, and

(ii) importation of goods into Canada,

to the extent such property and services were acquired for use in a commercial activity.

(xiv) Registered Vendor

Subject to the $30,000 threshold for small traders, every person engaged in a commercial activity who makes taxable (or zero rated) supplies of property or services is required to become registered and to collect and remit GST on taxable sales. Status as a registered vendor is also required as a condition to claiming input tax credits.

(xv) Value of the Consideration for a Supply

The term "value of the consideration" for a supply will be defined, generally, to mean the amount paid or payable for a supply. In the case of supplies between related persons it will mean the fair market value of the supply.

(xvi) Exports

Exported property and services will, generally, be "zero rated". The Draft Legislation lists by schedule the property and services, including exported supplies, that are zero rated.

(xvii) Imports

Imported goods which are neither zero-rated nor exempt will be taxable to the importer of record at the time of importation.

Imported services will be taxed, as such, on a self-assessment basis, where imported for use other than in a commercial activity (i.e. for personal use or in the provision of an exempt supply of property or services). A registered vendor who imports a service for use in making a taxable supply will not be entitled to an input tax credit with respect to the imported service. Therefore, GST will be imposed indirectly on that element of his selling price when the registered vendor makes a taxable supply of property or services.

(xviii) Exempt Suppliers

A supplier of exempt property or services is denied any input tax credit for the GST on property and services purchased for use in such exempt supply. Such a supplier is, in effect, treated as the consumer in respect of the inputs it uses to supply an exempt property or services. Purchasers of an exempt supply of property and services pay no tax on the value of the consideration paid or payable for that supply and are entitled to no input tax credit in respect of that supply.

As noted above, a supplier of exempt property or services, and consumers, must self-assess for the tax on taxable imported services. For example, a financial institution which retains an architect outside Canada, who is not a registered vendor, to design a building in Canada will have to report and pay GST on the value of the consideration for the architectural services.

(xix) Wages and Salaries

Employment is not a commercial activity and therefore employees are generally outside the scope of the GST. Payments in respect of wages, salaries, and other remuneration (including pension plan contributions, etc.) are not taxable and therefore do not attract tax or entitle the employer to an input tax credit. However, the Technical Paper does indicate that in certain circumstances employees (i.e. commission salesmen)

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will be able to obtain a GST rebate (but not an input tax credit) for the GST paid on certain expenses they incur pursuant to their contract of employment for which they are not reimbursed to the extent they are entitled to deduct those outlays and expenses for income tax purposes.

Fees charged by a person engaged in a commercial activity for the services of its employees (such as cleaning services) will be subject to GST as a taxable supply unless the services fall within the exempt or zero rated category.

E) Input Tax Credits

The input tax credit mechanism is new to the Canadian sales tax system. Some witnesses appearing before the Committee were understandably confused about its operation and the likely impact on their business or industry. However, legitimate concerns regarding the impact of the credit mechanism on compliance and cashflow were raised by business organizations whose members would normally be in an refund position under the new system.

This section of Chapter 2 addresses generally the input tax credit mechanism, including entitlement and apportionment. In addition, it reviews the Committee's deliberations and recommendations regarding the restrictions represented by witnesses as being particularly burdensome and creating needless complexity. The Committee's concerns and recommendations regarding the input tax credit complications resulting from provincial sales tax are also discussed.

Another section of this Chapter reviews general operational aspects and witnesses' representations that taxing outputs and crediting inputs will add to operating and financing costs. Chapter 4 discusses specific concerns of small business. The Committee's deliberations regarding the compliance cost of apportionment for specific dual status organizations, are contained in Chapters 3, 7, 8, 9 and 11.

(i) Technical Paper Proposals

The Technical Paper indicates that vendors who have registered to collect the tax will generally be entitled to recover the tax paid on their purchases to the extent such goods and services are acquired for use in a commercial activity. Section 108 of the Draft Legislation reduces somewhat the requirement to allocate for incidental use. It provides that property or service shall be deemed to be used exclusively in the course of commercial activities, if substantially all of the consumption, use or supply of that property or service is in the course of commercial activities. Conversely, the property or service will be considered used exclusively in the course of non-commercial activities if substantially all of the consumption, use or supply of that property or service is in the course of non-commercial activities.

A registrant generally will not be able to claim an input tax credit for the tax on a purchase until a satisfactory invoice, or other documentation of the tax paid or payable, has been obtained from the supplier. (Another section of this Chapter discusses documentation requirements.) There will be no matching requirement with respect to purchases and sales as

a condition to claiming an input tax credit on a particular purchase. Rather, if an organization makes only taxable or zero-rated supplies, generally it will be entitled to recover all of the GST paid on its purchases in the period of acquisition. However, an organization will not be able to recover any input tax credit in respect of its purchases if it makes only exempt supplies. A charity, a qualifying non-profit organization (NPO) or a registrant in the "MUSH" sector may, however, obtain a partial rebate under the separate rebate mechanisms established for groups in this sector.

The Technical Paper outlines various exceptions to the basic rule that registrants will be entitled to recover, through the input tax credit mechanism, the tax paid on their purchases, to the extent such goods and services are acquired for use in a commercial activity. The exceptions include:

- real property and improvements to real property purchased by charities, NPO's and those in the public sector. Input tax credits will be allowed for these organizations only if the real property is acquired for use primarily in a commercial activity; and

- capital property, and improvements to capital property, purchased by registrants, other than financial institutions. Full input tax credits will be allowed for such registrants only if the capital property is acquired for use primarily in a commercial activity.

Because of the foregoing entitlement rules, allocations of input tax credits will be necessary in various circumstances. For example, since an organization making both exempt and zero-rated (tax-free) or taxable supplies, will be entitled to claim input tax credits in respect of some of its input taxes but not others, it will be necessary for such organization to allocate its input taxes in some appropriate manner. Some such dual status organizations will be free to make such allocations, in any reasonable manner, between those for use in non-commercial activities and those for use in commercial activities. However, other dual status organizations, such as financial institutions, may be required to follow as-yet-to-be-defined allocation rules. As previously noted, other organizations, such as those in the "MUSH" sector, will use as-yet-to-be-known percentages to calculate a rebate under a separate rebate mechanism.

Allocations of input tax credits will also be necessary where registrants make personal use of business inputs, where registrants (other than charities, NPO's and those in the public sector) purchase real property and improvements to real property, and where financial institutions acquire capital property. No allocations will be necessary with respect to capital property acquired by non-financial institutions or real property acquired by charities, NPO's and those in the public sector. Rather, as stated above, input tax credits will be allowed for these registrants, purchasing these properties, only if the property is acquired for use primarily in a commercial activity, in which case a full input tax credit may be claimed.

Recognizing that the relative proportion of commercial use to total use may change over the life of the asset, change-of-use rules are proposed in the Technical Paper for both

capital property and real property. To avoid the rules applying regardless of the degree of change, a de minimis rule is contained in the Draft Legislation. Section 238 provides that the use of the property shall be deemed not to have changed if the change-in-use is less than 10% of the total use of the property, deeming this change-in-use "insignificant". The same section deems a change will, however, not be considered "insignificant" if the primary use of the property has changed.

Generally, the Technical Paper proposes that provisions, similar to provisions in the *Income Tax Act*, will deny input tax credit entitlement in respect of:

° membership fees or dues in any club whose main purpose is to provide dining, recreational or sporting facilities;

° personal or living expenses not incurred during business-related travel;

° the portion of the cost of automobiles in excess of the cost deductible for income tax purposes;

° 20% of meals and entertainment expenses, that is, the portion of these expenses in excess of the amount deductible for income tax purposes;

° acquisitions by employers of goods or services all, or substantially all, of the acquisition of which is for the personal use or benefit of the employee;

° capital property, other than real property, purchased primarily for a non-commercial activity; and

° real property acquired primarily for the owner's personal use and enjoyment.

Under the Technical Paper proposals, employers are generally required to collect the GST from employees with respect to employee benefits, and remit in the normal manner. The value of the benefits would be determined and become taxable once a year, at the time the T4 Information Returns for the employees are prepared. Also, the general rule is that, where a property is acquired partly for commercial use and partly for the employee's personal use, a full input tax credit would be available to the employer, and the benefit to the employee would be subject to GST in the manner just described. Where no input tax credit is available to the employer, such as in the circumstance outlined in (e) above, no GST will be payable on the amount of the employee benefit.

There is an exception to the full input tax credit entitlement rule where a passenger vehicle is acquired or leased by registered self-employed individuals partly for commercial use and partly for personal use. Rather than allowing a credit, the Technical Paper proposes to allow the individual to claim a credit at the end of the fiscal year equal to 9/109 of the capital cost allowance in respect of the vehicle, as claimed for income tax purposes. Thus, some credit is available to self-employed individuals even when personal, non-commercial use is the main purpose, that is, greater than 50 percent. Similar exceptions exist to the full input tax

credit entitlement rule where a passenger vehicle is acquired or leased by certain partners and employees. (The treatment of partner and employee expenses is discussed in Chapter 13.)

(ii) Witnesses' Representations

Witnesses, such as the Canadian Medical Association and the Association of Universities and Colleges of Canada, represented that compliance costs will increase because of the need to allocate input taxes between those related to tax-exempt supplies and those related to taxable or zero-rated supplies. Other witnesses, including the Private Sector Supply to Government Group, the Canadian Association of Data and Professional Service Organizations, and the Canadian Advanced Technology Association, represented that the lack of rebates for organizations making tax-exempt supplies, such as financial services, and the partial rebates for selected other groups, such as charities, NPOs and the MUSH sector, indicate both a potential towards self-supply and a tax cascading effect where the supply is made to a registered business. Witnesses also represented that, each time special treatment is granted, additional complexities, inequities and economic inefficiencies are created. Recommendations were therefore made to the Committee that zero-rated (tax-free) rather than tax-exempt treatment should be used if special treatment must be given.

The Society of Management Accountants of Canada, the Tax Executive Institutes Inc., the Canadian Manufacturers Association, and the Retail Council of Canada were some of the witnesses who recommended eliminating all or most of the special restrictions on input tax credits for club memberships, passengers vehicles, meals and entertainment. It was represented to the Committee that the proposed rules to restrict credits increase the compliance burden and seem to have limited rationale, in a consumption tax system, other than paralleling the Income Tax Act. However, other witnesses made opposite representations and recommendations. For example, the Canadian Labour Congress recommended the credit for business meal and entertainment expenses be eliminated, unless incurred during business-related travel. The Committee did not receive specific representations with respect to the input tax credit restrictions involving capital goods and real property.

Numerous witnesses, including the Canadian Chamber of Commerce, the Canadian Federation of Independent Business, the Canadian Organization of Small Business and the Retail Council of Canada, represented to the Committee that the lack of a joint federal/provincial system will increase complexity and business compliance costs.

(iii) Committee's Conclusions and Recommendations

1. Entitlement and Apportionment

The witnesses' concerns about complexity were of prime importance to the Committee. The Committee feels the system must be as simple as possible so that business compliance costs and government administrative costs are minimized. The Committee sympathizes with the witnesses' concerns about self-supply and tax-cascading. The Committee also recognizes certain activities are difficult to tax, and some degree of complexity in the system stems from the perceived need to exclude certain items, such

as basic groceries, from the tax base to avoid regressivity. (Chapter 3 discusses this matter further.)

Although zero-rating rather than exemption avoids the complexity of apportionment and reduces the potential for self-supply, pressure is increased on "borderlines" where the former rather than the later treatment is used. Exempt treatment may be appropriate for those organizations which the government does not wish to register. Exemption may also be appropriate where the government wishes to provide partial relief, by removing the tax on the value added by an organization but not on the inputs it uses in making exempt supplies.

As stated in Chapter 3, after careful deliberation the Committee believes the balance struck in the Technical Paper between taxable and zero-rated and exempt supplies is generally a reasonable one. Therefore the Committee proposes no major tax status changes, except in the area of financial institutions, discussed separately in Chapter 11.

The Committee also does not make a recommendation regarding the general entitlement and apportionment rules, feeling they are reasonable. The Committee compliments the government's attempt to reduce the need for registrants to pro-rate supplies between commercial and non-commercial activities, for purposes of obtaining the input tax credits and for purposes of applying change-of-use rules for capital and real property. However, although the provisions are intended to help simplify compliance with the GST, it may, in certain circumstances, be difficult to determine whether the "substantially all" test (set out in the Section 108 de minimis rule) has been met or whether the 10% "insignificant" test (set out in the Section 238 de minimis rule) has been met. The Committee nonetheless agrees with these provisions. (However, it recommends an additional de minimis rule in Chapter 4.)

2. Restrictions on Credits

The Committee recognizes both the policy argument for taxing the personal consumption component of automobiles, meals and entertainment, and the importance of making compliance under the GST system as simple as possible. Therefore, while not wishing to abandon either of these objectives, the Committee reviewed several simplifying policy options, including whether to:

a. leave all restrictions on credits as proposed but implement a simplified annual adjustment to the input tax credit claimed in the immediately preceding taxable year. For example, the Committee considered the possibility of allowing full input tax credits during the course of the year but requiring an appropriate adjustment at the time of filing an income tax return, recapturing the input tax credit allowed on 20% of the GST on meals and entertainment expenses; or

b. eliminate the passenger vehicle restriction and/or the meal and entertainment restrictions on GST input tax credit entitlement and, instead,

increase the non-deductible income tax portion. That is, since the mechanism for taxing the personal consumption components already exists in the income tax system, the Committee considered the possibility of substituting, for the denial of full input tax credits, an increase in the non-deductible portion of the outlay or expense under the income tax system. (For example, 20% non-deductible portion of meals could be increased to 22%.)

As the Committee feels it is of utmost importance to make the GST system as simple as possible, the Committee recommends:

19. That full GST input tax credit be allowed for meal and entertainment expenses, and for passenger vehicles purchased or leased, including those purchased or leased by self-employed individuals, partners and persons meeting the criteria of paragraph 8(1)(f) of the Income Tax Act. If the Minister deems it advisable to make appropriate adjustments because of the personal consumption component, the changes should be made by amending the Income Tax Act. The Income Tax complications should not be added to the legislation implementing the GST

3. Provincial Sales Tax Complications

The Committee recognizes the process of identifying the input tax credits for persons doing business in two or more provinces is complicated by the existence of provincial retail sales tax (PST) on inputs purchased for consumption. Since GST will be applied to the selling price of a supply exclusive of any PST, the input tax credits claimed in respect of a supply must be calculated on the purchase price exclusive of the PST. The Committee also recognizes that complications increase where the value on which PST is payable varies by province. For example, some provinces may charge their PST on the GST; others may impose PST on the selling price exclusive of GST. Where the PST rate applied to the level of inputs varies as a result of purchasing in provinces with different PST rates, complications increase which may require sophisticated accounting procedures to trace the GST separately.

Because of the potential complications, the Committee recommends:

20. That a simplified method to eliminate the provincial sales tax component prior to determining input tax credits be allowed. The optional simplified method could involve use of a reciprocal tax factor to determine the GST input tax credit on the gross selling price including provincial sales tax and GST. An adjusted reciprocal factor to reflect an assumed tax status and value combination could be used where a business is supplying goods with a different tax status for provincial sales tax and GST purposes.

For example, assume the PST rate for a province is 10%, the selling price exclusive of GST and PST is $100.00 and the price including PST and GST is $119.90. Under the 9% GST, a simplified reciprocal factor of 7.51% could be used to determine that the GST input tax credit was $9.00. In the same situation, but with a GST rate of 7% and a tax included price of $117.70, a simplified reciprocal factor of 5.95% could

be used to determine that the GST input tax credit was $7.00. The Committee believes this will reduce compliance and administrative costs.

If provinces include the GST in the tax base, a related concern is the businesses' ability to recover the PST paid on the business inputs that are subsequently refundable under the GST input tax credit mechanism. For example, in construction supply and install contracts, PST recoveries will be complex since the GST will be charged, and input tax credits taken, on many goods and services on which the PST has been charged. The Committee believes that businesses should not have to make PST refund claims or adjustments on each and every transaction in a province where the necessary legislative changes have been made to ensure the business is a consumer for PST purposes. Rather some sort of pro-rata aggregate adjustment should be made where PST is calculated on a value that includes GST, and the GST is subsequently recovered.

Therefore, the Committee recommends:

21. That the government cooperate with the provinces to ensure GST input tax credits are treated as a price adjustment for PST purposes.

F) Documentation Requirements

Documentation requirements affect both business compliance costs and financing costs. As pointed out in the previous section of this Chapter, a registrant generally will not be able to claim an input tax credit in respect of the tax paid on a purchase until a satisfactory invoice, or other documentation of tax paid or payable, has been obtained from the supplier. If it is hard to determine the input tax credit amount, compliance costs will increase. Also, if it is hard to obtain satisfactory support for the tax paid or payable, since credits may be delayed, financing costs will increase. Therefore, the general position of the Committee is that the documentation requirements should be as flexible as possible, within the constraint of protecting against over claiming of tax (or tax avoidance).

(i) Technical Paper Proposals

In the Technical Paper, the Government says its approach to documentation requirements will rely on existing business records and invoicing practices and that, as a consequence, the GST will involve little, if any, change to existing billing practices. Vendors will be subject to certain documentation requirements, both to provide evidence to purchasers that their tax liability has been discharged and to verify their input tax credit claims.

In order to minimize documentation costs for vendors, the Technical Paper states there will be no restrictions on the form or physical characteristics of documents used to support input tax credit claims, provided they meet certain basic information requirements. The information that registrants will be required to obtain from their suppliers will vary depending on whether the value of the supplies is less than $30.00, at least $30.00 and less than $150.00, or $150.00 or more.

No supporting documentation to support input tax credit claims is required in certain circumstances, such as where reasonable per diem reimbursements are made to employees. Registered vendors will be under a general obligation to issue an appropriate document, containing the requisite information, if requested to do so by a registrant to whom a taxable supply is made. However, registered vendors are given the option of either selling tax-included (with an indication to the effect that prices include GST) or tax-excluded (with separate indication of the tax amount).

(ii) Witnesses' Representations

Witnesses represented that business compliance cost may increase, and credits may be inaccurately claimed, where the actual GST amounts are hard to determine. For example, the Canadian Institute of Chartered Accountants represented that information as to actual GST amounts may be hard to determine, or inadequate, in the travel and hospitality industry. They also represented that identification of GST would be difficult where gratuities and provincial retail sales tax (PST) are on documents. Other witnesses, such as the Canadian Gift and Tableware Association and the Commercial Travellers' Association of Canada, represented the invoice dollar amounts for information requirements are too low, suggesting alternative amounts.

Witnesses, such as the Consumers Association of Canada, the Canadian Labour Congress and the Canadian Federation of Labour expressed concerns regarding the Technical Paper's proposal of optional pricing. The Tax Executive Institute Inc., the Canadian Institute of Chartered Accountants, the Society of Management Accountants of Canada and the Council of Forest Industries of B.C. where some of the witnesses recommending optional pricing be removed and separate identification of the GST amount required, except in clearly defined situations. Various business organizations, including the Edmonton Chamber of Commerce, the Vancouver Board of Trade and the Saskatchewan Chamber of Commerce represented that tax visibility is important to control revenue increases.

(iii) Committee's Conclusions and Recommendations

1. Identification of Credit Amount

Situations may arise where, because of insufficient documentation, payment for goods and services purchased is made prior to being able to claim the credits. In other circumstances, input tax credit amounts may be hard to determine. Since it is important to be able to identify taxes paid on purchases at the earliest opportunity in order to protect against negative cashflow effects, the Committee recognizes the importance of making this identification process as easy as possible.

The Committee is therefore sympathetic to businesses' concerns about compliance and cashflow, and believes that documentation requirements should be as flexible as possible. Although the Committee does not feel the arbitrary

dollar amounts for additional invoice information should be increased, the Committee recommends:

22. That businesses be allowed to claim a standard percentage on GST tax included (invoiced and non-invoiced) purchases as a GST credit when information as to actual amounts may be inadequate and the risk of revenue loss from error is not significant. The input credit could simply be calculated by applying an appropriate reciprocal factor. Satisfactory documentary evidence should be maintained by the registrant.

For example, the reciprocal factor of 8.25% (i.e., 9/109) under the 9% rate proposed in the Technical Paper could be authorized for use where inputs purchased do not include PST. A reciprocal factor of 6.54% (i.e., 7/107) under the 7% rate proposed by the Committee could be used where inputs purchased do not include PST. To the extent that PST is imposed on the purchase of inputs to a commercial activity, it will be necessary to eliminate the PST component prior to applying the faction 9/109 (or 7/107) to arrive at total GST paid on taxed inputs. To simplify, as discussed in the previous section of this Chapter, a reciprocal factor reflecting combined federal/provincial rates, or a deemed combined rate, could be used to determine the GST input tax credits. Wherever possible, aggregate calculations should be allowed, and estimates and rounding permitted.

2. Optional Pricing

The Committee understands the concerns expressed regarding the optional pricing proposals. However, it recognizes the current federal sales tax is entirely hidden from the consumer and the GST will achieve a great deal of visibility. The Committee is also sympathetic to retailers' and small businesses' representations to have the tax as easy as possible to collect, placing as few demands as possible on cash registers to select between taxable and exempt sales under both a federal and provincial regime.

The Committee considered the Department of Finance's representation that the federal government lacks constitutional authority to mandate tax "extra pricing". It also considered that, based on other countries' experience, vendors will likely sell on a tax inclusive basis at the consumer level and on a tax extra basis to registered persons. The Committee recognizes there are good reasons for not requiring GST identification by retailers to the final consumer, including the impractical nature in certain types of businesses and the potential to use such documentation falsely.

The Committee acknowledges the Technical Paper proposals to provide retailers, pricing tax-included, with signs indicating the GST is included in the price. Consumer confusion, represented by some witnesses to be of concern, should be lessened because of the use of signs. The promotion by the government of consistent pricing and advertising practices, through consultation with business associations and advertising councils, should decrease the potential for competitive inequities.

For the foregoing reasons, the Committee concludes that the Technical Paper proposals for optional pricing are reasonable.

G) Direct Mail Imports

Under the current law the Postal Imports Remission Order and Courier Imports Remission Order provide duty and tax relief on importation of goods through couriers and the post office if the value for duty does not exceed $40, or the aggregate of duties and taxes does not exceed $5.

The Technical Paper proposes to amend these orders upon introduction of the GST to exclude books and periodicals in order to allow for the application of GST to imported book and periodical subscriptions. This is intended to ensure that sales of books and magazines, both foreign and domestic, are placed on an equal footing for GST purposes.

The Committee was told by the Canadian Magazine Publishers Association that the proposal to tax foreign publishers on their subscription sales in Canada was unenforceable. They argued that these publishers would refuse to collect GST on their Canadian subscriptions and would instead mail magazines more cheaply to Canadian subscribers directly from outside Canada. The CMPA told the Committee that it would be impossible for Revenue Canada to police the imposition of GST on these magazines and periodicals because they could not be ascertained amongst the millions of pieces of mail entering Canada daily. As a result foreign magazine subscriptions could be sold to Canadians without GST while similar Canadian magazines would be subject to GST.

However, the Committee was told by officials of the Department of Finance that imposition of GST on foreign publishers was possible and has been accomplished without difficulty in value added tax jurisdictions such as France. The Committee was told that policing the imposition of GST on non-complying foreign publishers could be achieved by arresting the bulk shipments of large foreign publications destined for sale on Canadian newstands. Since magazines for sale on newstands must be shipped in bulk Revenue Canada will have easily identifiable goods for border inspection in the event these publishers are not remitting GST on their Canadian subscription sales.

The Committee believes that the means to enforce the imposition of GST on subscription sales by foreign publishers in Canada are adequate. Therefore the Committee supports the proposals of the Technical Paper.

H) Operational Aspects

This section addresses general operational aspects of the GST contained in Section 2.8 of the Technical Paper. It also reviews the representations received by the Committee with respect to the impact taxing supplies, while allowing an input tax credit, will have on operating and financing costs.

(i) Technical Paper Proposals

The Technical Paper proposes every registrant will have a single fiscal year for reporting purposes which will be divided into reporting periods in the case of monthly or quarterly filers. Registrants will have the option of selecting either the calendar year or their fiscal year or, if it is more convenient, their fiscal period for income tax purposes. Registrants will calculate their net GST remittance or refund on a periodic basis (monthly, quarterly or annually) depending on sales volume.

Registrants with taxable and zero-rated sales in excess of $6 million per year will be required to file GST returns and remit tax on a monthly basis. Registrants with annual taxable and zero-rated sales of $6 million or less will be required to file and remit on a quarterly basis, with the option of filing monthly. Registrants with annual taxable and zero-rated sales of $500,000 or less will also have the option of filing annually and remitting instalments quarterly. Where the net tax remittable is less than $1,000, instalments will not be necessary under this option.

The Technical Paper proposes that both quarterly and monthly filers will be required to file their return, and remit net GST owing, within one month following the respective reporting period. Penalty and interest will be calculated at prescribed rates on any late payments and will be charged from the due date of the return. Where a refund of tax is due, refund interest will be credited from the twenty-first day following the date on which the registrant's return is received by Revenue Canada.

The Technical Paper contains an option to file on a divisional basis, where the divisions are identifiable according to certain criteria. No special rules have been proposed for transactions between related parties.

(ii) Witnesses' Representations

Some organizations represented to the Committee that the threshold limits for filing and remitting should be adjusted to enable more businesses to file less frequently. The Canadian Council of Grocery Distributors recommended allowing all retailers to file quarterly. The Canadian Gift and Tableware Association and the Commercial Travellers' Association of Canada suggested the $500,000 threshold should be increased to $1 million to allow more businesses to file annually.

Many witnesses including the Canadian Institute of Chartered Accountants, the Independent Petroleum Association of Canada and the Entertainment Tax Action Committee, represented that the proposal for paying interest for refunds on the twenty-first day was inadequate and could result in additional financing costs for business. Several witnesses, including the Western Barley Growers Association and the Alberta Cattle Commission, recommended "directly" excluding major farm inputs from the tax to alleviate the cashflow cost to farmers. Other witnesses, including the Canadian Federation of Farm Equipment Dealers Association and the Canadian Retail

Hardware Association, represented more general concerns regarding the effect of taxing outputs and crediting inputs on operating and financing costs.

Mr. Wolfe Goodman recommended allowing all sales by one registrant to another to be made tax free, on production of an exemption certificate. Another witness suggested that firms should be allowed to assign input tax credits to other firms which are in position to immediately utilize the input tax credits.

The additional financing costs for exporters was also represented by some to be of concern. Witnesses speaking on cash flow impacts of export-orientated businesses included, the Canadian Exporters Association and the Independent Petroleum Association of Canada.

There were also representations from witnesses that GST could be a factor in setting up legal entities since no provisions are proposed in the Technical Paper to permit consolidated returns for associated corporations. To avoid inter-entity transactions having GST consequences in each reporting period, businesses may consider restructuring. Witnesses represented that the complexities would be reduced if a group filing option were permitted. For example, the Canadian Institute of Chartered Accountants stated in their brief that if related companies had:

> "...the option of filing their returns on a consolidated basis. This would simplify the GST process for both the government and the registrants. It would reduce the number of returns, reduce the number of net refund claims and government cheques, and eliminate the registrant workload of assessing the GST on transactions between the related companies, e.g. data processing services."

Witnesses represented additional concerns for suppliers of financial services. For example, the Tax Executive Institute Inc. recommended that transactions between entities within a controlled financial group be made tax free or, alternatively, the government's Acts be amended to permit financial institutions to perform otherwise prohibited activities in-house. Further tax cascading on financial services would occur if these recommendations were not implemented. (The problems and discussions with respect to financial services are discussed in detail in Chapter 11.)

(iii) Committee's Conclusions and Recommendations

1. Filing Requirements

The Committee reviewed the threshold limits for required filing frequency. Representations from the Department of Finance indicated that the vast majority of businesses will be filing quarterly. Only approximately 30,000 will be required to file monthly and approximately one million firms will qualify for annual filing, with quarterly returns if they so desired. Relying on these representations, the Committee concludes the proposed sales levels for filing requirements are reasonable. The Committee also concurs with the dollar limits proposed for

requiring installments to be paid, recognizing the concerns by many, including the Department of Finance, that the higher the outstanding tax liability at the end of the year, the greater the potential for cashflow problems for smaller suppliers.

2. Cashflow

The Committee recognizes that the degree to which the GST will affect cashflow will depend on many factors, including the tax status of the supplies made, the terms of trade between customers and suppliers and the frequency of GST filings. For those registrants that will normally be in a liability position at the end of each reporting period, the change over to the GST system may in fact have a positive effect on cashflow, particularly if the business currently sells goods subject to federal sales tax and is able to start on implementation date with a tax-free inventory.

However, the Committee also recognizes that persons in a net credit or refund position, such as farmers and businesses that are heavily export-oriented, could experience a significant negative cashflow impact, especially if they are smaller businesses not electing to file on a more frequent basis in order to accelerate refunds. The Committee therefore reviewed several ways to try to lessen this impact.

The Committee rejects the suggestion to eliminate any lag time between the date on which interest on refund is calculated and the date the refund entitlement occurred. The additional administrative cost of performing interest calculations on virtually all claims is the main consideration. In addition, the Committee realizes that the extra interest cost would have to be borne by the tax system. It feels that the 21 day rule will ensure no direct loss to businesses from undo delay of processing the refund claim. The government should not be expected to compensate for the float being held by the vendor.

A prime objective of the new sales tax system is to ensure that ultimately the tax applies only on the value of final consumer sales and that all business input are relieved from the tax. Therefore, the Committee also rejects the suggestion to allow all sales by one registrant to another to be made tax-free, on production of an exemption certificate. To free capital goods and other businesses purchases from taxation, the Committee feels the input tax credit mechanism is superior to the exemption certificate mechanism used in retail sales tax systems. The suggestion to allow assignment of credits is rejected on similar grounds.

The Committee does not feel the option to make a limited number of purchases directly exempt to certain groups is appropriate since special treatment such as this would increase both the compliance cost of suppliers and the potential for abuse. It would also be difficult to decide which inputs and which groups to restrict the special treatment too.

That is, would the special treatment be restricted to major farm inputs to farmers and major fishing inputs to fishermen, or would similar treatment for inputs to other groups be allowed. Also, would only inputs specifically designed for the industry be allowed direct exemption, or would other goods commonly used by the group be allowed special treatment. The Committee considered that the cashflow impact to farmers and fishermen would probably not be negative, and maybe would be positive, if supplies by them were taxable. Consideration was also given to the fact that the benefits of full recovery of input taxes may offset somewhat the negative cashflow impact for zero-rated suppliers.

However, the Committee concurs that cashflow is a legitimate concern for businesses where transactions are for the most part outside of the normal course of the business. It therefore recommends:

23. That on transactions where both parties are registrants and goods, other than inventory and commercial properties exceeding $1 million, are supplied, GST be collected by the vendor and the input tax claimed by the purchaser on a notional basis only. That is, GST should be deemed collected and the corresponding input tax credit deemed claimed where the vendor and purchaser complete and file a prescribed form, containing details of the transaction, and Revenue Canada, Customs and Excise approves the notational collection and claim. Submission of satisfactory evidence that the proposed use will entitle the purchaser to a full input tax credit should be required, and the procedure should be allowed only in respect of purchases of goods (other than inventory) greater than $100,000, where a registered vendor has annual taxable sales greater than $500,000, and of purchases greater than $30,000, where a business has annual taxable sales less than or equal to $500,000.

Although, some compliance cost is involved in specific clearance of a transaction in the manner outlined, the procedure would be optional, and therefore likely used only on high price items by registered vendors in a net refund position. Businesses will benefit where the cost of financing the tax amount, between the time the purchase is made and the credit is received, outweighs the cost of filing the appropriate forms. The procedure ensures no negative cashflow effect when qualifying businesses make purchases outside the normal course of business, including purchases of such things as tractors, office buildings, large construction equipment and commercial property having a value of less than or equal to $1 million. (The recommendation regarding clearance certificates for commercial properties exceeding $1 million is contained in Chapter 7 of this report.)

3. Group Filing

The Committee carefully considered whether an economic entity should be allowed to report sales to outsiders and ignore sales within the group. It agrees that tax proposals should not cause businesses to alter their corporate structure, and recognizes the incentive under our current federal sales tax system to restructure in order to lower the tax base.

The Committee reviewed the rules for group registration in various countries. For example, Germany, the Netherlands, New Zealand and the United Kingdom allow parent companies, and their controlled subsidiaries, to be considered one enterprise for the purposes of the tax if they are very closely integrated in financial, organizational and economic respect. Since, transfers within the group, including transfers of assets, common administrative costs and staffing, as well as sales of the goods and services from other groups, generally do not attract tax, the advantages of registering as a group are significant, particularly vis-à-vis holding companies.

Alternately, if group registration is not provided for, companies may review whether they should continue their separate corporate existence, based on evaluations of the cost of financing the GST burden as it is paid and subsequently credited. Also, since fees charged by related corporations will be subject to the GST, the increased GST costs of corporations providing services to related persons selling exempt supplies may outweigh the benefits of separate corporations for income tax and other purposes. For example, health professionals may wind up their management service corporations when GST is implemented.

Although the Committee understands the GST consequences of inter-entity transactions, it also understands the Department of Finance's reasons for not proposing the option. They represented that their thinking:

> "...was really guided in the first case by the experience of a variety of European value added tax systems, which have allowed consolidated returns in group filing, and their experience was that they found it extremely hard to track and then enforce the tax properly."

For example, there is a potential to increase the input credits available, by grouping a company making exempt or partially exempt sales with a company making taxable sales. Thus, although the Committee does not wish to have GST as a factor in decisions regarding corporate structure, it believes any rules should be restrictive.

Therefore, the Committee recommends:

24. That certain related groups be allowed to elect to be treated as a single entity for GST filing purposes only. The related group given the option of group registration would be a related group as defined in Section 251 of the Income Tax Act, except that control would be deemed to mean 100% ownership. A member company could be designated as being responsible for accounting for the GST for the entire group. Although individual member companies would thereby be relieved of responsibilities to file returns, they would still be required to issue tax invoices and keep records. Also, although only one registration number could be given the group of companies, for control purposes individual member companies could be required to register as part of the group.

Businesses, who have had to set up separate companies for financing or other purposes, should have reduced compliance costs because of the foregoing recommendation.

3. DEFINING THE TAX BASE

The enactment of any new system of generalized sales taxation necessarily entails a detailed study of those goods and services which should bear the tax and those whose special status in our society merits their exclusion from taxation.

The Committee heard extensive testimony from Canadians who felt the base of the GST was either too broad or too narrow. Those seeking a broader base included groups such as The Consumers Association of Canada, The Canadian Chamber of Commerce, the Canadian Federation of Small Business, the Fraser Institute and a number of expert witnesses including Professor Robert Clark and Mr. Wolfe Goodman all of whom supported a broader base to include such items as food along with a lower rate of GST. Those seeking a more narrow base argued that particular goods and services were of sufficient importance to Canadians as to merit exclusion from the GST. These witnesses included representatives of the Canadian Labour Congress, the Funeral Service Association of Canada, Weall & Cullen Nurseries, the Canadian Magazine Publishers Association, the Canadian Veterinary Medical Association, the Don't Tax Reading Coalition, the Bowling Proprietors Association, the Prince Edward Island Draft Horse Association, and the Christmas Tree Council.

In examining the tax base as defined in the Technical Paper, the Committee has concluded that the balance struck between taxable and tax-free or tax exempt supplies is a reasonable one. As a result of its hearings across Canada however, the Committee believes a number of amendments to this chapter can be made to improve the efficiency and fairness of the GST.

A) Zero-Rated Supplies

(i) *Basic Groceries*

The Technical Paper proposes to zero-rate the sale of all basic groceries, that is, all sales of foods for preparation and consumption at home. However, two categories of food will be fully taxed.

Consistent with their treatment under existing federal sales tax, soft drinks, candies and confections and, snack foods will be taxable under the GST. For the purposes of the GST, definitions of soft drinks, candies and confections, and snack foods will be virtually the same as those in the existing *Excise Tax Act*.

In addition, restaurant meals and take-out prepared foods are not considered basic groceries and therefore will be fully taxable.

The question of whether or not to tax basic groceries was one of the most prominent issues in the course of the Committee's hearings. The Canadian Chamber of

Commerce was representative of numerous witnesses who argued in favour of a tax on food by pointing out that the GST would be vastly simplified for both consumers and businesses if artificial lines between prepared food and basic groceries were eliminated. With food in the tax base many businesses would be able to calculate their GST returns by merely subtracting their total purchases from their total sales and multiplying by the tax rate. Representatives of the Canadian Restaurant and Foodservices Association pointed out the confusing results that followed from the Technical Paper's proposal not to tax food: frozen pizza in a grocery store would be tax free but a take-out pizza from a pizzeria would be taxable; a whole pie would be tax free but a single serving would be taxable; a carton of milk from a grocery store would be tax free but the same carton of milk at McDonald's would be taxable.

Perhaps the most able description of this thorny issue came in a verse from Professor Robert Clark in the course of his comprehensive brief to the Committee. It read, in part:

What Is A Basic Food?

What is, I asked, a basic food
That should be free from tax?
I thought as I shopped at Safeway
With a little time to relax.

I looked at a tin of Helex
Snails, sixty-two grams, from France
The price for a dozen was $5.79
I looked at the tin askance.

"Are you", I mused, "a basic food?"
Expecting no answer, I guess.
But I thought I heard a faint reply,
And the answer was clearly "yes"....

Those witnesses who sought to tax all food acknowledged the regressive impact of a tax on food for poorer Canadians but they argued that the additional revenue received from taxing food could be used to increase the refundable sales tax credits and to lower the overall rate of GST on all other purchases. Moreover, they argued that all Canadians would benefit from the economic gains Canada would realize through a simplified system. Mr. Ken Battle, Director of the National Council on Welfare, summed up this position:

> "I accept the argument that there is an awful lot of leakage of tax revenue to high income people by exempting food, because we do know from family expenditure data that higher income people spend proportionately more money on food than do lower income people. Therefore a lot of the tax is being wasted on that top end.

The argument of course would be if you did tax food because that is such an essential, particularly for poor people, we would have a much larger refundable credit in order to offset the impact of tax on food, to make sure that the poor were protected."

(*Minutes of Proceedings and Evidence* of the Standing Committee on Finance, Issue No. 34, pp. 40)

Those witnesses who opposed extending the GST to basic groceries such as the National Anti-Poverty Organization, End Legislated Poverty, and the Canadian Labour Congress argued that even the most generous sales tax credits would be inadequate to compensate many poorer Canadians for a tax on basic groceries. They asked the Committee to consider that many poor families would, out of necessity, have to spend GST credits on the immediate needs of themselves and their children and would be unable to stretch their credits out over three months to cover any tax on basic groceries even if those credits were paid in advance every quarter. Moreover, they argued that many Canadians are incapable of claiming a tax credit through the tax system because of illiteracy, transience, mental disability or other reasons.

After careful consideration of these representations, the Committee endorses the conclusions of the Technical Paper that basic groceries be zero-rated despite the higher tax rate and complexities this brings to the GST.

In choosing to treat basic groceries as tax free the Committee recognized the need to carefully consider the definitions of those taxable food items that would remain outside the scope of basic groceries, namely soft drinks, candies and confection, snack foods, and restaurant meals and take out prepared foods.

The taxable status of soft drinks, candies and confection, and snack foods reflects their current treatment under the existing *Excise Tax Act* and most provincial retail sales tax systems. The Committee believes it would be unwise to further complicate the treatment of these items at the retail level by introducing a tax treatment inconsistent with that of most provincial retail taxes. The Committee is sympathetic, however, to the arguments of the Canadian Soft Drink Association and the Confectionery Manufacturers Association with respect to competitive inequities which may exist between the treatment of these items and other items recognized as basic groceries. The Committee would therefore urge that a regular review should be conducted by the Department of Finance to ensure competitive distortions are limited. However, as a consequence of the reduction in the current 13.5% rate of Manufacturers Sales Tax applied to these items to the 7% GST rate recommended by the Committee, albeit on a higher retail base, the Committee believes these competitive distortions are reduced.

Unlike the situation for those food items already taxed under the *Excise Tax Act*, the application of GST to restaurant meals and take-out prepared foods will require the implementation of new rules to define these supplies. The Technical Paper presented

two alternatives for incorporating restaurant meals and take-out prepared foods into the GST.

Option 1: under this method the tax status of the food is based on the nature of the vendor, the establishment itself.

Option 2: under this method the tax status of the food is based solely on the nature of the product itself. Under this method a specific list of prepared food products would be taxed regardless of the type of establishment from which they are sold.

Despite many representations concerning whether or not to tax food, the Committee received few representations with respect to the choice between Option 1 and Option 2. Only the Bakery Council of Canada expressed a strong preference in its choice of Option 2.

Nevertheless, the Committee has considered both options carefully. The advantage of Option 1 is that sales of food products are taxed consistently within each type of designated establishment. In restaurants, for example, all food products are treated as taxable. Therefore, the operation of GST becomes quite straightforward for these establishments. However in order to maintain competitive equity between restaurants and other eating establishments, certain differences are created under Option 1 in the treatment of sweetened baked goods such as pies and muffins depending on whether they are sold in combination retail outlet/eating establishments or in grocery stores. For example, a bakery treated as a combination retail outlet/eating establishment which dispensed beverages on the premises and sold more than 50% prepared foods would be taxable on the sale of its sweetened baked goods in order to maintain competitive equity with similar sales made in restaurants. Yet a bakery which did not dispense beverages and which sold less than 50% prepared foods would be treated as a grocery store and could sell sweetened baked goods tax free.

Under Option 2, any anomalies in the treatment of sweetened baked goods would be eliminated because all products defined as prepared foods would be taxable notwithstanding the nature of the establishment in which they were sold. However, this approach would create considerable complexities for restaurants in that they would have to distinguish between taxable and non-taxable sales within a menu to each customer depending on whether the foods were on the list of prepared foods. For example, an order of toast would be taxable while muffins would be tax free.

On balance, the Committee has concluded that Option 1 will provide the most straightfoward mechanism for both retailers and consumers under the GST. Moreover, this treatment is most consistent with that chosen in the retail sales tax systems operated by the provinces. Although the Committee recognizes that some competitive distortions are present between certain products purchased in different types of establishments, the Committee believes the impact of these distortions are mitigated at the proposed tax rate of 7%.

Therefore, the Committee recommends:

25. That tax by the nature of the establishment be adopted by the Government for incorporating restaurant meals and take out prepared food into the tax base.

(ii) Exempt Meal Plans Provided by Universities and Colleges

The Committee received representations from the Canadian Association of Colleges and Universities (CACU) with respect to the exemption for meal plans provided to university and college students. The Committee was told that by restricting the exemption to only those meal plans providing all meals for four consecutive weeks, many meal plans would not qualify under the Technical Paper. The CACU recommended that the exemption be available where ten meals per week for four consecutive weeks were provided. The Committee notes that the Draft Legislation now contains provisions allowing an exemption where 10 meals per week for four consecutive weeks are provided. **The Committee supports a definition which requires only 10 meals per week to be provided under such meal plans and endorses this provision of the Draft Legislation.**

(iii) Agricultural and Fish Products

Consistent with the zero-rated treatment of basic groceries, the Technical Paper proposes to zero-rate agricultural and fish products throughout the production-distribution chain. With the exception of certain non-food items such as flowers and furs, all sales of produce by farmers and fishermen will be zero-rated.

The Committee heard extensive representations from farm organizations across Canada with respect to the treatment of agricultural and fish products. The Canadian Federation of Agriculture, the National Farmers Union, UNIFARM, the Prince Edward Island Potato Marketing Commission, the New Brunswick Federation of Agriculture, and the Nova Scotia Federation of Agriculture, all supported the principle of zero-rating agricultural and fish products.

Several farm groups were prepared to support a tax on food and hence on agricultural produce. The Alberta Cattle Commission, and the Western Barley Growers Association both supported the principle of a broader base and a lower rate of GST.

However, for the reasons discussed in section (i) basic groceries, the Committee does not believe a tax on basic groceries is appropriate. **Therefore, consistent with the zero-rating of basic groceries, the Committee endorses the proposals of the Technical Paper to zero-rate agricultural and fish products.**

A number of issues with respect to the treatment of input tax costs, cash flow, and compliance for farmers under the zero-rated system are addressed in Chapters 2 and 4 of this report.

(iv) Prescription Drugs

The Technical Paper proposes to zero-rate all drugs which must be sold under prescription under federal law and a number of drugs which do not require prescriptions but which are used to treat life threatening conditions. In addition, where drugs for human use are sold under the prescription of a medical practitioner the drugs will be zero-rated.

The Committee was told by the Canadian Medical Association that in order to fully relieve the burden of GST, all over-the-counter drugs should also be zero-rated. The Committee believes that the zero-rating of any drug sold under prescription will substantially address this discrepancy and, moreover, by restricting zero-rated sales to the drug store dispensory, the operation of GST between taxable and tax free sales will be simplified for drug stores at the point of sale. The Committee also believes that because drugs purchased under prescription include a dispensary fee charged by pharmacists any incentive to abuse the use of medical prescriptions in order to avoid GST on over the counter drugs will be limited. **Therefore, the Committee endorses these proposals of the Technical Paper.**

(v) Medical Devices

The Technical Paper proposes to zero-rate those medical devices which are currently exempted under the FST. In addition, purchases of replacement parts used in zero-rated devices and charges for installation and repair will be zero-rated.

The Committee heard representations from several organizations representing the disabled including the Canadian Paraplegic Association and the Coalition of Provincial Organizations of the Handicapped (CPOH) with respect to this issue. These organizations stated to the Committee that relief through the Income Tax Act for their special expenses incurred to carry on employment would be their first preference under tax reform. However, given the implementation of the GST these organizations were supportive of the proposal to zero-rate medical devices but expressed concern that the list of items to be zero-rated would not be sufficient to meet the needs of the disabled.

The CPOH suggested, for example, that the full cost of vehicles and computers be zero-rated where these devices had been adapted for use by the disabled rather than merely zero-rating the adaptation equipment and installation charges as proposed.

The Committee understands the need to ensure that the list of medical devices to be zero-rated is as broad as possible but the Committee also recognizes that a balance must be struck between those devices used primarily by the disabled and those used by the entire community. The Committee believes the proposals of the Technical Paper with respect to medical devices are reasonable and therefore endorses those proposals.

However the Committee recommends:

26. That, the Government review the list of zero-rated medical devices in consultation with representatives of the disabled on a regular basis.

B) Tax Exempt Supplies

Health Care Services

The exemption of health care services falls under two broad categories.

(i) Institutional Health Care

The Technical Paper proposes that health care services provided by a public or private hospital, nursing home, or facility offering similar services for children or the mentally disordered will all be tax exempt. In addition, private nursing services provided to these institutions or to individuals in their homes will be exempt. **The Committee endorses these proposals.**

(ii) Health Care Practitioners

The Technical Paper proposes to exempt health care practitioners based on whether the practitioner's service was paid for under a provincial health insurance plan. Where a health care practitioner's service was only partially paid for under a provincial health insurance plan, the service will nevertheless be fully exempt. In addition, where a health care service is funded under a provincial medicare plan in two or more provinces, then the health care service will be exempt irrespective of whether it is funded by the local provincial medical plan.

While the Committee accepts this definition of exempt health care practitioners, the Committee is concerned that limiting the definition of exempt health care practitioners to those who are funded by provincial medicare is too narrow with the result that it discriminates against those health care practitioners not provincially funded. The Committee was told by the Canadian Psychological Association (CPA) that many community based private practice health care services provided by their members would become taxable under the Technical Paper imposing a further financial burden on patients already spending a large share of income on health care services. Moreover, the CPA argued that such psychological services significantly offset aggregate health care costs by reducing the need for subsequent utilization of expensive medical services. The Committee was also told by the Canadian Medical Association that they endorsed the view that health care services rendered by psychologists were deserving of exempt treatment under the GST.

The Committee shares the view that it is inappropriate that health care services such as psychology should be taxable. Moreover, because all health care services provided by a hospital will be tax exempt, including those services not funded by

medicare, the Committee is concerned that taxable health care practitioners will be forced to crowd into already overburdened hospitals.

The Committee believes that where a health care profession such as psychology is both a provincially regulated health care profession and included on the list of medical practitioners whose services are eligible for the medical expense tax credit under the *Income Tax Act* there should be an exemption provided under the GST for health care services provided by members of that profession. As with other exempt health care practitioners elective health care treatment should continue to be taxable.

Therefore, the Committee recommends:

27. That, health care service provided by psychologists who are registered under the Canadian Register of Health Service Providers in Psychology be exempt under the GST. The Committee further recommends that non-diagnostic psychological services provided on an elective basis continue to be taxable. For greater certainty, the Committee recommends that the Regulations to the Excise Tax Act provide that only those psychological services billed under codes A1-A2-A3 or T1-T2-T3 as diagnostic health care under the fee schedule of the Council of Provincial Associations of Psychologists be treated as exempt.

(iii) Educational Services

The Technical Paper proposes to exempt educational services where they fall under the following categories:

— elementary and secondary schools including private tutoring in academic subjects following a provincially approved curriculum;

— publicly funded colleges and universities;

— courses for entry into regulated professions or occupations; and

— training in private vocational language schools.

The Committee supports the exemption of these educational services. However, the Committee has received several representations which it believes should be addressed.

The Committee heard from representatives of private music tutors including the Nova Scotia Music Teachers Federation and the *Association des Professeurs de Musique du Québec*. These witnesses expressed concern that under the Technical Paper proposals only tutoring in academic subjects which follow a provincially approved curriculum would be exempt. Therefore, music tutors offering instructions in courses not part of a provincially approved curriculum would be required to distinguish between tax exempt and taxable services and to allocate their input tax credits between exempt and taxable supplies.

The Committee believes that such a compliance burden would be an unreasonable imposition on independent private tutors. However, under the terms of

the small trader's exemption anyone whose revenues from the supply of taxable services fall below $30,000 will not be required to charge GST. The Committee believes that in the case of independent music tutors their supplies of taxable services, that is non-provincially approved courses, would not exceed $30,000 and therefore such individuals would be relieved of charging tax on such services and the subsequent compliance burdens. Of course, all supplies of provincially approved courses would continue to be tax exempt.

The Committee also heard representations from the Canadian Association of University Teachers (CAUT) with respect to the proposed definition of an exempt university or college course. The CAUT was concerned that the Technical Paper proposed to exempt only courses which ..."can be taken for credit leading to diplomas and degrees"... It was put to the Committee that depending on whether the course "is" taken for credit or "can" be taken for credit could lead to different tax results. In the latter case a student might audit courses but not be receiving credit at the university. The CAUT expressed concern that the tuition paid by such students might have to be subject to GST by the university or college providing the course.

The Committee strongly believes that the exempt status for university and college credit courses should be determined by an objective standard dependent upon whether the course is recognized by the university or college for credit towards a degree or diploma and not by a subjective standard based on the intent of the student in taking the course. In testimony before the Committee, officials of the Department of Finance indicated that their intention in both the Technical Paper and the Draft Legislation was that the exemption apply based on the objective standard of whether or not the course was recognized by the university or college for credit towards a degree or diploma. However, even though the stated intent of the government would appear to be to provide an objective standard to determine the exempt status of university or college instruction the questions raised by the CAUT suggest that there may be some ambiguity under the Draft Legislation.

Therefore, the Committee urges the Government to clarify the intent of the Draft Legislation to provide an exemption for university and college courses based on an objective standard dependent upon whether the course is recognized by the university or college for credit towards a degree or diploma and to ensure that the Legislation is administered to give effect to this intent.

The Committee also heard a representation from the Association of Universities and Colleges of Canada that the taxation of non-credit courses intended as vocational training offered by universities and colleges versus the exemption of the same or similar courses offered by private vocational schools and professional regulatory bodies discriminates unfairly against universities and colleges.

The Committee believes that where universities and colleges offer courses in respect of maintaining or upgrading a professional or trade accreditation, or offer courses leading to certificates or diplomas that are prescribed by provincial regulation

and attest to competence in a trade or vocation, these courses should be exempt. Thus, universities and colleges will be on an equal footing with professional regulatory bodies and private vocational schools.

The Committee notes that under the Draft Legislation, the wording of the relevant sections appears to address these concerns by exempting supplies made by universities and colleges in respect of courses for upgrading or maintaining professional or trade accreditation, and in respect of courses leading to certificates or diplomas that are prescribed by provincial regulation and attest to the competence of individuals to practice a trade or vocation (Draft Legislation, Schedule I, Part III, s.4 & s.6). **The Committee endorses these provisions of the Draft Legislation and urges the Government to ensure that the Legislation is administered to give effect to this intent.**

(iv) Day Care

The Technical Paper proposes to exempt day care services provided on a non profit, commercial, or public basis. **The Committee supports the proposed exemption of day care services.**

Notwithstanding its support of the proposed exemption for day care, the Committee believes the application of the exemption may adversely effect some day care suppliers.

In testimony before the Committee in Vancouver, the National Action Committee on the Status of Women indicated to the Committee that, despite the exemption for day care services under the Technical Paper, some input tax costs will be passed on to consumers of day care supplies. Moreover, the amount of input taxes passed on will vary with the allowable input tax credit/rebate available to an exempt supplier of day care services depending on the nature of the supplier. Officials of the Department of Finance told the Committee that 100% input tax credits will be allowed to most employer provided work site day care excepting those businesses which supply exempt services such as banks; 50% rebates will be allowed for charitable and not for profit day care and; no input tax credits will be allowed to commercially operated day care. The Committee endorses the full input tax credits for employer provided work site day care and the 50% rebate for charitable and not for profit day care. This will ensure that day care provided by these suppliers is subject to either less tax under the GST or at least no more tax under the GST than under the existing FST.

However, the Committee believes that it is unacceptable that commercial day care suppliers will be denied all input tax credits. The Committee believes that these services are deserving of equal treatment.

Therefore, the Committee recommends:

28. That, all provincially licensed commercial day care services be entitled to a rebate of 50% of all GST paid.

(v) Legal Aid

The Technical Paper proposes to exempt all legal services provided under a provincially approved legal aid program.

The Committee recognizes the importance of legal aid services and supports the intent of the Technical Paper in seeking to ensure that GST results in no increase in the tax borne by consumers of these services. However, the Committee has concluded that exempt status for these services as proposed in the Technical Paper is not the appropriate method for relieving the impact of GST.

The Committee was told by the Canadian Bar Association that because lawyers provide all their services on a taxable basis with full input tax credits, the effect of introducing an exempt supply into their practices would be to create significant compliance costs because of the requirement to allocate input tax credits between exempt and taxable supplies. Such additional compliance costs would create a further disincentive to participation in the legal aid system. The Committee believes that the proposal presented to it by the CBA to treat all legal aid services as taxable and to allow a rebate of GST to the provincial legal aid societies would greatly simplify the operation of the GST for lawyers providing legal aid.

Therefore, the Committee recommends:

29. That, the provision of legal aid services be made fully taxable and that a full rebate of tax be paid to all provincial legal aid societies.

4. THE GST AND SMALL BUSINESS

Much of the criticisms of the GST proposal focussed on the compliance and administrative complexity, particularly as it will affect small business, especially those supplying goods and services directly to consumers. Witnesses made it clear that a national sales tax, with a common federal and provincial base, would greatly simplify matters for small businesses. Complications are likely to result from inconsistent treatment between the two systems rather than from special treatments within each system.

The Committee was very sympathetic to the fact that small businesses would have to cope with certain goods being taxable for federal purposes and exempt for provincial purposes and vice versa. Part A of this report discusses the Committee's views on the possibility of a joint federal/ provincial system and Chapter 2 of Part C reviews recommendations to simplify complications with respect to input tax credits under separate federal and provincial sales tax systems.

This Chapter discusses three of the four special measures proposed in the Technical Paper to accommodate small business and attempt to alleviate some of their disproportionate compliance cost. This Chapter also reviews transitional measures to ease compliance, the representations of witnesses with respect to small business measures and the Committee's analysis of and recommendations regarding these measures. The fourth measure, optional annual reporting with quarterly installments for registrants with annual taxable and zero-rated sales below $500,000, is discussed in Chapter 2.

A) Technical Paper Proposals

The Technical Paper proposes payment of a small business administration fee equal to 0.4% of the annual revenue from taxable and zero-rated supplies of the registrant, to a maximum of $600. Each registrant carrying on business who has revenue from taxable and zero-rated sales of $2 million or less will be eligible for this fee. Therefore, the $600 maximum would be available for registrants having sales (other than tax exempt sales) of $150,000 to $2 million inclusive. The amount of the fee will be deducted by the registrant in calculating net tax for the last reporting period each year, and is refundable to the extent it exceeds the net tax otherwise required to be remitted.

In order to avoid the need for small businesses to meet the compliance requirements of the GST, small suppliers with taxable and zero-rated sales of less than $30,000 in the preceding 12-month period (quarterly test) are not required to register for purposes of the GST. Unregistered small suppliers will be treated as exempt entities and, therefore, will not be obliged to collect tax on sales and will not be entitled to input tax credits for tax paid on inputs. The small suppliers' exemption will also apply to supplies made by charities, non-profit organizations, selected public sector organizations and governments. It will not

apply to sales of real property. Receipts from the sale of capital property (including real or personal property) will not be used in determining whether the vendor qualifies as a small supplier. A small supplier engaged in commercial activity who elects to become a GST registrant will be bound by that election for the balance of the fiscal year in which the election is made and for the subsequent fiscal year.

The Technical Paper proposes that registrants selling a mixture of taxable and zero-rated food products at the retail level, and having annual sales of less than $2 million, may choose to calculate the GST owing in respect of their sales on the basis of their taxable purchases. One of two "streamlined accounting" methods may be used to remove the need to operate the GST at the cash register. A transitional measure proposed is to allow those registrants with sales between $2 million and $6 million to take advantage of the streamlined accounting measures until 1993.

Another transitional measure proposed in the Technical Paper is to allow all registrants (small and large), that upgrade their electronic point-of-sale and inventory control systems prior to 1993, to deduct 100% capital cost allowance in respect of such costs in their income tax returns for the year of acquisition.

B) Witnesses' Representations

Many business organizations, including The Canadian Chamber of Commerce, the Canadian Federation of Independent Business and the Canadian Organization of Small Business Inc., represented that the small business administration fee was too low. The Retail Council of Canada suggested the fee should be 0.6% of sales, to a maximum of $1200. The Automotive Industries Association of Canada suggested 1% of revenues, to a maximum of $1500. Some witnesses recommended that compensation to all registered traders should be made.

Other witnesses represented that the threshold for exempt status should be increased. For example, The Metropolitan Montreal Chamber of Commerce recommended a threshold level of $75,000 to $100,000, the Alliance of Canadian Cinema, Television and Radio Artists and the *Conseil Québécois du Théâtre* recommended $50,000, the Direct Sellers Association recommended at least $150,000 and Professor Robert Clark recommended $40,000.

Several witnesses represented that the streamlined accounting procedures were inappropriate or too complex. Mr. Friedman, for example, described the methods as "probably the four most complicated pages" in the Technical Paper. He added, "to ask small business persons... to figure out what their standard mark-ups is on something is ludicrous". He suggested that the tax simplification measures provided for Japanese taxpayers meritted consideration.

The Canadian Institute of Chartered Accountants also said the proposed streamlined rules were of limited application and suggested the rules for retailers with non-sophisticated data gathering systems should be similar to those for small business under the Japanese sales

tax system. It represented use of prescribed mark-up may be preferable since businesses sell few products at pre-determined regular sales prices or at standard mark-ups.

Other witnesses represented that streamlined procedures should be available to more registrants. For example, the Canadian Council of Grocery Distributors represented that the threshold for streamlined accounting should be raised from $2 million to $4 million. Some witnesses noted that the simplifying procedures were only available to those selling taxable goods and zero-rated food products.

Certain witnesses represented that the transitional measures to ease compliance were not broad enough and increased rates of capital cost allowance should apply to all software and hardware that either eases compliance under, or transition to, the GST system. For example, the Retail Council of Canada recommended immediate write-off (with carry forward provisions) for all capitalized software costs, point of sale terminals and related dedicated processing equipment, with federal sales tax removed on these items for one year prior to implementation. It also recommended that retailers should be given a one-time GST credit to compensate for the cost of re-ticketing merchandise. The Canadian Council of Grocery Distributors also wanted full compensation (either by direct subsidy or income tax credit) to food distributors for the full amount spent on hardware and software needed to comply with the two tax systems.

Other witnesses represented that small businesses in certain industries would find compliance difficult under the Technical Paper proposals, and tax evasion through underground activities may be encouraged where supplies are to non-registrants and input costs are low.

Several industry specific recommendations were also heard by the Committee. For example, the Coalition of Canadian Transport Association and Carriers represented that tax-free treatment should be allowed for sub-contracting activities between motor carriers and independents. The Direct Sellers Association and Avon Canada Inc. wanted direct selling companies to be able to collect and remit the tax on behalf of their independent sales contractors. The Direct Sellers Association stated:

> "This approach results in the records, remittances, reports, etc., being the responsibility of the Direct Sellers Companies as opposed to the hundreds of thousands of Independent Sales Contractors...with all the accompanying benefits to the governments involved of fast remittance, limited collection points and professional accounting knowledge and systems. It also provides for collection on all sales, since the $30,000 threshold is not an issue."

The Saskatchewan Arts Alliance represented that a system should be set-up so artists' supplies could be traded by registered artists and arts' organizations without payment or claim of GST. The Vancouver Taxi-Cab Owners Association suggested that tax liability be based on aggregate data from financial statements rather then on individual fares.

C) Committee's Conclusions and Recommendations

(i) Small Business Fee

The Committee considered carefully whether either the small business fee percentage or dollar maximum should be adjusted. It reviewed the higher fee levels proposed by witnesses and discussed, at great lengths, various policy options. It considered whether the fee should be permanent or temporary, and whether the fee's purpose was to compensate for transition costs, collection costs or compliance and administration costs. In the Committee's deliberations, the following observations were made:

(a) the business community made strong representations that the government reduce expenditures further;

(b) there was an apparent contradiction between these representations for expenditure reduction and the representations for higher fees;

(c) the federal government does not currently pay businesses for collecting and remitting, on behalf of their employees, income tax, Unemployment Insurance or Canada Pension. Also, the federal government does not pay a compliance or administration fee for corporate income tax, federal sales tax or excise taxes; and

(d) businesses ought not to be paid for complying with the laws, including the tax laws, of this country.

Despite these observations, the Committee recognizes the concerns of small business, that they may face disproportionately higher costs. Therefore, it felt that perhaps either a collection fee or a compliance and administration fee would be appropriate. The Committee concludes a fee for collection rather than compliance would be more in keeping with the principle of not paying for adherence to tax laws. It concludes, that if any fee is implemented, it should be for collection and any fee amount exceeding the net tax remittance of the registrant should not be refundable.

Therefore, the Committee recommends:

30. That a small business collection fee be paid, equal to the lesser of $600 or 5% of the net remittance of the registrant. In accordance with the Technical Paper proposals, the fee should be available only to registrants who are carrying on a business and have revenue from taxable and zero-rated supplies of $2 million or less in a full fiscal period.

(ii) Small Traders Threshold

The Committee recognizes the importance of excluding businesses from the GST system that have costs of compliance and costs to administer exceeding the revenues they produce. Also it is sympathetic to witnesses' representations that compliance costs,

as a proportion of tax paid, is much higher for small businesses than for large businesses. However, although some witnesses represented that, to simplify tax compliance and administration, the threshold amount should be increased, the Committee also recognizes that a higher limit would raise the value of the exemption and therefore increase the perception of discrimination against larger firms.

Therefore, the Committee decided to review other countries' approaches to determining what small suppliers should be exempted. It was hoped that another approach might lesson the disadvantage noted above but still ensure the objectives, of minimizing compliance costs and administration costs, are met.

The different criteria used by other countries to identify which enterprises should be exempted (or given the choice to opt out of the system), included criteria relating to sales (turnover), profit, value added, capital assets, number of establishments, numbers employed and number of owners. Although the number of employees may be the easiest measure, as an alternative to using sales as the criterion, there are problems in defining "full-time employees". Also, the criterion could discourage the employment of extra persons, and the Committee was concerned with the potential tax-planning schemes to obtain exemption where supplies are made directly to consumers. Therefore, the Committee confirmed that the preferred option is probably the exemption method based on sales. However, it considered a revised version of the Technical Paper proposal.

To lessen distortion and ease complications, Sweden allows exempt traders to issue tax invoices. This creates less distortion than the exempt treatment proposed since registered firms trading with the exempted small business are able to reclaim input taxes in the normal way. Also, the exempt trader receives compensation for the GST he pays on his inputs in the form of the output tax charged. However, the advantage of having sales less than the threshold for exemption would increase, and small traders may therefore have a disincentive to grow. Also, revenues to the government would be lost.

Based on the foregoing deliberations, the Committee believes that both the method of exempting small suppliers and the level of exemption proposed in the Technical Paper are appropriate. However, as the Committee feels more should be done to reduce business compliance costs and government administration costs, it supports implementing simplified methods for small and medium size businesses who do not qualify for the small suppliers exemption or choose to opt into the system. Following is a discussion of the Committee's review of the streamlined accounting proposals and alternative simplified methods.

(iii) Streamlined Accounting Procedures

The Committee's review of the simplified methods proposed for registrants selling taxable and zero-rated food products at the retail level determined that neither option is without a number of costs and problems.

For example, Method 1. may cause small businesses to hold low inventory levels since the retailer under this option in theory pays GST upfront on purchases as opposed to sales. Also, a retailer may end up paying too much GST where inventory shrinkage is high. Since tax is paid upfront on purchases based on a regular selling price, it will be administratively inconvenient for the taxpayer to obtain credits where a retailer discounts the sale price.

Under Method 2., the retailer pays GST on taxable sales as opposed to purchases. However the tax base is not the actual selling price of the goods. Rather prescribed mark-ups will have to be identified. Thus, although Method 2. avoids the disadvantages associated with pre-paying GST on inventory, it creates new problems for the retailer. Since distortions occur whenever averages are used, some retailers will benefit more than others. The number of mark-ups, whether they will be codified, and the frequency with which they will change, are still unknown.

Because of the problems and the restrictions on use of the streamlined accounting procedures, the Committee supports the Department of Finance's representation that it is developing methods of estimating the GST collected or collectable by consulting with affected businesses, that is, those selling taxable and zero-rated food. However, the Committee feels that optional alternative simplified methods should also be developed for small and medium size traders not qualifying for the simplified procedures proposed. Therefore, for the purpose of making its recommendations to the House of Commons, the Committee reviewed other methods to meet the particuliar problems of small business registrants. In its review, the Committee considered the treatment of small firms under the value added tax system in selected countries.

For example, the Committee considered simplification methods used in Japan as witnesses represented that they may be appropriate. Mr. Friedman had mentioned this simplification method allowed small business the option of paying tax on their selling price and not claiming input tax credits. In Japan, the upper threshold for claiming a notional credit is than the Japanese threshold for complete exemption. Therefore, it eases businesses into the tax system. Specifically, for qualifying businesses, tax paid on purchases of goods or services is deemed to be 80% (90% in the case of wholesalers) of the tax due on taxable sales. In effect, this means that businesses can ignore the actual tax paid on inputs, and pay a lower tax on their sales revenues. Although the results obtained may be vary from the correct theoretical result, taxpayer compliance is simplified.

When Mr. Friedman appeared before the Committee, he also gave examples of how the process of farmers and fishermen obtaining credits has been simplified. He represented that:

"In one country, farmers and fishermen are allowed to charge 2% or 3% more for their goods and call it a tax. Their purchases get a credit but they do not have to remit it, so that is their reimbursement for any credits."

A flat rate compensation system, such as the 2% or 3% higher rate method referred to by Mr. Friedman, means that the small supplier does not normally need to register, keep books, issue invoices and file returns. However, the small supplier is technically within the tax scheme and is compensated for the tax paid on inputs through the increased price it is allowed to charge. Also, the flat rate increase in the price to customers is claimable as a credit by registered customers. Only minor problems in relation to the scheme have been identified by the Commission of the European Community responsible for monitoring the appropriateness of flat rate compensation.

The Committee recognizes certain problems existing in both of the foregoing options for simplification. The use of the Japanese reduced rate method, is a somewhat arbitrary way to compensate for the higher compliance cost of small businesse and probably would somewhat reduce revenue, create inequities and increase complexities. The flat rate method would not work for farmers under the GST system. As explained in Chapter C-3 of this report, most agricultural and fish products are zero-rated under the Technical Paper proposals. The flat rate compensation scheme can only operate where the small business receiving the special treatment has taxable sales. In addition, since the flat rate scheme is a method whereby the tax compliance burden is passed on to customers, it can only work when all sales are to the registered sector. Non-registered customers could not be expected to pass the tax on to the government. The applicability of flat rate schemes may also be limited to narrow industries of homogeneous products with very similar margins.

Despite these problems, the Committee feels a reduced rate on sales, to notationally account for unclaimed input tax credits, may be appropriate in limited situations. Also, although the flat rate method would not be possible under the GST proposals for farmers, and although, again, the theoretical result is not always as it should be, the Committee is of the opinion the flat rate method may be appropriate in certain circumstances. The choice between whether to determine the appropriate flat rate from inputs or from sales should depend on whether it is easier for the business in the industry to keep a record of sales or a record of purchases. Because flat rate schemes which apply to individual firms as opposed to individual industries are so costly to administer, the Committee feels they should be used in very limited cases.

The Committee reviewed other simplifying measures. For example, Uruguay has a further simplification method whereby certain farmers are allowed to offset their tax liability on purchase invoices against their income tax liability. Some countries subject sales to limited small exempt firms to a higher rate of tax. That is, suppliers collect an approximation of the tax that would have been levied on the sales of the small exempt firms and the small exempt firm is allowed to apply for input tax credits. Other

countries use "forfait" systems whereby the sales or tax base (based on previous years records or some external criteria, with adjustments) is determined for individual small businesses. Japan appears to have a provision which will allow full input credits to be claimed without proration, providing exempt revenue are not more than 5% of total revenues.

The Committee supports a de minimis rule, like Japan's 5% rule, to ease taxpayer compliance, and notes that, although a somewhat similar type of de minimis rule has been included by the Department of Finance in Section 108 of the Draft Legislation, Japan's rule is a simpler test as it depends on revenue rather than use. The Committee also supports the simplication represented by the other measures described above but recognizes there are problems with these schemes, as there were with the methods discussed previously. For example, a system similar to the "forfait" system would absorb an unsatisfactory amount of the government's time in administration and confer a lot of power on Revenue Canada. Also, a limit to the nominal tax liability calculated would have to be set and the system would not function well under rapidly changing conditions, such as inflation. Schemes whereby the tax compliance burden is passed on to suppliers create complications for the suppliers and should only be used where the mark-up tends to be uniform and well known, and where all sales by the small business are to the non-registered sector (otherwise unrefundable tax charges will be passed up the production chain).

Based on the review of other countries' simplified methods and the representations received by witnesses, the Committee feels a sensible balance must be achieved between the interests of simplicity and accuracy. As it encourages simplifying accounting for small businesses at the expense of accuracy of assessment, the Committee recommends:

31. That the government consider use of general simplification methods for various types of small businesses, and not just registrants selling a combination of taxable and zero-rated food products at the retail level. Since a second threshold limit could ease the transition to the GST for businesses exceeding the $30,000 threshold, the government should consider especially simplifying procedures for small businesses in particular industries that have supplies of goods and services between the $30,000 exemption limit and a $500,000 limit. In all cases where additional methods are developed, the use of the method should be optional only. Small business fees should not be paid to those using simplified accounting methods, and businesses using the methods should not be allowed to adjust the net remittance calculated under the method if a lower net remittance is later calculated under the regular method. However, businesses should have the option to change the method of calculation the following year.

As alternative simple but reasonable methods must be implemented immediately to reduce record keeping on the part of small business and administration on the part of government, the Committee further recommends:

32. That the government should allow the following simplifying methods when the GST system is implemented:

(a) a reduced rate option similar to Japan. Use of the option would have to be approved by the Minister;

(b) a de minimis rule similar to Japan. This revenue test would be in addition to the use test outlined in Section 108 of the Draft Legislation; and

(c) a direct seller option which provides that where all or substantially all of the goods supplied by a particular person (the "Supplier") are ultimately sold to consumers by itinerant vendors (i.e. persons selling from no fixed place of business) at prices not exceeding the suggested retail selling prices established by the Supplier, and the Supplier and all persons purchasing such goods for resale (the "Vendors") enter into a collection agreement, in prescribed form, with the Minister of National Revenue, for the purpose of the collection and remittance requirements, the Vendors shall be deemed to be employees of the Supplier. Under the terms of the Collection Agreement the Supplier will be deemed to have collected GST in respect of all goods sold by it on an amount equal to the value of the consideration for which the goods are offered for sale at retail. The value of the consideration for which the goods are offered for sale at retail shall be deemed to be not less than the suggested retail selling prices established by the Supplier.

5. GST AND THE CONSUMER

One of the great flaws of the existing Federal Sales Tax is that consumers are, for the most part, not aware of the taxes they pay. Many witnesses endorsed the concept of a visible tax. The *Fédération des ACEF du Québec* argued that "in order to provide real protection for consumers and to avoid abuse, the amount of the tax should be clearly indicated on any invoice." In the Committee's view, visibility is an essential feature of any good tax. Furthermore, it is believed that taxpayers cannot hold governments accountable for taxes raised when they do not know they are paying the taxes.

The Technical Paper identifies the following two elements as key components to a model presentation of the GST by retailers:

— Identifying separately the amount of tax on cash register receipts.

— Prominently displayed signs within the store informing consumers of the total of the cost of the good and the federal tax. Where vendors choose to incorporate the GST in their shelf prices, this fact should be clearly indicated.

Recognizing that most cash registers currently used does not have the capacity to identify separately the GST and the provincial retail sales tax, the Technical Paper does not insist that vendors adopt the above model approach for the presentation of the GST. To encourage retailers to upgrade their cash registers and to facilitate their showing of the GST separately on customers' receipts, the government proposes that a 100% capital cost allowance be provided for firms purchasing eligible electronic point-of-sale equipment and related inventory control systems prior to 1993. The Technical Paper also states that for retail establishments following inclusive pricing policy, the government will provide retailers with the appropriate signs required to indicate this fact to consumers.

When the idea of a National Sales Tax was discussed in Chapter 3 of Part A, the complexity of imposing simultaneously a GST and provincial retail sales taxes was raised. The Committee agrees that operating with two sales taxes makes it impossible to impose a common method of displaying the GST by all vendors. For example, the Canadian Federation of Independent Grocers told the Committee "... as long as the Provincial and Federal sales taxes are administered separately, it would seem almost impossible to operate without showing a price inclusive of GST." Eventhough forcing all vendors to adopt strict pricing and display policies would minimize confusion among consumers, the Committee believes it would be unfair for many small traders who lack sophisticated cash registers to comply. As stated in Chapter C.2. relating to documentation requirements, the Committee supports the measures as proposed in the Technical Paper to encourage vendors to adopt pricing and display policies that make the GST payable as transparent as possible.

In terms of the benefits to consumers, the Committee agrees with the government that competitive forces in the marketplace will be sufficient to ensure that the savings from the removal of the actual Federal Sales Tax be passed on to consumers. Moreover, as was discussed in Section B.1.b when the price effect of the GST was examined, the 7 percent rate proposed by the Committee will greatly reduce inflationary pressures which should in turn be beneficial for consumers' spending power.

In order to assess the effects on prices of the removal of the FST and the introduction of the GST, the Government will put in place an independent body that will report to the Parliament through the Minister of Consumer and Corporate Affairs. The Committee supports the proposal as a way of ensuring that Canadians will get the full benefits associated with the GST and that consumers are protected against unfair pricing practices.

6. TRANSPORTATION AND TRAVEL

For many areas remote from major urban centres, tourism makes up a large proportion of the regional economy. As well, such areas are especially sensitive to any fluctuation in transport costs. The Finance Committee heard extensive testimony, during the public hearings outside Ottawa, from various groups about the potential impact of the GST on tourist activities and freight transportation services.

This chapter deals with four items: tourism, passenger transportation services, freight transportation services and excise tax on fuel.

A) Tourism

Under the existing federal sales tax system, certain economic activities are taxed less than others, and thus benefit from an unwarranted tax advantage, which skews consumer choices. Evening out relative prices by expanding the tax base, with a view to reducing economic distortions, will inevitably create transitional problems for the sectors that were previously not part of the base, and this is what the new tax treatment will mean for the tourism industry.

As Tourism Ontario pointed out to the Committee, it is difficult to define a "tourist activity" with any precision. Tourism is the whole range of goods and services designed to simplify access to entertainment, leisure and business activities outside the purchaser's normal consumption area. The goods and services usually consumed during travel for pleasure or business include private and public transportation, food and drink, accommodation, and cultural, recreational and entertainment activities. The tourism industry thus includes such divergent elements as sports fishing, art galleries and conventions.

A number of aspects of the Technical Paper's proposed tax reform will directly affect the tourism industry's level of activity in Canada. All activities included in the definition given above will be affected, to a greater or lesser degree, by the GST. On the rules that affects the tourism industry the Committee heard from such groups as the Hotel Association of Canada, the Tourism Industry Association of PEI, of Nova Scotia, the Canadian Ski Areas Operators Association and the Alliance of Canadian Travel Associations.

In terms of the economic theory behind taxes on consumption, there is no rationale for excluding tourism related activities from the proposed tax. In accordance with the normal rules, the GST will apply to tourism related services. Registrants who buy those services will be able to claim an input tax credit. Foreign visitors will also be entitled to an input tax credit under defined circumstances since sales of goods not consumed in Canada and taken out of the country will be treated as exports. Registrants who will provide tourism related services will be eligible to claim an input tax credit on any purchase required by their

provision of that service. The tax treatment of tourism-related activities has been the object of many concessions (eg. tax treatment of passenger air transportation and of temporary accomodation), and thus does not reflect some of the theory's main principles. These compromises proved necessary to satisfy the many interest groups involved and to diminish the shock of transition. Moreover, because tourism contributed $24 billion to the Canadian economy in 1988, employed directly 624,000 individuals, brought in $6.9 billion in foreign exchange, those concessions are defensible on practical grounds.

The Tourism Industry Association of Canada claims that the GST "will encourage Canadians to seek lower cost destinations, particularly in the U.S.A. and will discourage foreign visitors." Witnesses represented to the Committee on the basis that both Canadian and foreign tourists are keenly sensitive to relative price variations, that they will choose cheaper destinations once the GST is in effect. The Committee believes that although short-term adjustments in tourism may result, in the long term the tourism industry will gain as a result of the economic benefits of the GST. Canadians' increased disposable real income will inevitably result in increased consumption of tourist activities. Consequently, the Committee does not view these difficulties as being permanent. Furthermore, the transitional negative impact will be greatly reduced by the lower tax rate of 7% proposed by the Committee.

In the immediate future, the potential negative effect of the GST on Canada's tourism industry will be neutralized by an increase in the number of business trips, which will cost less because of the input tax credits for business inputs. In addition the Technical Paper proposes the introduction of a tax rebate for foreign tourists, to encourage foreign visitors to Canada. The Technical Paper provides that claims must be for a minimum rebate of $25 and may be made only in respect of goods that are purchased in Canada and then exported within 60 days (except on alcohol, tobacco or fuel, but including expenditures on hotels, motels and other short-term accommodation). Although the rebate may arguably be considered too generous, given that it includes short-term accommodation consumed in Canada by tourists, the Committee supports the compromise. It is a concession that should encourage tourists from other countries. The Committee believes that the proposed application of the GST to tourism related activities, as set out in the Technical Paper, is a well balanced compromise between treating tourism services and goods sold to foreign visitors as exports and as consumption activity taking place in Canada. For foreign visitors for example, major ticket items such as accommodation and — as will be discussed in the next section — transportation services bought outside Canada will be tax free. The Committee estimates that to include tourism packages and transportation services purchased by foreign visitors whilst in Canada in the rebatable purchases, as proposed by the Tourism Industry Association of Canada, is too big a diversion from the principle that supply and consumption of goods and services made within Canada should be subject to tax.

The Committee, like the Vancouver Hotel Association and the Tourism Industry Association of Yukon, believes that claiming a GST rebate must be made as straightforward as possible. The Committee therefore recommends:

33. That the claiming process for the foreign tourist rebate be simple and visible. At any point of entrance into Canada, information explaining the rebate system should be available to foreign visitors. The tourist sales tax rebate must be refundable, in

Canadian dollars, through mail or refundable immediately at designated points of departure from Canada. The government should remit the GST through the Duty Free Shops so that tourists can get their rebate instantly and in cash as they leave the country.

Tourism Industry Associations stated that in their view the GST would cause a downturn in the convention business because of increased prices and of a high price sensitivity. Their recommendation was that the organizer of an international convention held in Canada be zero-rated to increase the competitiveness of the industry and to ensure that foreign delegates are not charged GST. This proposal is troublesome since there is no rationale to explain why some convention related activities (eg. meals, transportation services) would be zero-rated while the same goods and services consumed outside a convention environment would become taxable. Furthermore the difficulty of defining criterias to assess the international degree of a convention is likely insurmontable. The Committee believes that the competitiveness of this important business will not be damaged by the GST since Canadians attending a convention on behalf of their business will be allowed to claim a GST credit and foreign delegates will be able to claim back the GST on accommodation expenses under the tourism rebate program.

B) Passenger Transportation Services

The G.S.T. will apply to commercial domestic transportation services including buses, trains, taxis, ships and aircrafts. Local or municipal transit service will be tax exempt. Air passenger travel services to the continental U.S. or the islands of St. Pierre and Miquelon will be taxable since they will be considered as part of domestic transportation services. All other international passenger transportation services will be zero-rated. Continuous journey to an international destination which includes a domestic air transportation service will be treated as being an international transportation service and will therefore be tax free.

The air-travel industry complained to the Committee about the treatment of transborder air travel between Canada and the United States.

The Air Transport Association of Canada argued that:

> The proposed tax treatment for U.S. travel renders Canadian air carriers less competitive vis-à-vis their U.S. counterparts and will encourage Canadians ... to travel to U.S. border points for trips into the continental United States.

The proposed tax treatment does indeed differ from that proposed for other means of transportation, such as buses and trains. More fundamental still, taxation of this kind is not consistent with the principle of a tax on domestic consumption. Nonetheless, the Committee considers that treating flights to the United States and the islands of St. Pierre and Miquelon as tax free exports would have created an even greater incentive for Canadians to buy air travel services via the United States, and therefore would have been more damaging to the Canadian airline industry than the Technical Paper proposals. If border flights were tax free the domestic market of the Canadian tourism industry would have been hurt by the lower

relative prices of air travel to American destinations compared to Canadian destinations. Furthermore the fact that return transborder flights bought in the U.S. will be tax free should not cause any desincentive for Americans to visit Canada.

The Technical Paper proposes changes to the Air Transportation Tax. The Air Transportation Tax (ATT) imposed on tickets purchased in Canada for air travel within the North-American continent will change from the present ad valorem rate of 10% plus $4 (to a maximum of $50 per ticket) to 5% plus $10 (to a maximum of $40 per ticket). The GST will be calculated on the ATT included air fare. For overseas destination from Canada the flat tax of $19 will increase to $40. Tickets purchased outside Canada for travel to Canada will be imposed the current $19 flat tax.

A number of witnesses challenged the proposed method of calculating the ATT. The Coalition of Canadian Transport Associations and Carriers and the Air Transport Association of Canada objected to the fact that the ATT was to be included when the amount of the GST was being calculated, on the grounds that this would would lead to a tax pyramid effect. Air B.C. said that including the ATT would significantly increase the effective rate of tax on the least expensive airline tickets (short-haul flights, one-way flights, etc.).

The Committee considers that the ATT should be retained as a cost recovery measure for operating airports. Based on information received by the Committee from the Department of Finance it appears that the ATT under the actual rules and projected air travel ticket sales in 1989-90 will result in $520 million in revenues. For the same year, the proposed method for calculating the ATT would yield approximately $475 million. This is the result of a substantial reduction in revenues from domestic ticket sales which is partially offset by increased revenues from international flights. The Estimates shows that for 1989-90, the total operating costs and capital expenditures for major federal airports, federal dependent airports and development airports in the outlying regions should total $724.6 million. Revenues, recoveries and the ATT should total $807.1 million. Assuming the proposed ATT, the surplus would go down to $37.6 million from $82.6 million. If the ATT was to be eliminated the forgone revenue of 475 million would have to be made up by raising taxes. In the Committee's view, it is appropriate that the cost of operating airports be borne by those using these services through the imposition of the ATT.

Increasing the flat rate of $19 to $40 on tickets for travel from Canada to overseas destinations will restore the balance in relative prices between airline tickets to Canadian and overseas destinations. Some witnesses opposed this measure on the grounds that it was an incentive to travel via the United States. However, the Committee believes that this measure of levelling off prices will benefit Canada's tourism industry.

With the goal of reducing the cost to travel agents of administering and gathering the tax, the Alliance of Canadian Travel Associations proposed to the Committee the use of the Bank Settlement Plan (BSP) to remit the GST on tickets sold and on travel agents' commission. The BSP is currently used by travel agents as a means of remitting, among others, ATT moneys direct to the federal government. The Committee believes that the Alliance of Canadian Travel Associations may have underestimated the cash-flow advantage

associated with the remittance rules. Furthermore it may have overestimated the reduced compliance cost of using the BSP since travel agents would have to file returns to claim the input tax credit entitlement and to remit the GST in respect of sales of goods and services outside the BSP system. The Committee, therefore, would leave this administrative issue with the various private organizations active in the area (ACTA, BSP, International Air Transport Association) to pursue with Revenue Canada the feasibility of remitting the GST in the proposed manner.

C) Freight Transportation Services

The tax rules that apply to freight transportation will be altered by the government's proposal. Under the existing federal sales tax system, all services used to transport goods manufactured in Canada from the manufacturer's premises to the purchaser are excluded from direct federal sales tax. In the case of imports, the federal sales tax is computed on the duty paid value of the imported goods and therefore do not include transportation costs to Canada in the tax base. In the case of integrated manufacturing firms that market and distribute their own finished products, a deduction from the federal sales tax base is allowed for these transportation costs. However, the cost of transporting raw material and other production inputs is included in the cost of manufacturing goods in Canada and therefore is subject to federal sales tax as an element in the manufacturer's selling price of the finished product. In other words the current tax base includes all in-bound transportation costs for production inputs.

Under the new system, the GST will apply to all domestic freight transportation services in the production and distribution chain provided by any mode including common carriers, independent carriers, private carriers and postal and courier services. Supplies of international transportation services will be zero-rated. In accordance with normal rules registrants who provide freight transportation services will be eligible to claim an input tax credit on any purchase required by their provision of that service. As stated by the Department of Finance in response to a question from the Committee:

> It is important to recognize that the transportation sector faces a substantial tax burden under the existing Federal Sales Tax (FST). The FST applies directly to motive fuels, loading equipment, computers and construction materials. In addition the cost of items which are nominally exempt, such as the transportation equipment itself, includes a significant indirect tax component. In total these factors result in an average tax burden of roughly 2 percent on freight transportation. However, the burden is somewhat higher on long-haul freight movement where fuel represents a substantially higher proportion of total costs. This burden will be removed under the GST because transportation companies will be able to claim full input credits for the tax on their purchases.

Equally, registrants who buy transportation services for use in making taxable or zero-rated supplies will be able to claim an input tax credit under the GST.

A recuring concern raised during the Finance Committee's hearings outside Ottawa, has been the GST's impact on the cost of transporting goods to be consumed in Canada's outlying regions. The Edmonton Chamber of Commerce, the Port of Halifax, the Coalition of Canadian Transport Associations and Carriers and the Atlantic Provinces Transportation Commission were among the many groups that expressed their views over the proposed tax treatment of freight transportation. There was general agreement that carriers' costs would go down, as a result of input tax credits, but it was argued that the price of goods and services purchased by final consumers living far from the producer would go up, since transportation of finished products would now be taxable. In addition, it was submitted the competitiveness of producers of finished products located far from their markets would be eroded, since even though they will become eligible for an input tax credit for taxes paid on transportation charges in respect of the inputs they consume, the GST will be calculated on a broader base, which will include the value added by the transportation service.

It is important to distinguish between inputs used in providing transportation services, the charges made for transportation services and the transportation element included in the selling price of goods. As stated above, the tax paid on transportation charges will be fully recoverable through the input tax credit system by purchasers who are registered vendors and use the goods in making taxable or zero-rated supplies. In the case of an unregistered purchaser (such as a consumer) no input tax credit will be given for tax on the direct transportation charges or on the transportation element included in the selling price.

The Committee recognizes that the GST could potentially increase the cost of transporting finished products that are consumed far from the point of production since the tax rate on any direct transportation charges, or on the transportation element included in the final selling price, will increase to 7% from an effective tax rate of approximately 2%. However, this inflationary effect in regions remote from production and distribution centers will be offset by a reduction in the price of zero-rated products (primarily food) that are consumed far from their point of production since the inputs used in the supply of transportation services and transportation charges as such will be effectively relieved from all tax through the input tax credit system. Evidence before the Committee indicated this tax saving could be as high as 2%. Furthermore the cost of transporting business inputs to those same regions should go down by a similar amount. As noted earlier, the transportation of inputs is currently subject to federal sales tax. Under the new system, the cost of transporting inputs will be initially taxable, but the GST paid will be fully recoverable through the input tax credit system.

The Technical Paper states, "international freight transportation services — including both inbound and outbound services — generally will be zero-rated." Segments of domestic movements of freight (from the manufacturer to a port, for example) will also be "zero-rated where the contracting shipper provides a declaration that the domestic movement is part of a continuous outbound international move."

In the case of an inbound international freight service which includes segments of domestic movements, the service will be zero-rated if the origin specified on the covering bill

of lading is a point outside Canada. However, where a separate bill of lading is issued for a transportation service commencing and ending in Canada (i.e. from Customs to the final destination in Canada) the service will be subject to GST. This treatment could increase the freight rate for foreign shippers since they will not be able to claim any input tax credit for the GST paid on the domestic movement.

The Port of Halifax represented to the Committee that the proposed tax treatment would have repercussions on every maritime point of entry to Canada, since foreign shippers would have an incentive to divert vessels to American ports and to use untaxed ground transportation originating in the United States. Specifically, if two bills of lading are to be issued there would be a tax advantage for foreign shipper to use American ports or airports and to use ground transportation from the point of arrival in the U.S. to the final destination in Canada. Assume for example two movements of goods: Liverpool (U.K.)-Halifax-Montreal and Liverpool (U.K.)-Boston (U.S.A.)-Montreal. Under the government proposal the ground transportation from Halifax to Montreal would be taxable but the Boston to Montreal trip would be tax-free. As the Coalition of Canadian Transport Associations and Carriers told the Committee:

> Canada-based truckers [could suffer] potentially serious prejudice, especially with export or import movements to the United States, [since] U.S.-based truckers can obtain operating authority within Canada to compete with domestic truckers for the domestic portion of any inbound freight movement, utilizing a single through bill of lading.

The Committee therefore recommends:

34. That, if prepaid by the foreign shipper and as long as a declaration specifies that the transportation services is part of an international continuous movement of goods, the domestic segment of inbound international freight movements be zero-rated, whether there is a second bill of lading or not.

D) Excise Tax on Fuel

Across the country, the hearings revealed that a number of interested parties (such as the St. John's Board of Trade, the PEI Potato Growers the Coal Association of Canada and the Atlantic Building Supply Dealers Association) requested elimination of the excise tax on fuel. It was argued that this hidden excise tax created distortions and made our exports less competitive. In the same way the tourism and passenger travel industries (such as the Tourism Industry Association of Yukon, Tourism Ontario and Air B.C.) said that the excise tax on fuel made their services less competitive. The Committee realizes that economic benefits would flow from the elimination of the excise tax on fuel for commercial use. However, the cost of such a move is estimated at just over $1 billion. Since immediate elimination would do too much damage to Canada's fiscal equilibrium, the Committee recommends:

35. That once its financial position is more balanced, the government should consider the advisability of integrating the excise tax on fuel into the GST through the input tax credit system, in order to eliminate the distortions associated with the excise tax.

This decision should be balanced to reflect environmental concerns such as a reduction in the demand for energy and the application of the "user pay" and "polluter pay" principles with a view to protecting the environment.

7. REAL PROPERTY

The Committee's review of the application of the Goods and Services tax to the real property sector is structured in three parts. Part A sets outs the conceptual framework for the Committee's analysis. Part B analyzes the Technical Paper proposals under the following headings: Summary of Technical Paper proposals, Representations received by the Committee, and Views of the Committee. Part C sets out the reasons for the choice by the Committee of its recommended tax rate and the elements and detailed calculation of the tax base.

A) Conceptual Framework

The determination of the proper treatment to give to real property under a consumption tax is a difficult exercise. The issue is sensitive given that housing is an important part of household consumption.

One of the most fundamental issues that underlies the determination of the basic structure of a consumption tax that applies to real property is the appropriate measure of consumption. The more common suggested approaches to measuring consumption focus on either "flows" or "stock". At times, however, the very existence of a consumption activity is at issue. In this regard, a threshold issue was raised by some witnesses before the Committee. As stated by one witness, "land is the ultimate non-consumable".

The Committee believes that good pragmatic and conceptual arguments nevertheless exist for the taxation of land.

First, the principle of fairness suggests that land should be taxed when sold for personal use. For example, it would not be reasonable to exempt the purchase of a waterfront lot on the basis that land is a non-consumable. Although not physically consumed, land is clearly used. Moreover, even should it be a valid proposition that the purchase for personal use of real property that includes land or that is vacant land is not in itself an act of consumption, it is nevertheless an equivalent to consumption acts such the purchase of a new motor vehicle. Both represent personal expenditures in a general way and therefore should at least on pragmatic grounds be brought within a value-added tax system.

Second, the building component of real property is clearly a consumable — it is used up over time. As discussed in detail below, separating the land component of real property which includes a building raises serious technical problems.

Third, value added taxes also apply to transfers of stock, for example buildings. Land is a stock and value can be added to land. It is therefore logical to tax land, at the very least to permit input tax credits for taxes paid on land improvements.

The treatment of land and buildings in different jurisdictions is not consistent. The jurisdictions in which real property is taxable address the taxation of land through a mix of measures including value-added taxes, registration fees, transfer taxes and stamp duties.

Fundamentally, a consumption tax that applies to flows of real property uses rents as the measure of consumption. Under such an approach, tenants pay tax on actual rental payments whereas owners pay on imputed rentals. A consumption tax applying to real property stock applies instead to transfers of property.

These two approaches are not necessarily mutually exclusive. Rather, it is possible to devise a tax that applies in certain instances to stock, and in others to flows.

The Technical Paper proposes an approach that blends the taxation of both stock and flows depending on the circumstances. Whereas the substance of the proposals is to tax transfers of stock, not all such transfers are taxable. Moreover, flows do not always escape taxation.

In the non-commercial sector, the substance of the Technical Paper proposals is to tax transfers of newly residential stock. Transfers of existing stock are generally exempt. Flows are also generally exempt: long-term residential rents (one month or more) are exempt but rents of a duration of less than one month are taxable. Moreover, property owners are not required to calculate tax on the basis of imputed rentals.

In the commercial sector, the Technical Paper proposes to tax both flows and transfers of stock but generally proposes to remove the burden of such taxes from registrants through the input tax credit system. In this regard, the tax can be viewed as taxing neither flows nor stock since the input tax credit effectively removes the tax burden from the commercial sector, leaving the ultimate burden of the tax borne by the consumer on purchases of taxable property or services from the commercial sector. There are however important exceptions. Financial institutions do not receive immediate relief for taxes paid on acquisition of stock to the extent that the stock is used by the institution to provide exempt supplies; a credit for such taxes is however available when the property is resold. Additionally, the tax on rents paid by financial institutions is not rebated to the extent that the leased premises are being used to make exempt supplies. Similarly, charities, non-profit organizations and selected public sector organizations are only entitled to input tax credits for the taxes payable on the acquisition of commercial real property to the extent that the property was acquired primarily for use in a commercial activity. These entities however receive partial rebates for any taxes that have not been credited through the input tax credit system. Similarly, taxes on rents paid by these entities are only creditable to the extent of the commercial use of the property.

The Committee believes that the goods and services tax as a consumption tax should not ultimately be borne by the commercial sector. As discussed in Chapters 8, 9 and 11, the Committee concurs with the rationale of the Government for limiting the availability of input tax credits for financial institutions, charities, non-profit organizations and selected public sector organizations in respect of exempt supplies.

The Committee believes that the most appropriate approach to the application of a consumption tax to non-commercial real property is to tax transfers of stock. In theoretical terms, taxing flows may have merit since arguably this would result in the application of tax to a more appropriate measure of current consumption. Such an approach, however, raises extremely difficult technical and compliance issues such as the determination of imputed rents for homeowners. The Committee believes that adopting a flows approach to the non-commercial sector is impracticable. The Committee thus rejects this approach as cumbersome administratively, and supports the application of the tax to transfers of residential stock.

The Committee believes that a consumption tax on the transfers of real property stock should be based on the following principles:

(i) The Tax Should Not Distort The Housing Markets

The Committee believes that if one accepts as it does that taxing stock is the appropriate method of measuring consumption, the tax should apply equally to all housing or residential stock. The Committee believes that it would be inappropriate to apply the tax to a select portion of the real property stock, and not to apply it to another part that has otherwise the same characteristics. For example, applying the tax to new buildings but not to existing buildings creates a serious risk of distortion in favor of existing buildings and, presuming that markets operate freely, has the potential of giving existing owners a windfall gain. Furthermore, applying the tax to some land sales and not to others also leads to distortions.

The Committee addresses these issues more fully in the next section which details its analysis and recommendations.

(ii) The Tax Should Treat Home Owners and Residential Tenants Equally

The Committee believes that the application of a consumption tax should not discriminate between home owners and residential tenants. A consumption tax should apply equally to all types of consumption of shelter and not induce individuals to choose one form of shelter over another.

Under the Technical Paper proposals, a tax rate of 9% applies to the acquisition of new rentals buildings while a net rate of 4.5% (rate of 9% less a housing rebate of 4.5%) applies to new residential construction costing $310,000 or less. This has the potential of being distortionary.

(iii) The Tax Should Be Consistent Between Acquisitions and Sales of Similar Properties

The Committee believes that a consumption tax should not discriminate between different methods of acquiring of real property. In particular, an individual vendor should not be in a posistion to gain a permanent advantage or a windfall through the

tax system from constructing his own home rather than contracting out such construction to a developer, or from renovating or making an addition to an existing home rather than purchasing a similar home. The Committee does not propose to tax self-supply of services in these situations. However, the Committee believes that the value added, whether by a contractor or an individual homeowner, should ultimately be equally recognized under a consumption tax system.

The Committee believes that the taxes payable by a person on the acquisition of property should depend on the nature of the property and not on such subjective elements as the status of the vendor and the use of the property by the vendor. Otherwise, the tax leads to inconsistent results and can confer windfall gains.

By way of example, under the Technical Paper proposals:

- A sale of property renovated by an individual who is not in the renovation or construction business is exempt, where a similar sale by an individual carrying on such a business is taxable;
- Personal-use land sold by an individual is exempt, where land sold by a developer is taxable;
- Land sold by an individual in the business of buying and selling land is taxable, while land sold by an individual who is not in such a business is exempt;
- Land sold by a charity to an individual is taxable, while land sold by the same charity to a developer is not taxable in most cases.
- Sales of existing residential properties are usually exempt if the vendor is an individual but, if the vendor is a developer who carried out a substantial renovation to the property, the sale is taxable;
- A sale by a vendor who claimed an input tax credit in respect of a property is taxable, whereas a sale by another vendor may be exempt.

Providing exemptions for some sales while taxing others confers potential windfall gains to owners of property the sale of which is an exempt supply. The vendor may increase his price on the sale by reference to the tax imposed on the taxable supply of similar properties. Moreover, exempting certain sales of property creates confusion in the marketplace.

These are some examples of inconsistent treatment that can be found in the Technical Paper. To be fair, the Committee recognizes that, in some cases, the inconsistencies may be more apparent that real and that purchasers may in certain cases by operation of market forces not face different prices for property sold in different circumstances. However, the proposals are nevertheless potentially inequitable, confusing and conducive to uncertainty.

The Committee addresses later how its recommendations eliminate the differences noted below (see Section C of the present Chapter — tax base).

(iv) Competing Resources Should Bear Comparable Tax Burdens

The Committee believes that taxpayers who compete with others for the allocation of the same resources should benefit from comparative tax treatments. For example, under the present proposals, the not-for-profit sector enjoys a comparative advantage over the private sector with regard to the supply of comparative rental housing. Similarly, the Technical Paper proposals may favor the acquisition of vacant personal-use land over that of land sold by developers. These results are not justifiable.

(v) The Application of the Tax Should Be Clear and Simple

The Committee believes that taxpayers should be able to plan their affairs with certainty, particularly with regard to real property purchases. The Committee believes that, by basing the tax liability of a purchaser of real property on the status of the vendor, the Technical Paper proposals create substantial confusion.

B) Technical Paper Proposals

The Committee's comments under this part address the proposed taxation of land, new residential housing, existing residential housing, other personal-use properties, rental buildings, commercial buildings, and renovations.

1. Land

(i) Technical Paper Proposals

The Technical Paper proposes that the tax apply to all sales of land, unless the sale is specifically exempt. The Technical Paper proposes to exempt sales of personal-use land by individuals or trusts (all the beneficiaries of which are individuals), other than real property which was used or rented by the vendor in the course of a taxable commercial activity, or real property sold in the course of a business. Sales of land by charities, non-profit organizations, and certain selected public sector organizations to persons other than individuals are also to be exempt unless an input tax credit was claimed by the vendor in respect of the land. Sales of farmland between related individuals or as part of a going concern are additionally to be exempt.

(ii) Representations Received by the Committee

The Committee received many representations to the effect that the sale of land should not be a taxable supply.

The Canadian Home Builders Association (CHBA) represented that the exclusion of land, coupled with a housing rebate scheme, is the most mitigating of all other options with regard to the expected negative effects of the tax on new housing. The

CHBA represented to the Committee that differences in land values account for regional variations in housing costs and, consequently, the relative affordability of housing.

The CHBA represented to the Committe that it would be administratively feasible to separate land from the total sales price of new homes. In this regard, the CHBA suggested the following two methods to separate the land component from the selling price of new homes. First, the builder could, by means of a self-assessment procedure, estimate the land value. Second, guidelines could be established to aid the builder in determining the land component —such guidelines would set out allowable proportions of land to total price and would address variations by house type, lot size, density and market area, and be similar in scope to the Maximum Unit Prices (MUPs) established by CMHC for social housing. Of the two approaches, the CHBA favors the assessment by the builder.

The CHBA represented to the Committee that land costs as a percentage of the selling price of single-family houses and apartment condominiums are as follows:

LAND COSTS AS A PERCENTAGE OF SALES PRICE

	Single-Family Houses	Apartment Condominiums
	%	%
Toronto CMA	45	15
Vancouver CMA	35	15
Montreal CMA	27	15
Rest of Canada	19.2	15
Canada	22.5	15

The CHBA submitted to the Committee on the basis of the above data that, on a regional basis, land costs account for widely-varying proportions of the selling price. The CHBA thus argues for the removal of the land component.

The CHBA submitted alternatively to the Committee that treating sales of personal-use land by an individual and sales of certain land by the non-profit sector as exempt supplies, as the Technical Paper proposes, creates competitive inequities with land purchased from developers, as the latter transactions are taxable. The CHBA represented that the proposals do not entitle a developer to a notional input tax credit when raw land is purchased in a transaction that qualifies as a tax-exempt supply. The CHBA suggests that this could lead to tax cascading. Moreover, the CHBA submitted that it is appropriate that no self-supply rule apply in such cases since an individual

could acquire personal-use land from another individual without tax, and then build his own house.

The Canadian Home Builders Association suggested finally that the classification as taxable supplies of land sales by individuals who are engaged in the course of a business is confusing to purchasers as such a determination is highly subjective.

Other witnesses also argued in favor of the exclusion of land from the tax base.

The Canadian Real Estate Association stated that the zero-rating land may prevent the tax from exacerbating required differences in housing costs. The Association feels that such a measure could permit the elimination of the proposed housing rebate program. The Association recognized however that there are technical problems associated with such an approach.

As noted below, the thrust of the submission by the Urban Development Institute (UDI) was that both new and existing housing should be taxed in accordance with a "trade-up" approach. However, the UDI submitted alternatively that another approach to reducing the impact of the tax on the housing market would be to eliminate land from taxation. The UDI argued in this regard that land, not taxable under the federal sales tax, is neither a manufactured good nor a service and that many of the inequities in the proposed tax result from the fact that while construction costs do not vary significantly across the country, the cost of land does. The UDI suggested that while some may argue that this would be complicated to administer, most provincial assessments clearly distinguish between land and improvements.

The Canadian Construction Association (CCA) questioned the conceptual foundation of a consumption tax on land in particular, whether the purchase of land can be a consumption activity. The CCA recognized however, that, if land were excluded from the tax base, there would likely be a strong bias to allocate as much as possible of the total purchase price of a property to the land component and the least possible to the buiding component. Thus, while the CCA objects to the inclusion of land in the tax base, it recognizes the technical difficulties in allocating the total purchase price of a property between the land and building.

Mr. Wolfe Goodman, Q.C. from Goodman and Carr also raised concerns in relation to the proposed treatment of land sales. Mr. Goodman stated that the Technical Paper contains a great many anomalies . Mr. Goodman was particularly concerned that, under the Technical Paper proposals, the taxation of land transactions varies considerably depending on the status of the parties. Mr. Goodman submitted that land sales should be exempt.

Mr. Goodman conceded that there are administrative difficulties in separating the land component from the building component for the purpose of exempting land sales. Mr. Goodman suggested however that statutory rules and administrative guidelines could be developed to provide an effective and reasonable exemption in respect of the

land portion of housing sales without abandoning the principle that land itself when sold should not be the subject of a goods and services tax.

Professor Robert Clark also submitted that land sales should not be taxed, regardless of the purposes for which land is used. Professor Clark submitted that the purchase of land is not a consumption expenditure, and that exempting land would lessen the need for a housing rebate.

(iii) Views of the Committee

The taxation of land under a consumption tax could be addressed under one of three approaches. First, all land transactions could be excluded from the tax base. Second, as the Technical Paper proposes, only specified land transactions could be taxed. Third, all land transactions could be taxed. The Committee favors the third option with one exception: The Committee recommends the taxation of all land sales except, as the Technical Paper proposes, transfers between individuals of land used for farming purposes, and transfers of land used for farming purposes as part of the transfer of a going concern. The reasons of the Committee are discussed below.

The Committee rejects the exclusion of land from the tax base because this would require the development of complex rules designed to separate the land component from the building component in order to permit that the land component of a property not be subject to tax on the sale of the property. While it was suggested to the Committee that the calculation of the land component could be achieved by such diverse methods as statutory rules, government guidelines, historical costs, municipal assessments and self-assessment procedures, the Committee is not convinced that any of these methods could be satisfactorily applied to exclude land in a clear and simple rule while respecting the principles of certainty, simplicity and consistency of treatment. The Committee is also very concerned that providing an exemption for land transactions would lead to valuation disputes and, in this regard, fears that in any dispute, the legal, accounting, appraisal and other costs of contesting the valuation of the land could outweigh any potential tax benefits to the purchaser. The Committee recognizes that land costs account largely for regional differences in housing prices. In view of the considerations discussed above, however, the Committee believes that the issue is best addressed by a general reduction of the tax rate applied to real property, rather than by the introduction of any mechanisms to exclude land from the base (see Part C for discussion of the tax rate).

The Committee also rejects the selective taxation of land sales based on the vendor's status, as proposed by the Technical Paper. As noted above, the Technical Paper proposes that sales of personal-use land by individuals and certain trusts, and certain sales of land by charities, non-profit organizations and selected public sector organizations be exempt. The Committee judges that it is not in the best interests of the market place that a system be developed under which some land transactions are taxed and others are not. The Committee believes that such a measure could prove to be inequitable, distortionary, complex to administer and lead to uncertainty and confusion.

The Committee therefore recommends that the taxation of all land sales except the following transfers of farmland:

- ° transfers of land used for farming purposes between related individuals;
- ° transfers of land used for farming purposes as part of the sale of a going concern.

In keeping with the principles noted above, the Committee believes that this approach substantially lowers the risk of distortion and confusion with respect to real property transactions. Furthermore, this approach is clear, simple, leads to consistent results and will be clearly understandable to Canadians.

2. New Residential Housing

(i) Technical Paper Proposals

The Technical Paper proposes that the tax apply to the sale of newly constructed houses. The tax is to apply without exceptions, even where the sale is made by a charity, non-profit organization, selected public sector organization or government.

The Technical Paper proposes furthermore that a new home purchaser who is a resident of Canada and who proposes to use the home as his principal residence be entitled to a rebate of 4.5 percentage points of tax where the consideration paid for the house is $310,000 or less. Where the consideration paid by such an individual is more than $310,000 but not more than $350,000, the individual is to be entitled to a rebate of $13,950 — the value of the 4.5 percentage point rebate on a $310,000 house. Where the consideration paid by the individual is more than $350,000, but not more than $400,000, the individual is to be entitled to a rebate of a fraction of $13,950, based on a formula which progressively decreases the amount of the rebate as the house price moves up towards $400,000. Beyond $400,000, no rebate is available.

(ii) Representations Received by the Committee

The representations received by the Committee largely dealt with the structure and quantum of the housing rebate and the advantages of excluding land from the tax base, rather than the merits of the imposition of a consumption tax to new housing. The Canadian Home Builders Association, the Canadian Construction Association and Professor Robert Clark did suggest however that an alternative option was the taxation of imputed rents.

° ***Housing Rebate***

The Committee received many representations with regard to the structure and operation of the housing rebate. Industry groups, including the Canadian Home Builders Association and the Urban Development Institute, submitted to the Committee that the operation of the phase out of the rebate is such that home

builders will avoid constructing homes in the $310,000 to $450,000 price range, given that consumers will be reluctant to purchase these homes. Furthermore, it was suggested to the Committee that the choice of the $310,000 threshold will induce builders and purchasers to engage in tax planning activities to keep the initial house price at or near the $310,000 to $350,000 level. For example, it was suggested that developers could cap their sales price at $350,000 and provide the extras over and above $350,000 under a separate contract.

The Committee also heard that the rebate formula is inequitable for homes costing $350,000 or more. Of particular concern to the Urban Development Institute is the rapid phasing out of the rebate for homes costing between $350,000 and $400,000. The Urban Development Institute represented to the Committee that the rebate scheme results in an effective marginal tax rate of 36.9% on these homes. The UDI further represented that the rapid phase out of the housing rebate fails to recognize that in high land-cost markets such as Toronto and Vancouver, homes costing in excess of $350,000 are not a luxury. The UDI suggested therefore that the rebate of 4.5 percentage points proposed in the Technical Paper apply to the first $310,000 tranche of the price of a house with the excess being taxable at 9%.

For houses costing $310,000 or less, the Canadian Home Builders Association (CHBA) represented to the Committee that the rebate is not sufficiently generous to ensure that the tax does not pose a barrier to the affordability of housing. The Technical Paper states that the rebate will substantially offset the impact of the tax on the vast majority (over 90 percent) of new houses purchased in Canada. The Technical Paper states that as the current average effective rate of federal sales tax on a home is slightly more than 4.0 percent, a net rate of 4.5 percent on houses costing $310,000 or less should not increase materially the price of most housing in Canada. The CHBA challenged the Technical Paper's assertions on two principal grounds. First, the CHBA submits that the current average effective rate of federal sales tax is approximately 3.7%. Second, the CHBA suggests that market operations will be such that approximately one third of the potential savings resulting from the elimination of the federal sales tax will not be passed along through lower prices. The Urban Development Institute generally corroborated this latter view.

The Newfoundland and Labrador Home Builders Association (NLHBA) adopted and supported the brief of the Canadian Home Builders Association. The NLHBA submitted that the tax would add substantially to the cost of a home in Newfoundland because the tax rate is applied to the full selling price of the home, as opposed to the present imposition of the federal sales tax only to taxable construction materials.

The Canadian Institute of Public Real Estate Companies submitted that the proposed rebates will work well for most of the regions of Canada but that, as the demand for accommodation in a number of urban centres, such as Toronto, has

far outstripped the supply of serviced land and has created a rapid escalation of house prices, the tax will adversely affect the affordability of new housing in these areas.

Professor Robert Clark recommended that the rebate formula reflect the fact that the average selling price of homes varies greatly across Canada. Under this approach, varying rebates would be paid on the basis of regional differencesin home prices.

The Northwest Territories Construction Association also felt that the tax rate proposed by the Technical Paper is too high.

° *Land Exclusion*

As noted in the above discussion on land, the CHBA submitted an extensive analysis to the Committee for the purpose of its review of the tax on new homes. The CHBA suggested that while a solution to the purported affordability problem may be to enrich the housing rebate so as to lower the effective rate of tax, the preference of the Association is the exclusion of land from the tax base coupled with a rebate of 4.5 percentage points of tax on the price of the home excluding the land. The CHBA submitted to the Committee that this would be the best option to mitigate the adverse effect of sales tax reform on the affordability of new ownership housing total.

The Committee heard a number of other representations to the effect that regional differences in land costs in Canada will account for significantly different burdens of tax on the acquisition of new homes. The Canadian Construction Association corroborated this view. It was suggested to the Committee that the exclusion of land from the tax base would significantly reduce the cost of purchasing a house in the high land cost markets and, in so doing, would remove the need for a housing rebate. The Urban Development Institute suggested as one of the alternatives raised in its submission that housing could be taxed progressively by applying a 4.5% rate to a regionally adjusted average price of all homes, and the general GST rate to any excess amount.

(iii) Views of the Committee

The Committee's views on the Technical Paper proposals and on the representations received by it are as follows:

° ***Housing Rebate Rate***

As noted above, the Technical Paper proposes that new housing costing $310,000 or less be taxed at a net rate of 4.5%. Housing costing more than $310,000 but less than $350,000 is to be taxed at an effective rate ranging between 4.5% and 5.0%. Housing costing more than $350,000 and less than $400,000 is

taxable at an effective rate ranging between 5.0% and 9%. The actual and effective tax rate on houses costing more than $400,000 is to be 9%.

The assumption that underlies the choice by the Department of Finance of a 4.5% rebate for eligible houses is that the current average effective rate of federal sales tax for the nation as a whole on housing prices is approximately 4.2%. As noted above, the Committee heard representations from the Canadian Home Builders Association that the actual rate is closer to 3.7%.

The Committee endeavoured to reconcile the figures of 4.2% and 3.7% respectively. Rather than being in a position to conclude on the correctness of either number, the Committee is simply able to note the differences in methodology.

The estimate of the Department of Finance was arrived at by using 1984 input-output data while that of the CHBA used 1980 input-output data. Although the CHBA contests this analysis, (see below) the Department of Finance submits that the 1980 input-output data underestimates the federal sales tax component of house prices for two reasons. First, the Department of Finance submits that the recession that occurred between 1980 and 1984 tended to make the production of goods more capital intensive. The Department feels that the 1980 input-output tables systematically underestimate the amount of capital equipment involved in the construction of a house. Second, the Department of Finance feels that the trend toward increasing the amounts of capital used in the production of a house continued to increase since 1984 so that even its estimate of 4.2% may today be low.

The CHBA challenges the assertion by the Department of Finance that the use of 1980 input-output tables underestimates the amount of federal sales tax for three reasons. First, the CHBA submits that the volume of new residential construction activity was actually higher in 1980 than in 1984 - the CHBA thus finds it difficult to conceive that the industry made major investments in machinery and equipment in 1984 or during the recession period. Second, the CHBA submits that the homebuilding industry has never been capital intensive, nor is it today, and has lagged when it comes to the introduction of new technology. Third, the CHBA submits that most productivity improvements in house construction in Canada occurred prior to the mid 1970's and have been relatively low since that time.

The Department of Finance points out that the CHBA estimate does not capture significant base changes since 1984, such as the rescinding of the on-site, off-site provisions. In response, the CHBA states that such broadening only adds very marginally to the average federal sales tax component.

In summary, although the Committee is not in a position to arbitrate the differences discussed above, it notes that the CHBA does not contest that its

estimate was computed using less recent input-output tables and that its estimate does not incorporate certain changes in the tax base.

As noted in Part C, the Committee recommends that a single rate of tax of 5% be applied to all supplies of real property. The Committee feels that this will relieve the system from the difficulties of the dual rate and of the structural difficulties of the housing rebate. For the reasons given in Part C, the Committee considers that the affordability of housing would not be materially adversely affected by the introduction of a 5% rate.

° *Housing Rebate Thresholds*

The Committee concurs with the representations made before it to the effect than the housing rebate and the thresholds for the application of the rebate could induce builders to avoid the construction of homes the cost of which ranges between $310,000 and $450,000. The Committee accepts furthermore that consumers may avoid such homes. The Committee thus concludes that the thresholds and the phase-out schedule of the housing rebate program could lead to serious distortions.

The Committee recognizes that the design of a program such as the housing rebate program can inherently pose problems because of the necessary and arbitrary choices that need to be made. The Committee recognizes furthermore that the thresholds were chosen so as to address regional differences in housing prices and to offer a program of appeal to the vast majority of Canadians. Unfortunately, because of widely varying house prices across the country, the thresholds may be too generous for some Canadians and not generous enough for others. Although it was put to the Committee that the thresholds could be improved by designing a system of regionally-adjusted thresholds, the Committee rejects this option as being much too complex and arbitrary.

As explained in Part C, given that the Committee proposes that a single tax rate of 5% apply to all real property transactions, the housing rebate program will not be required. This, obviously, does away with the threshold problems discussed above.

As discussed above (see Land), the Committee does not favor the exclusion of land from the tax base. The Committee feels that the application of a tax rate of 5% is, all things considered, the preferable approach.

3. Existing Residential Housing

(i) Technical Paper Proposals

The Technical Paper proposes that resales of existing housing be exempt unless the vendor claimed an input tax credit in respect of the acquisition or the improvement of the home. The Technical Paper proposes however that the sale of an existing home

be taxable where the home underwent a substantial renovation in the course of a business involving the purchase, renovation and resupply of used homes.

(ii) Representations Received by the Committee

° *Exemption of Existing Stock*

Many industry representatives submitted to the Committee that exempting resales of existing homes would be distortionary. The CHBA represented that applying the tax only to new housing could cause harmful distortions and inequities between the new and existing houses, and would hurt housing markets and their constituents. The CHBA represented furthermore that the application of the tax only to new housing could drive up the price of existing homes, thereby creating a windfall gain for owners of such homes.

The UDI corroborated the view of the CHBA by stating that the tax as currently proposed would induce taxpayers to avoid its application by renovating current residences, or by acquiring existing homes instead of new homes. The UDI felt that with fewer resale homes available and more purchasers, resale prices could rise more than the new GST would warrant, thereby further distorting the market place.

The Conservatory Group stated that by taxing only new housing, one of two outcomes could occur. First, homebuyers could shun new construction in favour of existing supply, thereby severely impacting on the already volatile house building industry. Second, the price of existing housing could rise artificially as a result of the "discount" induced demand.

Mr. Goodman remarked that one of the obvious effects of taxing the sale of new housing on the basis of both the land component and the building component would be to depress the sales of new houses and the housing industry, and to increase the price of old houses.

The Canadian Real Estate Association was less certain on the impact of the tax on houses priced lower than $310,000, given the importance of the assumptions concerning the amount of the federal sales tax embedded in current house prices and the degree to which the federal sales tax conponent would be eliminated through competitive market forces. The Association was clear however that the tax will in the absence of countervailing market forces, tend to increase the price of new houses that cost more than $400,000, and thereby cause the price of comparable existing housing stock to rise in tandem.

The Canadian Construction Association took a somewhat opposite view by suggesting that the housing rebates would effectively minimize any windfall gain to owners of existing housing that could result from the application of the tax. The CCA thus concurred with the view of the Department of Finance that the

proposed 4.5% rebate would not affect the price of new housing unit below $310,000.

The Atlantic Building Supply Dealers Association did not specifically recommend the taxation of existing housing. However, the ABSDA urged the Government to eliminate all exemptions and to make the GST universal. The ABSDA felt that it is a matter of vital importance for the housing industry that the burden of the GST be spread as much as possible. The ABSDA recommended that the rate be reduced to 5%.

° ***Taxation of Existing Stock***

In light of the expected impact of the Technical Paper proposals on the housing markets for new and existing homes, the Canadian Home Builders Associaton, the Urban Development Institute and the Conservatory Group supported the principle of the taxation of existing homes. The Canadian Home Builders Association made it clear however that its principal submission was that land should be excluded from the tax base and that a rebate equal to one-half of the tax paid on the acquisition of the house should be given. The CHBA thus stated its views in respect of the taxation of existing stock in a follow-up submission.

The Committee received a distinct proposal from each of the UDI and the CHBA with regard to the calculation of the tax base for the taxation of existing housing.

The Urban Development Institute proposed to tax only additional housing spending and thereby to apply tax to each purchase on the amount by which the purchaser of the house trades up in price. A purchaser of a house would thus pay tax on the basis of the cost of the house purchased, but receive a credit for any taxes collected by him on the sale of his previous home. The tax would apply at 4.5% on the first $310,000 of house price and at 9% thereafter. For example, a purchaser of a house costing $300,000 concurrently with the sale by him of a house at a price of $200,000 would attract a net tax of $4,500 in his hands, this amount representing the difference between the gross tax of $13,500 otherwise payable on the purchase, and the tax of $9,000 collected on the sale. The proposal was stated by the UDI to be a tax on additional housing spending since only the incremental spending or the trade-up (in the present example $100,000) effectively gives rise to tax for the purchaser. Following this example further, and assuming that the purchaser of the $200,000 home is a first-time home buyer, the said purchaser would owe tax of $9,000 on the purchase.

The Canadian Home Builders Association proposed instead to tax the first sale after 1990 of every existing home on January 1, 1991, and to disregard subsequent sales of the same property. Under this approach, the vendor of the

existing home bearing tax would not be credited with such tax on a subsequent acquisition.

(iii) Views of the Committee

The Committee believes it is inequitable and potentially distortionary to tax only sales of new housing. The Committee believes that this could cause harmful distortions in the marketplace and lead to the realization of windfall gains by existing homeowners. The Committee also believes that there is merit in the proposition that a tax applying only to new housing could potentially alter consumer choices.

Although, as a matter of theory, one could argue as the Department of Finance does, that the proposed housing rebate effectively negates any possible distortions, the Committee is concerned, even should this be true, that the housing market could nevertheless be affected by consumer perceptions that new housing is more expensive than tax-paid existing housing. The Committee thus considers that the root of the problem is not necessarily whether the housing rebate is sufficient but, rather, that industry participants and consumers, faced with an apparent if not real distortion, could alter their behaviour.

In light of the foregoing, the Committee favors the taxation of existing housing stock. As fully explained in Pact C, the Committee proposes that the tax base be computed in accordance with an incremental spending or "trade-up" approach.

4. Other Personal-Use Properties of Individuals

(i) Technical Paper Proposals

The Technical Paper proposes that sales of personal-use real properties (for example country properties, non-commercial hobby farms and other non-business land) by individuals or trusts (all the beneficiaries of which are individuals), other than real property which was used or rented by the vendor in the course of a taxable commercial activity, or real property which is sold in the course of a business, be exempt.

(ii) Representations to the Committee

The Committee did not received formal representations on personal- use properties other than to the extent discussed above.

(iii) Views of the Committee

Given that the Committee recommends that sales of new housing, existing housing and rental properties be taxable, it would not be consistent to exclude new and existing personal-use properties from the tax base. The Committee proposes therefore that sales of such properties be taxable in accordance with the trade up approach described in Part C.

5. Rental Buildings

(i) *Technical Paper Proposals*

The Technical Paper proposes to apply tax to the sales of new rental buildings, with no housing rebate. As long-term residential rents (one month or more) are to be exempt supplies, no input tax credit will be available to owners/landlords for taxes paid. All sales of existing stock are however to be exempt.

The Technical Paper proposes a self-supply rule where a developer/landlord constructs a residential complex such as an apartment building for subsequent lease to tenants. The developer will be able to claim input tax credits in the normal manner on purchases related to the construction of the residential complex. However, the developer will be required to pay tax on the fair market value at that time that the residential complex is put into rental use. The residential complex will there often qualify as a used residential dwelling and, hence, any resale will be exempt.

This self-supply rule for residential complexes will also apply to charities, non-profit organizations and selected public sector organizations where they develop and subsequently lease residential complexes. Although the Technical Paper proposes that charities, 50% government funded non-profit organization and selected public sector organizations be eligible for partial rebates on their purchases, such rebates will not be available for the tax paid on the purchase or on the self-supply of a residential complex to the extent that the complex is used to provide residential rents at market rates in order to maintain competitive equity with private sector developers. The rebates will be available for residential complexes built to provide accommodation for students, subsidized rental housing or accommodation for the mentally or physically disabled.

(ii) *Representations Received by the Committee*

° *Competitive Equity of Tenants with House Owners*

The Canadian Home Builders Association represented to the Committee that the proposals have the effect of almost doubling the effective federal sales tax on new rental housing (which it estimates at 4.7 percent) to 9 percent. The CHBA suggested that without some form of reduction in the tax rate, there would be a sharp decline in new rental investment by the private sector until rents adjusted — which the CHBA feels could be lengthy because of provincial rent controls. Moreover, the CHBA submits that investors/landlords, and consequently tenants, will face a disproportionate amount of tax when compared to new home purchasers who benefit from the housing rebate. The Association suggests to the Committee in light of this that developers/landlords will be motivated to complete appartments buildings and to put them into use before 1991 to avoid the tax.

The Rental Housing Council of British Columbia submitted that at the proposed rate of 9%, the tax is too severe for tenants. The Council suggested that the base be broadened and the rate reduced to 5%.

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The Canadian Real Estate Association also expressed its concern about the effect on a 9% tax on rent affordability.

- *Competitive Equity of Private Sector with Non-Profit Sector*

The Canadian Construction Association represented in particular that it sees an inequity in the rebate system for owner-occupied housing to the extent that owners of such housing will pay less tax on their consumption of housing services than will renters. The Association suggested that decisions to own or rent are complex and that the entire spirit of tax reform to this point has been to leave such decisions to market forces, rather than attempting to force outcomes through the tax system. The Association therefore represents that the housing rebate system as proposed to new housing should also be applied to newly constructed rental housing units.

The CHBA submitted also that private sector landlords will be at a disadvantage to charities, non-profit organizations and selected public sector organizations in relation to providing rentals because of the availability to the latter group of the rebate of 50 percent of the tax paid on their purchases which effectively reduces their tax rate to approximately 4.5%. The CHBA represented to the Committee that the private sector also provides housing to socially disadvantaged Canadians under the auspices of Government programs or through joint ventures with government bodies and that the private sector will thus be at a competitive disadvantage in providing such services because of the difference in tax rates. The CHBA emphasizes that competitive equity must be maintained.

In light of the above, the CHBA and the Canadian Construction Association submitted to the Committee that a rebate of 4.5 percentage points of tax should also apply to all new rental housing, including market housing.

The CHBA and the Canadian Construction Association represented furthermore that the tax operates effectively as a tax on rents given that residential rents of one month or more are to be tax exempt. Given that landlords will not be entitled to input tax credits, these Associations suggested that the tax will become part of their cost structure.

The Canadian Housing and Renewal Association and the Canadian Home Builders Association pointed out that the non-profit sector will only receive rebates on the tax paid on the purchase and self-supply of a residential complex to the extent that the complex is used for purposes such as subsidized rental housing and not for providing market rates. These Associations submitted that the notions of "subsidized rental housing" and "market rates" are unclear and may lead to competitive inequities due to inconsistent interpretations.

° *Definition of Long-Term Residential Rents*

The Canadian Housing Renewal Association submitted that defining long-term residential rents as being rentals of one month or more will have a severe impact on thousands of low-income singles who generally pay weekly rent in rooming houses and hotels. The CHBA represented that in major urban centres such as Vancouver, Toronto, Winnipeg and Montreal, rooming houses and hotels are the primary source of housing for low-income Canadians. The CHBA submitted that such rents will not qualify under the Technical Paper proposals as long-term residential rents and will therefore be taxable. The CHBA asks that these rents also be exempt supplies.

° *Taxation of Existing Buildings*

The Committee heard representations that the sale of existing rental buildings should also be subject to tax (see Part C).

(iii) Views of the Committee

° *Housing Rebate*

The Committee concurs that the proposed taxation of new rental construction at 9% and that of most new residential construction at 4.5% potentially provides a comparative advantage to homeowners over residential renters.

As owners/landlords are not to be entitled to input tax credits for the tax paid on the acquisition of a new rental building, they will likely seek to recover the additional costs otherwise borne by them from tenants through higher rents.

By recommending that all real property transactions be taxed at a 5% rate, the Committee feels that it is placing homeowners and renters on an equal footing and is thereby remedying the above-noted problem.

The Committee notes that denying an input tax credit to landlords for operating costs does not discriminate against tenants in favour of home owners. Under the Technical Paper proposals, both homeowners and landlords will be liable to pay tax on operating costs that qualify as taxable supplies. Although landlords will likely seek to pass on the cost of the tax to their tenants, the tenants should bear no greater cost to that borne by homeowners, assuming the level of expenditures by both is equal, because the taxes paid by homeowners on housing operating costs are also not creditable.

° *Competitive Equity Between Profit and Non-Profit Sectors*

The Committee agrees with the representations that it has received that where the private sector competes with the non-profit sector, the Technical Paper

proposals may confer a tax advantage on the non-profit sector by rebating one-half of taxes paid to the latter. The Committee concurs furthermore that allowing rebates to the non-profit sector on the acquisition or self-supply of a building where the building is to be used to provide subsidized rental accommodation may lead to inequities, uncertainty, and introduces difficulties of interpretation.

As noted below in the recommendations, the Committee proposes that, rather than extending the housing rebate to new rental properties, sales of all such properties as well as other real property be taxable at a 5% rate in accordance with the trade-up approach (see Part C). As a 5% rate is also proposed for new residential housing stock, rental properties will no longer receive unequal treatment.

Although the Committee recommends that all real property transactions be taxed at 5%, this will not entirely remove the competitive inequities between the private sector and the non-profit sector where rebates are paid to the latter.

Therefore, the Committee recommends:

36. That rebates not be paid to charities, non-profit organizations and selected public sector organizations for taxes paid on real property acquisitions or by application of the self-supply rule.

° ***Short-Term Residential Rents***

The Committee acknowledges that the definition of long-term residential rents may exclude rentals in rooming houses and hotels by the needy. The Committee recognizes however that the removal of the minimum time-period of one month would allow the daily rental of hotel or motel rooms to be an exempt supply. The Committee feels that an appropriate approach to address this issue would be to recommend that per diem rentals at a cost of twenty dollars or less be exempt. The Committee hopes that this would cover the cost of rentals in rooming houses while not capturing the usual cost of a commercial hotel or motel room.

Therefore, the Committee recommends:

37. That per diem rentals of residential units at a cost of $20 or less be exempt supplies.

° ***Taxation of Existing Rental Stock***

For the same reasons as that already discussed for existing residential housing, the Committee concurs that providing an exemption for sales of existing rental stock may lead to distortions. Therefore, the Committee recommends that the sale of existing rental stock should also be taxable in accordance with the trade-up approach described in Part C.

6. Commercial Real Properties

(i) Technical Paper Proposals

The Technical Paper proposes that sales of new and existing commercial real properties be taxable at 9%. A purchaser of a commercial real property is to be allowed an input tax credit to the extent that the property is for use in a commercial activity, subject to two exceptions. First, no input tax credit is to be allowed for the commercial use by an individual of any real property where the property is primarily for the individual's personal use. Second, the same rules as for capital property are to apply to real property acquired by a charity, non-profit organization on selected public sector organization: this will mean that an input tax credit with only be allowed if the real property is acquired primarily for use in a commercial activity; otherwise, no input credit will be permitted.

The Technical Paper proposes a number of change-of-use rules that are to apply if the use of commercial property changes significantly.

(ii) Representations Received by the Committee

The Committee did not hear specific representations of broad scope with regard to the application of the tax to commercial real properties. The Urban Development Institute represented however that it has significant concerns that purchasers of commercial real estate will be required to finance the 9% tax from their own funds until the point in time that it is refunded. The UDI submitted that the tax will not form part of the value of the property for long term financing purposes and that thus, at closing, the purchaser will be required to provide additional equity for a short term to fund the additional 9% of the purchase price.

The Urban Development Institute (UDI) submitted furthermore that the potential cash flow disadvantages to most purchasers would be aggravated because of the requirement that the purchaser secure a clearance certificate from the vendor before an input tax credit can be claimed. The UDI fears that the payment to purchasers of input tax credits will be delayed as, under the proposals, it is the vendor who will be required to remit the tax and, because of this, Revenue Canada will wish to audit the vendor's remittance before it consents to sending to the purchaser the amount in respect of his input tax credit.

(iii) Views of the Committee

The Committee generally concurs with the proposed treatment of commercial property except that the Committee proposes that acquisitions of commercial property also be taxed at 5%. The Committee notes that to the extent that a purchaser of a commercial property is entitled to a full input tax credit for taxes paid on the acquisition of the property, the purchaser should generally be indifferent to the tax rate, except to the extent that it must finance input tax credit refunds. The Committee notes that the reduction in tax rate will benefit charities, non-profit organizations, selected

public sector organizations and financial institutions to the extent that they do not make taxable supplies.

The Committee notes that as taxes payable on the acquisition of commercial properties are fully recoverable through the input tax credit rules, the trade-up approach is inapplicable to such properties.

With regard to the provisions relating to clearance certificates, the Committee believes that this requirement will delay the ability of purchasers to claim input tax credits as their right to do so may depend on whether the vendor remitted the tax and on the amount of his remittance. The Committee concurs with the representation that it has received to the effect that, where a purchaser purchases a property having a value in excess of $1 million, the purchaser should be liable to remit the tax.

Therefore, the Committee recommends:

38. That, where the value of a commercial property exceeds $1 million, the purchaser, rather than the vendor be required to remit the tax. The vendor should, in these cases, be required to notify Revenue Canada of the sale by sending a form to this effect.

7. Renovations

(i) Technical Paper Proposals

The Technical Paper proposes to apply specific rules where, in the course of a business, a home is purchased, renovated and sold.

The rules proposed by the Technical Paper distinguish between substantial renovations and non-substantial renovations. A substantial renovation is to mean a renovation that incorporates no more of the original building that the external and interior supporting walls, roof, floors, staircases and the foundation. The Draft Legislation adds that the conversion of a building that is not a residential complex to use as residential complex will be deemed to be a substantial renovation, whether or not the conversion involves the renovation or alteration of the building.

The difference between a substantial renovation and a non-substantial renovation lies in the extent of the application of the tax when the property is resupplied. Where the renovation is a substantial renovation, the resupply or the renovated dwelling is to be treated similarly to the sale of a new home, meaning that the full value of the land and building are to be fully taxable. Where the renovation is a non-substantial renovation, only the value added by the renovator is to be taxable on resale.

(ii) Representations to the Committee

The Committee heard representations from the Canadian Home Builders Association to the effect that the rules governing substantial renovations are technically deficient and distortionary. Because the Technical Paper proposes that the sale of used residential buildings be exempt, the CHBA submits to the Committee that the proposals

lead to tax cascading to the extent that the land and building are taxed a second time by application of the above-noted rules governing substantial renovations. To remedy this problem, the CHBA suggests to the Committee that renovators be entitled to input tax credits for taxes paid on the purchase of buildings to be renovated.

It was also represented to the Committee that the definition of a substantial renovation is so restrictive that a renovator could very easily circumvent the application of the rule.

(iii) Views of the Committee

The Committee considers that the Technical Paper proposals applying to renovations often lead to inconsistent and inequitable results.

First, the proposed definition of a substantial renovation is so limited and simple to circumvent that its application can almost be said to be elective.

Second, the rule governing substantial renovations results in tax cascading since the renovator is not to be entitled to an input tax credit for taxes paid on the acquisition of the used dwelling to be renovated because the supply of such property to the renovator would likely qualify as an exempt supply. The tax cascading occurs because the full value of the substantially renovated property including the land component is taxable on resale.

Third, the Technical Paper proposals favor the acquisition of existing housing stock from renovators who perform a less than substantial (but a material) renovation, over the acquisition of new housing. The advantage occurs because only the value added by the renovator becomes taxable at the time of sale.

Fourth, because existing stock is not to be taxable under the Technical Paper proposals and because the substantial renovation rule does not apply to individuals who are not in the renovation business, the proposals may induce an individual to purchase an existing house and to perform a substantial renovation, rather than purchasing a new house.

The Committee considers that the rules governing substantial renovations require to be reworked. However, since the Committee recommends that existing housing be taxed in accordance with the trade-up approach described in Part C, this will remove the major inequities noted. Under the Committee's proposal, the four situations described above will be treated as follows:

- *Application of the Substantial Renovation Rule*

Under the Committee's proposal, the acquisition and resale of any existing house in the course of a business will be treated as a commercial activity. The purchaser will thus be entitled to a full input tax credit for the taxes paid on the acquisition and the improvements to the house. The house will be fully taxable on

resale regardless of the nature and extent of the renovation. There will thus no longer be a need for a rule addressing substantial renovations since the supply of all new and existing homes will be taxed identically.

° *Tax Cascading*

As discussed above, any person who, in the course of a renovation business acquires a used residential dwelling for the purposes of resale will be entitled to an input tax credit for the taxes paid. Therefore, no cascading will occur on resale.

° *Substantial versus non-substantial renovation*

As also addressed above, all renovations, whether substantial or non-substantial will give rise to identical tax results: all taxes paid on the acquisition and improvement of buildings in the course of a business will be creditable and the full selling price of such buildings will be taxable on resale.

° *Substantial renovations by non-business individuals*

The Committee believes that by applying the tax to the acquisition of existing homes at the rate of 5%, and by applying the tax at construction materials and services at the rate of 7%, there should be no material difference in the tax cost between acquiring a new home, and acquiring an existing home and contracting out renovations. The Committee acknowledges that an individual who acquires an existing home and self-supplies the renovations may face a marginally lower tax cost.

C) Calculation of Tax

1. Tax Rate

The Committee proposes to apply tax to taxable supplies of real property at 5%. The Committee has chosen the said rate of the basis of several considerations.

First, the Committee, as discussed later, concluded that it would be more appropriate to tax only incremental amounts of spending on non-commercial real property, rather than the full price in all cases. In light of this, the Committee felt that non-commercial real property transactions could be taxed at a slightly higher rate of tax than that proposed by the government for housing costing $310,000 or less while achieving base broadening.

Second, the weighted-average rate of tax on all housing, as proposed by the Government, is 5.6% (because homes costing more than $310,000 are to be taxed at effective rates varying between 4.5% and 9%). The Committee considers in light of this that a rate of 5% achieves an overall reduction in the applicable tax rate while contributing to simplicity and equality of treatment.

Third, the Committee feels that, housing being such an important element of consumption, a preferential rate of tax applicable to housing is warranted. As the general rate proposed by the Committee for other goods and services is 7%, housing, at 5%, does benefit from such a preferential rate. Under the Technical Paper proposals, as discussed in Chapter 1 housing and residential rental properties are taxed at an average rate of 6.9%.

Fourth, the Committee concluded based on the representations received by it that a tax rate of 5% would remove the need for a housing rebate program. As discussed above, the Committee felt that the housing rebate program as proposed could prove to be distortionary because of the arbitrary nature of the thresholds, the pattern of the phase-out of the housing rebate, and the relatively higher burden of tax assumed by persons purchasing homes costing more than $310,000. The Committee accepted the proposition that the structure of the housing rebate was such that builders would avoid or limit the construction of homes in the price range of $310,000 to approximately $450,000. It was thus important for the Committee to remove this potential distortion.

Fifth, the Committee took account of the estimates that were put to it concerning the amount of federal sales tax currently embedded in the price of new homes. While, as discussed above, it was represented in the Technical Paper that the said amount corresponded to an average of 4.2% for the nation as a whole on newly constructed houses, the Canadian Home Builders Association represented to the Committee that the actual figure was closer to 3.7%. Although the Committee was not able on the basis of the evidence before it to resolve the issue, the Committee felt relatively comfortable in proposing a 5% rate as it gained some comfort from the assertions from the Department of Finance which the CHBA did not contest that more recent data had been used by the Department of Finance in estimating the said figure. Moreover, the Committee was reassured by the representation by the Department of Finance that, if current tables existed today, the actual percentage may be higher than 4.2%.

Sixth, the Committee felt that it was important to correct the comparative inequities that owners of rental buildings (and consequently tenants) would bear under the Technical Paper proposals in relation to homeowners due to the proposed taxation of new rental buildings at 9% rather than the 4.5% rate applicable to housing costing $310,000 or less. A single rate of 5% corrects this anomaly.

Seventh, the Committee believes that private landlords should not bear a materially higher rate of tax on the acquisition of rental properties than that payable by competing non-profit organizations. As discussed above, private landlords would under the Technical Paper proposals pay tax at 9% on the acquisition of rental properties while competing non-profit organizations would generally pay at the proposed net rate of approximately 4.5%(after the rebate to which such organizations are entitled). A rate of 5% removes this gap.

Eighth, the Committee felt that a single rate of 5% would resolve the above-noted potential inequities in the application of the self-supply rule to private developers who supply market rents.

Ninth, the Committee judged that a 5% rate on real property acquisitions does not pose a competitive disadvantage to renovators whose materials and services are to be taxed at 7%, particularly when the renovation is self-supplied. The Committee does not feel that a 2% difference on such activities is sufficient to alter consumer behaviour.

Tenth, the Committee received many representations that the tax rates should be lowered and that the base should be broadened.

Therefore, the Committee recommends:

39. That a tax rate of 5% be apply to all taxable supplies of real property.

2. Tax Base

(i) Elements of the Tax Base

The Technical Paper proposes a number of rules designed to make real property transactions taxable in certain circumstances and exempt in others. Particularly, as noted above, the tax consequences of the sale of land, new housing, existing housing, rental buildings and commercial properties depend on such factors as the personal characteristics of the vendor and purchaser, the use of the property, the existence of commercial activities by the vendor, and the fact that the vendor may or may not have claimed an input tax credit in respect of acquisition or improvement of the property.

The Committee believes that the Technical Paper proposals could prove to be distorting, often inequitable, and confusing for the parties that conduct real property transactions. The Committee feels that it is preferable to include all real property transactions in the tax base (except transfers between related individuals of land used for farming purposes, and transfers of land used for farming purposes as part of the transfer of a going concern) and to tax such transactions at a lower rate. Providing an all-inclusive tax base is not only fair, but contributes immensely to achieving simplicity in the administration of the system. Under the Committee's proposals, purchasers will know that all real property acquisitions (with the exception of certain transfers of farmland as noted above) are taxable transactions. The only issue will be whether input tax credits are available.

The Committee noted throughout the present chapter examples of cases where the Technical Paper proposals lead to inconsistent or anomalous results. Appendix A compares the Technical Paper proposals and the Committee's recommendations with regard to the tax consequences of the more common real property transactions.

(ii) Calculation of Tax Base

The Technical Paper proposes generally that the sale of new construction be taxable but that the supply of existing non-commercial properties be exempt. As indicated above, the Committee proposes to include existing properties as a component the tax base. Notwithstanding this, the Committee considers that it would be unfair to apply tax to the full selling price of each existing non-commercial property at every time that it changes hands, as this would represent a turnover tax on real property. On the basis of the representations noted below, the Committee proposes a form of rollover which makes the system fair and equitable for both new and existing non-commercial properties. As previously indicated, the sale of new and existing commercial properties is generally to be taxed, but will give rise to input tax credits. Commercial properties will therefore not be subject to this methodology as it will not be required.

Two groups submitted detailed proposals to the Committee with regard to the calculation of the tax base of non-commercial properties.

The Canadian Home Builders Association was not conceptually opposed to the taxation of existing non-commercial properties. In a follow-up submission to the Committee subsequent to its appearance, the CHBA submitted that if existing housing is to be taxed, the tax should apply to the full selling price of each home in existence on January 1, 1991, at the time after 1990 that it is first sold (the "first sale" method). Afterwards, the home would be tax-paid and would thus not be taxable again on resale.

The Committee does not believe the application of the "first sale" method would be appropriate for several reasons. First, the Committee fears that the application of the tax in accordance with this method would lead to confusion and further distortions in the housing markets over time as housing would become divided into three categories: new taxable housing, tax-paid existing housing, and taxable existing housing. Second, such a tax could be argued to constitute a retroactive tax on housing gains on the date of implementation. Third, such a tax could be construed as a selective and disguised one time tax that discriminates against those individuals who have chosen to invest their funds in real estate, rather than other forms of investment.

The Urban Development Institute proposed two methods of taxing non-commercial residential stock: one that would apply to new and existing housing and personal-use properties, and one that would apply to new and existing residential rental properties.

With regard to non-commercial properties but not including residential rental properties, (new and existing homes and personal-use properties), the Urban Development Institute proposed that both new and existing properties be taxed in accordance with an approach which would define the tax base as the incremental spending by a purchaser, or, in other words, the "trade-up" in price by the purchaser. For example, a purchaser who sold a home for $100,000 to move into a home costing $200,000 would be taxable on his additional spending or trade-up of $100,000. As long

as the purchaser of the $200,000 property chose to limit his real property spending to the said property, the purchaser would escape further tax. If, instead, the purchaser subsequently acquired a higher price home or another non-commercial property, he would then again be liable for tax on the difference between the cost of the house purchased and the selling price of the house sold. Alternatively, if the purchaser chose to sell the $200,000 property to acquire a home of a lesser price, he would not pay tax on the home purchased but would not receive a refund for the taxes paid in excess of the taxes otherwise payable on his property.

With regard to residential rental properties, generally meaning rental buildings or "speculative" real estate, the UDI proposed that a purchaser of a new or existing property be taxable on the full price of the property at the moment of purchase. However, at the time of sale, the purchaser would be refunded the tax paid on acquisition provided that an amount at least equal to the said amount was paid by the subsequent acquiror. Under this approach, taxes would effectively be payable on the purchase price of the property and on the subsequent realized gains (the "gains approach").

The Committee believes the trade-up approach is the more appropriate method to apply to all non-commercial properties, including residential rental properties.

Although the gains approach has some merit because it operates similarly to the "tax and input tax credit" system proposed in the Technical Paper, the Committee rejected this approach for the following reasons. First, the introduction of a separate approach for rental properties would require the development of complex rules to permit the interaction of both the trade up and gains approaches; this would also pose substantial compliance and technical difficulties. (Consider for example, the tax treatment under the gains and trade up approach of a triplex of which one unit is occupied as a residence by the owner). Second, the gains approach would be cumbersome for individuals because of the necessity to maintain records of the taxes paid on capital improvements in order to claim a refund on resale. Finally, in the Committee's view, the gains approach is not a demonstrably fairer method than the trade approach of taxing rental buildings.

The merits of the trade-up approach are numerous.

First, the trade-up approach spreads the application of the proposed tax over the housing sector (whether the property is new or existing) by imposing tax where a person purchases a more expensive house or other residential property. It is not restricted to the purchase of new homes. As housing starts in a given year account for only approximately 3% of the housing stock, the application of a tax to such stock only, as the Technical Paper proposes, can lead to serious distortions. Moreover, restricting the tax to new housing is inequitable as new home buyers bear the full impact of the tax while existing owners potentially receive a windfall by operation of normal market forces.

Second, as compared with the Technical Paper proposals, the trade-up approach operates in most cases to lessen the impact of the tax on new home purchasers since only the incremental spending, rather than the full purchase price, is included in the tax base. To illustrate, assume that a $400,000 new home is built and that the sale of the new home entails the consequential sales of three existing homes having respective selling prices of $100,000, $200,000 or $300,000. The four individuals who participate in the four transactions each upgrade their housing by $100,000, the individual purchasing the $100,000 being a first-time home buyer. Under the Technical Paper Proposals, the individual purchasing the $400,000 home would incur a tax liability of $36,000, or 9% of $400,000. Under the trade-up approach, each of the four individuals incurs taxes payable of $5,000, or 5% of $100,000. This approach is thus arguably more equitable to home purchasers.

Third, while the trade-up approach would at first glance appear to impose additional costs on purchasers of existing homes, particularly first-time home buyers, this is not the case. In fact, the overall impact on housing costs should be similar to the effects of the approach proposed by the Technical Paper. To illustrate, the Committee assumes that a first-time home buyer wishes to purchase an existing home having a selling price of $100,000. Given that the Technical Paper does not propose to tax sales of existing homes, the Committee believes that market forces may move the price of the said home to its notional tax-paid amount of $104,500, in view of the fact that a new home should sell for this price. Under this scenario, the purchaser would under the trade-up approach pay tax of $5,000 on the said transaction, thereby making his total cost $105,000. The additional cost of $500 would not necessarily be a disadvantage since the trade-up approach will allow the purchaser a notional credit equal to the taxes payable by a second purchaser on the sale of that home, usable on any subsequent purchase of non-commercial real property. For example, should the said purchaser then wish to upgrade his accommodation to a $200,000 new home, his maximum additional tax cost would then be $5,000, presuming that he is able to sell his existing home for at least his original purchase price. Under the Technical Paper, proposals, the purchaser would face additional taxes of $9,000 on the purchase of the $200,000 new home with no credit for the taxes paid on the original $100,000 purchase.

Fourth, the trade-up approach does not tax the gains of a vendor, only incremental spending. The credit that an individual receives on the sale of a property is not based on the cost of the property, but on the selling price.

The Committee recognizes however that, under the Technical Paper proposals, the economic impact of the tax on the acquisition of a new home could be lessened should the price of the purchaser's existing home have increased in price by operation of market forces (i.e. the taxation of new housing). Nevertheless, the Committee believes that the above example illustrates that the trade-up approach accomplishes explicitly what the Technical Paper proposals achieves implicitly, and thereby lessens the risk of distortion.

Moreover, the Committee recognizes that even if the prices of new homes should not increase by the amount of the tax, (the above example assumes otherwise) the total tax-paid price of existing homes should move in tandem. The taxation of the sale of existing homes should therefore not increase the cost of purchasing such a home when compared to what such cost would be under the Technical Paper proposals.

Therefore, the Committee recommends:

40. That all supplies of real property (except supplies of land used in a farming business by an individual to a related individual, or supplies of land used in a farming business as part of the transfer of a going concern) be taxable at 5%.

41. That the taxable amount of a supply of non-commercial property (new and existing housing, new and existing personal-use properties and new and existing residential rental properties) be computed in accordance with the trade-up approach, generally meaning that a purchaser of a non-commercial real property will only be liable for tax to the extent of the difference in price between the property sold and the price of the property purchased.

42. That the trade-up approach not apply to the purchase of commercial real property, meaning real property used or sold in the course of a commercial activity.

Appendix A contains a comparison of the taxation of real property transactions under the Technical Paper and the Committee's proposed trade-up approach.

Appendix B contains supplementary information on the Committee's proposed trade-up approach to the taxation of non-commercial real estate.

Appendix C is a table excerpted from a note prepared by Ernst & Young for the Urban Development Institute providing estimates of GST revenues from the housing sector under certain assumptions.

APPENDIX A

Taxation of Real Property Transactions

The table below compares the tax consequences of certain real property transactions under the Technical Paper proposals and the Committee's recommendations. Where the Committee noted inconsistencies between the Technical Paper and the Draft Legislation, the Committee relied on the Technical Paper.

Transaction	Technical Paper Proposals	Committee's Recommendations*
A. Land		
1. Sale of land in the course of a commercial activity by developer	Taxable - 9%	Taxable - 5%
2. Sale of land by individual in the course of a business	Taxable - 9%	Taxable - 5%
3. Sale of personal-use land by individual not carrying on a business	Exempt	Taxable - 5%
4. Sale of vacant land by a non-profit organization to a corporation	Exempt	Taxable - 5%
5. Sale of land by a charity, non-profit organization or selected public sector organization to an individual	Taxable - 9%	Taxable - 5%
6. Sale of vacant land by non-profit organization to an individual where the land was not used by the organization in the course of commercial activities	Taxable - 9%	Taxable - 5%
7. Sale of farmland to developer	Taxable - 9%	Taxable - 5%
8. Sale of farmland by individual to related individual	Exempt	Exempt
9. Sale of farmland as part of a going concern	Not taxable unless taxable treatment elected	Not taxable unless taxable treatment elected
B. New Housing		
10. Sale of new housing to individuals		
(a) sale of house to non-resident individual	Taxable - 9%	Taxable - 5%
(b) sale of house to resident individual who does not occupy the house as his principal residence	Taxable - 9%	Taxable - 5%

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* Where commercial property is sold, the purchaser may be subject to tax on the full purchase price but may also be entitled to an input tax credit for the tax paid, in accordance with the proposals of the Technical Paper and the Draft Legislation. On the other hand, where the property is non-commercial property (housing, residential rental properties and personal-use properties such as land or second homes), the purchaser will only be subject to tax at 5% in accordance with the trade-up approach, meaning that only his incremental spending on non-commercial property will be subject to tax.

Transaction	Technical Paper Proposals	Committee's Recommendations*
B. New Housing—(cont'd)		
(c) sale of house costing $310,000 or less to resident individual who occupies the house as his principal residence	Taxable – net 4.5%	Taxable – 5%
(d) sale of house costing between $310,000 and $350,000 to resident individual who occupies the house as his principal residence	Taxable – net effective rate varies between 4.5% and 5% depending on house price	Taxable – 5%
(e) sale of house costing between $350,000 and $400,000 to resident individual who occupies the house as his principal residence	Taxable – net effective rate ranging between 5% and 9% depending on house price	Taxable – 5%
(f) sale of house costing $400,000 or more	Taxable – 9%	Taxable – 5%
11. Sale of new house to corporation	Taxable – 9%	Taxable – 5%
C. Existing Housing		
12. Sale of existing house by individual not carrying on a business to individual	Exempt	Taxable – 5%
13. Sale of existing house by individual not carrying on a business to a developer	Exempt	Taxable – 5%
14. Sale of existing house by individual carrying on business of trading real property and who claimed an input tax credit in respect of the property	Taxable – 9%	Taxable – 5%
15. Sale of substantially renovated existing house by individual carrying on a renovation business	Taxable – 9%	Taxable – 5%
16. Sale of substantially renovated house by individual not in the renovation business	Exempt	Taxable – 5%
17. Sale of less than substantially renovated house by individual not carrying on a business	Exempt	Taxable – 5%
18. Sale of less than substantially-renovated house by renovator	Exempt (Renovator pays tax on value added by application of self-supply rule)	Taxable – 5%

* Where commercial property is sold, the purchaser may be subject to tax on the full purchase price but may also be entitled to an input tax credit for the tax paid, in accordance with the proposals of the Technical Paper and the Draft Legislation. On the other hand, where the property is non-commercial property (housing, residential rental properties and personal-use properties such as land or second homes), the purchaser will only be subject to tax at 5% in accordance with the trade-up approach, meaning that only his incremental spending on non-commercial property will be subject to tax.

Transaction	Technical Paper Proposals	Committee's Recommendations*
D. Rental Buildings		
19. Sale of new rental building to private sector landlord	Taxable - 9%	Taxable - 5%
20. Sale of new rental building to non-profit organization qualifying for rebate	Taxable - net 4.5%	Taxable - 5%
21. Sale of existing rental building when vendor did not claim input tax credit	Exempt	Taxable - 5%
22. Sale of existing rental building where vendor claimed input tax credit	Taxable 9%	Taxable - 5%
E. Other Personal - Use Properties		
23. Sale of cottage by individual	Exempt	Taxable - 5%
24. Sale of cottage by renovator in the course of business - input tax credit claimed	Taxable - 9%	Taxable - 5%
F. Commercial Buildings		
25. Sale of new commercial building used exclusively for commercial purposes by vendor	Taxable - 9%	Taxable - 5%
26. Sale of existing commercial building used exclusively for commercial purposes by vendor	Taxable - 9%	Taxable - 5%
27. Sale of hotel or motel	Taxable - 9%	Taxable - 5%

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* Where commercial property is sold, the purchaser may be subject to tax on the full purchase price but may also be entitled to an input tax credit for the tax paid, in accordance with the proposals of the Technical Paper and the Draft Legislation. On the other hand, where the property is non-commercial property (housing, residential rental properties and personal-use properties such as land or second homes), the purchaser will only be subject to tax at 5% in accordance with the trade-up approach, meaning that only his incremental spending on non-commercial property will be subject to tax.

APPENDIX B

SUPPLEMENTARY INFORMATION ON TRADE-UP APPROACH

The present appendix contains additional comments on the trade-up approach, along with an example of its application and the identification and brief discussion of certain technical matters which the Committee recognizes will need to be addressed.

1. Additional Comments on Trade-Up Approach

The Committee proposes that the trade-up approach apply to the taxation under the GST of non-commercial property, meaning residential real property: owner-occupied houses, rental properties of any size and personal-use real properties such as personal-use land and second homes such as cottages and country properties. Commercial properties are to be taxed in accordance with the "tax and input tax credit" system proposed in the Technical Paper; they will thus not be submit to the trade-up approach.

The trade-up approach will apply to any person who purchases or sells non-commercial property. Thus, individuals, corporations, partnerships, trusts and other persons will be subject to it in respect of their non-commercial property.

The Committee selected the trade-up approach as the means of taxing purchases of non-commercial property on the basis of its belief that, while it is preferable to apply tax to the purchase of both new and existing properties, the Goods and Services tax should only apply to incremental amounts of spending on non-commercial property subsequent to the date of implementation of the tax.

Under the trade-up approach, the tax to be paid as a result of an acquisition by a person of a non-commercial real property corresponds to the difference betwen the taxes otherwise payable on the acquisition of the property and the unused credit of the person, defined as the "unused portion" of the aggregate of taxes paid on previous sales of non-commercial property by the person. The "unused portion" of such taxes is calculated as the total taxes collected by the person on previous sales of non-commercial property, less the proportion of such taxes that, through the credit mechanism, the person has used to offset his taxes otherwise payable on other acquisitions of non-commercial real property.

The system is to be designed so that when a person makes a taxable supply of a non-commercial real property, the purchaser be liable to pay tax of 5% on the purchase price, subject to the availability of offsetting unused credits. Moreover, the person

receives a national credit equal to the taxes paid by the purchaser. The said credit will be available to the vendor during his lifetime to offset taxes otherwise payable by him on other acquisitions of non-commercial property. The system will not in this regard distinguish between types of non-commercial property: credits "earned" on the sale of any type of non-commercial property will be usable against taxes otherwise payable on the purchase of any type of non-commercial property. For example, a person will be entitled to use a credit earned on the sale of a house against taxes otherwise payable on the purchase of a rental property or cottage.

Credits earned on the sale of non-commercial property will not be refundable. Rather, they will only be usable against taxable otherwise payable on other purchases, as just discussed.

The Committee recognizes that, under the proposed approach, an individual may suffer unintended consequences when he is obliged to purchase a house which he intends to use as his principal residence without having had an opportunity to sell his current residence. Were it not for the special relieving provision explained below, the individual would not be in a position to use the credit on the sale of the current residence, when ultimately sold, against the taxes paid on the purchase of the new residence. In order to provide relief in this situation, the Committee proposes that any taxes paid by a person on the purchase of a principal residence be refundable to the extent of any credit which arises within one year from the date of purchase of the new principal residence on the sale of a previous principal residence. For example, should an individual who owns a principal residence having a value of $100,000 be obliged to purchase a new principal residence costing $200,000 before selling the other residence, the individual will pay tax of $10,000 on the acquisition of the $200,000 residence but, if he sells the previous house within one year of the purchase of the new house, will be entitled to a refund of $5,000. He will therefore be in the same position as if he had sold the first house before purchasing the new house.

The trade-up approach generates additional revenues for the Government when a person permanently reduces his spending on non-commercial property.

This will generally occur when a person sells non-commercial property and does not reinvest the proceeds in other non-commercial property. The more common circumstances of such an occurrence are death, retirement, emigration, or changes in investment strategies.

2. Example of application of trade-up approach

Example

Facts:

- Individual A owns a home purchased in 1965 at a cost of $30,000, and that has a value of $200,000 in 1992;

- ° In 1992, Individual A chooses to sell the said home and to purchase a larger home costing $300,000 from Individual B who is a retiree and would like to move into a condominium costing $150,000; and

- ° Individual A sells his home for $200,000 to Individual C who is a first-time home buyer.

Tax Consequences:

Individual A

- ° Individual A will not pay any tax on the sale of his home but will pay tax at 5% on his trade-up of $100,000, or $5,000; and

- ° Individual A will on the eventual sale of any of his new property, be entitled to carry a credit until death, equal to the tax collected on the sale of the said home. The credit will not be refundable, but will be available to offset taxes paying on a subsequent purchase.

Individual B

- ° Individual B will not pay tax on sale of his home; and

- ° Individual B will receive a credit of $15,000 ($300,000 x 5%) on the sale of his home, to be used to offset taxes payable on a subsequent acquisition. In the present case, Individual B will not be liable to pay tax on the purchase of the $150,000 condominium because the tax of $15,000 paid on the sale of the $300,000 property exceed the taxes of $7,500 otherwise payable on the purchase of the $150,000 property. The remaining unused credit of $7,500 will not be refundable to Individual B, but will be available until the death of Individual B to offset taxes payable by him on subsequent purchases of non-commercial property.

Individual C

- ° Individual C will be liable to pay tax of $10,000 ($200,000 x 5%) on the acquisition of the $200,000 house because the full purchase price of the property corresponds to his incremental spending on non commercial property. This tax corresponds roughly to the amount of federal sales tax embedded in present house prices.

- ° If Individual C sells the home during his lifetime, he will benefit from a credit as discussed above, of 5% of the consideration received on the sale.

Although the above example is based on the purchase of homes by individuals, the Committee proposes that the trade-up approach not discriminate between types of non-commercial properties, as discussed above.

3. Specific Technical Issues addressed by the Committee

The Committee has identified certain technical issues that need to be addressed. These are outlined below very summarily and only for discussion purposes. The Committee recognizes that other issues will need to be addressed.

A. *Credit Accounts*

In order to simplify the system, persons should be permitted to "bank" unused credits in a "pool" or special purpose account. The operation of the account will be quite simple: the balance of the account will increase when a person sells real property and will decrease when a person acquires of real property and uses all or a portion of the account. The account will increase when a person pays taxes owing and will decrease where the person incurs tax liabilities.

As stated above, the system will not discriminate between types of non-commercial properties the sale of which is a taxable supply. It follows that the account will not either so discriminate. This will simplify the administration of the system and avoid the occurrence of untoward problems created by timing differences between purchases and sales.

Example

Facts:

- In 1992, X purchases a house costing $200,000. X does not own other real property on that date;
- In 1993, X purchases land at a cost of $100,000;
- In 1994, X sells his house for $300,000 and purchases a cottage at a cost of $50,000 and a rental property at a cost of $400,000; and
- X retires in 1996, sells his land for $200,000, his cottage for $100,000 and his rental property for $500,000. X uses a portion of the funds to purchase a condominium costing $250,000.

The above transactions will be recorded as follows in the individual's account:

CREDIT ACCOUNT

Additions

• Payment of taxes on 1992 house purchase	$10,000
• Payment of taxes on 1993 land purchase	$5,000
• 1994 house sale $300,00 x 5%	$15,000
• Payment of taxes on 1994 purchases ($450,000 – $300,000) x 5%	$7,500
• 1996 sales of land: $200,000 x 5%	$10,000
• 1996 cottage sale: $100,000 x 5%	$5,000
• 1996 rental property sale: $500,000 x 5%	$25,000
	$77,500

CREDIT ACCOUNT

Reductions

• 1992 house purchase: $200,000 x 5%	$10,000
• 1993 land purchase: $100,000 x 5%	$5,000
• 1994 Cottage purchase: $50,000 x 5%	$2,500
• 1994 rental property purchase: $400,000 x 5%	$20,000
	$37,500
Account balance before 1996 condominium purchase	$40,000
Taxes otherwise payable on 1996 condominium purchase: $250,000 x 5%	($12,500)
Unused credit at the end of 1996	$27,500

Although the above calculation may seem complex, a person can simply at any one time calculate his unused credit as 5% of the difference between his lifetime sales of non-commercial properties and his lifetime purchases by him of such properties, plus lifetime taxes paid. Thus, should X wish to calculate his unused credit after all of these transactions, X could proceed as follows:

Lifetime Sales

1994 house sale	$300,000
1996 land sale	$200,000
1996 cottage sale	$100,000
1996 rental property sales	$500,000
	$1,100,000

Lifetime Purchases

• 1992 house purchase	$200,000
• 1993 land purchase	$100,000
• 1994 cottage purchase	$50,000
• 1994 rental property purchase	$400,000
•1996 condominium purchase	$250,000
	$1,000,000
Difference between sales and purchases	$100,000
5% of difference	$5,000
Add: lifetime taxes paid (see credit account)	$22,500
Unused credit at the end of 1996	$27,500

B. *Rollovers to Spouses*

The tax should not apply to dispositions of non-commercial real property to spouses, whether inter vivos or on death. Unused credits of a person should also be tranferable to a spouse inter vivos or on death.

C. *Trade Downs*

The rules as proposed above will not entail a loss of credits for persons who voluntarily reduce non-commercial real property holdings. Therefore, individuals who

for reasons of emigration, separation, divorce, or for reasons of personal choice reduce their spending on real property will not lose credits arising from such dispositions.

D. *Splitting of Credits on Marriage, Separation or Divorce and Common Law Arrangements*

The Committee proposes that the allocation of credits between spouses and common law spouses both during and after marriage or cohabitation be governed by family law.

E. *Collection and Remittance of Tax*

The Committee proposes that the purchaser rather than the vendor of non-commercial property bear the obligation to remit the tax.

The Committee proposes that vendors of non-commercial property be required to send a notice of the sale to Revenue Canada within ten days of the sale and that the purchaser be obliged to remit any taxes within thirty days of the sale.

APPENDIX C

Table

Estimates of GST Revenue from the Housing Sector, 1991

	GST Revenues $ millions	
Existing Proposal (as in the GST Technical Paper)	3,000	
Alternate Proposal	50–Year Ownership	40–Year Ownership
GST Payable on Sales of:		
1. New Construction (a)	2,170	2,170
2. Existing Homes of owners who exit the market permanently (b)	1,013*	1,266*
3. Vacation–properties of owners who exit the market permanently	55*	69*
4. Existing homes and vacation properties of owners who trade down @ 10% of (2) and (3)	107	133
5. Rental–properties of owners who exit the market permanently	178	178
NET REVENUES FOR 1991	3,523	3,816
Annual Interest on Float	29	29
TOTAL	3,552	3,845
MIDPOINT (Average of 2 totals)	3,684	

* The estimate in Column 1 is based on an average turnover of 2%, which implies an average owner occupancy (of the same or different residences) period of 50 years. Column 2 is based on an average turnover of 2–1/2% (i.e. a 40–year owner occupancy period).

(a) 5% of estimated value of new residential construction as estimated by the Department of Finance.

(b) based on 127,037 housing sales at an average price of $159,439.

Source: This table is excerpted from a Note prepared by Ernst & Young for the Urban Development Institute providing estimates of GST revenues from the housing sector under the existing and alternate proposals. It is based upon a number of assumptions described in the Note. A full copy of the Note is available upon request from the Committee.

8. CHARITIES AND NON-PROFIT ORGANIZATIONS

A) Technical Paper Proposals

Charities are currently given special recognition for Canadian tax law purposes through exemption of their income from income tax and through the tax credit granted in respect of donations to a registered charity. They are generally not given special status under the existing federal sales tax system, except to the extent that remission of sales tax is occasionally granted for certain large capital projects carried out by charities.

The Technical Paper proposes to provide special status for charities under the Goods and Services Tax (GST), but not to the extent that was sought in submissions before the Committee. The rules are, in general:

The definition of charities is extended to include registered amateur athletic associations as well as registered charities as defined under the *Income Tax Act*;

Supplies sold by charities will in general be exempt from GST, except for supplies "which are of a type generally made by commercial businesses".

Charities as defined under GST will have the automatic right to a rebate of 50% of the GST paid on their purchases of taxable supplies to the extent that these are not recoverable as input tax credits.

The activities of non-profit organizations cover a wide range, including social services, sport, recreation, housing, lobbying, interest groups, and professional associations. Some non-profit organizations function almost as charities, some are clearly involved in working for the general welfare, and some — such as private clubs or trade associations — are primarily concerned with serving their members. The Technical Paper also provides these groups with special status, but does so on a more limited basis than is provided to charities, presumably because of the diversity of these organizations. The rules for non-profit organizations are, in general:

The definition of non-profit organizations (NPO) will be the same as the very broad definition provided under the Income Tax Act , i.e. such an organization can be run for social welfare, civic improvement, recreation, "or for any other purpose except profit" and no member or shareholder can draw any income from the organization as a personal benefit.

Supplies by non-profit organizations "made in the course of a commercial activity" will generally be taxable under GST under specifically identified as exempt.

NPOs which are more than 50% funded by governments (taking all levels together) will have the right to a rebate of 50% on GST paid on their purchases which is not recoverable through the input tax credit system.

Non-profit nursing homes will qualify for the 50% rebate even if less than 50% funded by government.

The Committee heard from a wide variety of non-profit and charitable groups, particularly in the arts. The special concerns of arts and sports organizations are discussed separately at the end of this chapter, but many of the issues that they raised touch on other types of NPOs and charities. The Committee's proposals for taxing rental units built or acquired by co-operative and non-profit housing groups are set out in Chapter 7.

(i) General Impact of GST

There was no question raised before the Committee that charities and NPOs deserved special treatment under the GST; the issue was, how much? It was submitted before the Committee that the 50% rebate provided to charities and qualifying NPOs was inadequate and would result in an increase in the cost of providing important charitable and social services. A number of witnesses argued for 100% rebate or for zero-rating of charitable and non-profit activities.

Apart from the arts sector, little evidence was put forward to evaluate whether the 50% rebate is an appropriate offset to the increase in costs created for charities and non-profit organizations under the proposed GST. Nor was it specifically defended by the Department of Finance.

Finance officials told the Committee that the Department's objective in drafting its proposals for this sector was to strike a balance that would recognize the important social purpose that charities and some NPOs accomplish in society, but also establish "a reasonable amount of competitive equity with private sector suppliers who may be providing very similar services".

Out of this desire flowed the rule that charities will generally be exempt from GST on their sales, except for certain cases, while non-profit organizations will generally be taxed unless they are specifically exempt.

Depending upon their activities, the impact of the GST may vary widely for different charities and non-profit organizations. While varying rates of rebate were proposed for the four so-called MUSH sectors, no such proposal was made for charities and non-profits. In the Committee's view, there is no doubt that having more than one rate of rebate for this group would contribute substantially to making the GST system more complex.

Many of the typical expenditures of charities and non-profits which are affected by the GST were not previously taxed under the FST. Examples are postage, commercial rents, and fees for legal, accounting, fund-raising, public relations, editorial, and other services. Services

such as air travel, telecommunications, printing, and the purchase of equipment and supplies were taxable under the FST as well as under the GST.

The following example illustrates how the tax on inputs under the GST may affect a charity or a non-profit organization more than 50% funded by government, compared with the present treatment under the manufacturer's sales tax (the impact of GST on supplies made by such organizations is considered separately below). This estimate assumes that suppliers eliminate the present sales tax in their price before computing GST, and makes no estimate for any general effect of the GST on costs or revenues.

Impact of GST on Charities and Non Profit Organizations

	Under FST	Under GST
Income		
Grants, donations, etc.	$1,000,000	$1,000,000
Expenditures		
Wages and salaries	600,000	
Rent, postage, services etc. not subject to FST	250,000	
Indirect FST on above	(5,000)	
Printing, communications, travel, equipment, ect. subject to FST	150,000	
FST on above (taxable value $106,000)	(14,300)	
Total direct and indirect FST	(19,300)	
Purchased goods and services subject to GST		$380,700
Total direct and indirect FST	19,300	
GST at 9%, less 50% rebate		17,131
GST at 7%, less 50% rebate		13,325

The potential impact of the GST depends a great deal on one's estimate of the level of the hidden federal sales tax which is currently paid by charities and NPOs as a component of their purchases rather than as a direct cost. In the example, this indirect FST is estimated at 2% of the value of purchases not directly liable to tax. This would cover such items as tax paid on the office equipment, delivery van, or overheads of a supplier or landlord which does not charge federal sales tax directly.

Bearing these uncertainties in mind, this example suggests certain conclusions:

- The rebate of 50% for charities and qualifying non-profits will lead to GST burden approximating, or less than, the present FST.

° While the direct federal sales tax to be paid may increase, the total GST liability may still be reduced once indirect FST has been calculated.

° The higher the wage and salary component in a charity's budget, the less sensitive is its budget to the change to GST.

° A 7% GST rebate with 50% rebate is almost certain to reduce the sales tax burden on charities' inputs from the present level.

° The loss of the 50% GST rebate for a non-profit organization can be relatively costly, i.e. about 1% of the overall budget in the above example; hence some relieving provision may be worth considering.

° The GST on non-profit organizations which are not eligible for the rebate will tend to be substantially higher than the FST burden that these organizations are now carrying.

(ii) Policy Options

There are a number of ways to provide special treatment under a value-added tax to charities and qualifying non-profit organizations. The main options are:

* Tax charities and qualifying NPOs on their purchases at the full rate, but reduce the burden by providing a rebate on GST paid. This is the Technical Paper's proposal.

* Zero-rate charities and qualifying non-profit organizations, so that their inputs are taxed at zero per cent or in other words, they pay no tax.

* Tax charities and qualifying NPOs at a separate rate, say at 4.5% instead of the 9% proposed in the Technical Paper.

* Tax charities and non-profits in full, as is done under the New Zealand GST, but offset the extra costs with an increase in other subsidies.

These options were not raised in any depth in the briefs or the evidence received by the Committee; rather, the focus of the witnesses was on the treatment of supplies by their organizations or sector.

The Committee concluded that zero-rating or taxing charities and NPOs at a separate rate would involve a great deal of administrative complexity, particularly for the business sector supplying the sector, would create some potential for abuse and therefore should not be recommended. Moreover, zero-rating of these organizations would cause a revenue loss of perhaps $100 million, that is the value of the remaining 50% of GST that will be collected after rebates to this sector. This question is dealt with at greater length in the next section.

The Committee also concluded that in view of the important services provided by charities and many non-profit organizations, it would not be appropriate to tax them at full rates with the promise that some offsetting revenues would be provided by Charities would not be assured that the grants would offset their extra costs in GST; some charities could be ineligible or may not wish any form of direct government assistance.

With respect to the rebate, the proposed rate of 50% appears to be adequate to maintain or even improve the tax position of charities and non-profit organizations, relative to the existing FST. This will be especially likely in the event that the Committee's recommendations for a 7% rate of GST are accepted. However, the Committee believes that the Department of Finance should carry out additional research and consult with affected charities and NPOs to confirm that the 50% rebate figure is satisfactory.

Therefore, the Committee recommends:

43. That, as proposed in the Technical Paper, charities and qualifying non-profit organizations should get special treatment under the Goods and Services Tax in recognition of their important services to the community. In the form of a 50% rebate on Goods and Services Tax paid on their purchases.

44. That, the Department of Finance review the proposed 50% rate of rebate with affected charities and non-profit organizations to ensure that it is equitable and that the overall federal sales tax burden of this sector does not increase with the introduction of the Goods and Services Tax.

(iii) The Question of Zero-Rating

Many exemptions to the federal sales tax are now provided through a certificate system, which allows holders — such as hospitals and municipalities — to purchase supplies free of FST. Under a value-added tax, this privilege can be achieved by the practice of zero-rating, whereby supplies are taxed at a zero rate but the vendor can claim full input credits. Many witnesses sought to have tax-free status or zero-rating for their organization or sector, in view of its importance or its contribution to society.

Zero-rating is an important part of the GST system in two areas, food and export sales, which amount to a substantial portion of Canada's gross domestic product. These are areas which can be relatively easily identified for tax purposes. Food is identifiable because of the nature and use of food products. Although some border problems exist; exports can be readily identified since evidence of shipment out of Canada or importation into a second country will generally be available.

Sales to charities or qualifying non-profit organizations, to the MUSH sector or to the provinces — where the same arguments for zero-rating are sometimes made — would be much more difficult to identify because they would depend on providing the status of the purchaser. This is a major reason the Committee is reluctant to recommend zero rating beyond the areas covered in the Technical Paper.

There are also strong administrative and compliance reasons for recommending a rebate system over a system of zero-rating or exemptions. There are 60,000 charities in Canada and hundreds of thousands of non-profit organizations ranging from the Business Council on National Issues through to tiny community sports clubs. Under zero-rating, each qualifying charity or NPO would probably have the right to issue certificates of their eligibility for the special rate. Certificates would have to be issued with every zero-rated purchase and retained by vendors for audit purposes. In the Committee's view, this would entail a substantial hidden compliance cost on suppliers, purchasers, and on the government.

The alternative would be to leave the decision as to eligibility of a purchaser for zero-rating up to the vendor or, in practice, an employee of the vendor who will usually have little experience in tax law and administration. If zero-rating were also to apply to the provincial governments or the MUSH sector, then a whole range of agencies, boards and commissions which are in varying degrees agents of the Crown or of a recognizable institution in the MUSH sector would become eligible for zero-rating. It can be very difficult for tax collectors to decide which of the agencies should quality for special status under GST; but vendors and their agents would be required to make this kind of decision on a daily basis.

The Technical Paper proposes to make the vendor as well as the customer liable for the payment of GST. Hence a mistake discovered through audit could lead to a vendor having to pay a substantial sum on account of GST which, through error, was not collected at the time of a sale. On the other hand mistakes or deliberate "errors" which are made to defraud National Revenue and which are not caught can be very costly in terms of lost revenue. Zero-rating or exemption of charities and of other worthwhile sectors therefore is not in the Committee's view preferable to the rebate system proposed in the Technical Paper.

Under the GST, there will be almost 1.5 million registrants actively doing business, many of them with charities or with the MUSH sector. Determining which charity or MUSH organization should be eligible to claim rebates on GST paid is likely to be a good deal easier and more efficient than forcing every supplier to make that decision through a certificate system. Charities are particularly easy to define, since they have to be registered under the *Income Tax Act* — a simple question of fact. In the MUSH sector, there about 1200 hospitals in Canada, about 4500 municipalities, and about 250 universities and colleges. The numbers are much smaller, in other words, than the number of suppliers who would be forced to adapt their systems to a zero rate.

If a rebate system is adopted as recommended in the Technical Paper, on the other hand, the accounting by suppliers to charities and other rebated organizations will be relatively simple. Registered vendors will be required to collect and remit GST at the general rate on all taxable suppliers to this sector, just as to any other purchaser. The vendor's involvement will then end; it will be up to the charity or the MUSH institution to prove that it qualifies for a rebate.

Therefore, the Committee recommends:

45. That, in general, relief from Goods and Services Tax which is given to charities, to qualifying non-profit organizations and to public-sector organizations in Canada should be provided through a rebate system as proposed in the Technical Paper rather than through zero-rating or by providing tax-free status on purchases. The affected organizations should therefore pay the Goods and Services Tax on their purchases and get relief through rebates rather then buying goods and services free of tax.

(iv) The Level of Rebate

The Technical Paper proposes that non-profit organizations will have to receive 50% or more of their funding from federal, provincial or municipal government grants in order to qualify for a 50% rebate of the GST paid on their inputs. All registered charities will be eligible for the rebate regardless of their level of government support. A number of witnesses criticised the qualifying rule for non-profit organizations as arbitrary and asked that it be changed.

A major concern expressed to the Committee from this sector, particularly from sports groups, was that the federal government was sending out conflicting messages. Governments have been pressing sports and cultural organizations to become more autonomous by developing corporate sponsorships and other sources of revenue, and forcing them in this direction by restraining the growth in public support. Yet under the GST, non-profit organizations which succeed in reducing their dependence on government funding below 50% will suffer a significant penalty.

The apparent purpose of the 50% government funding test is to provide a relatively simple way to identify those non-profit organizations that deserve, on policy grounds, to be relieved of some of the cost of GST. This treatment is automatically given to charities and parallels the rebates which reduce the net rate of GST for municipalities, universities, school boards and hospitals — what is known in the Technical Paper as the MUSH sector.

The Department of Finance told the Committee it is prepared to look at the 50% test for non-profit organizations must have a significant amount of funding from some level of government to qualify for special treatment under the GST, the Committee agrees that the Technical Paper's proposals is arbitrary and should be changed. The Committee also believes that there should be a provision to give a partial rebate to non-profit organizations which fall just short of qualifying for the 50% rebate of GST — in other words, a notch provision. Otherwise, a non-profit organization could lose a substantial amount of rebate because of a very minor shift in its level of government funding.

The Committee considered two alternatives:

(i) reduce the 50% test to a lower level;

(ii) authorize officials or Ministers certify non-profit organizations to allow them to qualify for a 50% rebate even if their level of government funding is below 50%.

The Committee prefers the first option because it is relatively easy to administer and because it involves an objective, rather than subjective, test that an organization is performing a worthwhile public function — i.e. that it has been granted a significant level of government funding to carry out its activities.

The Committee therefore recommends:

46. That non-profit organizations should be eligible to receive a 50% rebate of the GST paid on their purchases if they are 25% or more funded by government in a given year, not 50% as proposed in the Technical Paper. For non-profit organizations falling short of the 25% test, the 50% rebate should be reduced by one-fifth for each percentage point that the organization's funding from government falls below 25% of its revenues.

According to the Technical Paper, registered amateur sports organizations are to be treated as charities and will therefore qualify automatically for the 50% rebate. This provision does not cover the provincial sports federations, however, which carry out many of the same functions as the national sports bodies; take a substantial responsibility for developing promising young athletes; but are not registered under the *Income Tax Act*.

The Committee recommends:

47. That for the purposes of GST, provincial sports federations should be treated on the same basis as registered amateur sports organizations in order that they automatically qualify for 50% rebate of GST paid on their purchases.

In the area of the arts, the Committee believes that its proposed reduction of the required level of government funding to qualify for a 50% rebate of GST on purchases, and the rules set out by the Department of Finance to provide full input credits for performing arts organizations, should protect most arts organizations from being unduly affected by the GST. The concerns of arts and sports groups are dealt with in greater detail below.

(v) Eligibility for Rebate

According to the Technical Paper, qualifying non-profit organizations will have to wait until the end of their fiscal year to apply for the 50% rebate of the GST paid on their purchases, even if the sums involved are substantial. The reason offered is that eligibility will depend on the degree of government funding which they receive, and this can only be determined when the year's financial statements have been prepared.

Witnesses objected to this rule because of the effect on cash flow of delaying a GST rebate for a full year, and because of the difficulty for a non-profit organization that was close to the qualifying line of budgeting without knowing whether or not the rebate would be

available. This factor will be less important for many non-profit organizations if the Committee's recommendation for a notch provision is accepted.

The Department of Finance told the Committee that it is examining alternatives to this rule on the timing of rebates. Officials informed the Committee that the Department was seeking to strike a balance between the concerns of non-profit groups "with respect to certainty as to their eligibility", and the fact that some non-profit organizations receive one-time government funding for a specific project, and it would be "inappropriate" in such cases to base eligibility for the rebate in future years on historical information.

While these concerns may be valid in certain cases, the Committee does not feel they are sufficient to justify requiring all NPOs which may qualify for the rebate to wait for up to a year to collect it. Many non-profit organizations in such areas as social services, recreation, housing and corrections receive government funds regularly and act, in many respects, as extensions of government programs. A delay in providing their rebate for GST for a year would be equivalent to imposing a holdback of up to 2% of their budget and could therefore affect their ability to provide programs and to carry out their objectives.

Charities will be permitted to file for a GST rebate on a regular basis, and the Committee sees no reason why non-profit organizations which receive a regular flow of government funding should not be treated in the same way.

The Committee therefore recommends:

48. That a non-profit organization which qualifies for the 50% rebate of GST paid on purchases because it is substantially funded by government should be able to continue claiming the rebate on a monthly or quarterly basis rather than wait to the end of each fiscal year, as proposed in the Technical Paper, provided that it has met the qualifying test for the 12 preceding months.

(vi) Interest on Overdue Rebates

There is an anomaly between the government's proposal for paying interest on GST input tax credits after 21 days, and its proposal to pay interest on GST rebates due to charities and non-profit organizations and to the MUSH sector only after 60 days.

In its written response to the Committee's question on this subject, the Department of Finance stated that rebates "serve different policy objectives than input tax credits". According to the Department,

> "Rebates are designed to confer a benefit to specific individuals or sectors. Input tax credits, on the other hand, are simply the technical means of ensuring that business inputs are fully relieved of tax and sales to final consumers are not subject to double taxation."

The Committee does not accept this distinction. If rebates of GST are paid to a charity or non-profit organization, it is because they are deemed to be carrying out important activity for the public good. This is also the case with the MUSH sector, and the Committee sees no

reason why interest on GST rebates and on input tax credits should not be paid on the same basis.

Some witnesses expressed concern at the effect of the GST on the cash flow of charities and non-profit organizations. According to the Committee's calculations, the impact is likely to be less than is feared. A charity with a $1 million budget and fairly heavy taxable expenditures might buy $400,000 worth of taxable supply in a year. At the 7% rate of GST, the value of the 50% rebate on GST paid by the charity would be $14,000 per year or $1,167 per month. At current interest rates, a two-month delay in receiving each month's rebate would cost the charity about $30 and the total interest cost of a loan that would maintain its cash flow while awaiting the rebate would be $381 per year, or about 0.1% of the value of its expenditures.

This calculation suggests that the value to the government of delaying the payment of interest on GST rebates is minimal, and reinforces the Committee's recommendation:

49. That the government should pay interest on rebates of GST to charities, to qualifying non-profit organizations and to the MUSH sector starting 21 days after filing, rather than starting after 60 days as proposed in the Technical Paper.

(vii) Commercial Supplies

A major concern in submissions from charities and non-profit organizations was the requirement that these bodies charge tax on supplies that are considered to be commercial. The Committee was asked to change the general rule, the definition of which supplies should be taxable, and the proposed exemptions. Witnesses expressed concern about the principle of having to charge tax, about the impact of GST on people using their services, and about the cost and administrative complexity of this provision.

The Technical paper provides that supplies by charities will generally be exempt from GST, except where they are specifically designated as taxable; supplies by non-profit organizations will be taxable unless specifically exempted. The aim of this policy is to ensure relative equality in the GST charged for commercial type services, whether provided by a private business or by a non-profit organization. The Committee agrees with this policy.

The Technical Paper sets out the following rules with reference to charities charging GST:

- Services in the areas of research, counselling, education, and social services which are provided by charities without charge will not be subject to GST.

- Charities will be eligible for the small traders' exemption if supplies, or sales, that would otherwise be taxable do not exceed $30,000. Sales of used or donated goods will be exempt from GST, as will donations received by charities.

- Any supply by a charity will be exempt if "substantially all of the day-to-day administration and operation" of the activity to provide the supply is undertaken by volunteers.

- A supply of goods or services for a nominal amount, which does not cover the direct cost of making the supply, will be exempt. Direct cost is defined as the cost of purchased inputs and excludes labour, capital and overhead expenses.

- A supply of food, drink or accommodation made "for the relief of poverty, suffering or distress" will be exempt.

- Charities will be eligible for 100% input credits on goods exported for charitable purposes.

Commercial supply that is provided by a charity will be liable for GST unless it is covered under one of the exempted categories. Hence, sales of goods or of prepared food that are carried out "substantially" by volunteers will be exempt from GST; but will be taxed if sold from a store or booth run by a charity with paid staff.

The categories of supply that will be considered to be commercial are:

- Sales of new goods and ancillary services, such as gift shop in a museum or a mail-order operation selling UNICEF cards.

- Sale of prepared food or drink in an eating establishment or provided as a catering service.

- Admissions to museums, exhibitions, professional sporting event, recreational facilities, etc. (but amateur performances and sporting events are exempt).

- Adult recreational programs except for "recreational programs established primarily for mentally or physically disabled or disadvantaged individuals". Sports, arts and recreation programs provided by charities for children will be exempt from GST. The same exemption rules will apply to non-profit organizations.

- Commercial gambling, unless the event is undertaken by volunteers and is held elsewhere than in a commercial bingo or gambling hall.

- Rental of non-residential property, including the renting of a hall for metings or receptions.

- Public parking rented on a regular basis.

- Sales of land or new residential housing.

As already stated, the rules for non-profit organizations are more restrictive than for charities, since supplies by these organizations are to be generally taxable under GST unless they are specifically exempted. The distinctions between the two categories are not as great as the general principles suggest, however, because the Technical Paper provides a long list of permitted exemptions from GST for non-profit organizations. These exemptions include:

- Small traders' exemption if sales of taxable goods and services do not exceed $30,000.

- Sales by volunteers other than from a permanent retail store, i.e. at the door or in the street.

- Admissions to amateur performances and events.

- Recreational programs for children and for disabled or disadvantaged adults.

- Homemaker and home care services if provided by an agency that is provincially or territorially approved.

- Meals on wheels and similar programs.

- Membership fees in organizations provided that they do not entitle the member to receive for nothing or at a significant discount, periodicals, admissions, or other goods and services which would normally be sold.

- Trade union dues and mandatory professional dues, although an association may choose to have its dues treated as taxable supplies and thus give its members an input tax credit.

- Non-commercial gambling, on the same basis as charities.

- Supplies of non-residential real property, except for sales of land or new housing, parking, and short-term commercial rentals.

- Lodging and recreation provided at a camp and primarily for people who are disabled or disadvantaged.

Speaking on behalf of the charitable sector, the National Voluntary Organizations submitted to the Committee that an activity should not be considered to be commercial if it was carried out to raise funds for a charity or non-profit organization. It said the charging of GST should be related to the intent of the activity and not just to its nature or its comparability with the private sector. According to the NVO's brief,

"To equate charitable services with for-profit services denies the distinct character of the activities of the charitable voluntary sector. The motive of service delivery cannot be separated from the service itself."

On this basis the National Voluntary Organizations recommended that the activities of charities should be tax-exempt, i.e. not bear GST. In an elaboration of this approach it recommended that GST be charged only for "related businesses" established by charities under the Income Tax Act, but that the sale of goods and services by charities otherwise be exempt in the same way that they are exempt for income tax purposes. This approach, it was suggested, would ensure consistency between the GST and the Income Tax Act. If the government wanted more supply by charities to be taxed, it should do so through amending the Income Tax Act definition of related businesses.

This definition is in s. 149.1(1)(j), as follows: "'(R)elated business' in relation to a charity includes a business that is unrelated to the objects of the charity if substantially all of the people employed by the charity in the carrying on of the business are not remunerated for such employment." By inference, any business that is related to a charity's objets may be carried on without affecting the charity's non-taxable status for income tax purposes.

The Canadian Society of Association Executives, speaking for the non-profit organizations, argued that their activities were not commercial and that to label, and tax, them as such might jeopardize the non-profit status which these organizations now enjoy. The CSAE drew a distinction between for-profit activity, which by definition its members did not engage in, and added-value activity which would be taxed under the GST. It asked that the GST legislation be drafted to reflect this difference and to clarify that organizations that add value, and are therefore liable for GST, are not automatically commercial.

These two associations, and many other witnesses from the non-profit sector, raised concerns about the feasibility and costs of charitable and no-profit organizations, often with many branches, administering the Technical Paper proposals. Rich Baillie of the NVO described one large charity to the Committee with 17 staff and 70 or 80 "outposts" or local organizations:

"...the way the tax is presently described ... they will have to keep every receipt so if government auditors come in they can see it. This organization has one office in Toronto. They will have to get all of those (receipts) from across the country...In effect the 50% rebate means nothing to them. They will not be able to collect it."

Charities and non-profit organizations raised a number of specific concerns with respect to the exemptions and override rules which will govern whether or not sales that they make are liable for GST. These are dealt with below. Concerns relating to the impact of GST on housing provided by co-operative and non-profit groups are discussed in the section on housing.

(viii) Is an Exemption Justified?

The overriding question is whether to substantially change the proposals in the Technical Paper by exempting all or most of the value of supplies by charities from GST. This would be an alternative to the patchwork of exemptions, taxable areas and special rules proposed by the government.

One reason for the concern shown by the voluntary sector is that under the GST, most taxable supply by non-profit organizations and charities will lie in the area of services which were not previously liable for federal tax rather than goods. The government has not taken an explicit stand on the amount of sales tax to be raised from the voluntary and non-profit sector, but nor do its measures appear to be directed specifically at this sector. Rather, the new tax liability is a result of the general base-broadening proposed under the GST.

A major reason for the government's decision to tax supplies by charities and non-profit organizations is its desire to maintain a level playing field with commercial organizations offering similar services. The National Voluntary Organizations, speaking on behalf of charitable organizations resisted this principle and argued that the activities of charities should be judged as a whole and should not be confined to services to the poor and the handicapped in order to be exempt. Hence even those activities that appear to be commercial, such as YMCA fitness course or health club, should be seen as contributing to the overall program of the charity and should therefore be exempt.

The Committee considered a number of alternatives for dealing with supply by charities and qualifying non-profit organizations. They included:

(i) Provide full exemption from charging GST;

(ii) Exempt all supply by this sector except supply by related (or unrelated) businesses;

(iii) Exempt activity that might otherwise be taxable, if the intent is sufficiently worthwhile;

(iv) Stick with the approach taken by the Technical Paper. This would mean taxing commercial supply, subject to the exemptions already mentioned, but allowing charities and non-profits to claim 100% input tax credit for the GST paid on related inputs, just like any business.

Another alternative was put forward by the Alberta YMCA in a meeting with MPs from that province in October. Its proposal is to exempt supply by organizations like the YMCA from the GST, but in return do away with their right to a 50% rebate on GST paid on purchases.

The impact of this proposal would vary a great deal between different charitable organizations, depending on how much of their revenues came from commercial supply and

to what extent they required outside goods and services taxable under the GST. Unless it were made optional, this approach would hurt charities with a small amount of commercial supply and substantial amount of purchased inputs on which they could claim 50% rebate of GST.

The Committee notes that the social purpose of charities and qualifying non-profit organizations is recognized in the Technical Paper by the provision of a 50% rebate on GST paid on purchases and by a lengthy list of exemptions from charging GST on supplies. The activities that are still taxable are, for the most part, those most likely to be in competition with private sector suppliers and services. In the Committee's vie, it is appropriate to tax these activities under the GST even if the intent of the activity is to support the main work of a charity rather than make a profit.

The Committee recommends:

50. That commercial supply by charities and non-profit organizations should generally be liable to GST, subject to exemptions such as those which are provided in the Technical Paper.

(ix) Reducing the Administrative Burden

The Committee is concerned, however, at the administrative costs and complication of taxing commercial supply by this sector and at the difficulties of trying to track the inputs related to these sales in order to provide 100% input credits like those received by business. It considered a number of options to make the administrative problems less onerous or to reduce the compliance cost of collecting and accounting for GST. The two most attractive choices were as follows:

(A): Introduce streamlined accounting so that charities and non-profits would not be obliged to track down the GST paid on inputs required to make commercial sales. The alternative would be to establish a guideline that these inputs are worth, say, an average of 50% of the value of commercial sales. It is a lot easier for a charity to add up all its commercial sales than to track thousands of invoices. Once total sales were determined, an inputed amount for inputs could be calculated and so could the total of GST input credits for the period. This would be much easier and clearer to operate than a full-fledged calculation of GST credits, the revenue implications would be minor, and charities would have a system that could be operated by small branches or by volunteers.

(B): Take the full amount of GST paid on commercial supply by the charity, deduct it from the total GST paid by the charity, and then calculate the charity's GST rebate on the remainder. This approach would simplify accounting for charities and qualifying non-profit organizations, but might result in some material reduction in GST revenue for the government. It would also provide an incentive for these organizations to develop their resources through commercial activity and to rely less on donations and government support.

The Sales Tax Counselling Society

Revenue: Donations and grants:	$750,000	$750,000	$750,000
Taxable supply — books, counselling, conferences, etc.	$250,000	$250,000	$250,000
Total revenue	$1,000,000	$1,000,000	$1,000,000
9% GST collected on taxable supply (9/109ths)	$20,642	$20,642	$20,642
Expenses, excluding wages:			
Inputs related to taxable supply (tracked by invoices)	$135,000		
GST component	$11,146		
All other inputs	$165,000		
GST component	$13,623		
Total purchases of goods and services	$300,000	$300,000	$300,000
Estimated value of inputs related to taxable supply (50% of total inputs)		$150,000	
GST component		$12,385	
Estimated value, all other inputs		$150,000	
GST component		$12,385	
GST on purchases, eligible for rebate (9/109 x price)			$24,770
GST due on sales	$20,642	$20,642	$20,642
Less: GST input tax credit on actual sales	($11,146)		
Less: GST input tax credit on est'd sales		($12,385)	
GST owed before rebate	$9,496	$8,257	
GST rebate, 50% of GST paid on other purchases	($6,811)		
GST rebate, 50% of estimated GST paid on other purchases		($6,192)	
Remainder of GST eligible for rebate			$4,126
Net GST to be paid or (received)	$2,684	$2,064	($2,064)
Add: GST paid in price of inputs	$24,770	$24,770	$24,770
Total GST paid	$27,454	$26,834	$22,486

The box shows how these two approaches would work for a small charity dedicated to helping people confused by sales tax, compared to the approach in the Technical Paper.

As the box shows, a streamlined method can be relatively accurate in arriving at GST liability but be considerably easier to administer. In the above example, all that is needed to make the calculation is the value of the organization's commercial supply and the value of its taxable inputs, or the total GST paid on its inputs.

The second option is also easy to calculate, but it entails a decrease of almost 20% in GST revenues. This second option would offer what amounts to a bonus to commercial activity by charities, because it reduces the effective GSt rate on their sales by increasing their input tax credits. This would allow them to either reduce their prices (by about 2%) or generate greater revenues to help maintain their charitable activities.

As witnesses told the Committee, there would be substantial problems in tracking input tax credits through a charity or non-profit organization most of whose activities are exempt from GST. Allocating costs and input credits to such activities as occasional rental of facilities, or determining what share of overheads should be attributed to taxable activities, is likely to be extremely difficult. The problems of administering GST would be exacerbated in organizations that are wholly or partly run by volunteers or which operate a common accounting system, but have large numbers of local branches involved in fund-raising events.

Both of the options suggested above would be considerably easier and less costly for charities and non-profit organizations to administer than being required to track input tax credits in the conventional way. The Committee believes that a streamlined approach is needed to assist charities in accounting for commercial supply under the GST and is satisfied that an acceptable model can be developed. Affected organizations could use such a streamlined system in all cases, or it could be offered as an option to those that wish to reduce their administrative costs.

The Committee recommends:

51. That the Departments of Finance and National Revenue work with charities and non-profit organizations to develop a streamlined approach that would simplify their accounting for taxable supplies under the GST and reduce the related complexity and administrative costs.

B) "Non-Profit Status"

Non-profit organizations expressed concern that because they would be taxed for GST, their activities would come to be defined as commercial and their non-profit status would ultimately be jeopardized.

The distinction between activity that is "commercial" and activity that is "taxable" is very subtle, as the Canadian Society of Association Executives acknowledged in its brief. The draft legislation defines "taxable supply" as follows:

° "'Taxable supply' means a supply, other than an exempt supply, made in the course of a commercial activity"

Its definition of "commercial activity" includes the following:

"(a) any business carried on by a person;

(b) any adventure or concern of a person in the nature of trade."

The Association Executives proposed that the liability for charging GST start with the concept of business in the Income tax Act, i.e. the test that there be a reasonable expectation of profit. The GST would be charged only on those activities of the non-profit sector which were specifically set out by government. This is very close to the approach already taken in the Technical Paper with respect to charities.

As an alternative, the Association suggested avoiding the use of the terms "business" and "commercial" and using the approach adopted in New Zealand. That country's GST legislation defines "taxable activity" as follows:

"(a) Any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club."

The Committee notes that non-profit organizations already collect provincial sales tax on the sale of goods without having thereby lost their non-profit status. There is no inherent reason why this should be different if they become liable to collect federal sales tax in the form of the GST. The Committee recognizes that the concerns of the no-for-profit sector are valid, however. Organizations are being told they must collect GST because they are carrying on a business which is deemed to be commercial. Then they risk being told by Revenue Canada that because they are running a business, they will lose their right to non-profit status and to exemption under the Income Tax Act.

The Committee therefore recommends:

52. That the government should issue an interpretation bulletin to clarify that non-profit organizations will not lose their exemption from tax under the Income Tax Act by virtue of engaging in "commercial activity" as defined for the purposes of the GST.

C) The Volunteer Exemption

The government has included what is called a "volunteer exemption" in its GST proposals at the request of charities and non-profit organizations, so that they would not be obliged to charge GST on supplies that are provided through volunteer activity. Nonetheless, certain charities and non-profit organizations expressed concern over how the volunteer exemption as proposed in the Technical Paper and draft legislation will work.

Section 3 of Part VII in the draft legislation's schedule of supplies that are exempt from GST provides for the following exemption:

3 (a) "A supply made by a charity of any property or service...where...

(d) the supply is made in the course of a business... and all or substantially all of the direct day-to-day administration and operation of the business is undertaken by volunteers."

The volunteer exemption for NPOs is much more stringent, covering only street and door-to-door sales where all the salespersons are volunteers, the consideration for each item is less than $5, and, according to the schedule of exemptions,

"16 (d) (T)he property is not sold at an event at which supplies of such property are made by persons who carry on the business of selling such property".

This rule quite clearly excludes exemption from GST for activities such as selling hot dogs or favours at a parade or a fair, because for-profit vendors would also be present. It denies any exemption from GST on sales by a non-profit organization from a permanent establishment or store, whereas a charity could sell goods from a store, such as a hospital gift shop, if the sales and daily administration were carried out by volunteers. A non-profit organization could put on an event in a hall, such as a dance or bean supper, without charging GST but only if the admission fee were kept below $5.

The major concern of the charitable sector is the test that "substantially all" of an activity must be by volunteers for the activity to be exempted from GST being Charged. "Substantially", in this case, is thought to mean at least 90% since this is the interpretation that has evolved under the Income Tax Act.

The National Voluntary Organizations recommended that the exemption be defined "as meaning 60% of a charity's total administration and direct service must be in the hands of volunteers." It did not specify whether this participation should be measured in time worked or by some other means.

Such a change would ensure that activities that are directed or coordinated by paid staff, but mainly carried out by volunteers, would be exempt from charging GST on their sales. But it could also mean that supplies provided by charities with a substantial base of volunteers were in practise never liable for GST. This would go against the intention of the Technical Paper that commercial supplies should have comparable tax treatment, whether they are provided by government, the voluntary sector or private business.

The Committee agrees that the volunteer exemption should be made more specific so that it is easier for affected organizations to interpret and less likely to lead to litigation. (It also agrees that there should be some reduction in the requirement for volunteer participation, recognizing that it is common for paid staff of charities to devote a substantial amount of time to organizing events though they are carried out almost entirely by

volunteers.) (It is satisfied with the present test that 90% of the activity be carried out by volunteers, however, and does not recommend that it be reduced.) Since there is no monetary test that can be used in measuring the proportion of volunteer, unpaid effort to that of paid staff, the Committee believes that volunteer participation should be measured according to the proportion of total paid and unpaid work or time devoted to the activity.

The Committee therefore recommends:

53. That the volunteer exemption proposed in the Technical Paper be amended and clarified to specify that charities will be exempt from charging GST on supplies where all or substantially all (i.e., 90% or more) of the time worked in day-to-day administration and operation of the activity providing the supply is carried out by unpaid volunteers. Alternatively, Revenue Canada should issue an interpretation bulletin to clarify that this is what the volunteer exemption provided under the GST means.

The volunteer exemption provided for non-profit organizations in the Technical Paper is very restrictive and could inhibit fund-raising efforts by community associations, little league groups and similar bodies without making any substantial contribution to federal revenues. Many of these groups will qualify for the small trader exemption, however, and a fairly strict rule may be justified if its intention is to exclude the large number of non-profit organizations whose primary objectives are not so community-oriented as to justify special treatment.

The Committee accepts that many non-profit organizations are similar to charities in their activities and purposes and in their benefit to the community, however, and therefore should get comparable treatment. One way to identify which non-profit organizations are of benefit to the community is the government funding test used to determine whether they qualify for a rebate on GST paid on their purchases. The Committee has recommended that non-profit organizations which have more than 25% funding from all levels of government qualify under this test. It recommends:

54. That the "volunteer exemption" applied to charities should also be extended to those non-profit organizations which qualify, because of their level of government funding, for a 50% rebate of GST paid on their inputs.

D) Service Clubs

Service Clubs are one particular form of non-profit organization affected by the GST. These clubs exist for the combined purpose of fellowship, community service, and networking for business purposes and are responsible for a substantial amount of volunteer community activity, but do not receive government funding except for special initiatives such as sheltered housing or day care projects.

The Association of Kin Clubs submitted that service clubs such as the Kinsmen should be treated in the same way as registered charities and non-profit organizations substantially funded by government, and hence be eligible for the 50% rebate of GSt paid on their

purchases. They were also concerned that the GST would raise price levels and adversely affect the amounts service clubs can raise towards charitable and community projects.

Smaller branches of service clubs will probably qualify for the small trades' exemption, but the fund-raising activities of larger clubs are likely to exceed the $30,000 limit and may therefore be chargeable for GST.

The Committee believes that service clubs are comparable to a number of other non-profit organizations which do good works but are not funded by government. It is reluctant to recommend treating service clubs like charities when part of their purpose is the social and business benefit of their members.

A charity is limited in its areas of activity or of donation, and must demonstrate that it disburses at least 80% of its income from donations and investments annually. Service clubs are free to seek charitable status, but must then be prepared to accept the restrictions that this would impose on their activities. They may also establish a charitable foundation linked to their club, or organize events in which funds flow directly to a charity rather than through the club. In each of these cases, community-oriented activities organized by a club would benefit from any relevant exemption or rebate from GST.

The Committee is therefore satisfied that means exist in the GST proposals for service clubs to take advantage of the exemptions provided to charities, and that no special provision is required.

E) Membership Fees

The Committee is concerned that the Technical Paper's treatment for GST of membership fees in non-profit organizations and charities is likely to create confusion, although the issue was not raised during testimony. Such fees will be exempt from GST if paid to a charity, but exempt in a non-profit organization only if certain conditions are met, i.e. that they provide no other benefit beyond the right to vote and to attend meetings, and to receive the occasional repOrt or newsletter.

This rule is understandable if a membership acts as a season ticket or also provides a seasonal discount on admissions, as is the case at the Vancouver Aquarium and the Metro Toronto Zoo. It is harder to justify if the benefit given to members is modest and is not the primary reason for acquiring membership. The Committee believes that the GST rule on membership fees should be relaxed, and recommends:

55. That membership fees in non-profit organizations should be exempt from GST where they have a direct cash value that does not exceed $25 and is less than 50% of the cost of the membership.

F) Below Cost Supplies

The Technical Paper provides that a supply of goods or services by a charity for a nominal consideration, which does not cover the direct costs of making the supply, will be

exempt from GST. the same rule applies to non-profit organizations. However, direct cost is narrowly defined and essentially includes only the cost of materials and such direct costs as rent and electricity used in production. Direct and indirect labour, capital and overhead expenses are not included in direct costs.

It was submitted that this rule was too strict and that some or all of direct labour, financing charges, administrative expense or overhead should be included in the definition of direct cost. In effect, any selling price up to a break-even price on a supply from a charity would qualify for exemption from GST.

Since selling goods or services at below the cost of acquiring them is not a viable means of fund-raising, this provision has a fairly narrow application. It will most likely apply to the production of goods for sale by sheltered workshops. Other types of below-cost supply by charities or non-profit organizations are likely to be exempt from GST because they are made for the relief of poverty, suffering or distress, for example in a soup kitchen or a hostel charging nominal amounts for accommodation.

Many charities and non-profit organizations receive donations and grants to assist in their activities in addition to receipts from commercial supply. Since they are by definition non-profit, a cost of sales that included direct labour, capital and overhead costs would in many cases be equivalent to their selling price. Hence the proposed redefinition of direct costs for the nominal consideration exemption could substantially broaden the range of supplies which this sector could sell tax-free. For these reasons, the Committee recommends:

> **56. That the exemption from GST for supplies at nominal consideration provided by charities and non-profit organizations should remain as proposed in the Technical Paper.**

G) Self-Supply

The issue of self-supply was raised on a number of occasions, notably by a group of food service, cleaning and temporary help companies called the Private Sector Supply to Government group. This group told the Committee that,

> "...a number of the proposals (for the public and voluntary sectors) will create serious biases towards self-supply and a corresponding lessening of private sector activity. These biases will endanger the economic efficiencies and jobs that have been created to date, and in many areas will encourage the public sector to develop internal sources of supply for goods and services in preference to external supplies, putting upward pressure on public sector employment levels and budgets."

Some bias to self-supply is inevitable in any system of value-added tax, both for final consumers and for organizations that are tax-exempt and do not get input credits. Most goods do not lend themselves to being self-supplied, but it is much easier to shift services such as catering, cleaning and maintenance to in-house supply if there s a tax incentive.

The measure of this incentive is the difference between the rate of tax paid on purchased services and the rate of GST paid on self-supply, i.e. the cost of GST on the inputs needed for in-house production. The higher an organization's net rate of GST, the more there is an incentive to self-supply.

This issue is discussed elsewhere in this report with relation to banks and other financial services which have exempt status under the GST. The incentive to banks to move labour-intensive contracted services such as cleaning or food services in-house is relatively high, since purchased services will carry a 7% or 9% tax which is not borne on work carried out by employees. Non-profit organizations which do not qualify for a rebate on the GST paid on purchased inputs will have the same degree of incentive to self-supply as the banks.

At the other end of the scale, hospitals will have a net rate of GST, after rebate, of about 2% under the government's proposals. Since they will also pay some tax on services performed internally, the incentive to self-supply is around 1% GST, which is unlikely to have a great impact on make-or-buy decisions.

The GST paid on contracted services by charities and qualifying non-profit organizations will be 3.5% or 4.5% depending on the final rate of GST. The perception of the advantages of self-supply could be higher, of course, if purchasing managers base their decisions on the 7% or 9% tax charged on invoices without regard to the entitlement to a 50% rebate.

The Private Sector Supply group proposed that this bias be eliminated either by zero-rating sales to these organizations (and to other public sector organizations) or by reducing the tax base for GST on sales to this action to a level well below the actual selling price. According to the Private Sector Supply group, the tax base in these cases should be reduced by the value of the private sector supplier's "non-taxable inputs", such as groceries and self-supplied labour. The group estimated that these account for over 80% of the inputs of its members.

In terms of turnover, non-profit nursing homes are the largest group of non-profit organizations whose purchasing decisions could be influenced by the GST. Special provisions are made in the Technical Paper to give these nursing homes a 50% rebate of GST paid on inputs, even if they do not meet the government funding test. Private nursing homes will be exempt institutions but will be required to pay the full rate of GST on their inputs, and hence have a greater incentive to self-supply.

The Finance Department gave a very brief response to the Committee's question about possible distortions in make-or-buy decisions arising out of the GST: "The rebates will so significantly reduce any incentive to self-supply that no significant biases should arise."

Earlier in this report the Committee expressed its objections to zero-rating sales to public sector institutions, because of compliance problems and the very substantial administrative costs such a system would create for suppliers selling to the public sector. The creation of a reduced tax base for GST on sales to public sector institutions would created

similar problems. Catering and cleaning companies that do a major business with this sector would obviously benefit, but administrative and accounting costs for other supplies would rise and GST revenues from voluntary organizations could drop substantially.

The Committee recognizes that some bias to self-supply in the voluntary sector will be created by the GST proposals, but notes that this will be reduced if the Committee's recommendation is accepted to reduce the rate of GST to 7%. It estimates that the bias to self-supply among charities and qualifying non-profit organizations caused by the imposition of GST will be of the order of 2% to 3% of total cost after the GST will be of the operations has been counted in. Tax is not the only factor in make-or-buy decisions, however. Managers must consider the entry costs of moving production that is now contracted back in-house, then compare the total costs of in-house supply to the total costs of contracted supply.

The committee accepts that there is some incentive to self-supply in the Technical Paper proposals, but not enough to substantially influence make-or-buy decisions in the same area of charities and qualifying non-profit organizations.

Some action would be useful, however, to ensure that decisions on whether to buy contracted services are not distorted by false perceptions of how the GST works — i.e. that self-supply is 7% or 9% cheaper than buying outside services — and that suppliers to public sector institutions have an accurate understanding of how the GST affects their business. The committee therefore recommends:

57. That the federal government should develop information packages with private sector suppliers and with associations in the charitable and non-profit sectors to help ensure that make-or-buy decisions in public-sector organizations are not distorted by lack of knowledge about the GST and rebate systems.

H) Recreation and Sports

(i) GST and Recreation

A contentious issue in testimony relating to voluntary organizations and the MUSH sector was the Technical Paper proposal that GST be charged on recreation services provided to adults. This tax will also apply to "athletics, sports, outdoor recreation, music, dance, arts and crafts or similar activities", or classes, provided to teenagers by charities or by non-profit organizations, since children are defined as being 14 years of age or less. This is likely to lead to a substantial additional expense for families.

The Committee notes that arts, recreation or sports activities that are provided privately to children of any age will be liable for GST. Such activities as hockey schools, ski instruction, dancing lessons, private art classes and guitar will all be taxable, as will privately-operated summer camps, although some of these activities may be exempt because of the small traders' exemption.

Most activities of this nature for children and teenagers are provided through public sector organizations like schools, community centres, YMCAs, and boys and girls clubs,

however, and the Committee finds it hard to understand why these organizations will be required to charge GST on programs for teenagers which are generally considered to be socially worthwhile. Legally, children do not become adults anywhere in Canada until the age of 18; in a number of provinces, the drinking age is 19. Under the Income Tax Act, parents may claim deductions for child care expenses for their children up to the age of 13. This appears to be the basis for the limited exemption for children's recreation in the Technical Paper.

GST will not be applied to adult recreation programs "established primarily for mentally or physically disabled or disadvantaged individuals". It was submitted that this implies a means test to determine whether or not people taking a course will or will not have to pay GST. It was also submitted, particularly by the YMCA, that the nature of voluntary sector services is not comparable to commercial outlets, that the YMCA exists as a charity to serve a broad range of the community, not just the poor, and that a part of the function of the Y was to bring together people from different backgrounds and income levels.

Particular problems will arise in determining how to apply GST in cases where exempt and taxable services are mixed together, it was submitted, for example recreation services offered to children and to adults.

The Committee considered a number of solution to these problems and found none of them satisfactory. The alternatives include exempting all recreation courses offered by charities and non-profit organizations from GST, regardless who took part; apply the exemption only if adult recreation courses are provided by charities or by qualifying non-profit organizations, but not by a non-profit group such as a local golf or tennis club; exempt all recreation courses provided by a charity or non-profit organization, or municipality, if at least 80% of the courses being provided would otherwise be exempt.

The problem in every case is whether to grant the exemption when similar programs of adult recreation are also provided commercially and will be subject to GST. If all recreation were to be exempted, the federal government would lose an important and growing source of revenue as leisure markets continue to expand.

The Committee has already proposed a streamlined system of accounting to assist charities and non-profit organizations in administering taxable supplies under the GST. It believes that the main flaw in the Technical Paper's proposals for recreation is the plan to treat teen-agers as adults for GST purposes when they are normally considered in law to be children until the age of 18 or 19. The Committee therefore recommends:

58. That recreation programs provided by public sector bodies should be exempt from GST for teenagers as well as for children, and for this purpose the qualifying age should be 18 and under, rather than under 14 as proposed in the Technical Paper.

(ii) GST and Sports

Many of the issues already discussed with reference to charities and non-profit organizations also affect the sports community directly. The Sports Federation of Canada

expressed its concern that the GST will raise costs, reduce participation, cut back commercial sponsorships of sport, and work against government efforts to make sport less reliant on government funding.

A key issue, already referred to, is the apparent policy contradiction between encouraging increased self-reliance, and denying a GST rebate to sport organizations which have reduced their reliance on government funding to below 50%. This problem does not arise for registered funding to below 50%. This problem does not arise for registered amateur athletic associations, because they will be treated as charities and qualify for a 50% rebate of GST paid on purchases regardless of their level of government funding. Nor should it arise for the corresponding provincial sports federations under the Committee's recommendation that they, too, be treated as charities for the purpose of the rebate. Other sports organizations below the national level may be caught in this trap, however, depending on how they are registered or organized.

The Committee agrees with the concern of the Sports Federation and has therefore recommended that for non-profit organizations, the qualifying level to receive the 50% rebate be reduced to 25% of government funding, and that there be a notch provision to allow a reduced level or rebate to organizations that just fail to qualify for the full amount.

The increased costs of recreation and of sports programs for teenagers and for adults, arising out of GST, have been discussed above. This effect will be even more substantial in the case of an athlete competing at a national or international level, with costs of coaching, equipment, travel, etc. that can easily exceed $20,000 per year. Many coaches earn their living on a contract basis, and will therefore have to increase their fees to include GST. Some may qualify for the small trader's exemption, but this is not likely for coaches at the national level. Teams that travel will face increased expenses due to the GST, as will teams and athletes that need costly equipment and facilities such as arenas and ice time.

The Sports Federation submitted that corporate sponsorships of sport will be adversely affected by the GST and that the tax could affect supply agreements for equipment with corporations. According to its brief,

> "The application of GST to sponsorship agreements would jeopardize hundreds of millions of dollars annually not only to the amateur sports sector but to the cultural, education, health, and social sectors as well."

It was also suggested that future events like the Calgary Olympics could be jeopardized if GST is to be charged on all the facilities and activities involved. (Ticket sales and TV contracts for such an event would be taxed under the GST, however GST input credits for such an event would likely be greater than the additional costs of the tax on facilities and rentals.)

The Sports Federation in its brief submitted that supplies of goods and services by a non-profit organization should be exempt. The Royal Canadian Golf Association made the same case in its brief, arguing that multi-million dollar events like the Canadian Open at

Glen Abbey golf course in Oakville should not have to charge on admissions because the purpose of the event it to raise funds to support amateur programs.

Sponsorships have become increasingly common as a means for businesses to provide support for sporting activities and for the arts. Sponsorships also often provide a direct marketing benefit for the sponsoring company in terms of commercial exposure, brand-name recognition or promotion of a particular product, and hence would appear to be a taxable supply.

The Sports Federation asked that sponsorships not be liable for GST, fearing that contributions from this source will decline after 1991 because of the perception that a sponsorship costs 7% or 9% more as a result of the GST. This perception is not accurate, however, because it will cost a company exactly the same amount to enter into a sponsorship agreement for a particular sports or cultural event as to make a donation. Here is an illustration:

> The Canadian Yachting Association asks an accounting firm to make a $100,000 contribution to its forthcoming "Great Sail Tacks" race off the Grand Banks of Newfoundland, either in the form of a donation or a sponsorship. The senior partners meet to consider the alternatives:

	Donation	Sponsorship
Net value of contribution	$100,000	$100,000
GST liability	$7,000	—
Total amount payable to Yachting Association	$107,000	$100,000
Less: value of GST input tax credit	$7,000	—
Net cost of contribution to Yachting Association	$100,000	$100,000

Whichever route is taken, the example shows that the net cost of the contribution is the same. There is little difference in terms of cash flow either, because the GST input credit on the sponsorship fee can be claimed immediately against taxes collectible for the period immediately the fee has been invoiced or paid. Moreover, GST generally will apply to the cost of advertising and all other forms of marketing and promotion will attract GST, and will generate input tax credits, on the same basis. The Committee believes the business community will overcome the perception problem referred to above relatively quickly as it becomes accustomed to working with a multi-stage tax system.

A number of the Committee's recommendations respond to concerns raised by the sports sector, notably the broadening of eligibility for the 50% rebate paid by non-profit organizations and the extension of exempt treatment to sports and cultural programs offered to teenagers by public sector organizations. The Committee proposals for streamlined

accounting for non-profit organizations who receive revenue from making taxable supplies will also assist the sports sector.

For reasons already discussed the Committee is not prepared to recommend a GST exemption for all recreation programs offered to adults. It is also reluctant to exempt major sporting events like the World's Cup ski race, or the Canadian Open, from GST on admissions on the grounds that the proceeds go to amateur sport. These events are a commercial type of spectacle, a form of entertainment competing with professional sports and with other diversions such as films and theatre, and the Committee believes that on policy grounds admissions to these events should be taxable.

The question of when GST would be payable on admissions to an amateur event in which some professionals are involved was raised by both arts and sports organizations. The issue is not discussed in detail in the Technical Paper, but the Draft Legislation is fairly explicit. It provides exemption from GST for admission to a performance or sporting event,

> "where all or substantially all of the performers or athletes taking part in the performance or event do not receive, directly or indirectly, remuneration for doing so other than a reasonable amount as prizes, gifts or compensation for travel or other expenses... and the performance or event is not advertised or represented to be a performance or event featuring any of the paid participants."

Hence a track and field meet advertising a professional athlete who was paid to appear would be required to charge GST on the admission, but an amateur theatre company which used one or two professional actors in a performance without featuring them in its advertising would be exempt. Some areas for confusion remain. According to the Department of Finance, if a professional skater (for example) agreed to appear at an exhibition performance by a local non-profit skating club but on an unpaid basis, admissions to the performance would be exempt. A track meet which paid substantial appearance fees might not be required to collect GST on its tickets because the elite athletes for whom it was paying are classed as amateurs.

While there is a need for some clarification, the Committee does not see the need for any basic change in the treatment of admissions or in the treatment of amateur events.

In general, the Committee agrees that amateur sport merits public support, but would contend that this is sufficiently reflected in the 50% rebate on GST paid on inputs as proposed in the Technical Paper. In this regard, amateur sport is currently liable for federal sales tax on equipment, communications and travel with no special federal sales tax treatment.

Concern is natural that a new sales tax may increase the cost of recreation, of participation, and of competitive amateur sport. It may be easier to provide relief to this sector through other government programs, however, than to trying to incorporate additional exemptions into the GST.

In a society where many people have leisure, the demand for adult sport and recreation activities is likely to increase. In other words this have become a major area of

consumer expenditure. While sport and recreation can contribute to well-being and health so can books, travel, entertainment, hobbies, and many other activities which are taxed. The question therefore is to what point should this particular merit good, the area of sports, receive special treatment under the GST.

The Committee recommends:

59. That the federal government should cooperate closely with sports federations and other sports organizations to resolve administrative and compliance problems created by the introduction of the GST.

60. That federal support for national sports organizations should be increased in the early 1990s if it appears this is needed to maintain the standard of Canada's national sport program under the GST.

61. That revenue Canada should clarify through an interpretation bulletin the status of sponsorships by business of sports and cultural activity. The charging of GST on sponsorships should be optional unless they provide the sponsor with a substantial and direct commercial benefit.

(iii) Umbrella Groups

The Edmonton Federation of Community Leagues is a unique organization bringing together some 136 community leagues, and 280,000 members, which are responsible for recreation programs in different parts of the city. The Regroupement Loisir Quebec is a service organization (somewhat like Sport Canada) serving some 115 member organizations in the areas of sports, arts and recreation. Both of these groups appeared before the committee and submitted that volunteer-run recreation groups should not have to collect, or to pay, the GST.

They also urged that services which an umbrella group like the Regroupement provided to its members should be exempt from GST. This point was also made in a brief from the Canadian Sport and Fitness Administration Centre, which provided common administrative in Ottawa. Similar services exist for sports federations in several provinces.

The Committee has recommended a certain flexibility with respect to intra-group transactions in the financial sector, and among co-operatives and credit unions. It recommends:

62. That where services are provided to a group of charities or non-profit organizations by a related organization, or an umbrella organization that is set up for that purpose and certified by the Minister of National Revenue, these supplies should be exempt from GST.

I) The Arts

Arts organizations took a very gloomy view of the government's GST proposal and were almost unanimous in urging zero-rating of inputs, an exemption on ticket sales, or both. During the hearings it was learned that the Department of Finance has indicated that the

Technical Paper proposals are intended to close to 100% input tax credits on the GST paid on purchases by most arts organizations.

Most arts activities have traditionally been exempt from the manufacturer's sales tax, which does not apply to admissions, to performers' contracts, or to most other business dealings in the arts sector. Under the GST, arts organizations are anticipating the impact of sales tax for the first time both on ticket sales and on the cost of purchased inputs. The current system does affect some arts organizations more substantially, however, notably theatre and opera companies which pay heavily for sets, costumes and lighting.

The reaction of arts organizations, in submissions to the committee, was very strong. Some examples:

> "The GST is a tax on creativity, on works of the intellect. It denies the importance of the role of the arts and the cultural industries to Canadian society. It is on these grounds that our sector has tremendous resistance, if it is not opposed outright, to the introduction of the GST."
>
> (Canadian Conference of the Arts)

> "The proposed GST will have a profound negative impact on the whole very price-sensitive cultural sector, but especially the visual arts one."
>
> (Canadian Artists' Representation)

> "(The) effects (of the GST) on performing arts organizations are of great concern to us. All of the organizations (surveyed by the Council) would have to raise ticket prices between 9% and 12% in addition to a normal inflation adjustment to restore their financial position to its present level... It seems likely that prices of these items will have to rise more than those of certain other goods and services, and may therefore encounter consumer resistance."
>
> (Canada Council)

> "The GST proposed in the Technical Paper will give rise to a price increase at the box office exceeding the GST rate with the result consumer demand is expected to decline by a factor greater than 9%."
>
> (Entertainment Tax Action Committee)

> "This proposed tax is particularly onerous in view of the fact that in many jurisdictions across the country, theatres are forces to pay an amusement tax that runs as high as twenty per cent. This cascading of taxes threatens the economic viability of many of our smaller members with the resulting negative impact on the entertainment options in communities across the country."
>
> (Motion Picture Theatre Associations of Canada)

> "While there are many movie houses, symphony orchestras are usually the solo providers in (their)market. They will incur increased operation deficits, thus increasing their cumulative deficits. One can expect, over the first few years of

implementation, the demise of organizations with a high percentage of fixed costs (symphony orchestras) and organizations with existing major deficits."

(Association of Canadian Orchestras)

"... the imposition of the GST on everything from gift shop sales, facility rentals, art rental and community membership fees will seriously erode our self-generated revenue base, place our volunteers in the position of raising funds to pay tax, and ultimately make the art museum community increasingly dependent on government grants."

(Canadian Art Museums Director Organization)

"It would seem counterproductive on the one hand for the government to support financially the production of television and film through Telefilm, the NFB and the licence fees of the CBC and on the other hand to recoup a portion of that financial assistance through the GST. There is a legitimate public policy objective served by the financial encouragement of production both by independents and through public agencies such as the CBC. The GST should not have the impact of threatening that objective."

(Association of Canadian Cinema, Television and Radio Artists)

"We disagree with the Department of Finance assumption that consumer spending will be unaffected because all prices will rise equally. We believe that the consumer's cultural dollars will remain constant, and the volume of product purchased will decrease by 9%."

(Professional Association of Canadian Theatres)

"We feel it is important for cultural workers that the level from which the small trader's exemption applies be raised from $30,000 to $50,000. This would not cost the government significant revenues but it would avoid, in a fair and equitable manner, double taxing these workers and would simplify the management of their affairs."

(Conseil québécois du théâtre)

"The professional theatre, opera and ballet . . . are already drastically underfunded. The imposition of a 9% tax on the services of our members will seriously inhibit their limited bargaining power. This tax, in other words, will come right out of the artists'' pockets."

(Canadian Actors' Equity Association)

(i) General treatment

Arts organizations generally have charitable status or are non-profit organizations, but there are also a number of private, professional arts organizations which will be treated like any other businesses under the GST. These groups did not appear before the Committee.

The arts sector receives a substantial amount of public support through the Canada Council and other channels, through equivalent bodies at the provincial level, and through grants, donations and sponsorships. Hence ticket and admission revenues may be as low as 10% of total budget in the case of museums and galleries, rising to around 40% to 60% in the case of theatre and opera companies.

Artists tend to be self-employed and to have low incomes. Many have regular jobs to support themselves and their families and carry out their art on a part-time basis. Actors' Equity gave the committee an example of the incomes of its membership. Work was "sporadic"and the number of weeks worked by its members averaged 27 in 1988. Actors could have as many as 8 "engagers" or employers in a year, and the average income of Equity's 12,700 members was $10,000.

The arts are not treated separately in the Technical Paper but are grouped together with other charities and non-profit organizations. Many of the issues raised by witnesses from the arts sector were similar, in fact, to concerns expressed from other groups in the voluntary sector.

Arts organizations which are charities will be entitled to a 50% rebate of the GST paid on their inputs, as will those which are non-profit organizations and meet the government funding test. However, the government has agreed to two major clarifications which benefit the performing arts organizations:

* grants and donations will not be taxed under the GST and will not be considered in allocating input tax credits.

* arts organizations will be allowed a 100% tax credit on all inputs that can be reasonably attributed to commercial activities such as admissions.

The effect of this is that even if an arts organization less than half of its revenues from box office, all or virtually all of the GST paid on its inputs will qualify for a 100% input tax credit. The effect of this provision is goods and services purchased by arts organizations will actually cost somewhat less than at present after allowing for input tax credits, assuming that suppliers remove the present federal sales tax burden before calculating GST.

Here is an example of how the treatment of inputs will work, using figures from the Canada Council's study of the Winnipeg Symphony Orchestra:

Winnipeg Symphony Orchestra

1987–88 season

Tax	Present federal sales tax	Goods and Services
Total expenditure (including $28,653 federal sales tax)	$3,488,067	
Total expenditure (no sales tax included)		$3,459,414
Goods and Services Tax (at 7% rate)		$79,353
Total expenditure including sales tax	$3,488,067	$3,538,766
Less: GST input tax credit		$79,353
Net total expenditure	$3,488,067	$3,459,414

The effect of the government's interpretation of the rules, in this case, is to lower the cost of the Winnipeg Symphony's inputs by $28,653, the value of federal sales tax paid under the current system. (This estimate assumes that the federal tax will be fully removed before suppliers start to calculate GST.) Since no upper limit has been defined for the full refund of input tax credits, it is extremely unlikely that there will be an increase in the costs of arts organizations due to the tax, as any amount of GST charged on purchases would be eligible for refund as an input tax credit immediately.

The problem for the arts organizations is the requirement that their ticket sales, or entrance fees, be treated as commercial supply and therefore be liable for GST. The issue is the same as was discussed with respect to the GST and sports: should the imposition of GST be based on the nature of a service or of an event, or on the intent with which it is offered? The Technical Paper proposes to tax commercial supply regardless of the motive of the supply, or by whom it is offered. Organizations in the arts disagree with this approach: an example of this view is expressed in this submission from the Canadian Conference for the Arts:

> "For arts organizations that are registered charities or non-profit organizations, the so-called commercial activity in which they engage is not profit driven: the surpluses, if any, are returned to the organization to further its aims and objectives. Thus revenue-generating activities undertaken by arts charities and non-profit organizations to meet their objectives (in recognition of which the government has granted charitable or non-profit status) should not be subject to the application of the GST (both for inputs and outputs)."

Here is how the tax on admissions would affect the Winnipeg Symphony. This example assumes that sponsorships will be taxed for GST but that ticket prices are left unchanged, and that GST is charged at the 7% rate recommended by the Committee.

Winnipeg Symphony Orchestra

1987–88 season

	Present federal sales tax	Goods and Services Tax
Tax		
Net total expenditure (as above)	$3,488,067	$3,459,414
Revenue:		
Tickets	$1,485,000	$1,485,000
Sponsorships	$176,000	$192,000
Grants & donations	$2,004,000	$2,004,000
Total revenue	$3,665,000	$3,681,000
Federal sales tax on revenue & sponsorships (7% GST)	—	$113,000
Revenue after tax	$3,665,000	$3,568,000
Less net total expenditure	$3,488,067	$3,459,414
Operating surplus	$177,000	$108,600

As the example shows, the symphony's surplus will decline by about $70,000 if GST is 7% and there is no increase in ticket prices. This is equivalent to a 5% increase in ticket prices, but this increase will take place at a time when the cost of tickets for films and other attractions, previously exempt from federal sales tax, will also be increasing by comparable amounts.

The most substantial submission the Committee received on the arts was from the Canada Council, which based its testimony on a lengthy study of the economic impact of the GST by Woods, Gordon. The Council submitted that arts organizations will have to raise ticket prices 9% to 12% in order to maintain their financial position, because of the GST, and that admissions to cultural events may fall because the price of tickets will have to rise more than those of other goods and services.

The Council estimated that performing arts organizations will pay "not less than 5% of their annual budget on GST", even if they get a 100% tax credit on GST paid on inputs, which had done the most to reduce their reliance on government.

The Committee has examined the Council's figures closely and believes that they may create a misleading impression. In the case of the Winnipeg Symphony, for example, the Committee estimates the symphony would have to raise ticket prices by 5% if the general rate of GST if 7% (or 6% if the GST rate is set at 9%) in order to maintain its financial position.

This is considerably less than the Council's estimate that a 9% increase in ticket prices would be required.

The Committee's figures for Les Grands Ballets Canadiens differ from the estimates prepared by the Canada Council. The Council's study shows that GST of $274,000 would be payable on taxable revenues for Les Grands Ballets, which, exclusive of fundraising and grants, would amount to a maximum of $2,334,000. This indicates a GST rate of almost 12% and appears to be in error. The Council acknowledges that corporate sponsors might increase sponsorships by an amount equal to the GST they will bear, since the GST will be returned very quickly as an input tax credit, but has made no allowance for this in its estimates. The Committee's estimate for Les Grands Ballets is as follows:

Les Grands Ballets Canadiens

1987–88 season

	Under Federal Sales Tax	Under Goods & Services Tax
Total expenditures (including $153,000 federal sales tax)	$5,273,000	
Total expenditure (No sales tax included)		$5,120,000
Plus GST at 7%		$358,000
Less GST input tax credit		($358,000)
Net total expenditure	$5,273,000	$5,120,000
Revenues:		
Ticket sales		$1,311,000
Other taxable supply		$30,000
Total taxable revenue		$1,341,000
Exempt revenue (grants, fund–raising, donations)		$3,941,000
Total revenue:	$5,282,000	$5,282,000
Less: Net total expenditure	$5,273,000	$5,120,000
Surplus for the year	$9,000	$67,000

This exercise indicates that Les Grands Ballets should in fact benefit from the new tax, because it GST input credits will result in the elimination of a substantial cost of federal sales tax being paid under the current system. According to the Committee's estimates, the increase in Les Grands Ballets' surplus would be enough to reduce ticket prices by 5% (or by

2.5% at a 9% rate of GST), rather than increase ticket prices by 9% as forecast by the Canada Council, if the company wanted to maintain its old financial position.

The Committee acknowledges the concerns raised by the arts community and accepts that certain arts organizations will be required to raise ticket costs or increase other sources of revenues in order to meet their new obligations under the GST. As stated earlier, however, the Committee agrees with the contention that the cost of admissions to arts events should be taxed. This is consistent with the base broadening involved in the GST and with the fact that arts performances or events are a commercial type of activity, even if they are subsidized.

The Committee's review suggests that the impact of the GST on the arts community will be less than many of the organizations which appeared as witnesses feared. Nonetheless it is difficult to forecast the precise impact of the GST on the arts community, particularly if the new tax has an unusually heavy effect on the rate of inflation. This possibility would be reduced with a 7% rate. Some increase in funding through the Canada Council and other granting agencies could be needed to assist arts organizations in the transition to the new tax. The Committee therefore recommends:

> **63. That the federal government make special grants to the Canada Council and other agencies supporting the arts beginning in 1991, to the extent that this may be needed to offset any serious problems created for arts organizations through the introduction of the GST.**

(ii) Administering GST in the Arts

A number of the Committee's proposals for charities and non-profit sector respond to concerns raised by arts organizations. The Committee's proposal to make it easier for non-profit organizations to qualify for a 50% rebate of GST paid on inputs would benefit those arts groups which do not qualify for input credits like the performing arts groups, as will its proposals for a notch provision and for a streamlined accounting system for charities and non-profit organizations providing some commercial supply.

A number of arts groups asked that the small traders' exemption be raised from the $30,000 level proposed in the Technical Paper to $50,000 in order to allow the vast majority of artists and performers to work on an exempt basis. Elsewhere in this report the Committee sets out its reasons for supporting the figure chosen in the Technical Paper. It notes, however, that the small trader exemption would cover most artists and actors in Canada, and that the figure has been raised from the $5,000 level originally proposed by the government in 1967. The Committee's proposal to guarantee the exemption for each year on the basis of a trader's taxable supply in the previous year also responds to the desire of artists for more certainty.

The submissions by ACTRA, by the American Federation of Musicians and by other witnesses with respect to the administration of GST in contractual arrangements with performers and artists deserve careful consideration. They contended that it would be difficult for organizations like film production companies or the CBC to account for the services of

artists when some are registered in the GST system and some are exempt, particularly since payment for contract services is often made without an invoice being submitted.

If the Committee's recommendation for determining small trader status a year in advance is accepted, the administrative problems for producers of maintaining a record of an artist's GST status will be relatively easy to resolve, in the same way that records must now be kept of the address and and social insurance number of artists on contract.

ACTRA went further, however, in proposing that producers pay GST on all contract fees to performers whether or not the performer is classified as a small trader, and therefore take over the performer's responsibility to remit GST. Since the producer would be entitled to an immediate input tax credit, there would be no material effect on its cash flow. The GST attributed to performers would be accounted directly to National Revenue rather than being paid to the artist; if an artist was a registrant, he or she could claim input tax credits on goods and services purchased in order to earn the revenue.

The effect of this proposal would be to substantially reduce paperwork by accounting for GST in the same way that income tax is deducted from employees at source and reported on T-4 slips. A performer registered in the system will only be required to file a GST return and remit GST that payable once a year. Under ACTRA's proposal, GST attributed to performers' contracts would be remitted on an ongoing basis. This suggestion would therefore improve compliance, simplify administration in the cultural sector, and improve the government's cash flow from GST.

The Committee recommends:

64. That to simplify the administration of GST in relation to contracts with artists and performers, the government permit producers and arts organizations to deduct GST that is payable on these contracts at source in a manner similar to the deduction at source of income tax.

A number of arts organizations raised concerns re the need to charge GST on sponsorships, which are becoming an increasingly common vehicle for corporate support of the arts. Whether a company donates to the arts by means of a a grant or a sponsorship, however, the impact on its accounts is the same, as the Committee notes in its comments on the GST and sports.

The Committee believes that charging GST on sponsorships in the arts may create a temporary problem of perception, but should not be a financial disadvantage for arts organizations. As noted earlier, it believes that the status of sponsorships should be clarified by Revenue Canada and that GST should be required to be charged on sponsorships only where they provide the sponsor with a substantial and direct commercial benefit.

Some confusion was expressed to the Committee with respect to the exemption from charging GST that is proposed for foreign performers temporarily working in Canada. ACTRA contended, for example, that non-Canadian performers and writers working on

Canadian productions could enjoy a competitive advantage over resident Canadians, and that the GST could inhibit non-Canadian companies from producing in Canada.

The reason for the exemption for foreign performers is that the tax would be hard to collect and difficult for performers unfamiliar with Canadian taxation to understand. No loss of revenue to the Treasury is involved, since no input tax credit will be provided to the employer who contracted with the performer to come to Canada.

A related area is the impact of GST on Canadian film production and the film industry in general. The Motion Picture Theatre Associations of Canada contended that the GST would "devastate the box office potential" of Canadian films and urged that the entire film production industry be exempt with the exception of GST charged on box office receipts. This would make the GST into a retail sales tax on films and is a form of zero rating on a domestic industry which the Committee in general rejects.

Most film-making in Canada is for export. While all aspects of film-making are exempt from federal sales tax, the industry still bears a significant amount of indirect, hidden federal sales tax in its cost structure just like many export industries. This tax will be reimbursed to film-makers through the input tax credit system under the GST, and refunds are to be paid during the course of a film's production even if it is months from completion or if the producer has not yet found a buyer. Revenue Canada will honour refund demands from film-makers, in other words, so long as the production is commercial and has a reasonable expectation of profit.

What this means is that, contrary to the contention of some witnesses, the costs of film-making for domestic as well as for export markets will tend to decrease if the GST is substituted for the current federal sales tax. Any increase in tax will, in the end, be passed on to consumers and be paid at the box office.

Witnesses also contended that production of films for Canadian markets would be reduced because of a fear that domestic sales would reduce GST input credits available for exports. This is not the Committee's understanding. Input tax credits are to be refunded on a regular basis as a film is produced. If distribution rights are then sold for export, the sale will be zero-rated. To the extent that distribution rights are sold sold for Canadian use, GST will be charged to the distributor and eventually passed through to consumers when they pay at the box office. The same treatment would apply to a foreign distributor, or to rights to a foreign film, and the GST should therefore be neutral as between its treatment of Canadian and non-Canadian films.

The Canadian Association of Broadcasters was one of the few witnesses from the area of arts and communications not to request exemption from GST — even though it offered the Committee some pessimistic forecasts about how the tax will affect small radio and television stations. The Committee notes the broadcasters' concern that a level playing field be maintained in local media markets, so that GST is applied to newspapers and other local print outlets on the same basis as to broadcasting. As noted elsewhere, the Committee has rejected proposals that newspapers and other publications should be exempt from charging GST.

9. THE PUBLIC SECTOR

This chapter deals with the impact of GST on governments and on the institutions making up what is called the MUSH sector, namely Municipal governments and related agencies; Universities and public colleges; Schools and school authorities, whether tax-funded or privately-funded, non-profit institutions; and public Hospitals.

The public sector as defined in the Draft Legislation includes charities and non-profit organizations, which are dealt with in the previous chapter; the provincial and federal governments; and the MUSH sector.

Under the Canadian constitution, provincial governments are not liable for federal tax on their purchases and the federal government is not liable for provincial sales tax. Eight of the provinces and the federal government have had an agreement, however, under which they pay the other governments' tax rather than seeking exemption or refunds. These Reciprocal Taxation Agreements will expire with the introduction of the GST unless they are renegotiated. The Committee would support renewal of these agreements, particularly because of its desire — discussed in the previous chapter — to avoid the creation of more exempt purchasers, such as the provinces, within the Canadian market.

A) Technical Paper Proposals

The MUSH institutions enjoy substantial exemptions from sales tax under the present federal system. Special treatment is to be continued under the GST under a rebate system designed, according to the Technical Paper, "to ensure that the reform of the federal sales tax imposes no greater burden than before reform."

The general approach to taxation in the public sector is laid out in the Technical Paper. It states that the federal government

> "must ensure that the GST is applied in a fair and uniform manner to commercial supplies made by both the private and public sectors. This will ensure competitive equity and minimize tax-based distortions. At the same time... the government recognizes the special role that public bodies play in our society and, therefore, will ensure that the tax system does not impede their non-commercial activities."

The Technical Paper goes on to state:

> "To the extent that governments and their emanations engage in commercial activities, they should be subject to the same general rules as private sector organizations... (S)upplies by governments will, in general, be subject to GST if

they are made in the nature of a commercial activity... (I)t is the nature of the supply itself which will generally be the central determinant of tax status, not the nature of the organization that makes the supply."

The Committee has already indicated its support for this approach. It recognizes, however, that the structure of GST and the decision to tax commercial supply by the public sector will create significant problems in administration and compliance.

The Federation of Canadian Municipalities, Association of Universities and Colleges of Canada, and Canadian Hospital Association all submitted substantial briefs to the Committee and provided assistance to the research staff. The Committee also received assistance from the Canadian School Trustees Association although it did not submit a brief.

The biggest concern of institutions in the MUSH sector is how the proposed rebate system will affect its members. Only the barest details of the system are provided in the Technical Paper, and the the sections referring to rebates for the MUSH sector were not released with the rest of the Draft Legislation in October.

The Committee is therefore handicapped in evaluating the MUSH rebate system for lack of information, and it fears that Parliament will likewise be handicapped when the GST is brought forward for legislation.

B) Rebate or Exemption?

In its submission the Federation of Canadian Municipalities rejected the rebate system because, it said, the government had failed to consult and to resolve the concerns it had raised about this proposal with the Department of Finance in the spring. Instead the FCM proposed an exemption/certificate system under which sales to municipalities would bear tax at a special low rate rather than the regular rate of GST.

There are strong reasons for recommending a rebate system over a system of exemptions, however, relating to administration and compliance. These reasons were acknowledged by the FCM in a May 31 submission to the Department of Finance.

The Committee discussed the alternatives to a rebate system in the previous chapter and has concluded that a rebate system for the MUSH sector along the lines proposed in the Technical Paper is preferable to relieving this sector from sales tax through a system of exemptions, certificates, or a special low rate of GST.

Setting the Rate of Rebate

The general impression left by witnesses representing MUSH-sector institutions is that the percentage of rebate to be paid is crucial to whether they reluctantly accept the new sales tax, or actively resist it. In initial meetings, the Department appears to be proposing much lower rates of rebate than the levels the MUSH groups feel are justified.

Both the Federation of Canadian Municipalities and the Canadian Hospital Association reported that they had experienced lengthy delays in their efforts to discuss how the rebate system might work, and what rate of rebate might be used, with the Department of Finance. A meeting between the FCM and Finance to discuss the numbers, originally set for July was rescheduled to November; even then the focus was on principles rather than the calculations each side had made.

The FCM stated in its brief that:

> "In our discussions, Finance officials agreed that FCM would have an opportunity to review the estimated 1991 FST liability without reform together with estimated GST liabilities, and that such a review would take into account the painstaking research the municipal sector has undertaken. Finance officials have described some of this research as "the best that could be done.""

> "The White Paper states that the federal government will unilaterally make the determination, without consideration of the substantial body of research undertaken by FCM and its members."

With respect to timing, the Finance Department stated in its written response to the Committee's questions that:

> "The department is currently beginning the process of consulting with representatives of each sector on the appropriate rebate rates and delivery mechanisms. When the final GST legislation is tabled, it will contain the authority to provide rebates to the various institutions. The precise rebate rates will be prescribed in regulations to follow."

Regulations are often used in financial legislation to allow a government to deal more easily with complex technical issues, and to provide flexibility to make changes in legislation future years without the need to return to Parliament.

There is little complexity involved in this area, however. Only one rate of rebate is being applied in each MUSH sector, and if the initial rate of rebate in each sector has been calculated fairly and accurately there should be no reason for it to change in future years.

Organizations in the MUSH sectors will have great difficulty contributing to debate on the final GST bill if they are still in the dark with respect to the rebates to be provided in each sector when it is introduced. For this reason the Committee believes it is important that the rates of rebate to be provided in the four MUSH sectors be determined at the earliest opportunity. It therefore recommends:

65. That the Department of Finance proceed immediately to determine rebate rates for the MUSH sectors in close consultation with the affected institutions and their respective associations.

The current federal sales tax includes a certificate system that allows MUSH institutions to purchase a wide range of goods free of federal sales tax. Public hospitals have the most comprehensive set of exemptions and as a consequence pay the lowest net rate of federal sales tax of the four MUSH sectors, equivalent to a GST rate of about 1%.

Expressed on a GST base, this net rate of federal sales tax is believed to range up to 2 or 2.5% for other MUSH sectors. But it has proven very complex and difficult to calculate the actual burden of federal sales tax, either for individual institutions or for each sector as a whole, particularly when estimating the value of hidden sales tax that is borne indirectly by MUSH institutions. Yet the government is committed to ensure that the GST burden on these institutions is no greater than before reform, and an estimate of the present sales tax burden must therefore be arrived at if this commitment is to be honoured.

The formula used in the Technical Paper provides that liability for sales tax in 1991 is to be calculated for each of the four MUSH sectors and then expressed as a fraction of the estimated GST liability that would apply in this sector if no special treatment were given. The rebate rate is the reciprocal of this fraction, expressed as a percentage. Each of the four sectors will have its own rate of rebate, which the Technical Paper states will be calculated "using federal estimates of the federal sales tax and GST liabilities of these organizations."

Hence if the actual federal sales tax liability for a sector in 1991 was estimated to be $1 billion and the GST liability was estimated at $4 billion if there was no special treatment, then

$$\textbf{Rebate (\%)} = [\, 1 - \frac{\$1 \text{ billion (FST)}}{\$4 \text{ billion (GST)}} \times 100 \,]$$

or a rebate of 75%.

The associations representing the MUSH sector have tried to arrive at a current estimate of the federal sales tax burden using recent, detailed financial statements of selected members, and adding in an estimate for sales tax paid indirectly. On this basis their calculations point to rebates of around 70% (municipalities); 77% (school boards); 84% (universities and colleges); and 80% to 90% (hospitals).

The Department of Finance believes that estimates from each sector of the present FST burden on MUSH institutions are too low, and is preparing its own estimates of the direct and indirect liability for federal sales tax without reform on the basis of input-output tables dating from 1984 and updated to 1991. As of early November, however, it had only just begun to share its calculations with the respective MUSH sectors.

According to the Department, the equivalent tax base of the MUSH sector in 1991 — if sales tax was levied at regular rates — would be $7.8 billion and the federal sales tax revenues would be just under $1,000 million. Arguments over the appropriate percentage of rebate to

be allowed therefore have a substantial value to the sector concerned. The attached table treats the four MUSH sectors as one in order to show why:

GST in Mush Sector to be paid after rebate

	Rebate % of GST ($ million)			
	75%	77%	80%	85%
Spending liable to GST	$27,000	$27,000	$27,000	$27,000
GST paid at 9%	2,430	2,430	2,430	2,430
Rebate	1,823	1,871	1,944	2,066
Net GST after rebate	607	559	486	364

In this example, each one point difference in the rebate is worth $24 million in gain or loss to the federal government and to the affected institutions.

The Committee believes that the government commitment to the MUSH institutions involves not increasing their current sales tax burden, but it does not require reducing that burden if the GST rate is set at 7% instead of 9%. In this case, the rate of rebate would be lowered sufficient to result in the same net rate of GST as had been worked out under a 9% rate.

Many witnesses from the MUSH sector addressed the rebate issue, in most cases to recommend that their institutions be further relieved of GST through exemption, zero-rating, or a 100% rebate. As the Canadian Association of University Teachers put it,

> "... the tax system and tax changes should have a completely neutral impact on the funding budgeted for public services... the central principle should be that funds originally intended for the provision of these services should not be reduced indirectly by changes in the tax system. To the extent that the existing federal sales tax is already being applied to public sector institutions, this principle of tax neutrality is being violated."

The Federation of Canadian Municipalities had a very specific interpretation of the minister's commitment not to impose a greater tax burden than before reform:

> "No two municipalities are alike. Since the Minister's undertaking is to all municipalities, not to some notional "average", no single municipality should, on a net basis, pay any more tax under GST than it paid under (the federal sales tax)."

To achieve this with one rate would mean rebating all municipalities down to the rate of FST that the most lightly-taxed city or town in Canada would have borne in the base year. But if an average rate of FST is used, as the FCM pointed out, that will mean that half the

municipalities in Canada will pay more GST than they would have under the FST, and half will pay less.

Both of these approaches would result in reducing the federal sales tax revenues from the MUSH sector under GST relative to the FST. The sums involved are not trivial; to remove federal sales tax entirely on the MUSH sector would cost the equivalent of an increase of 1/3 of 1% in the rate of GST. According to the Department of Finance, the government's intention with the MUSH sector was not to remove sales tax entirely from the public sector, but to mirror the existing revenue situation as closely as possible.

The FCM has carried out an extensive study of federal sales tax costs based on the City of Calgary's books for 1987. The sales tax burden was calculated for each major area of municipal activity, then the results were applied to the budgets of a number of other municipalities with different activity patterns and of different sizes. The effective federal sales tax rate in every case, expressed as a net rate of GST against taxable purchases, was remarkably similar:

Estimates of 1987 Effective Tax Rates for Surveyed Municipalities

Municipality	Effective GST Rate
Calgary	1.657%
Castlegar	1.602%
Edmonton	1.702%
Hull	1.622%
Montreal	1.650%
Regina	1.609%
Saint John	1.577%
Truro	1.639%

Source: FCM Submission to Department of Finance, May 31, 1989

The Committee shares the concern of the MUSH organizations at the prospect that the percentage of rebate to be applied, to fulfill the government commitment not to increase sales taxes in this sector, will be determined unilaterally.

All parties agree that calculation of the current burden of FST on MUSH institutions is excruciatingly difficult and subject to error, because so much of the tax involved is indirect rather than direct. With the limited time now available, this means that the Department of Finance and the affected sectors may in the end not have reliable numbers to work from; their only choice will be to sit down and negotiate a rate of rebate which appears to be fair to both sides.

The Committee questions whether the use of econometric tables to calculate the federal sales tax paid by the MUSH sectors is as accurate as working from the books of the institutions themselves. The government's input-output tables are based on 1984 figures projected to 1991 and may not have been originally constructed to make precise estimates of

sales tax. In dealing with the MUSH sector, the Committee urges the Department of Finance to be sufficiently generous in its negotiations that the affected institutions feel they have been given a fair deal.

C) Number of Rates

A number of witnesses submitted that because the circumstances and activities of different MUSH institutions vary widely, they are likely to have wide variations in the rate of federal sales tax now being paid on their inputs. They also suggested there could be substantial differences in the rate of tax paid between larger and smaller institutions, so that more than four rates of rebate would be justified.

The Federation of Municipalities study did not support that contention, and the AUCC also testified that it could not find a substantial variance in the rate of federal tax between different types or different sizes of universities. No satisfactory suggestion was made, moreover, as to how the federal sales tax burden for each institution might be estimated if there were to be a system of multiple rates of rebate.

The Technical Paper defines the municipal sector to include a number of special-purpose bodies such as library boards, police commissions and transit undertakings which act as municipal agencies and which may have different patterns of spending. The B.C. Library Association made a special plea to the Committee that libraries be given a special rate of rebate, arguing that their sales tax expenditure under the current system is very low because books are exempt. A similar point was made by the Canadian School Trustees Association, which suggested to Committee staff that new school buildings should be rebated at a rate of 100% of GST paid because building materials are currently exempt under the Excise Tax Act.

With four MUSH sectors and four rates of rebate, the system of rebates proposed in the Technical Paper is already complex. The rates may also need to be adjusted for specific cases of mixed-use facilities such as a university, hospital or a community centre jointly run by a school board and municipality. Defining more sub-sectors in the MUSH sector and adding new rates of rebate would add to the complexity of the system and should therefore, in the committee's view, be discouraged.

The Committee therefore recommends:

66. That, as proposed in the Technical Paper, there should be only one rate of rebate of GST paid on inputs for each of the four major areas in the MUSH sector.

The Federation of Canadian Municipalities proposed that to implement the government's commitment not to increase the tax burden on MUSH institutions as a result of the GST, the rebates be set at a level that ensured that no municipality would pay more tax.

As discussed above, it would be very difficult to determine which municipality should set the standard or to calculate its effective rate of federal sales tax. The Committee is

concerned, moreover, that the FCM's proposal would result in a substantial revenue loss to the federal government from the MUSH sector.

The committee therefore accepts that the rate of rebate in each of the MUSH sectors should be set at approximately the average rate of federal sales tax paid in that sector, even though this means that some institutions will gain and some lose because their individual rate under the current system was below or above the average. The Committee believes, on the figures which it has seen, that these gains and losses will tend to even out over time.

D) Administrative Problems

A number of witnesses expressed concern about the proposed GST rebate system because of the complexity, costs and administrative problems they feared it would entail. The City of Vancouver estimated it will cost $750,000 more per year to administer the GST, while the City of Calgary estimated its costs of preparing for the GST will be $1 million out of a total annual budget that exceeds $1 billion.

The FCM estimated that administrative costs of GST could rise to O.5% of taxable purchases, while according to the Federation of Prince Edward Island Municipalities.

> "Of the 88 municipalities on PEI 12 have populations under 1,500. Many of these municipalities have no or very little administrative staff; any work is done by community volunteers. The constant process of determining the source of goods, the type of rebate/credit applicable, and claiming of rebates can simply not be handled by small municipalities."

MUSH institutions will have to keep track of two types of inputs, those that are taxed and those that are zero-rated or exempt, and of two types of supply — taxed (at zero percent or at the full GST rate) and exempt. Commercial undertakings such as a university bookstore or municipal cafeteria will have track purchases so that GST input credits can be claimed at a full rate. School boards will have to determine which adult education courses are to be taxed, and at community centres, municipalities will have to charge GST on the fee for recreation courses to teenagers and adults, but remember to exempt those who are disabled or disadvantaged.

The major problem for MUSH institutions appears to lie not in calculating the value of GST on purchased inputs, or reckoning the value of taxable supplies for GST, but in segregating inputs that are used in making taxable supplies in order to qualify for full GST input credits. Given the complexity this entails, it is worth looking for an alternative approach to the GST for the MUSH sector which would preserve federal revenues but be easier to operate.

One such solution is to zero-rate sales to the MUSH sector. This would result in a substantial loss in federal revenue, however, and for reasons given in the previous chapter is not a solution the Committee would support. Similar objections apply to the creation of a low rate of tax for the MUSH sector, because the compliance and administration problems

are similar whether a supplier sells to a MUSH institution at a zero rate or at a special low rate of GST.

One solution which would simplify the administration of MUSH institutions without cutting into sales tax revenue would be to charge MUSH institutions GST in the normal way, but to rebate 100% of GST paid rather than 75% or 80%. Since this would cost the federal treasury close to $1 billion in revenues, the federal government would adjust its transfer payments to the provinces to offset the loss of GST from the MUSH sector. The provinces in their turn would adjust their payments to MUSH institutions to make up the loss of transfer payments from the federal level.

A system of 100% rebates on GST paid on purchases would greatly simplify accounting for the tax. Input tax credits would not have to be tracked and matched to commercial supply to gain a full refund. MUSH institutions are already familiar with their provincial governments and would negotiate at that level regarding the adjustments in provincial support needed for this plan to work.

The Committee has discussed this proposal with organizations representing the four MUSH sectors and has had a mixed response. The hospital sector, which is funded almost wholly through provincial support under medicare, reacted favourably. The school and municipal sectors were negative, fearing that they stood to lose more from reductions in provincial grants under this proposal than they would save through the raising of the rebate rate to 100%.

This plan would require special arrangements in the province of Quebec because for the past 10 years, municipalities in that province have been autonomous and independent of provincial financial support. Larger school boards in Ontario and British Columbia are also financially autonomous and receive no provincial grants that could be adjusted to compensate for the change in sales tax treatment.

An alternative to this proposal is the streamlined accounting system proposed in Chapter 8 for charities and non-profit organizations. This could be applied equally well to MUSH institutions, particularly when they had only small amounts of commercial supply.

The Calgary Board of Education, for example, had a budget of $398 million in 1988 of which it estimates only $1 million was commercial supply. Under a streamlined system, it would calculate its input credits on taxable supply in the following way:

1. Calculate GST payable on commercial supplies such as rentals, parking, catering and taxable adult education courses. At a 9% rate of GST, this would be worth $90,000.

2. Estimate the GST paid on inputs to provide the supply at a rate set by regulation, say 50% of the GST payable on supplies. This results in an input credit of $45,000.

3. Calculate the GST paid on all taxable purchases for the board, which amounted to $48 million. This amounts to $3,963,300. Take away the amount of the input credit on commercial supplies, which will be applied against GST payable. This leaves a net amount of GST paid, ($3,963,000 — $45,000) which is equal to $3,918,300.

4. Calculate net GST payable by deducting the input credit of $45,000 from the total payable of $90,000. This is equal to $45,000.

5. Calculate the board's rebate at the rate of 75% set in the GST legislation for school authorities on the net amount of GST paid: (75% x $3,918,300), or a total of $2,938,725).

6. The Calgary Board would then submit for a rebate of $2,938,725 less the net GST of $45,000 which it owes on its taxable supplies. In practice, of course, it submits its rebate return and GST claim monthly rather than annually.

The major benefit of this kind of system is that it saves MUSH institutions the need to track input credits on commercial supplies while preserving a reasonable measure of competitive equity with the private sector. The Committee believes this is a better alternative than providing a 100% rebate on GST paid on purchases and then making adjustments through the transfer payment system.

The AUCC proposed that there be a simplified method of rebate calculation under which GST on all purchased goods and services bought by universities would be rebated at a standard rate, whether they were to be used to supply taxable activity (a bookstore or cafeteria); exempt activity (teaching); or zero-rated activity (staff assistance to a developing country). Under this system, commercial activity such as a bookstore would receive rebate on inputs at a standard rate of perhaps 80% (in the AUCC example) rather than the standard 100%, while GST would be collected and remitted on taxable sales at the full GST rate.

This approach would greatly simplify accounting in the MUSH sector, but could be unfair to those institutions which have a relatively high proportion of taxable activity in their operations. While it could be offered as an option, the Committee prefers instituting a streamlined accounting system along the lines outlined above.

The Committee recommends:

67. **That the Departments of Finance and of National Revenue work with MUSH institutions to develop a streamlined accounting system that will simplify their accounting for the net amounts of GST payable on their taxable supplies.**

The Committee believes this recommendation would contribute in a major way to reducing the administrative complexity and costs of the GST in the MUSH sector.

The FCM also expressed concern at the added costs to municipalities of paying provincial sales taxes on top of GST which is subsequently rebated. This issue is related to the

"tax on tax" issue discussed in Chapter I. According to the Federation, the added cost of the provincial tax levied on municipal inputs, because of the GST, could be as much as O.7% of the value of purchases.

The Committee notes that this would not be a problem if the two levels of government were to agree to join in a national sales tax. Municipalities are closely related to provincial governments, and the Committee believes that this problem should be resolved at the provincial level.

A number of issues raised by universities and colleges were resolved by the Department of Finance during the course of the Committee's hearings. Students not intending to proceed to a degree — or whose intentions are not known — will be able to take university courses without being charged GST, for example, provided that the courses are part of a degree-granting program. The conditions for exempting meal plans for students in residence have been relaxed. Universities have been assured that student council, library, and various other fees that are paid at registration will be exempt if the course is exempt.

The Canadian Association of University Teachers had some specific concerns with respect to university-based research. If companies paid GST on research grants to universities, the CAUT said, there would be a danger the activity would be considered as a taxable business and money meant for scientific activity would be drained away in federal income tax. University research would also be at a disadvantage to that in the private sector, because the GST paid on inputs would be only partly rebated whereas full input credits would be available for researchers in industry.

In the Committee's view, the problems for scientific research under the GST are mainly ones of perception. Major university-based research programs attracting commercial support will likely want to registered for GST in order to benefit from input tax credits. In net terms, there will be no difference on the balance sheet for a company between making a research donation to its local university without paying GST or entering into a research contract which is taxed and immediately refunded.

The McMaster Students' Union were concerned that students earning under $6,175 per year would not be eligible for the $140 additional credit provided for low-income single adults, despite the fact that many students in this income category would pay GST with money borrowed through student loans as well as with income. This issue is addressed in the Committee's proposals to reduce the rate of GST and change the proposed GST Credit.

For school boards, the administrative problems raised by the GST could reach down into the classroom. A number of activities related to education programs are likely to be considered as taxable supplies, such as the rental of textbooks, the rental of instruments to students in a school band, and the sale of car repairs or beauty treatments from high school vocational programs. An exemption may be justified for such activities when they are an incidental part of an education program.

A number of witnesses expressed concern at the impact of the GST on cash flow and related costs in the MUSH sector. In the Committee's view, this concern is not justified. A municipality with a $200 million budget and $60 million in purchases subject to GST would be liable to pay approximately $450,000 per month in GST on its purchases if the GST rate were 9%. It would be entitled to a rebate of perhaps $337,500 and if this was paid within 30 days, the municipality would suffer a continuing draw of $337,500 on its cash flow — the equivalent of O.16% of its budget. If the funds required were borrowed, the interest cost would be equivalent to 0.02% of the operating budget, or just $2 in every $10,000.

Also of concern was the provision that interest be paid on GST rebates to the MUSH sector beginning 60 days from their being filed, whereas claims for input tax credits will begin to draw interest after 21 days. As recommended earlier, the Committee believes interest on MUSH rebates should also begin after 21 days.

It was submitted that the government's pledge not to increase sales tax on the MUSH sector would require exemption from the impact of any future increase in the GST. The committee does not accept this contention.

In the past, exemptions from federal sales tax brought the effective federal sales tax rate on MUSH institutions down to a very low level; but if the tax was raised by 10%, i.e. from 10% to 11%, then the federal sales tax borne by the institution would also rise by 10%, for example from 1.6% to 1.76%. The rebate formula in the TP will result in a percentage of rebate which will preserve each MUSH sector's relative position. Hence an 11% rise in the general rate of GST would result in an 11% increase in the institution's much lower net rate of GST, just as under the current system.

Under the rebate system proposed in the Technical Paper, MUSH institutions will have net rates of GST in the 2% to 3% range if they contract out services such as catering and cleaning, and would pay a net rate of perhaps O.5% to 1% if they perform the service in-house. As discussed earlier in this report, the Committee does not believe that tax differentials such as this represent any significant competitive distortion or incentive to self-supply.

The federal government intends to pay GST rebates directly to eligible institutions rather than to the provincial governments, despite the request of certain provinces (notably New Brunswick) that they receive the rebates first. New Brunswick's argument is that direct payment of the rebate will lead to the perception that provincial support for institutions is down (because it is worth 9% less due to GST) while federal support is up (because of payment of the 4.5% rebate). It can be argued in response that the federal government currently collects some federal sales tax from these institutions, and that the tax/rebate system is simply a means of maintaining the federal tax at about the current level.

A number of institutions expressed concern about how rebates will be paid on broader grounds. If rebates of GST paid by the MUSH sector were channelled back to institutions via the provinces, they said, the provinces might divert the rebates and use them for other purposes while the MUSH institutions bore the increased costs of paying GST on all their

purchases. Such a change from the Technical Paper proposal was strongly opposed. The Committee agrees, and recommends:

> **68. That, as proposed in the Technical Paper, rebates of GST paid on purchases be paid directly to MUSH institutions rather than being paid through provincial governments.**

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65. that, as proposed in the Technical Paper, rebates of GST paid on purchases be paid directly to MUSH institutions rather than being paid through provincial governments.

10. INDIANS AND INDIAN BANDS

Under Section 87 of the *Indian Act* Indians are exempt from federal taxation on their personal property situated on a reserve, as well as their interest in reserve or designated lands.

However, the precise scope of this exemption raises several questions of interpretation under the *Indian Act*; does the exemption apply to services as well as goods? does the exemption apply to purchases made off a reserve? do some Indians have rights to an exemption by virtue of certain existing treaty rights over and above the provisions of the *Indian Act*?

The Technical Paper has made no proposals in this area but indicates the government will wish to consult with representatives of the Indian community.

The Committee heard from many Indian leaders across Canada with respect to these issues as well as from businesses concerned with the tax treatment of Indians.

It was represented to the Committee by Chief Roland Crowe of the Federation of Saskatchewan Indian Nations that the best method to ensure compliance with s. 87 of the *Indian Act* was to provide that upon presentation of a card or certificate proving status as a registered Indian vendors would be allowed to waive collection of GST on the sale of otherwise taxable goods and services. Such a system using "exemption cards"is followed by several provinces in relieving Indians of provincial sales taxes and given that the GST will now make federal sales tax visible at the point of sale such a system could also be adopted by the federal government.

However a system of exemption cards does raise several problems. Firstly, this system would arguably go beyond the provisions of Section 87 in that it would exempt all persons showing proof of Indian status wherever they made a purchase whereas Section 87 may, arguably, apply only to purchases that occur on reserve property.

Secondly, an exemption card system can create administrative problems for retailers. The Committee was told by representatives of the Hudson Bay Northern Stores that where retailers operate on a reserve or near a reserve it is often difficult to determine among many native people who is a "carded" status Indian and who is not, especially when many native customers often do not bring their card. As well, many younger people do not have an exemption card and this creates further difficulties. In addition to these problems in stores on or near reserves, it was pointed out that in many larger urban areas retailers are not familiar with exemption card systems since they do not encounter them as frequently. This naturally causes further problems for such retailers.

Thirdly, provincial retail taxes are calculated on a tax extra basis, that is, tax is calculated separately at the point of sale on the price of goods. Thus retailers presented with a provincial exemption card simply do not add on the provincial tax to the price of goods. But under the GST retailers are given the option to sell either tax extra or tax included. For retailers selling tax included, that is, selling with tax already included in the price of goods before the final sale, the presentation of an exemption card would require them to perform a calculation at the point of sale in order to back out the GST component from the tax included price of goods. Clearly this would impose a considerable burden on those retailers using the tax included option.

Finally, apart from these administrative considerations the Committee also heard representation from Indians during its hearings in the Yukon and the Northwest Territories that exemption cards attached a social stigma to Indians in that they were treated in one manner at the cash register while all other customers were treated in differently.

Another approach for relieving the imposition of GST on Indians was put foward by the Hudson Bay Northern Stores. They suggested that the tax apply universally to all customers but that status Indians be allowed a credit through the income tax system to fully reimburse them for any GST paid. Thus the need for a point of sale exemption would be eliminated. Under such a system Indians would remain eligible for GST credits but would be allowed an additional top up for any GST paid over and above the normal credit. Since such a system would be administered through the income tax act it would also provide a check on abuse of the s. 87 exemption as refund claims for the sales tax paid on purchases could be cross checked against declared income. Like the exemption card system this approach would also require a determination as to whether the s. 87 exemption was intended to apply to purchases by status Indians off the reserve.

The Committee also heard representations from the Council of Yukon Indians and the Dene-Metis Secretariat with respect to the impact of GST on their land claim negotiations.

The Dene-Metis Secretariat stated that the s. 87 exemption will not apply to their land claim settlements as it does to other Indian reserves. They represented that any GST exemptions extended under s. 87 should also extend to Dene-Metis settlement lands.

The Yukon Council of Indians represented to the Committee that in their preliminary land claim negotiations with the Government of Canada they had agreed to forgo any recourse to s. 87 as a condition of their land claim settlement. However, they made this undertaking on the understanding that s. 87 would not confer any advantage on status Indians under the GST. In the event s. 87 does confer special benefits on status Indians they represented to the Committee that they would seek greater compensation under the terms of their settlement if recourse to s. 87 were to be relinquished.

11. FINANCIAL SERVICES

A) Exempt Treatment of Financial Services

The Technical Paper proposes to "exempt" the supply of financial services to consumers and businesses and to "zero-rate" the supply of financial services to non-residents. Consequently, GST will not be payable on the consideration paid for receiving a financial service, such as interest paid by a borrower on a consumer loan or interest paid by a bank in respect of monies held on deposit, whether the supply is made by a consumer, a financial institution, or any other business. Moreover, financial institutions generally will not be entitled to recover input tax credits with respect to any property or services they purchase for use in making an exempt supply of financial services. Under the Technical Paper, input tax credits would be allowed to financial institutions, however, for the taxes paid on purchases used in making taxable or zero-rated supplies. The definition of "financial services" and the allocation rules for income tax credit entitlement purposes are discussed below.

(i) Why Exempt Financial Services

The decision by the Department of Finance to propose "exempt" treatment of financial services was driven by the technical difficulty in treating financial intermediation services as a taxable supply.

For most services, the "value added" can be measured as the difference between the amount charged by the supplier for the service and the cost of any goods and services (excluding wages and salaries) used in making the supply. In the case of financial services, however, it is virtually impossible to apply this approach to calculate the value added. For example, the value added by a financial intermediary in a loan transaction is the portion of the total charge that represents the amount the intermediary receives for supplying the "service" of bringing together a "lender" (the depositor) and the borrower. In theory, this might be calculated as the spread between the interest paid by the financial intermediary on deposits plus an allowance for credit risk and the interest it charged on the loans. In practice, however, it is virtually impossible to calculate the value added through financial intermediation in any particular transaction for a number of reasons. A financial institution may provide services without any explicit fee, such as "free" or "no-charge" chequing; the cost of such services to the purchaser may be an "implicit" charge recovered, without being identified specifically, by reducing the interest otherwise payable on deposits. Moreover, financial intermediation transactions may be funded through a variety of sources (e.g., demand deposits, interest-bearing savings accounts, guaranteed investment certificates), making it difficult or impossible to identify the specific interest expense incurred by a financial institution in making a particular loan.

Since the value added in any particular financial intermediation transaction cannot be identified with certainty, it is not practicable to treat these transactions as taxable supplies under the GST.

(ii) The "Margin" Tax Proposal

The Department of Finance has indicated that the so-called "margin tax" on financial intermediation services determined on an aggregate basis, as outlined in the June 1987 White Paper, was flawed and that it is not practicable to proceed with such a proposal at this time. A number of financial institutions concurred with this view, including the Canadian Life and Health Insurance Association Inc. and the Trust Companies Association of Canada. Others, such as the Canadian Bankers' Association, referred to the Department of Finance's comments by way of background without commenting on the feasibility of correcting the perceived deficiencies in the margin tax proposal. No financial institution, however, proposed returning to the "margin tax" in place of the exempt treatment of financial services proposed in the Technical Paper.

Recognizing the technical difficulties inherent in treating financial services as taxable supplies, the Committee concurs with the Technical Paper proposals to treat financial intermediation and related financial services as exempt supplies.

B) Definition of "Financial Services"

Having determined that financial services would constitute an exempt supply, it becomes necessary to determine which of the services supplied by financial institutions should be exempted as "financial services" and which should be categorized as "taxable" or "zero-rated" supplies.

The Technical paper identifies two competitive equity considerations to be balanced in determining which services are to be included in the tax-exempt category of financial services:

The range of services to be exempted as financial services has been formulated by balancing the following competitive equity considerations:

- On the one hand, the range of exempted services shoud be narrow in order to preserve tax neutrality with other equity considerations.

- On the other hand, services which are closely related to the intermediation process should be exempt to minimize the incentive to combine these fees with interest charges in an effort to avoid the tax.

The Technical Paper goes one to provide examples of taxable supplies and exempt supplies by sector for banks, trust and loan companies and financial co-operatives; life and property and casualty insurers; and investment dealers.

(i) Property and Casualty Insurance

The Committee received only one specific request for reconsideration of exempt treatment. The Insurance Bureau of Canada and The Laurentian Group Corporation, among others, requested that the Committee recommend that property and casualty insurance services be treated as a taxable supply instead of an exempt supply.

The Insurance Bureau of Canada submitted that the proposed exempt treatment of property and casualty insurance services will substantially increase the operating costs of the industry by denying input tax credits for the tax payable by an insurer in respect of payments it makes for the repair or replacement of property loss or damage. It was submitted that the resulting higher cost in claims settlements will be passed through to businesses and consumers in the form of higher insurance premiums. It was further submitted that this is an inappropriate result, because a business that itself paid to replace or repair property used in making a taxable supply would obtain a full input tax credit.

The Insurance Bureau of Canada also told the Committee that the proposed exempt treatment of property and casualty insurance could result in compliance problems in allocating inputs between exempt and zero-rated supplies (ie., exports) and would create a bias in favour of unlicensed non-resident insurers.

It was pointed out by several witnesses that the government of New Zealand, when it enacted a goods and services tax, treated property and casualty insurance as a taxable supply.

As we understand it, the denial of input tax credits in respect of payments by an insurer for the repair or replacement of property arises from the manner employed to settle loss or damage claims. To control the cost of claims, the property and casualty insurance companies make payments direct to suppliers of replacement property or repair services. The insured who is a registered vendor could claim an input tax credit where the goods are used in making taxable supplies if payments were made by the insurer to the insured under the insurance policy and the insured paid for the replacement or repair of property. The Insurance Bureau of Canada argued, however, that such a change would result in substantially inflated costs for the repair of damaged goods.

The Committee is sympathetic to the industry's request for taxable treatment of property and casualty insurance. However, the Committee notes that a significant element of an insurer's business is the investment of the funds it receives as premiums. It would, in the Committee's view, be inequitable to grant the tax relief requested by property and casualty insurers unless this financial intermediation activity can be taxed in a manner equivalent to that applicable to financial intermediation activity carried out by other financial institutions.

Moreover, it is not entirely clear that an alternative approach, such as allowing a registered business carrying insurance to claim an input tax credit by treating the insurer's payment as a payment paid by the insured for the replacement property or repair services, would not respond more appropriately to the problems raised by the property and casualty insurance industry. The Committee therefore accepts the Technical Paper proposal to exempt property and casualty insurance services.

The Committee therefore recommends:

69. That the Department of Finance give consideration to the appropriate means by which input tax credits on business inputs supplied to registered vendors pursuant to a property and casualty insurance policy could be allowed.

(ii) Gold, Platinum and Silver Coins

The Technical Paper proposes that the initial supply of "investment quality precious metals" by domestic refiners be zero-rated. Similarly, the importation of investment quality precious metals would not be subject to tax on importation. Subsequent supply of investment quality precious metals for investment purposes would be taxed in keeping with the exempt treatment afforded to investments in financial instruments.

To qualify for treatment as investment quality, the precious metal would have to be in the form of a bar, coin, or wafer and would have to be refined to a purity level of at least 99.5% for gold and platinum and; 99.9% for silver.

The Committee received a representation from the Canadian Association of Numismatic Dealers (CAND) that the effect of setting those purity levels would be to deny exempt treatment to most investment grade coins other than the one-ounce gold Canadian Maple Leaf and the one ounce silver Canadian Maple Leaf. CAND stated that many gold and silver coins trade entirely on their bullion value and on the same investment criteria as Maple Leaf coins but that those coins falling below the purity levels set out in the Technical Paper would be fully taxable. This discriminatory tax treatment would drive much of the investment coin market underground. Moreover, the discriminatory tax treatment between Maple Leaf coins and, for instance, U.K. Britannia and U.S. Eagle coins could invite allegations of unfair trade practices.

CAND requested that the criteria for the exempt treatment of investment quality precious metals be amended to include an exemption for gold and silver bars, coins and wafers where the premium charged over the intrinsic value of the precious metal did not exceed 15% of the precious metal's market price as established by the Handy and Harman (Canada) noon quotation for gold and silver.

The Committee is concerned that the proposed criteria put forward by CAND could present difficult audit and compliance problems as it would make the sale of a particular coin taxable or exempt, at any particular time, depending upon the spot price of precious metals at that time. The Committee is concerned, however, that the

proposed standard, in the case of coins, could invite allegations of discriminatory treatment.

Through representations from CAND and through consultations with the Royal Canadian Mint the Committee has learned that numerous investment grade gold coins would fall below the proposed purity level of .995/1.000 fine and be ineligible for an exemption. These include:

United States one-ounce Eagle (.9166/1.000)
United Kingdom one-ounce Britannia (.9166/1.000)
Mexico 1.205-ounces 50 peso (.9000/1.000)
United Kingdom .2325-ounce gold sovereign (.9166/1.000)

In addition, numerous investment grade silver coins would also fall below the proposed purity level of .999/1.000 fine. These include:

Canadian 1966 and prior silver coin .800/1.000
United States 1964 and prior silver coin .900/1.000
Canadian 1976 Olympic coins .925/1.000

Consultations with the Royal Canadian Mint have confirmed that most numismatic coins purchased as collectibles have a bullion content of no more than 50% to 65%, whereas coins purchased for investment as precious metals have a bullion content of at least 90%.

The Committee therefore recommends:

70. That the definition of investment quality precious metal be amended to include gold and silver coins with a purity level of at least 90%.

C) Definition of "Financial Institution"

The Technical Paper indicates that "the proposed rules for financial services will primarily affect a specific group of registrants — such as banks, trust companies, insurers, financial cooperatives and investment dealers — since the vast majority of financial services are provided by these institutions". The Technical Paper states that virtually all businesses are engaged in financial activity to some extent but for most firms these activities are only ancillary to their other activities.

The Technical Paper provides that registrants will not be required to allocate inputs to any supply of financial services where the annual revenue of an income nature received for the supply of financial services is less than $10 million and less than 10% of the total annual revenue from all supplies. In the result, registrants falling outside this *de minimis* rule would receive a full input tax credit for the tax paid on good and services used in making exempt supplies of financial services.

The Technical Paper contemplates that there would not be an explicit definition of a financial institution.

The Draft Legislation, however, contains a specific definition of a financial institution that goes beyond the *de minimis* rule described in the Technical Paper. Under the proposed definition of a financial institution set out in the draft legislation, a person will be a financial institution if it meets any one of the following three tests.

Under a "status" test a person will be a financial institution if, throughout the taxation year, it is a bank, trust company, credit union, caisse populaire, investment dealer, stock broker or insurance company. This test should include most persons licensed or regulated as financial intermediaries.

Under the "principal business" test a person is a financial institution if throughout the taxation year its principal business is lending money or purchasing debt securities or a combination of these.

Finally, under a "revenue" test, in very general terms, where a person's "financial" revenue for the preceding year exceeds 10% of the person's total revenue or $10 million, the person will be deemed to be a financial institution. More specifically, under this test, a person is a financial institution for a particular taxation year if:

(i) the total amount included in computing the person's income from a business, for purposes of the Income Tax Act, for the immediately preceding taxation year that is interest, a dividend (other than a dividend in kind), or a separate fee or charge for a financial service exceeds either:

(ii) 10% of the total of the aggregate described in (i) and the aggregate value of all consideration that became due in the preceding taxation year, or that was paid in that preceding taxation year without becoming due, to the person for supplies other than supplies by way of sale of capital property of the person or supplies of financial services made by the person, or

(iii) $10 million (pro-rated to a lesser figure for a short taxation year).

The Committee agrees that for reasons of competitive equity, it is appropriate that the term financial institution extend not only to regulated entities but to persons whose principal business is providing financial services. We question, however, the need to preserve the entire *de minimis* rule contemplated in the Technical Paper in light of the inclusion of a principal business test in the draft legislation. The Committee believes that the term financial institution should be defined so as to include only persons who can reasonably be regarded as direct competitors with financial institutions in respect of the supply of financial services. We are concerned that the *de minimis* rule proposed would include holding companies and other corporations that cannot reasonably be regarded as competing with financial institutions.

The Committee believes, as a general principle, that it is appropriate to include within the term financial institution any person whose gross income from interest and dividends included in income from a business for Canadian income tax purposes exceeds $10 million. In this regard, assuming an average rate of return of 10% per annum, this test would generally apply only to persons with interest — or dividend-yielding investments in excess of $100 million. However, given that this rule is intended to bring within the meaning of financial institution persons competing directly with other financial institutions, the Committee believes that in computing gross income for the purposes of the revenue test, interest and dividends received from related persons should be excluded.

The Committee also questions the need for the 10% rule given that a principal business test already exists. The 10% rule creates a hairline trigger that could produce anomalous results for holding companies and for corporations with short taxation years. Moreover, the Committee seriously questions whether, for example, a corporation with $10,000 of interest income from investments in term deposits or second mortgages, but whose principal business is not lending money or dealing in debt obligations, can be regarded as a competitor with financial institutions. The Committee believes there is a serious risk that, contrary to the intention of the Technical Paper, the 10% rule could apply to persons whose financial services activity is merely ancillary to their other business activities. In the Committee's view, the inclusion of such persons within the definition of a financial institution is not warranted.

The Committee therefore recommends:

71. That the 10% rule should be rescinded and a revenue test should apply to persons whose annual revenue in the immediately preceding taxation year, in the form of interest and dividends received from unrelated persons and required to be included in income from a business for Canadian income tax purposes, exceeded $10 million, or a pro-rata amount for a short taxation year.

D) Allocation Rules for Input Tax Credit Entitlement

The Technical Paper indicates that registrants will allocate inputs between their use in making taxable and zero-rated supplies and exempt supplies using a method suitable in the circumstances, with the method to be subject to audit by Revenue Canada. It states further that prior to implementation the government will be providing guidelines with illustrative methods for allocating inputs for the purpose of claiming input tax credits.

Registrants who fall outside the definition of a financial institution, discussed further below, will not be required to allocate inputs to any supply of financial services.

The Canadian Bankers' Association requested that the Committee recommend that the allocation rules for determining input tax credit entitlement be administratively simple to reduce compliance costs for financial institutions. The Draft Legislation provides that where substantially all of the use or intended use of a property or service is in a commercial activity (i.e., a taxable supply), it will be regarded for GST purposes as being used exclusively in a commercial activity.

The Technical Paper proposes that for both real property and capital goods, input tax credits be allowed to the extent such properties are acquired for use in making taxable or zero-rated supplies under the proposed change-in-use rules; however, a "significant" change of use of real property or capital goods by a financial institution may trigger a further input tax credit where the use in making taxable or zero-rated supplies increases, or a tax liability based on the fair market value of the property at the time, where its use in making exempt supplies increases.

The Draft Legislation proposes that, for the purposes of the change-in-use rules, a change in the use of property from use primarily for one purpose to use primarily for another purpose is not insignificant, but any other change of less than 10% of the total use of the property is insignificant.

The Canadian Bankers' Association represented to the Committee that input tax credits should be recoverable by all businesses, including banks, to avoid an indirect form of taxation, cascading and the possibility of double taxation. The Laurentian Group Corporation stated that that life insurance should be zero-rated, "so that savings inherent in life insurance products would not have to bear the GST", and that for banks and trust company services, "the list of tax-exempt services [should] be revised to ensure that the GST on inputs will be fully absorbed by taxes on services so as to eliminate the possibility of the cascading effect of any unrecoverable taxes on inputs".

The Committee believes that, in an ideal system, the value added in supplying financial services should be fully taxable, with full input tax credit entitlement to both the financial institution and any registered business receiving such supplies. However, given that the technical difficulty of designing such a tax led to the adoption of exempt treatment of financial services, the Committee does not believe it follows that the input tax credit entitlement rules should be established in such a way as to permit financial institutions to receive an input tax credit for all inputs, including those used in making exempt supplies of financial services. This would amount to zero-rating the supply of financial services.

The Committee believes it is appropriate for the financial services sector to bear its fair share of tax and that the proposed denial of input tax credits relating to the supply of exempt financial services is therefore entirely appropriate.

The Committee is concerned that financial institutions may structure their affairs to avoid any disallowance of input tax credits in respect of supplies they use to make exempt supplies and that considerable audit and compliance costs will arise for both government and industry. The Committee therefore proposes that the right of financial institutions to allocate a taxable supply purchased by it to the taxable supplies it makes for input tax credit entitlement purposes should be restricted to where substantially all of the purchase supply is used in making taxable supplies. Nevertheless, to avoid harming the global competitiveness of the industry, the Committee would permit financial institutions to claim a pro-rated input tax credit for supplies used in making exported services.

The Committee therefore recommends:

72. That, unless substantially all (i.e., 90%) of a taxable supply purchased by a financial institution is used by it in the course of making a taxable supply, the input tax credit entitlement of such financial institution be limited to the portion of the purchased taxable supply that can reasonably be considered to have been used by it in making zero-rated supplies described in Part IX of Schedule II.

E) Group Relief for Inter-Company Transactions

The Technical Paper proposes no group relief for inter-company transactions within a related group of companies. Consequently, the value added in supplies between related members of a group will be subject to GST unless the supplies are otherwise exempt or zero-rated. This is of particular concern to financial institutions because they will be denied input tax credits with respect to goods and services purchased for making an exempt supply of financial services.

The Technical Paper does recognize that special rules may need to be developed in limited circumstances, such as for data processing services, and goes on to state that discussions with the affected financial institutions will be held.

The Committee received various representations from financial institutions, including the Canadian Bankers' Association, the Canadian Life and Health Insurance Association Inc., The Laurentian Group Corporation and the Trust Companies Association of Canada, requesting that group relief rules be adopted.

Under true group relief rules, for the purpose of determining input tax credit entitlement, inter-company transactions are ignored. Instead, input tax credit entitlement would depend upon the nature of the supply made by the purchaser company. Since the purchaser company may in turn perform a service for another related company, it may become necessary to look through a series of transactions between related companies to determine the input tax credit entitlement of the first supplier.

The Committee is sympathetic to the request of the financial services industry for group relief rules, and recognizes that competitive inequities may result if no group relief rules are adopted. It is concerned, however, about the lack of detail with respect to input allocation rules and the possibility that, as in Europe, group relief rules could permit tax avoidance.

The Committee therefore recommends:

73. That the Minister of National Revenue be permitted to grant group relief to particular named corporations with respect to specified types of transactions with financial institutions (including data processing, management, accounting and administrative services).

F) Relief for Transactions Between Credit Unions and Between *Caisses Populaires*

The Committee received representations from the Canadian Cooperative Credit Society and the *Fédération des Caisse Populaires et d'Économies Desjardins* to the effect that a group relief rule would not give proper GST relief to these sectors of the financial services industry. The Committee was told that credit unions and caisses populaires are structured along co-operative lines under which unrelated entities within a federation perform services for each other. It was submitted that treating these transactions as taxable supplies would result in aparticular hardship and competitive inequity to credit unions and *caisses populaires* because of the lack of integration in these sectors, as compared with Schedule A banks, which would generally operate on a branch basis throughout Canada.

The Canadian Cooperative Credit Society requested that transactions between credit unions be tax-exempt. Similarly, the *Fédération des Caisses Populaires et d'Économies Desjardins* requested that transactions between financial institutions be tax-exempt.

The Committee therefore recommends:

74. That, if group relief is provided for transactions between financial institutions and related corporations, comparable relief should be extended to transactions between *caisses populaires* and credit unions with like institutions that form part of a federation.

G) Self-Supply Bias

The Committee received representations from various witnesses to the effect that financial institutions may have a strong incentive to self-supply services used in making exempt supplies of financial services. Since wages and salaries are excluded from GST, a financial institution could minimize its GST liability by self-supplying services instead of purchasing these from third parties.

While zero-rating, instead of exempting, financial institutions would remove any incentive to self-supply, it would also eliminate any tax liability for this sector. Such a proposal should be coupled with some other form of taxation, such as a capital tax, which would result in the financial services sector bearing a fair share of tax.

Another approach would be to impose a tax on the self-supply of services by financial institutions. The first difficulty in legislating such a tax would be identifying where competitive considerations would require a tax on self-supply to be imposed. One would not, for example, expect a bank to be liable, under a self-supply rule, for tax on a bank teller's services. How would one distinguish, for purposes of a self-supply rule, between the services performed by bank vice-presidents and those performed by outside consultants? Should the self-supply of cleaning services be taxed?

A second difficulty would be devising a fair rule to value the services that are to be taxed under a self-supply rule. Should the services be taxed at their fair market value; if so,

how would one determine this amount? Should they be valued at an amount equal to the direct labour cost or include amounts for indirect labour and for profit?

The Committee recognizes that, given the exempt treatment of financial services, financial institutions may choose to self-supply certain services. It should be recognized, however, that in many areas there will be offsetting disadvantages to the self-supply of services. For example, a financial institution might attempt to reduce its GST liability by bringing cleaning services in-house, but in so doing it would incur employment obligations to the cleaning staff, as well as compliance costs, the total cost of which might exceed the tax savings.

The Committee therefore recommends:

75. That no self-supply rule be enacted for financial institutions.

The Committee is concerned, however, that certain suppliers, such as property and casualty appraisers/adjusters, are so integral to the operation of property and casualty insurance companies that for the purposes of the GST they should be regarded as employees or agents of such companies.

The Committee therefore recommends:

76. That all supplies made by a property and casualty appraiser or adjuster who performs all of his or her services for one or more property and casualty insurance companies be treated as an exempt supply.

H) Transitional Rules

The Committee received representations requesting transitional rules with respect to two areas relating to financial institutions.

(i) Supplies of Financial Services

Several witnesses, including the Canadian Bankers' Association and the Canadian Life and Health Insurance Association, requested that long-term contracts for the supply of financial services, such as mortgages and life insurance policies that straddle January 1, 1991 be treated as zero-rated supplies instead of exempt supplies. It was submitted that exempt treatment of such supplies would be inequitable because financial institutions would be unable to reprice the supply of financial services under such contracts to take into account the denial of input tax credits on goods and services acquired for use in making such supplies; consequently the GST paid by financial institutions in making such supplies would have to be recovered from customers entering into contracts after January 1, 1991 or reflected in lower profits. Either result, it was submitted, would be inequitable.

The Committee notes that financial institutions had notice no later than August 8, 1989 of the government's intention to extend exempt treatment to financial services supplied by financial institutions and therefore to include appropriate language in their contracts to permit them to adjust pricing if the government proceeded with the proposed GST. The

Committee therefore believes that no transition relief is warranted for contracts entered into after August 8, 1989.

No evidence was presented to the Committee with respect to the level of inputs that would be used by a financial institution in making supplies of financial services under contracts entered into before August 8, 1989. The Committee is not satisfied that the level of input tax credits relating to the supply of financial services under contracts made before August 8, 1989 warrants relief in the form of zero-rated treatment.

Moreover, the Committee is concerned that if services supplied under contracts entered into before August 8, 1989 were permitted to be characterized as zero-rated supplies, this could result in financial institutions receiving an excessive input tax credit entitlement in respect of inputs relating to services supplied under contracts entered into after 1990, by increasing the relative proportion of a financial institution's revenue that is derived from making zero-rated supplies.

The Committee therefore recommends:

77. That supplies of financial services made under contracts entered into before January 1, 1991 not be zero-rated.

(ii) Supplies Under Lease Contracts With Financial Institutions

The Committee received representations from the Equipment Leasing Association of Canada and the Trust Companies Association of Canada requesting that supplies made under leasing contracts entered into with a financial institution before January 1, 1991 be treated as tax-exempt supplies for GST purposes. It was represented that federal sales tax will have been paid on the acquisition of the capital goods that are the subject of such leases. The Committee was told that under the Technical Paper proposals, financial institutions may have an incentive to buy out such leases or convert them to conditional sales contracts before January 1, 1991 to avoid the application of GST to lease payments after that date.

As noted in Chapter 12, the Committee recommends that all leases of goods that are subject to federal sales tax and that were entered into before January 1, 1991 be given exempt treatment until December 31, 1993. This would permit equipment lessors to continue leasing to financial institutions until January 1, 1991. It is possible that financial institutions would enter into leases before the end of 1990 in order to avoid the non-creditable GST that would apply to such leases after 1990. However, since the equipment leased in 1990 would bear federal sales tax and the alternative for financial institutions would be to purchase the capital goods outright, the Committee does not believe this is a compelling argument against exempting such leases. The proposed exempt treatment should not be extended to real property since no federal sales tax is exigible with respect to such property.

12. TRANSITION

This Chapter reviews the Technical Paper proposals to provide federal sale tax ("FST") relief and timing rules for transactions straddling the start-up date to the goods and services tax ("GST") system. It discusses witnesses representations and the Committee's deliberations, conclusions and recommendations regarding potential demand shifts, double taxation and increased contact costs. Transitional measures to ease compliance are contained in Chapter 4.

A) Technical Paper Proposals

No specific transitional rules are proposed in the Technical Paper for contracts, including leases, straddling implementation, or capital purchases prior to January 1, 1991 or commercial buildings under contruction on January 1, 1991. However, several special arrangements are proposed to provide relief on transition for certain inventories and residential buildings under construction on January 1, 1991. Timing rules, in the context of transactions straddling the GST implementation date, are also outlined.

Taxable entities holding inventories of new and unused, FST-paid goods on January 1, 1991, will be entitled to a refund approximating the FST content of such goods where the goods are held in Canada for resale or lease. Included in the definition of new and unused goods for resale will be rebuilt and remanufactured goods, and new and unused contractors' building materials. Building materials that have been delivered to a job site will not qualify for the rebate. Recognizing that, in most cases, traders would have no knowledge of the actual FST content of their inventories, the Technical Paper proposes the estimation of tax content by use of prescribed formulae "suitably modified". No details regarding the process of estimation are provided.

A rebate of FST content will also be available on new single semi-detached and attached homes, where the purchaser has entered into a written agreement of purchase and sale prior to January 1, 1991 and takes possession for occupancy prior to March 31, 1991. The rebate will be paid to the purchaser and the amount will depend on the month during which the purchaser takes possession. The rebate will be 3/4 of the estimated FST per square foot if possession takes place in January, 1991, and 1/2 of the estimated FST per square foot if possession takes place in February, 1991. In the case of new condominium and rental apartment buildings under construction, the amount of FST rebated will depend on the actual degree of completion on January 1, 1991. It will be capped at 3/4 of the estimated FST content if the building is more than 50 percent completed and 1/2 of the estimated FST content if the building is between 25 and 50 percent completed. It appears this rebate would be paid to the developer/owner.

Generally, transactions entered into subsequent to December 31, 1990 will be subject to GST, while transactions entered into and completed prior to January 1, 1991 will not be

subject to GST. Transactions entered into prior to 1991 and completed subsequent to 1990 will, in most cases, be subject to GST, albeit on a modified basis. For transactions straddling the start-update, the date of delivery or passage of title will generally determine whether GST applies. In the case of taxable supplies of real property, the date on which ownership or possession transfers will determine whether GST will apply. In the case of imports, the date of "release" of the goods from Canada Customs will be the determinant. Where a prepaid taxable service is substantially completed before the end of 1990, GST will not apply. Where a prepaid taxable service does not meet this criteria, tax GST will apply on a pro-rata basis. There are four overriding exceptions to the general timing rules in the context of transactions straddling the start-update. Generally, these exceptions are:

(i) simply issuing an invoice prior to 1991 for a supply occurring in 1991 will not avoid a liability for GST;

(ii) the normal FST rules will apply if goods currently taxed are delivered, or the title to the goods is transferred, prior to January 1, 1991;

(iii) no GST will apply if delivery or title transfer of goods not currently subject to FST occurs prior to January 1, 1991, and the vendor issues an invoice for the supply prior to March 1, 1991. This rule does not apply to lease payments for real or personal property, construction progress payments and telecommunication services; and

(iv) payments to suppliers by corporations, partnerships and sole proprietors after August 31, 1989, in respect of goods to be delivered or services to be performed after December 31, 1990, will be subject to GST. Special rules are provided to determine whether the purchaser is required to self-assess or the vendor is required to collect the GST. If the payment by the purchaser is made prior to April 1, 1990 (and after August 31, 1989), the tax will be payable on a self-assessing basis on January 1, 1991. If the payment by the purchaser is made after March 31, 1990 and before January 1, 1991, the vendor will be required to remit the tax with his first GST return.

Lease payments made after January 1, 1991 will be subject to GST. Progress payments after December 31, 1990 in respect to commercial construction will also be subject to GST. Progress payments made prior to January 1, 1991 will not attract GST provided they are reasonably related to the percentage completion of the project at the time the payment is made. The normal FST rule will apply to all billings to users of telecommunications services and telecommunications programming services covering periods commencing prior to 1991 and ending before February 1, 1991. Billings for telecommunications services in respect of periods either beginning in 1991 or ending after January 31, 1991 will be subject to GST.

B) Witnesses' Representations

Many witnesses, including the University of Toronto Policy Analysis and the Economic Council of Canada represented a lower GST rate would ease transition. Also, many witnesses

represented the transitional rules were inadequate. Some had general concerns and recommendations others had more specific representations.

Witnesses, including the Retail Council of Canada, represented the need for sufficient lead time to implementation from the date the details on GST are finally and firmly established. The Hudson's Bay Northern Store Inc., represented the timetable, from the tabling of the legislation to the implementation of the legislation, was too short. The Federated Co-operatives Ltd. represented there should be a one year lead time to implementation after Royal Assent.

The Tax Executive Institute Inc. was concerned about lack of transitional relief for long-term contracts which are tax exempt, the necessity of apportioning GST on such things as maintenance contracts that expired during 1991, and the lack of FST relief for unused goods on hand at December 31, 1990.

Other witnesses represented the potential for tax cascading and increased costs on construction contracts. The Canadian Institute of Chartered Accountants, the Society of Managment Accountants of Canada, the Retail Council of Canada, the Canadian Manufacturer's Association and the Canadian Exporters' Association all recommended that transitional rules should provide FST relief for capital goods acquired, and leases entered into, prior to January 1, 1991. They represented a risk of negative impact on pre-1991 demand for capital investment if transitional relief was not provided. Other witnesses, including the Equipment Lessors Association of Canada and the Canadian Automotive Leasing Association, also represented the potential for tax cascading on lease payments, and a risk of negative impact on pre-1991 demand for vehicle leases to individuals and persons providing exempt supplies.

Some recommendations were made to provide relief, the most popular of which was to provide partial FST rebate during 1990 on a sliding scale (either on a refundable basis or by way of an input credit to be offset against GST collected). Alternatively, the Canadian Institute of Chartered Accountants and the Canadian Exporters Association recommended accelerating capital cost allowance on taxable goods acquired or lease during 1990, or continuing the instalment contract provisions presently contained in the *Excise Tax Act*, that is, allowing the due date to determine whether GST applies rather than making the percentage of completion the determinant. Similarly, the Tax Executive Institute Inc. recommended providing transitional relief by way of either sliding scale partial rebates, accelerated capital cost allowance or continuation of instalment contract provisions.

Other witnesses represented concerns about the transitional rules for inventory. Representations were received both about the burden of having to count and calculate a value for inventory during a very busy commercial period of the year, and about the difficulties with determining FST content. For example, the Retail Council of Canada said that inventory estimates should be allowed to calculate the amount of the refund, with adjustments to actual physical inventory on hand at the end of January, 1991. The Canadian Council of Grocery Distributers, the Retail Council of Canada and the Retail Merchants Association of British

Columbia all suggested the tax introduction date should perhaps be moved to February 1, 1991.

The Tax Executive Institute Inc. represented the government should consult with the private sector regarding factors for recovering FST buried in prices, representing the existing formulae were not sufficient. The Retail Council of Canada also represented:

a) the formulae for extracting the tax amount of tax-included inventories should be modified;

b) suppliers should be obliged from January 1, 1990 to show separately the FST included in prices so that inventory rebate amounts could be more readily determined; and

c) vendors should have the option of either an input tax credit or rebate, with interest from the date of entitlement, for FST content of inventories.

Other witnesses represented the transitional rules for new single semi-detached and attached homes should be improved. The Canadian Institute of Chartered Accountants stated:

> "Since there are to be no grandfathering rules with respect to the GST, the full 9% (subject to any GST rebate) will be collected at the time of closing. If closing does not occur until March 1991, this individual will not be entitled to any FST rebate. Furthermore, depending upon the terms of the contract the developer may not be required to lower the agreed-upon purchase price for any FST savings he will realize under the new rules."

With respect to the rules for new condominiums, the Canadian Institute of Chartered Accountants indicated they did "not believe that these proposed rebates are adequate". The Canadian Home Builders' Association also represented the transitional rules for new housing should be improved, stating:

(a) the provisions applying to housing are such that the availability of a credit for FST could be lost because of undue delays in construction due to strikes, adverse weather, material shortages or other reasons;

(b) the inclusion of townhouse projects under the single-detached house transitional measure is not reasonable since townhouse projects are more comparable in terms of construction lead times to apartment projects than single-detached homes;

(c) the proposal applying to rental apartment buildings are reasonable but should be extended to townhouse projects; and

(d) fully completed condominiums and rental buildings should be rebated 100% of the FST. The builder, not the purchaser, should get the rebate.

The Canadian Home Builders Association also expressed concern regarding the lack of transitional measures for businesses involved with the acquisition, renovation and resupply of used housing, and for unsold finished new houses and unsold new houses in progress in inventory on December 31, 1990 and built "on spec" by builders. In addition, they represented it was unfair and unnecessarily disruptive for the marketplace that a purchaser, who signs an offer to purchase a condominium prior to 1991 for closing after 1990, should be subject to GST. Therefore, GST should not apply to condominium projects where:

(i) construction has commenced or footings are in place prior to January 1, 1990;

(ii) there is a written agreement of purchase and sale entered into before January 1, 1991; and

(iii) legal transfer is effected before July 1, 1991.

The Canadian Home Builders Association represented the foregoing approach would allow many projects in progress, to avoid the application of the GST where prices may have already been fixed and units pre-sold. It suggested such projects should not qualify for a FST rebate on 1990 purchases or for GST input tax credits on 1991 purchases.

The Urban Development Institute also represented the transitional rules for new housing were too restrictive, and there could be "chaos" in the market place due to the single day implementation deadline. With respect to condominiums, they represented it takes roughly two years for a unit to be delivered, whereas a new single family homes can be delivered within three to four months. Thus, even in 1989, sales by condominium developers are subject to GST on closing, while competing sales by developers of other housing are not subject to GST.

The Urban Development Institute represented condominium sales are already being lost in 1989 because of GST proposals, at a time when the proposals have not even reached the legislative stage. In order to place vendors of condominiums and houses on roughly the the same footing, the Urban Development Institute suggested that condominium units sold prior to September 1, 1990 be given tax-exempt status and, consequently, that builders not be granted input tax credits for materials incorporated after 1990.

In addition, the Urban Development Institute, among other witnesses, expressed concerns regarding non-residential complexes, representing that to avoid double taxation in the hands of the eventual purchaser or tenant, relief of the FST imbedded in the cost of property should be provided for commercial properties under construction on January 1, 1991 and existing commercial properties. The Canadian Construction Association added its support to this recommendation. Many witnesses also represented to the Committee that completed commercial properties in use should benefit from a FST rebate, for reasons of competitive advantage with buildings completed after 1990 with regards to the sale or rental prices.

C) Committee's Conclusions and Recommendations

The Committee sympathizes with the concerns about lead time and encourages release as soon as possible of final legislation including that regarding rebate percentages, allocation methods and transition. The Committee also considered carefully the comments that a lower GST rate would ease transition. This concern was one of the Committee's reasons for recommending the lower rate of GST outlined in Part B 2. of this report.

The Committee recognizes one of the first problems concerning transition is that of the public's perception to the GST. The Committee therefore encourages education of the public, including businesses, to make transition as smooth as possible, and supports the governments efforts in this area. However, the Committee was less certain of the fairness of the other government proposals to smooth transition and especially witnesses representations regarding the unfairness of FST-paid goods being subject to GST. Because of the many representations regarding potential demand shifts, double taxation and increased costs in certain contracts straddling implementation of the GST, the Committee felt it desirable to establish some guidelines with respect to when transitional relief should be provided.

It considered the implications and possible impacts of the transitional relief lacking, and the transitional relief proposed. The Committee concluded that deficit concerns precluded relief unless direct double taxation would result. If relief was granted where no direct double taxation would occur, but only a risk of demand shift was evident, then the effect on all industries would have to be considered, not just areas of concern to witnesses who appeared before the Committee. For example, the clothing industry could experience a boom at the end of 1990 and a slow-down in early 1991, but no representations were received by this industry for transitional relief. Also, the Committee concluded that, because of revenue concerns, it could not recommend relief of FST on inputs acquired prior to the implementation of the GST. The Government cannot be expected to provide relief for cascading caused by the defects in the current FST system.

1. Capital Goods

The Committee recognizes that potential demand shifts may occur if transitional rules with respect to capital goods are not provided since capital assets purchased prior to January 1, 1991 will have both direct and indirect FST content. However, the effect on the deficit of pre-GST transitional rules must also be considered and weighed against the potential deferral of purchases.

Indications are that the sliding scale refundable or creditable FST rebate proposal suggested by a number of witnesses may have a negative revenue impact of $1.5 billion. Proposals to accelerate capital cost allowance on FST taxable goods would also involve very substantial amounts of revenue that would be difficult to accommodate during this period of fiscal constraint. The Committee was concerned about the substantial revenue loss created by these schemes.

It therefore considered many other detailed methods to ease demand shift pressure. In general terms, schemes to avoid revenue loss, make the measure to ease transition self paying and perhaps even allow further incentives or other measures during transition, included:

(a) phasing in the input tax credits on FST taxable goods purchased in 1991;

(b) granting full credit for capital goods bought after the change to the new system, however, at the same time, imposing a special investment tax on FST taxable capital goods purchased prior to implementation, and reducing by stages that investment tax over some succeeding period;

(c) granting full credit for capital goods bought after the changeover to the new system, however, at the same time, reducing capital cost allowance for a period after GST implementation on FST taxable capital goods purchased prior to GST implementation; and

(d) combinations of the foregoing schemes and the suggestion by witnesses to provide sliding scale FST rebates for 1990 purchases.

The advantage of the "phase-in" methods is that transition could be made revenue neutral, and/or additional revenue could be received to allow additional fees to compensate for transition costs of businesses, while substantially eliminating the demand shifts that might otherwise occur. The principal difficulty associated with a "phase-in" of input tax credits after GST implementation is that they would be inconsistent with the principle of relieving all tax from inputs used in making taxable supplies. Also, a phase-in of input tax credits would delay the realization of the long term positive economic impacts of the new system.

The proposal for accelerated capital cost allowance and investment tax on post implementation purchases could similarly have a favorable revenue impact but unfavorable capital expenditure (and economic) growth impact. In addition the Committee could not ignore the additional compliance, administrative and legislative complexities. The combination schemes had similar advantages and disadvantages.

The Committee carefully considered the trade offs between the predicted positive effects of taking the tax off capital as quickly as possible, the potential revenue impact, and the potential to create undesirable demands shifts prior to implementation. With respect to demand and purchasing shifts, Finance represented: "the extent of displacement which will actually occur is relatively limited, because of lead times, etc., that are involved often on major capital purchases".

The Committee feels it is of utmost importance to maintain simplicity in the system for both the government and the business community, and to minimize delays of long term economic benefits. It concludes that the risk of demand shift did not justify the compliance, administrative and economic costs of implementing a scheme to ease transition for capital goods. Direct double taxation does not occur by the lack of transition rules on capital goods

since these goods are not purchased for resale. Rather indirect cascading occurs because of the defects in the current system.

In light of these deliberations, the Committee concurs with Finance's position not to propose transitional relief for capital goods purchased in 1990.

2. Inventory of Goods

The Technical Paper does not indicate whether a physical inventory has to be taken as of December 31, 1990 or when the FST rebate will be paid. The Committee recognizes concerns expressed by businesses about these uncertainties, regarding the taking of such an inventory and the timing of the proposed FST rebate.

Therefore, the Committees recommends:

78. That the Government allow as an option an actual physical stock taking within a reasonable period, perhaps 3 to 6 months, before or after the implementation date, with reliance on normal books and records (or previous year's averages) to estimate physical inventory as of December 31, 1990. In claiming rebates of federal sales tax in inventory, a business be allowed:

(a) to reduce its net GST remittances for periods ending on or before April 30, 1991 by an aggregate amount not exceeding its federal sales tax rebate entitlement: and

(b) after April 30, 1991, to claim a cash refund for the balance, if any, of the federal sales tax rebate, with interest on such amount to be paid on any amount not paid within 21 days from the date the rebate claim is received.

To prevent over on any amount not paid within estimates of physical inventory, and thus rebate claims for tax that was never paid, reference to current average monthly inventory amounts could be required, and prosecution for penalties where evidence of fraud is established could be provided for.

The Committee also recognizes the tax content in goods is often not apparent at subsequent trade levels, and that retailers, in particular, may not know the federal sales tax content of their inventory. It understands the concerns expressed that the formulae provided may not adequately compensate businesses for the existing FST content in their inventories. However, because the Department of Finance has indicated to the Committee that the federal government lacks the constitutional authority to mandate tax extra-pricing, it is not appropriate to recommend that suppliers be required to identify the FST amount on invoices in 1990. Rather where actual tax amounts cannot be identified by the claimant, or where the claimant chooses to use a formula to estimate FST, the Committee encourages flexible approval of refunds or credits based on fair formulae, or FST estimates supported by logical and reasonable assumptions.

3. Real Property

The Committee concurs that the transitional measures proposed in the Technical Paper for non-commercial real property may lead to unfair and inconsistent results. It

acknowledges however that the thrust of the measures was to provide limited relief, while not introducing complex rules that pose difficult audit problems.

The Committee discussed at great length what kind of transitional rules should exist for construction in process as of the implementation date of the GST. The Committee discussed: whether to consider construction in process like any other inventory item or whether a simpler method should be used. For example, the Committee considered a rule whereby, if a construction project was 50% complete as of December 31, 1990, the FST system would apply until September, 1992, such that further purchases of materials would be subject to FST and the subsequent sale of the property would not be subject to GST. If a project was not 50% complete as of implementation date, then no rebate of FST content would be received and the subsequent sale of the project would be subject to GST.

However, it was felt that a 50% rule would disturb the markets in 1990, encouraging builders and developers to make as many units as possible meet the 50% completion requirement. Also, arbitrary distinctions are involved when a percentage of completion cutoff is used. Therefore, the Committee considered whether residential and commercial buildings should be treated as any other inventory item. The Committee's deliberations with respect to each follow.

(i) Residential Property

Recognizing that the main current of thought that should underlie the transitional provisions is that the application after 1991 on GST should not lead to double taxation, the Committee felt that three issues should be addressed with respect to non-commercial properties. First, the FST rebates should, as much as possible, flush out the FST component at January 1, 1991 of non-commercial properties. Second, the consumer who bears the GST should benefit from the FST rebate. Third, the rebate scheme should not be unduly complex and arbitrary, and, very importantly, should be susceptible of audit with reasonable ease.

Although the Technical Paper proposals address the last two issues, the Committee believes that they do not sufficiently address the first issue. For housing, the proposals are too strict, as they do not allow sufficient flexibility to builders and purchasers with regard to the time of closing. Moreover, the rebate percentages are arbitrary in that they make assumptions on the FST content which may prove to be inaccurate. For example, should a house be 100% complete on January 1, 1991, the purchaser is only entitled to a 75% rebate if there is transfer of title in January 1991. The provisions governing condominiums and rental apartment buildings have similar problems.

The Committee considered the merits of recommending that FST rebates be provided to purchasers of non-commercial properties on the basis of the percentage of completion of each building, as this would likely result in a more accurate rebate scheme. However, to comply with such a system, builders would be required to estimate the degree of completion of each building and earmark each building with its estimated FST component for the purpose of calculating refunds to purchasers. This approach would therefore be burdensome on builders and would undoubtedly be very difficult to audit after the fact. Thus, although

this approach could lead to defensible results, the Committee rejected it because of its inherent administrative and compliance difficulties.

The Committee also considered but rejected the suggestion of the Canadian Home Builders Association and the Urban Development Institute that condominiums purchased in 1989 (and a portion of 1990 in the case of the Urban Development Institute representation) should be exempt from GST on closing in 1991. The Committee believes it is not in the interest of the marketplace that some condominiums units closing in 1991 or 1992 be exempt and that others be taxable, as this would be distortionary, would lead to perceptions of unfairness, and be confusing.

Rather the Committee believes that the best approach to provide relief, without the institution of a complex and arbitrary system, is to provide rebates to builders on the basis of non-commercial construction in progress on December 31, 1990. This approach is fair as it leads to rebates that correspond to the FST paid on property on hand, as calculated on the basis of accounting records. This approach also avoids the need for the estimation of the degree of completion of each building. It is susceptible to audit since it relies on the inventory records of builders.

Although the approach may be argued to be deficient to the extent that builders do not pass on the rebates to the purchasers of the property, the Committee is confident, as the Department of Finance states, that market forces will be such that the savings will be passed on. Furthermore, the Committee believes this approach is the most objective and satisfactory as builders will be in a position to price their products on the basis that all taxes on input costs, whether FST or GST, will be flushed out. The approach also responds to the concerns in respect of renovators, townhouse projects, and inventories of units built "on spec".

It benefits the condominium builders because it enables them to price their product accurately, which the Technical Paper proposals do not do, and provides certainty to them that all FST will be removed from their inventory on December 31, 1990. Moreover, because the Committee proposes in Chapter 7 that a 5% rate also apply to sales of condominiums (which corresponds essentially to the average FST rate), the Committee is confident the availability to the builders of FST rebates will allow the condominium builders to be in a position where they can demonstrate to purchasers that the 1991 price, inclusive of GST, does not exceed the 1991 price inclusive of FST, that would otherwise have been demanded had it not been for the GST.

Therefore, the Committee recommends:

79. That registrants who on January 1, 1991 hold inventories of non-commercial properties (including unregistered condominiums, and properties subject to an agreement of purchase and sale) receive a rebate of federal sales tax, based on their work in progress records and the estimated federal sales tax content per square foot, allowable only against net GST remittances under the new system.

(ii) Commercial Property

The Committee believes it would not be appropriate to relieve completed commercial properties from the FST embedded in their cost structure because of the technical difficulties of calculating the refunds and the consequential audit problems. Moreover, the Committee believes that any additional cost embedded in commercial property leases because of the FST component would be minimal and does not justify the elaboration of complex rules.

Also, in the interest of maintaining consistency of treatment with completed buildings in use, the Committee believes FST rebates should not be given for commercial buildings in construction on January 1, 1991. The Committee again believes additional FST costs will be minimal and, if any, will be immaterial with regard to the prices of sales to customers or rents to tenants. The development of complex rules is therefore not justifiable.

4. Leases

The GST is to be imposed on the purchaser of taxable services, and will therefore arise as a consequence of the lease. Therefore, the Committee believes that the absence of GST grandfathering rules for leases straddling the implementation date should not be a significant factor in contracts where both the vendor and purchaser have taxable status. However, where either the vendor or the purchaser in a lease has exempt status, the imposition of GST could be inappropriate for either party.

Where FST-paid leased goods are being used by a leasee in making exempt supplies, the lease payments would be subject to GST but the purchaser would not be entitled to an input tax credit (or a recovery of) previously paid FST. Double taxation would therefore occur where the purchaser cannot recover a full input tax credit, such as in leases to financial institutions, to individuals and to providers of healthcare, educational and day-care services.

Therefore, the Committee concludes transitional relief should be provided in leases to non-registrants and on leases to registrants in the course of a non-commercial activity. However, as the lessor would have an added compliance burden if these types of leases were treated differently than leases to registrants in the course of commercial activities, the Committee believes the proposed rule should be applicable to all leases of goods entered into before January 1, 1991..

Therefore, the Committee recommends:

80. That the lease of goods that were subject to federal sales tax pursuant to a lease entered into before January 1, 1991, be treated as an exempt supply until December 31, 1993.

13. OTHER OPERATIONAL ASPECTS

This Chapter discusses certain other operational aspects represented to the Committee by witnesses to be of concern.

A) Partner and Employee Expenses

(i) Technical Paper Proposals

Although the Technical Paper is silent on the treatment of syndicates and joint ventures, it states GST collected on supplies made by a partnership will be reported at the partnership level. However, the partner will be able to recover the GST paid or payable directly on those purchases for which he or she is not reimbursed but is able to deduct for income tax purposes in calculating his or her partnership income. Refund claims for GST paid on partner's expenses will be filed at the same time as the partner's income tax return. The draft legislation clarifies corporate partners may claim input tax credits with respect to any partnership expenses on either a monthly or quarterly basis. In respect of vehicles, either the partner or the partnership, as the case may be, will be allowed to claim a credit based on the capital cost allowance as allowed for income tax purposes, to the extent that the vehicle is for use in a commercial activity of the partnership. Individual partners will file for this amount on their annual GST refund claim for partner expenses, and partnerships will claim the credit on the partnership's GST return for the reporting period that includes the fiscal year end of the partnership.

Since employees, such as commission salespeople, will not be considered to be carrying on a commercial activity, they will not be able to claim an input tax credit for the GST paid on employee expenses. However, officers and employees will be refunded the GST paid on those employment expenses which are also deductible for income tax purposes. Where the income tax deduction is a capital cost allowance in respect of the item, such as passenger vehicle or aircraft, the Technical Paper proposes the credit will be based on 9/109ths of the capital cost allowance deduction allowed for income tax purposes. The GST refund claim will be filed at the same time as the income tax return of the employee for the calendar year in which the expenses are incurred.

(ii) Witnesses' Representation

Several witneses, including the Canadian Institute of Chartered Accountants ("CICA"), represented to alleviate cash flow concerns, partnerships (and joint ventures) should be given flexibility in filing returns. Although the partnership would purchase goods and services on a GST paid basis, they recommended each corporate partner should be allowed to report and remit GST on their proportionate share of taxable supplies, and claim their proportionate share of input credits.

The Independent Petroleum Association of Canada ("IPAC") represented GST should be levied at the operator level only with respect to joint venture operations. They also recommended all payments of ownership distribution, including override royalties, net profits and interests, should be specifically excluded from GST.

The Department of Finance ("Finance") has represented they did not allow individual partners to claim their input claim tax credits for simplicity. Although no specific rule is provided for joint ventures in either the Technical Paper or the Draft Legislation, Finance stated:

> "The result of the variety of rules that we do have provides maximum flexibility for joint ventures. They can, in fact, structure the way in which they report for GST purposes, and virtually in any manner they want"...

Finance further represented there would not be a forced pro-rating amongst participants and the operator with respect to "net-profit interest type ventures". Rather:

> "in most cases, the way they are structured, the operator will be accounting for tax and any funds that flow between the operator and the other partners would simply not be recognized for GST purposes... there is no further complications there whatsoever."

Further, in its testimony, Finance assured the Committee, it was addressing the "one or two minor wrinkles" it had been made aware of.

The Canadian Real Estate Association represented to the Committee that the Technical Paper proposal, allowing refunds of the GST paid to employees where the employment expense is also deductible for income tax purposes, is restrictive. The applicable paragraph in the *Income Tax Act*, paragraph 8(1)(f), limits allowable deductions of capital expenditures to certain automotive and aircraft costs. Therefore, agents who are considered employees will be denied input tax credit for such items as photocopiers, FAX machines and cellular telephones.

(iii) Committee's Conclusions and Recommendations

The Committee recognizes partnership agreements often provide that certain business expenses must be paid directly by the partners. For example, automobile expenses, interest and entertainment expenses are often paid by the partners rather than by the partnership. Although a rebate of the GST paid on business purchases will be claimable by the partners where the credit for these purchases would have been available if the partnership had incurred the expenses, the government has not announced the procedures which partners will have to follow to obtain the refund. All that is known is the refund will not be obtainable by non-corporate partners until they file their personal income tax return. Therefore, refund filing is on an annual basis, and the Committee sympathizes with the resulting cash flow concerns.

However, the Committee notes that the recommendation of the CICA with respect to corporate partners has been addressed in the Draft Legislation. It also recognizes that Finance's representations confirm positive resolution of the IPAC concerns. The Committee therefore commends the government on its attempt to address concerns. However, since the Committee desires not to have decisions as to business structure affected by tax laws (discussed in Chapter 2), the Committee concludes that individual partners should be given the same treatment as corporate partners for the purposes of GST credits. Therefore, the Committee recommends:

81. That individual partners be permitted to claim input tax credits with respect to partnership expenses on either a monthly or quarterly basis.

The Committee also supports Finance's efforts to address specific joint venture issues and encourages flexibility with respect to the concerns.

The Committee concurs that the restrictions imposed by paragraph 8(1)(f) of the *Income Tax Act* relate to the acquisitions of capital assets. Although the agent may always lease such assets, and thereby be entitled to a deduction for income tax purposes, and consequently to input tax credits where the agent meets the other criteria of the paragraph, the Committee believes it would be appropriate to broaden the input tax credit entitlement. Employed agents, who acquire capital property to earn commissions, should be entitled to input tax credits for such acquisitions. However, the Committee believes the other limitations contained in paragraph 8(1)(l) of the *Income Tax Act* are reasonable, including that the total allowable deductions be limited to the amount of commission income, and that the agent is required by his contract of employment to pay his own expenses, is ordinarily required to carry on his duties of employment away from his employer's place of business, is remunerated by sales commissions and does not receive an allowance for travelling expenses not included in his income.

Therefore, the committee recommends:

82. That individuals, who in the course of their employment earn commission income and who meet all the conditions of application of paragraph 8(1)(f) of the *Income Tax Act*, be treated as independent agents for the purpose of their entitlement to input tax credits for taxes paid on the purchase of any property acquired to enable them to earn their commission income. The input tax credits should only be available to the extent that all expenditures or outlays in a given year do not exceed the commission income for the year.

For completeness, an applicable Committee recommendation made in Chapter 2 is reproduced below. For a discussion of witnesses' representations and the Committee's deliberation with respect to the recommendation, the reader is referred to the input tax credit section of that Chapter.

As the Committee feels it is of utmost importance to make the GST system as simple as possible, the Committee recommends:

83. That full GST input tax credit be allowed for meal and entertainment expenses, and for passenger vehicles purchased or leased, including those purchased or leased by self-employed individuals, partners and persons meeting the criteria of paragraph 8(1)(f) of the *Income Tax Act*. If the Minister deems it advisable to make appropriate adjustments because of the personal consumption component, the changes should be made by amending the *Income Tax Act*. The Income Tax complications should not be added to the legislation implementing the Goods and Services Tax.

B) Bad Debt Relief

Registered vendors will be permitted to claim an input taxcredit for the tax component of bad debts written off, where the debt arose from the supply to a person with whom the registrant is dealing at arm's length. A debt becomes bad when it is established to be uncollectible. GST will have to be remitted at the rate of 9/109 (i.e. 8.25%) of any part of the bad debt subsequently recovered by the registered vendor. Under the 7% rate proposed by the Committee the fraction applicable to bad debt recoveries will reduce to 7/107 (i.e. 6.54%). The Technical Paper makes no provision for an allowance to a registered vendor for doubtful debts.

The Society of Management Accountants of Canada ("Society") represented that bad debt offsets against GST remittance should be allowed in the month following the month the bad debt is written off. However, the Committee notes that the Draft Legislation allows the offset any time within four years after the end of the reporting period in which the bad debt is written off in the books of account. Therefore, as the desired result of the Society is achieved if a business is required (or opts) to file monthly, and if it writes off its bad debts on a monthly basis, the Committee makes no recommendation with respect to this matter.

C) Gambling, Lotteries and Pari-Mutuel Betting

Under the Technical Paper proposals, pari-mutuel betting, gambling and lotteries operated on a commercial basis will be subject to GST. The tax will apply on the total revenues received by the organizer, less provincial taxes paid and prizes or winnings paid to bettors. In other words, the tax will apply to the organizer's margin: gambling or lottery winnings will be tax free.

The basic argument for taxing wagering is that it is a recreational activity in competition with other recreational activities and, when carried on a commercial basis, it should be taxed as other such activities are. While sound in principle, in the Committee's view this argument does not justify extension of the GST to pari-mutuel betting and provincial lotteries. The federal government vacated these tax fields to the provinces long ago, and to apply GST to them now would amount to reversal of this long-standing position under the guise of tax reform.

(i) Pari-mutuel betting

The federal government eliminated taxation of pari-mutuel bets in 1948, leaving the field entirely to the provinces. As Racetracks of Canada noted in their submission to the

Committee, most provinces have taken full advantage of their rights ever since, taxing pari-mutuel wagering to the hilt. In 1988, provincial taxes amounted to 57% of racetrack commissions. In addition, the industry is subject to a 0.8% levy on wagering, the proceeds from which are used to compensate Agriculture Canada for racetrack supervision services. Together, provincial taxes plus the federal levy in 1988 amounted to 63% of racetracks' revenues from wagering, making horse racing one of the most heavily taxed industries in Canada.

Application of the GST to pari-mutuel betting as proposed in the Technical Paper would increase the racing industry's net tax liability by almost $20 million, a sum that exceeds the net profits of racetracks by over 2.5 times. It is therefore impossible for the industry to absorb this tax increase.

At the same time, given the sensitivity of wagering to price changes, the tax cannot be passed on to racetrack patrons either. According to industry estimates, passing on the GST to bettors would increase the cost of betting by 5.4% and cause a 9-10% decline in wagering, leaving the racetrack industry worse off than if it absorbed the tax. The industry's predicament was succinctly captured by the Honourable Don Mazankowski, Minister of Agriculture, in a speech to the House of Commons on Bill C-7 (amendments to legislation governing pari-mutuel betting) earlier this year when he said that:

> there is no leeway for future [racetrack] commission increases to meet any further rise in costs. The combined take-out by the tracks, provincial governments and the federal operations levy has reached its probable upper limit. In other words, even a small increase in the take-out is likely to have a very negative impact on total amounts wagered.(1)

In short, a) the federal government withdrew from the taxation of pari-mutuel betting long ago; b) pari-mutuel betting is already very heavily taxed; and c) any additional tax burden could have an adverse impact on the racetrack industry and result in a decrease in overall tax revenues from that sector.

The Committee therefore recommends:

84. That the GST not apply to pari-mutuel betting.

It is important to note that exclusion of pari-mutuel betting from the GST does not imply that racetrack patrons will be free of the tax. GST will be payable on parking, admissions, programs, food and beverage purchases and other forms of consumption at racetracks. The industry estimates annual GST revenues from these sources at $12-15 million.

(ii) Provincial Lotteries

The federal government vacated the lottery field to the provinces in 1979, pursuant to a federal-provincial agreement under which the provinces agreed to remit to Ottawa $24 million annually, indexed to changes in the Consumer Price Index. Lottery receipts have been

a rapidly growing source of provincial revenues ever since. In fiscal year 1986/87, they accounted for $1.2 billion of provincial revenues.

Typically a provincial lottery retains about 50% of gross receipts from ticket sales and pays the rest our in prizes. Under the Technical Paper proposals, provincial lotteries would be charged 9% GST on the lottery receipts that they retain.

In the Committee's view, in addition to effectively reneging on an agreement with the provinces, application of GST to lotteries is ill-advised for another reason as well. The margin to which the GST would apply exists only because provincial lottery corporations enjoy state protected monopoly status. If the lottery business were open to competition, these margins would be bidden away and there would therefore be no surplus to contribute to provincial coffers. In effect, therefore, the provincial lottery margins are a form of tax, and to apply GST to them would be tantamount to applying tax on tax.

Therefore, the Committee recommends:

85. That GST not apply to provincial lotteries.

D) Provincial Sales Taxes

The Technical Paper proposes the GST will be levied on the price exclusive of the provincial tax where a sale is subject to the general provincial sales tax as well as the GST. Accordingly, where a business purchase by a registrant is subject to provincial retail sales tax as well as GST, the input tax credit will be calculated on the purchase price exclusive of provincial sales tax. The Technical Paper states that the appropriate GST treatment of provincial product taxes, mark-ups and other similar levies, such as those on tobacco products, motive fuels and alcoholic beverages, is an issue which requires further discussion with the provinces. The Committee's deliberations and recommendations with respect to the input tax credit complications involving provincial sales taxes are discussed in Chapter 2.

E) Used Goods

(i) Technical Paper Proposals

The Technical Paper proposes that the sale of a used good in the course of a commercial activity by a registrant will be a taxable supply and where the sale is made to a registrant the normal input tax credit rules will apply.

Sales of used goods by private individuals who are not registrants will not be subject to tax. Although goods sold by such persons will not be subject to tax on sale, if the purchaser is a registrant, subject to the restriction described below, the purchaser will be entitled to claim a notional input the credit in respect of GST originally paid when the used good was first purchased. The notional credit will be 9/109ths of the price paid by the registrant for used goods where the purchase was not subject to tax.

The exception to the general rule will apply in cases of appreciating used goods. Where a registrant buys an appreciating used good from a non registrant (i.e. an individual or exempt organization) no notional input tax credit will be allowed. An apreciating used good will be defined to include listed personal property as defined in paragraph 54(e) of the *Income Tax Act* such as coins, stamps, art and other collectibles as may be prescribed.

(ii) Witnesses' Representations

It was represented to the Committee by the Federation of Automobile Dealer Associations of Canada that the imposition of tax on sales of used cars by dealers (registrants) versus the absence of tax on sales by individuals would create a competitive distortion in the marketplace. Given the fact that dealers would qualify for a notional input tax credit when they purchased a used vehicle, the dealers would in fact only be charging tax on their margin (purchase price less sale price x 9%) and therefore no large price discrepency should occur. However it was represented by the FADAC that the public would nevertheless be under the impression that the full price of a used car bought from a dealer would be taxable while a used car bought from a private seller would be exempt. Moreover, the FADAC represented that if they were to explicitely show the GST as applying only to their margin, they would be forced to disclose their margins. The FADAC recommended that all sales of used vehicles be taxed or, in the alternative, a flat tax be levied against the average mark up (margin) on a dealers' sale of a used car.

The Committee also heard a representation from the Canadian Association of Numismatic Dealers (CAND). It was represented to the Committee by the CAND that the Technical Paper's proposal to deny a registrant a notional input tax credit on the purchase from a non-registrant of appreciating used goods would seriously damage the business of many dealers of used appreciating goods. Items such as coins, stamps, art, and jewellery would be taxed when new, and then taxed again every time they were sold by a registrant. It was represented by the CAND that this tax cascading would be particularly harmful to the trade in collectibles as many such items turnover between dealers and collectors as frequently as once a year. It was further represented that the practical effect of such tax cascading would be to drive legitimate dealers out of business in favour of "vest pocket" dealers who would neither charge nor remit tax.

(iii) Committee's Conclusions and Recommendations

The Committee believes that the concerns of FADAC with respect to the public perception of explicit GST on used car sales by dealers and their concerns with respect to the disclosure of the dealers margins can be addressed adequately under the Technical Paper. The Technical Paper provides that it is open to all registrants, including used car dealers, to sell on a tax included basis. Under this option tax need not be disclosed in the final selling price of goods and dealers need not disclose their margins. The Committee believes special rules such as a flat tax on dealers' margins or a tax on private used car sales are therefore unnecessary and moreover inconsistent with the application of the GST to all other taxable goods and suppliers.

The Committee believes that the concerns of the CAND are valid, and is not convinced that used appreciating goods purchased by a registrant should be entirely denied the notional input tax credit as proposed in the Technical Paper. The Committee believes registrants selling used appreciating goods should be treated in a manner consistent with those selling other used goods, namely,on their value added. However, the Committee in concerned that in extending the notional input tax credit to appreciating used goods there is a potential for a tax loss to the government. For example, a coin purchased new for $100 by an individual might have borne $9.00 in tax and then be resold to a registrant, after appreciation, for $1,000. The registrant would then be entitled to a notional input tax credit of $90. (9% of $1,000). Thus the notional input tax credit would exceed the tax actually paid on the coin. As long as the registrant eventually remitted at least $90 tax on the sale of the coin there would be no problem, however, if he made a tax free sale such as an export sale there would be a net loss in revenue to the government. Moreover, an unscrupulous coin dealer could make zero-rated export sales of coins on which he had claimed a notional input tax credit and then arrange to have the same coins smuggled back to Canada and sold to his dealership. He would then claim the notional input tax credit again and repeat the process.

Accordingly, the Committee believes that notional input tax credits on used appreciating goods can only be claimed by dealers where they have remitted tax on the sale of such goods that is equal to or greater than the amount of the notional input tax credit claimed. This will require dealers to inventory their used appreciating goods to show exactly how much was paid for such goods when purchased from non-registrants and how much was received on the resale.

Given these safeguards, the Committee believes used appreciating goods should be eligible for notional input tax credits just as other used goods.

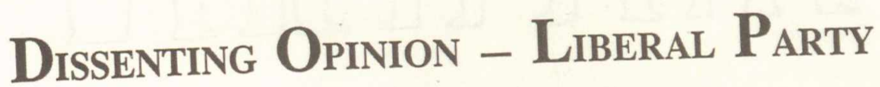
Therefore, the Committee recommends:

86. That a notional input tax credit be allowed to registrants for the purchase from non-registrants of used appreciating goods as defined in paragraph 54(e) of the *Income Tax Act*, such as coins, stamps, art and other collectibles, or as may be prescribed. The Committee further recommends that notional input tax credits be payable only upon the registrant establishing through sales documentation or other evidence satisfactory to Revenue Canada that the tax remitted by the registrant on the sale of the used appreciating good is equal to or greater than the notional input tax credit in respect of the same used appreciating good.

FOOTNOTE

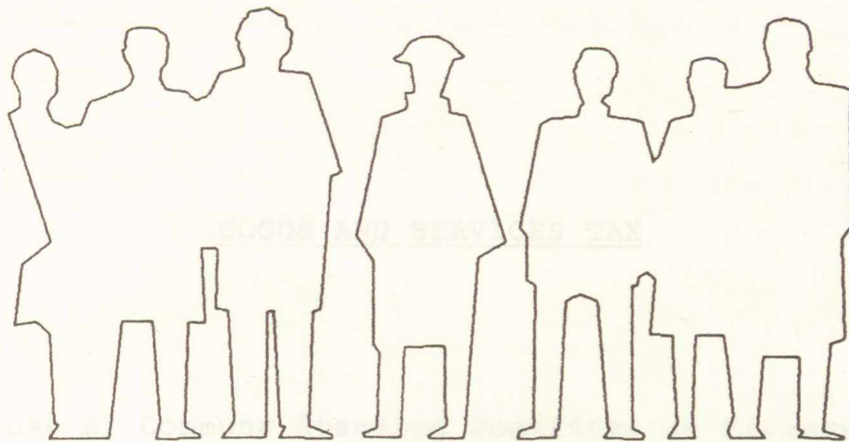
(1) House of Commons, *Debates*, April 19, 1989, p.694

APPENDIX A



DISSENTING OPINION – LIBERAL PARTY

GOODS AND SERVICES TAX



House of Commons Standing Committee on Finance:

Liberal Minority Report

November 1989

GOODS AND SERVICES TAX

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1.0 INTRODUCTION AND LIBERAL RECOMMENDATION

After weeks of hearings across Canada, and after carefully considering the views of Canadians expressed to the House of Commons Standing Committee on Finance, the Liberal Members of the Committee have concluded that the Goods and Services Tax ("GST") proposed by the government must not be implemented and that if it is implemented serious economic and social damage would result.

The desirability of reforming the $13^{1/2}$ percent sales tax applied to manufactured goods (the "Manufacturers Sales Tax") has long been recognized by the Liberal Party, as well as by many Canadians. However, the GST proposal presented to the people of Canada by the Minister of Finance in August 1989 is so fundamentally flawed, and creates such great economic danger for Canada, that it cannot be viewed as a satisfactory alternative.

The failure of the government to find an acceptable method of improving or replacing the Manufacturers Sales Tax underlines the need for genuine tax reform in Canada. The time has come for an overhaul of the tax system in Canada and a renewed commitment to fair taxation.

The need to reexamine, in consultation with other levels of government, our personal and corporate income taxes, as well as sales taxes and other forms of taxation, is long overdue. The failure of the Conservative government to engage in meaningful consultations on either the first or second phase of its so-called tax reform has resulted in the unworkable GST proposal that is before Canadians now.

The Liberal Members of the Finance Committee, therefore, make the following recommendation:

That the Conservative Goods and Services Tax proposal be withdrawn and that the federal government immediately begin consultations with Canadians and provincial governments on the creation of a fair and integrated reform of the entire tax system.

2.0 REJECTING THE FINANCE COMMITTEE MAJORITY'S RECOMMENDATIONS

It is the position of the Liberal Members of the Finance Committee that the Conservative Goods and Services Tax proposal is flawed and cannot be "patched up" in a way that would make it fair for Canadian taxpayers. The problems with the GST are so fundamental that the proposal cannot be made acceptable by lowering the rate or through modifications of the sort proposed by the Conservative majority.

The GST proposal, if implemented, would: create economic disruption; increase taxes on average families; introduce an unprecedented level of complexity into the tax system; impose further hardship on low-income Canadians; remain hidden from taxpayers; shift the tax burden in several important ways within Canadian society without the government fully understanding the long-term effects of these shifts; cause financial difficulties for provincial governments; and harm many sectors of the Canadian economy.

The GST proposal is fundamentally flawed and must be withdrawn.

3.0 THE PROPOSED GOODS AND SERVICES TAX: WHY IT MUST BE SCRAPPED

The proposed GST should be withdrawn for the following reasons:

3.1 The implementation of the GST would cause serious economic damage to Canada

The Finance Committee received several briefs indicating that if the government's GST proposal is implemented the economy would be subjected to serious disruptions in the form of higher inflation, higher unemployment and higher interest rates.

The impact which the GST will have on the economy hinges on three critical assumptions:

i) that businesses would pass along to consumers the full benefit associated with the removal of the existing 13.5 percent Manufacturers Sales Tax before applying the 9 percent GST in 1991;

ii) that workers would attempt to protect their real incomes from the inflationary impact of the GST by negotiating higher wages;

iii) that the Bank of Canada would raise interest rates in response to the inflation caused by the GST in 1991.

The Consumers Association of Canada told the Finance Committee that it was unlikely that the removal of the existing 13.5 percent Manufacturers Sales Tax would be passed along to consumers and predicted that labour would seek wage settlements that would protect workers against inflation brought on by the GST:

> "As we went through the exercise of metrification we saw that these savings were not passed on to consumers [by business], and we are already beginning to see that in labour negotiations people are trying to build in or wanting to build in the inflationary factor that will come from this particular implementation [of the GST]." (31:61)
>
> Nick Murray
> National President of the Consumers Association of Canada

The Liberal Members were impressed by evidence that business did not pass along to consumers the full savings when the Manufacturers Sales Tax was reduced from 12 percent to 9 percent by the Liberal government in 1978. Inflation increased by 0.5 percent in the year after the rate of the Manufacturers Sales Tax was reduced, rather than falling as the Finance Department had predicted.

In fact, the inflation rate for prices of durable goods increased from 4.8 percent for the twelve months before the rate reduction to 6.8 percent during the twelve months after the rate reduction. This previous experience suggests that it is unlikely that business would fully pass along to consumers the savings associated with the removal of the Manufacturers Sales Tax.

The Finance Committee also heard that Québec consumers are skeptical of the Conservative government's arguments that consumers will benefit from the removal of the Manufacturers Sales Tax:

> "We are afraid that these savings will result in only a partial price reduction at

best, and perhaps in none at all. Some years ago, the Quebec government thought it could count on petroleum producers to pass on savings to consumers of the reduced gasoline taxes to which it had agreed. Although the decrease was significant, there was no price reduction at the pumps."

Confederation of National Trade Unions
Brief to the Finance Committee
page 13

As to the impact of the GST on wage demands, the Economic Council of Canada's analysis showed that the GST would cause real wages to fall in 1991 by 2.4 percent, a substantial drop in the standard of living of working Canadians. National labour leaders who will be responsible for leading their members into future contract negotiations were clear about what their strategy would be:

"We will be aggressive to try to maintain the standard of living and certainly the rise in the cost of living as it goes along. We are not going to accept the principle that the worker has to suffer from all of this [GST]." (59:12)

Shirley Carr
President of the Canadian Labour Congress

"When the Minister, Mr. Wilson, asks us to absorb the 2% or 3% increase in inflation resulting from his new sales tax, he is seriously deluding himself... We want across-the-board protection against government-created inflation."

Gérald Larose, President
Confederation of National Trade Unions
le Devoir
October 11, 1989

Virtually all economic forecasts, except for that of the government, agree that the GST will raise inflation, raise unemployment and slow economic growth in 1991. The economic forecasts of several economic experts on the impact of the GST proposal on the economy are summarized in Table 1.

Table 1

THE IMPACT OF GOODS AND SERVICES TAX IN 1991				
Forecaster	Real GDP (%)	CPI Rise (%)	Jobs	Interest rate
Department of Finance	+0.2	2.25	+35,000	-
DRI [1]	-0.2	2.7	-25,000	
Wood Gundy [2]	-0.6	3.0	-75,000	+ 2%
Conference Board of Canada:				
Optimistic Case [3]	-0.9	2.7	-64,000	
Realistic Case [4]	-1.0	3.0	-71,000	+ 2%
U of T, Institute for Policy Analysis	-0.7	2.4	-75,000	
Economic Council of Canada: Case 1 [5]	-0.6	2.7	-41,000	
Case 2 [6]	-0.4	2.4	-41,000	

1. Data Resources Institute (DRI) projects that the GDP could drop by as much as 1 percent or by as little as 0.2 percent, depending on the Bank of Canada's monetary response.

2. Assumes a 1.1 percentage increase in wages. The Bank of Canada would then respond with a 2 percent increase in short-term interest rates.

3. The elimination of the MST is fully passed on to consumers. Workers do not demand higher wages. No change in interest rates.

4. Only 70 percent of the elimination of MST is passed on to consumers. Based on average wages increase of 1.3 percent in 1992. The Bank of Canada would then respond with a 2 percent increase in short-term interest rates.

5. Without the gains in economic efficiency which the government predicts.

6. Includes the economic efficiency gains predicted by the government.

The third key assumption in all of the economic models is the extent to which the Bank of Canada will adjust the interest rate in response to the economic turmoil the GST will create in 1991. Most of the experts rejected the government's contention that the GST would result in a one-time only increase in prices and that the Governor of the Bank of Canada would not raise interest rates.

In spite of slowing economic growth and increasing risk of recession, the Conservative government and the Bank of Canada have continued their high interest rate policy. The Liberal Members cannot understand how the Conservative Members of the Committee, who unanimously supported the Finance Committee's report earlier this year calling on the Bank of Canada to immediately lower interest rates by 2 percent, can support the GST proposal when the overwhelming majority of opinions among economic experts is that the GST will force interest rates up to even higher levels.

The Economic Council of Canada concluded that a GST rate of 9 percent is above what it called the:

> "flash point, where the inflation created by the GST begins pumping inflation into the economy."

> Economic Council of Canada
> Brief to the Finance Committee
> page 7

The Economic Council's research showed that interest rates would have to be increased by close to one additional percentage point in 1991 in order to limit the inflationary impact of the GST to 2.5 percent. The Economic Council's research revealed that the GST would swell the ranks of the unemployed by more than 40,000 in 1991.

Other economists predicted even more job losses. The Conference Board of Canada predicted that as many as 71,000 jobs could be lost in 1991 alone, while the University of Toronto's Institute of Policy Analysis predicts 75,000 job losses in 1991.

In contrast to the majority of economic opinion, the government's projections assume the best case: that business will pass along to consumers the benefit of removing the Manufacturers Sales Tax; that labour will not be able to negotiate higher wages in order to protect their real incomes; and that the Bank of Canada will completely ignore the inflation caused by the GST and will not raise interest rates. Most

witnesses and economic experts who appeared before the Finance Committee concluded that the government was understating the short-term economic problems which the GST would cause.

Although opinions vary, the majority of economic experts believe that the government's GST proposal would have a serious negative impact on the economy in the short term and that the GST could cause an economic downturn. This risk of recession appears to be growing because, after seven years of world-wide economic expansion, growth appears to be slowing. Imposing the GST at a time when the economy may be entering a period of reduced growth might be enough to push the economy into a full recession.

The Liberal Members recognize that there are no certainties in long-term economic forecasting. Any potential long-term benefits to Canada forecast by some analysts are too small, too uncertain and too far in the future to justify the major risk of the economic recession which the GST may cause.

3.2 The GST proposal is not revenue neutral

Tax reform should be a process whereby the tax system is improved by distributing the tax burden among taxpayers in a fairer way.

It has long been recognized that to use tax reform as a cover to raise taxes makes the process of tax reform more difficult than it otherwise would be, because rather than raising taxes for some and reducing taxes for others, everyone ends up paying more taxes. This lowers public support for tax reform and sows the seeds of a tax revolt. If revenue neutrality is not observed, then public acceptance and any benefits of tax reform are eliminated.

During the 1988 federal election campaign the government committed itself to respect this principle:

> "The bottom line is that the sales tax will not be used to raise the revenues of the government of Canada."
>
> Hon. Michael Wilson
> Toronto Star, October 8, 1988

34563-10

Having promised Canadians during the federal election that the GST would not increase taxes, less than one year after the election the Finance Minister produced the GST Technical Paper which on the very first page states as the first goal of the GST:

> "The GST will contribute to the deficit reduction effort..."
>
> GST Technical Paper
> August, 1989
> page 1

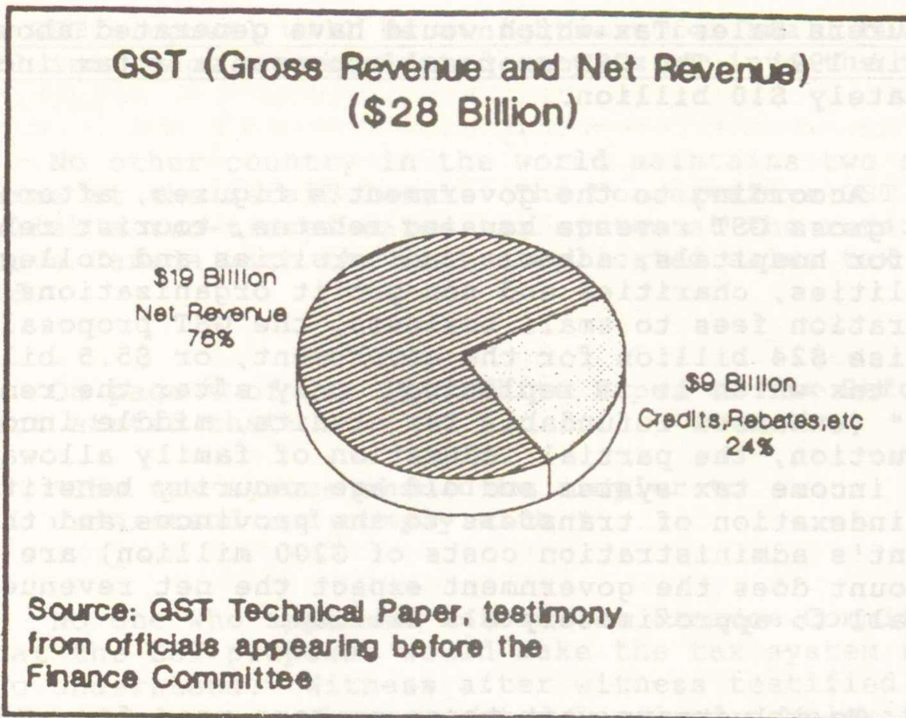
The Finance Minister cannot have it both ways; if the GST is revenue neutral, then it will not reduce the deficit. Canadians deserve a straight answer from the government as to whether the GST will reduce the deficit or not.

In addition to this reversal, the Finance Minister has since changed his definition of revenue neutrality. At the start of tax reform the Finance Minister promised that when the GST was implemented the 3 percent corporate income surtax and the "temporary" personal income surtax of 3 percent would be removed. But rather than announcing in the 1989 Budget that these surtaxes would be removed in 1991, the Finance Minister raised the general personal income surtax from 3 percent to 5 percent, taking another $1 billion out of Canadians pockets. Furthermore, he announced that he had changed his mind and that these surtaxes would not be removed when the GST took effect. These "temporary" surtaxes have now become permanent.

Revenue neutrality has also become a moving target. When the Finance Minister promised in his 1987 White Paper on Tax Reform that a new sales tax would be revenue neutral, that is that it would not raise more net revenue than the Manufacturers Sales Tax it was replacing, the rate of the Manufacturers Sales Tax was 12 percent. However, in the 1989 budget the rate of the Manufacurers Sales Tax was increased to 13 1/2 percent, taking another $2 billion out of Canadians pockets. Now the Finance Minister says that the GST will generate enough tax revenue to replace the 13 1/2 percent Manufacturers Sales Tax, rather than the revenues that would have been generated if the Manufacturers Sales Tax had remained at 12 percent, as was originally promised. Revenue neutrality has become a moving target, with the target continually rising.

Furthermore, the government's GST proposal is demonstrably a tax-grab. The GST could raise more than $28 billion in gross tax revenues, before all rebates and credits, in 1991. (See Figure 1 for a breakdown of the gross GST revenues of $28 billion). The GST is intended to replace the

FIGURE 1



Breakdown of GST Credits, Rebates, etc.
(fully implemented GST system)

Middle Income Tax Reduction
$0.7 billion

Refundable Tax Credits for the Poor
$2.4 billion

Social Benefits Indexation
$2.0 billion

Non-profit Organization Rebates
$0.1 billion

Administrative Costs
$0.2 billion

MUSH Rebates *
$1.5 billion

Small Business Admin Fees
$0.6 billion

Housing Rebates
$0.9 billion

Tourists Rebates
$0.6 billion

* municipalities, universities, schools and hospitals

Manufacturers Sales Tax which would have generated about $18.5 billion in 1991. The GST proposal represents a tax increase of approximately $10 billion.

According to the government's figures, after deducting from the gross GST revenue housing rebates, tourist rebates, rebates for hospitals, schools, universities and colleges, municipalities, charities and non-profit organizations, and administration fees to small business, the GST proposal would still raise $24 billion for the government, or $5.5 billion more than the tax which it is replacing. Only after the remaining "offsets" (enhanced refundable tax credits, middle income tax rate reduction, the partial indexation of family allowances, the personal income tax system and old age security benefits, the partial indexation of transfers to the provinces and the government's administration costs of $200 million) are taken into account does the government expect the net revenue of the GST to fall to approximately $19 billion.

To illustrate what these numbers mean for an average Canadian family one need only look at the government's own analysis in the GST Technical Paper showing that <u>an average middle-class family with two incomes, of $27,000 and $18,000 respectively, and two children, will pay $629 more in tax each year when the GST is in place</u>, even after receiving their refundable tax credits.

> "Because of its unfortunate consequences on family budget in the short, medium and long terms, we consider the draft reform of the federal sales tax totally unacceptable."
>
> Fédération des associations coopératives d'économie familiales du Québec
> Brief to the Finance Committee
> page 1

Furthermore, since the partial indexing of transfer payments to the provinces, family allowances, and the personal income tax system will not take place until the end of the first full year of operation of the GST, the impact of the GST on family budgets in 1991 will be even worse than the government has so far admitted. Family budgets are in for a rude shock in 1991 if the GST is implemented.

Average Canadians expected tax reform, not tax increases. They feel betrayed and angry, and justifiably so.

3.3 <u>The GST proposal will be a nightmare for small business and will introduce unprecedented complexity into the tax system</u>

No other country in the world maintains two separate sales taxes at the retail level. The Conservative GST proposal to establish a two-tiered sales tax system at the retail level would leave Canada with the most complicated sales tax system in the world.

On page 4 of its 1987 White Paper on Tax Reform the government stated that:

> "The tax system should be simpler to understand and comply with."

No one who appeared before the Finance Committee could state that the GST proposal would make the tax system simpler or easier to understand. Witness after witness testified that the GST would introduce an unprecedented level of complexity into the tax system that would cost small businesses and retailers billions of dollars in added expenses as they try to comply with the GST.

The Retail Council of Canada told the Finance Committee that the GST would cost small retailers as much as $2 billion a year to hire additional staff and accountants to handle the increased paperwork associated with the GST. The Canadian Federation of Independent Business (CFIB) estimated that it would cost an average small business $1,900 each or more than $1.2 billion for the entire small business community to comply with the GST, including the cost of purchasing new and expensive electronic equipment.

The most disturbing aspect of the added compliance costs for business is that very small businesses will bear most of this burden. The CFIB demonstrated that small businesses with less than five employees would bear 72 percent of the total compliance costs (more than $850 million a year). Small businesses would have to cope with a minimum of 4,000 additional federal tax collectors which would need to be hired to collect the GST. These added costs and red tape can only damage the competitiveness of Canadian small business.

The Manufacturers Sales Tax is levied against manufactured products and is paid predominantly by large firms. Most small businesses have never had to collect federal sales tax before. The GST proposal would force more than 1 million small businesses, who have never collected federal sales tax, to administer the GST for the government.

The Finance Committee heard that the nightmare for small business originates from the federal government's determination to impose the GST without the co-operation of the provincial governments. The most common complaint from small business associations appearing before the Finance Committee was that the GST proposal would thrust upon them a two-tiered sales tax system, whereby small businesses would have to cope with separate provincial retail sales taxes and the federal GST.

The federal GST and provincial sales taxes would each apply to a different set of products, each at a different rate of tax. Purchases of goods and services would be subject to any of four possible sales tax scenarios:

i) federal GST only;
ii) federal GST and provincial retail sales tax;
iii) provincial retail sales tax only;
iv) neither federal GST nor provincial sales tax.

If the customer then offers the retailer a discount coupon, even greater complexity arises, since the treatment of coupons for tax purposes is different in various provinces.

Most small businesses would find such a complicated tax system intolerable:

> "When you talk to a small businessman about operating two totally unharmonized retail sales tax systems, you are talking about a nightmare." (33:14)
>
> John Bulloch
> President of the Canadian Federation of Independent Business

There is no doubt that, at the same time as the government claims it is trying to make the tax system simpler, the GST proposal would introduce an unprecedented amount of complexity, violating one of the government's own stated objectives of tax reform.

3.4 The GST proposal is regressive and will hurt low-income families and persons living on fixed incomes, including seniors and welfare recipients

Sales taxes are, by their nature, regressive, simply because low-income Canadians spend a larger portion of their income on taxed goods and services than do high-income people.

Although refundable tax credits are intended to compensate poorer families for the increased federal sales tax which they will be paying in 1991, many witnesses appearing before the Finance Committee were convinced that these increased credits would not fully compensate low-income Canadians for the added cost of the GST:

> "The tax on goods and services means hardship on seniors. It seems that low-and middle-income seniors will be pushed toward poverty. The proposed tax credits do not reassure them." (40:36)
>
> Jean Woodsworth
> President of the One Voice Seniors Network

Many social policy groups and economic experts disputed the government's claims that low-income Canadians would be better off in 1991 with the GST proposal:

> "The goods and services tax is going to impose a heavier tax burden before credit on everybody, including low-income people. When we look at what happens, of course, after the credit is applied,...we find that even though the credit under the GST will be substantially enhanced because the GST is going to impose a much larger burden as well, when you net that out the figures are surprisingly similar [to the situation before sales tax reform]." (34:42)
>
> Ken Battle
> Director of the National Council of Welfare

The Finance Committee heard from the National Anti-Poverty Organization how the proposed system of refundable tax credits discriminates against large families living in poverty and against single people living on welfare:

> "Families of four or more persons, who live under the poverty line, will not be entitled to the full tax credit."

> "No single persons receiving social assistance (welfare) - with or without disabilities - would receive the full value of this special credit."
>
> National Anti-Poverty Organization
> Brief to the Finance Committee
> pages 10 and 12

One of the most common objections to the GST proposal, an objection which the Finance Committee heard many times, is that the refundable tax credits and the thresholds at which Canadians would begin to lose these credits, are not fully indexed to inflation. As taxes and prices increase in the future, the amount of protection for low-income Canadians would fall.

Virtually all social groups were unanimous that the lack of full indexation of the refundable tax credits will make an already unfair GST system even more unfair over time:

> "The shrinking sales tax credit and its falling threshold will weaken its capacity to protect low-income Canadians from the GST in future. In effect, their federal sales tax burden will grow heavier with each passing year because the sales tax credit will offset less of the GST. The sales tax credit also will be targetted further and further below the poverty line, thus leaving more and more working poor and modest-income families with little or no protection from the sales tax."
>
> National Council on Welfare
> Brief to the Finance Committee
> page 19

The Finance Committee heard from the National Council on Welfare that within five years, 700,000 poor families would be cut off from receiving any refundable tax credits because of the lack of full indexation. Within ten years, over 1 million Canadian families who need protection would lose their tax credits.

Statistics provided by the National Council on Welfare demonstrated how inflation also would eat away at the value of the credits over time. Within five years the maximum credit for a couple with two children would fall from $750 to $644 in 1991 dollars, taking an additional $700 million out of the pockets of poor families within five years.

In response to these concerns the Finance Minister has replied that the protection for low-income Canadians does not need to be fully indexed to inflation because the government, if necessary, would adjust the credits and the thresholds to protect the poor.

The Liberal Members of the Finance Committee simply cannot believe this assurance. If the government really intended to fully protect the poor from inflation by adjusting the credits and the thresholds, then there is no reason not to fully index the protection for the poor in the first place, unless of course the Conservative government intends to shift even more of the GST burden onto low-income Canadians in the future. The Liberal Members cannot support this Conservative attempt to increase taxes on the poor.

The Finance Committee also heard that the entire concept of aiding the poor through a refundable tax credit is a bureaucratic and ineffective approach to providing relief to low-income Canadians. It assumes that low-income Canadians will take their GST tax credit cheque, which they would receive every three months, and use it to offset the additional cost of the GST on their purchases until they receive their next cheque.

> "I think that it is very very difficult for people who earn enough money monthly that they can bank some of it to understand the conditions for people who cannot put money aside... [The refundable tax credit] does not relate to the day to day cost of living that those folks have. It is a completely middle-class idea." (76:51)
>
> Reverend Susan Eagle
> United Church of Canada

The government's proposal to provide enhanced refundable tax credits to low-income Canadians also assumes that all low-income families and individuals are capable of completing income tax forms in 1990 and that they have a permanent mailing address where their refundable tax credit can be mailed. Since many poor and illiterate individuals often have to forego filing a tax return or have no permanent address, they will not receive any refundable tax credits and will have no protection at all from the GST. Responding to a Conservative Member's assertion that these Canadians choose not to fill out their income tax forms and, therefore, it is their own fault if they do not receive any credits, one witness responded:

> "Those people are not refusing to fill out forms. I work with them every day. They are people who do not know about the forms. In

> some cases they cannot read or write, and in some cases they are very frightened about filling out forms. They do not understand the process. They do not understand the system. They are very often in a transient lifestyle and to simply dismiss them by saying they refuse to fill out forms is not fair to them." (76:46)
>
> Reverend Susan Eagle
> United Church of Canada

The Finance Committee also heard how the GST would be made even more regressive if the government accepted the advice of several witnesses that necessities, such as basic groceries, should be taxed. The Canadian Council of Grocery Distributors (CCGD) told the Finance Committee that if the GST applied to basic groceries, food prices could jump by as much as 13 percent in 1991. Since poor families spend a far larger proportion of their incomes on food than do wealthy families (22 percent versus 12 percent according to the CCGD), taxing food would hit low-income families especially hard.

The Liberal Members of the Finance Committee cannot support taxing basic groceries. Furthermore, the Liberal Members have concluded that the entire GST proposal and its system of refundable tax credits is regressive, placing an unfair and unacceptable tax burden on low- and middle-income families.

3.5 The GST will not be visible

The Finance Committee heard from economic experts that the GST will be a hidden tax which Canadians will not see when they make a purchase.

Although the Government of Canada has the legal authority to require that the 9 percent GST be displayed as a separate item on sales receipts, the government intends to make display of the GST voluntary for businesses. Consumers have no assurance that they will be able to clearly identify how much GST they are paying when they make a purchase.

At the outset of tax reform the government promised that the GST would be visible to consumers,

"Sales tax reform will eliminate the hidden tax in the prices consumers pay."

Hon. Michael Wilson
House of Commons
June 18, 1987

Taxpayers have a right to know how much tax they are paying and to whom their taxes are being paid. The great danger of making the GST a hidden tax is that it would be much easier for the government to raise the rate in the future.

Several witnesses expressed the fear that there was nothing to prevent the government from raising the GST rate higher and higher if and when it is put in place. Given that, over the last five years, the government has increased the Manufacturers Sales Tax on four separate occasions from 9 percent to $13^{1/2}$ percent, Canadians are understandably skeptical that the GST rate will not be increased if the GST is put in place.

The experience of other countries with a GST also leads Canadians to be skeptical that the rate will not increase once the GST is in place. Most countries which have introduced a GST or some similar value-added tax have found it difficult to resist raising the rate once the tax is in place.

Table 2 lists 44 countries which had instituted a similar tax prior to 1988. It shows that 25 countries of the 44 countries with such a tax, raised the rate of the tax after it was introduced.

Many witnesses appearing before the Finance Committee feared that the Conservative government would raise the rate of the GST soon after it went into effect. In fact, when asked point blank to give a commitment to Canadians that he would not raise the GST rate in the future the Finance Minister refused:

"I cannot give that guarantee, it is not possible." [translation]

Hon. Michael Wilson
La Presse, October 26, 1989

Table 2
Standard Value-Added Tax (VAT) Rates throughout the World

Country	VAT Rate Introduced or Proposed	VAT Rates at Introduction	On Jan 1, 1988
Argentina	Jan. 1975	16	18
Austria	Jan. 1973	8	20
Belgium	Jan. 1971	18	19
Bolivia	Oct. 1973	10	10
Brazil	Jan. 1967	15	17
Chile	Mar. 1975	20	16
Columbia	Jan. 1975	10	10
Costa Rica	Jan. 1975	10	8
Côte d'Ivoire	Jan. 1960	8	25
Denmark	July 1967	10	22
Dominican Rep.	Jan. 1983	6	6
Ecuador	July 1970	4	6
France	Jan. 1968	13.6	18.6
Germany, Fed.Rep.	Jan. 1968	10	14
Greece	Jan. 1987	18	18
Guatemala	Aug. 1983	7	7
Haiti	Nov. 1982	7	10
Honduras	Jan. 1976	3	5
Hungary	Jan. 1988	25	
Iceland	Jan. 1989	24	
Indonesia	Apr. 1985	10	10
Ireland	Nov. 1972	16.37	25
Israel	July 1976	8	15
Italy	Jan. 1973	12	18
Japan		3	
Korea	July 1977	10	10
Luxembourg	Jan. 1970	8	12
Madagascar	Jan. 1969	12	15
Mexico	Jan. 1980	10	15
Morocco	Apr. 1986	19	19
Netherlands	Jan. 1969	12	20
New Zealand	May 1986	10	12.5 (effective Mar. 1989)
Nicaragua	Jan. 1975	6	10
Niger	Jan. 1986	12	25
Norway	Jan. 1970	20	20
Panama	Mar. 1977	5	5
Peru	July 1976	20	18
Philippines	Jan. 1988	10	
Portugal	Jan. 1986	16	16
Senegal	Mar. 1961-80		20
Spain	Jan. 1986	12	12
Taiwan	Apr. 1986	11.1	23.46
Tunisia	July 1988	17	
Turkey	Jan. 1985	10	15
United Kingdom	Apr. 1973	10	15
Uruguay	Jan. 1968	14	21

Source: Alan Tait, Value-Added Tax: International Practice and Problems

Once again Canadians are being asked to trust this government. The Conservative legacy of unprecedented tax increases and broken promises gives Canadians little reason to believe that the GST would not be used to raise their taxes in the future.

Since it would be easier for the government to raise the GST rate in the future if Canadians were not aware of how much tax they were paying at the moment, it is imperative that the GST be visible. The Liberal Members cannot support a hidden tax.

3.6 The government has failed to consider the long-term economic and social effects of the GST

While the GST proposal would shift the tax burden within Canadian society in several important ways, the government has given no indication that it appreciates the long-term effects which these shifts could have on Canadian society. If the tax burden is distributed in a fairer way, most Canadians would be willing to endure the economic disruption caused by tax reform. However, the GST proposal would shift the tax burden in several disruptive ways that many Canadians find difficult to support, particularly as the government has shown little evidence that it appreciates the long-term effects of these shifts.

3.6.1 The GST proposal would shift the tax burden from corporations to consumers

Under the GST proposal, corporations would receive input tax credits for 100 percent of the GST they pay on all of their purchases. In this way the GST would remove the sales tax burden completely from corporations and pass it along to the final consumer.

At the beginning of tax reform the Finance Minister promised that corporations would pay a larger share of tax than they did previously and that individuals would pay less. However, Jim Frank, Chief Economist for the Conference Board of Canada, produced evidence that the GST would shift taxes from corporations to consumers in a significant way. He predicted that corporate profits would increase by $600 million in 1991 and by $4.9 billion in 1992, at a time when economic growth will be slowing, and while real disposable income of consumers is predicted to fall by $7.3 billion in 1991 and by $5.8 billion in 1992. These figures also suggest that the Manufacturers Sales Tax is currently being absorbed, at least partially, at the corporate level through reduced profits.

3.6.2 The GST proposal would shift the tax burden from manufactured goods to services

The GST would, for the first time, put a sales tax on services, the fastest growing segment of the Canadian economy. The Finance Committee heard from many labour-intensive service industries, such as tourism and food services, about the effects that the GST would have on their industries. As the service sector is the fastest growing part of the Canadian economy, the GST would put a new tax on that particular sector which is generating most of the new jobs in Canada. There has been no indication that the government understands the importance of this shift of the tax burden onto labour-intensive services or what this means for employment opportunities in the service sector.

3.6.3 The GST would shift the tax burden from central Canada to other regions

The Finance Committee received powerful evidence from the Atlantic Provinces Transportation Commission that the GST would discriminate against regions outside central Canada in two ways:

1. That regional manufacturers would be put at a competitive disadvantage vis-à-vis manufacturers in central Canada, putting further strain on the east-west economic links between the regions of Canada:

   "The GST will create the perception that goods from the Atlantic region are more costly, due to the application of the GST on higher transportation costs, than those of competitors located closer to the marketplace."

   Atlantic Provinces Transportation Commission
   Brief to the Finance Committee
   page ii

2. That consumers in the regions will pay more GST on their purchases than consumers in central Canada:

   "A tax on transportation will impact disproportionately on those regions of

Canada which are located farther from the
major markets and sources of supply of
central Canada."

Atlantic Provinces Transportation Commission
Brief to the Finance Committee
page i

The Finance Committee heard similar arguments from Canadians in Northern and Western Canada:

"The cost of living in the north now, in Whitehorse, is probably 25 percent higher than in the rest of Canada, and many of the other municipalities go up as high as 50 percent higher. So it is pretty simple arithmetic when you start putting 9 percent on 50 percent or 9 percent on 25 percent. The fact is that we in the North will pay very dearly for this increased tax." (47:20)

Dr. Don Branigan
Mayor of Whitehorse, Yukon Territory

The government's <u>Report of the Task Force on Tax Benefits for Northern and Isolated Areas</u> describes how the current tax system ends up taxing northerners more than inhabitants of southern Canada, where the cost of living and wages are lower:

"A tax system applied uniformly on the basis of income alone imposes a greater burden in real terms on individuals living in regions with higher costs of living and higher wages."

Report of the Task Force on Tax Benefits for Northern and Isolated Areas
October, 1989
page 12

No other country in the world which has introduced a GST or a similar value-added tax has the vast distances or faces the regional economic challenges which Canada does. While geographically-small countries may believe that a GST is an appropriate way of raising taxes in their countries, where regional disparities are not significant and transportation costs are not great, a large country like Canada has vastly different needs. The regional implications of the GST for a country of Canada's vast size are serious.

The evidence which the Finance Committee heard made it clear that the GST will penalize the regions for being located farther away from the large consumer markets and manufacturing centres in central Canada. In a country where transportation is such an important cost of doing business, applying the GST to the retail price of taxable items, which includes the cost of transporting the item to its final destination, will result in a major shift in the tax burden onto the consumers in the regions.

In spite of all of the evidence that the GST will contribute to even greater regional disparities within Canada, there is no indication from either the government or the Conservative Members of the Finance Committee that they either understand this shift or care about it. There is no government response to the regional unfairness which the GST will cause. The Liberal Members cannot support a tax which contributes to greater regional disparity.

3.6.4 <u>The GST proposal would shift the tax burden from big business to small business</u>

Most of the Manufacturers Sales Tax is currently collected by 75,000 manufacturing companies. Under the GST proposal, over 1 million small businesses, from wholesalers through to small retailers, would have to collect and comply with the GST. Experience in Great Britain showed that compliance costs with the GST, measured as a percentage of sales, are 30 times greater for a small business than for a large firm. Shifting the tax burden onto small businesses would damage this sector, which has been the engine of growth in the Canadian economy.

These important shifts in tax burden from one group in society to another will have dramatic long-term economic and social effects. The government has not given any indication that it either understands the implications that these shifts will have on society or that it considers these shifts to be desirable. By focussing entirely on macroeconomic aspects of the GST the government has ignored many of its ramifications.

3.7 <u>The GST would put further pressure on the budgets of provincial governments, forcing them to either raise taxes, cut services or run larger deficits</u>

The GST proposal represents an attempt by the federal government to push its deficit problem onto the provincial governments. Every provincial Premier has publicly opposed the GST.

A Conference Board of Canada study commissioned by the provincial governments indicated that during the first three years of operation the GST could reduce provincial tax revenues by up to $6.9 billion. Provinces would be faced with three alternatives:

1. recovering these lost revenues through additional tax increases of their own; or
2. reducing services to the public; or
3. running larger provincial deficits (or smaller surpluses).

Canadians could face the double burden of higher provincial taxes on top of the federal GST. A report prepared by the provinces on the fiscal effects of the GST summarized the impact it could have on the provinces:

> "In addition to needlessly threatening the economic situation in the short term, the federal GST would seriously jeopardize the provinces' financial position, already made difficult because of the federal government's policy of progressive financial withdrawal from health care, post-secondary education and regional economic development. The economic impact of the GST could thus be worse if provincial governments had to adopt measures to restore their fiscal situation."
>
> Report by the Provincial Governments on the Fiscal Impact of the GST
> November, 1989
> page 17.

If the GST takes effect in 1991 consumers face combined federal-provincial rates of sales tax ranging from 9 percent in Alberta, where there is at present no provincial sales tax, to 21 percent in Newfoundland, where consumers would pay the 12 percent provincial retail sales tax on top of the 9 percent federal GST. (See Table 3 for a list of provincial retail sales tax rates in effect in November, 1989).

Worse yet, consumers face the prospect of even higher sales taxes if provincial governments are forced to raise their tax rates to recover lost revenues. In fact, provincial governments have already indicated that the GST would leave them with no choice but to raise provincial taxes:

> "We will probably have to raise our provincial sales tax from 12 percent to 15 percent or more if the GST isn't

Table 3
Provincial Retail Sales Tax Rates
(As of November, 1989)

Province	Sales Tax (%)
Newfoundland	12
Prince Edward Island	10
Nova Scotia	10
New Brunswick	11
Quebec	9
Ontario	8
Manitoba	7
Saskatchewan	7
Alberta	-
British Columbia	6
Yukon Territory	-
Northwest Territories	-

withdrawn...Either that or we will have to incease our provincial income tax rate, which is now 62 percent of the federal rate, to 75 or 80 percent."

Hon. Huber Kitchen
Finance Minister of Newfoundland
The Globe and Mail,
October 18, 1989

Understanding that provincial co-operation is critical to any successful reform of the sales tax system, Finance Committee Members were shocked to learn that the federal government never actually put any specific sales tax proposal on the negotiating table with the provinces. Provincial governments were never asked whether they would join a unified national sales tax system before the federal government broke off negotiations in April, 1989:

> "We were told, and we accepted the government's word, that they were negotiating for two years. We have only uncovered from travelling across Canada and talking to people who were in those hearings that there was nothing on the table; that most of the meetings had been technical in scope while federal officials learned about implementing retail sales taxes. There were no negotiations." (33:18)
>
> John Bulloch
> President of the Canadian Federation of Independent Business

The government's haste to meet its self-imposed deadline to have the GST in place by 1991 has led to major flaws in the GST proposal. Mr. Bulloch makes this point:

> If the federal government were really serious about a unified system, they would not have made all the stupid mistakes they have made." (33:18)
>
> John Bulloch
> President of the Canadian Federation of Independent Business

The failure of the federal government to obtain provincial cooperation has doomed the GST to failure. The losers will be all Canadians.

3.8 <u>The GST proposal would damage several key sectors of the Canadian economy and society</u>

The GST will have a dramatic impact on numerous segments of Canadian society and the economy. To list all of those groups who told the Finance Committee about the particular hardships that the GST would cause would be impossible because of the sheer number of witnesses. However, the following comments provide a representative sample of the concerns expressed to the Finance Committee during the hearings.

The Tourism Industry Association of Canada told the Finance Committee in its brief that:

> "A GST of 9 percent will be devastating for our labour intensive industry. By 1992 Canada will lose over $1 billion per year in tourism revenue as a direct result of the 9 percent tax."
>
> Tourism Industry Association of Canada
> Brief to the Finance Committee, page 1

The tourism industry's problems will be felt particularly heavily in Western Canada and Atlantic Canada, where tourism is a growth industry and tourist dollars are an important source of income.

In Vancouver, Members of the Finance Committee heard that the drastic impact which the GST would have on the entire service sector of the economy would have a disproportionate effect on employment opportunities for women:

> "Calculating the proportion of women's jobs held and what we feel is the cost of each job, we estimate that 100,000 jobs in services alone will be eliminated." (48:57)
>
> Dr. Marjorie Cohen
> Co-Chair of the Taxation Committee of the National Action Committee on the Status of Women

The Canadian Home Builders' Association told the Finance Committee that the GST proposal would raise the price of a typical new house in Canada in every city right across Canada, reducing the demand for new construction. Price increases for new houses would range from $1,900 in Halifax, $2,200 in Montreal, $2,300 in Edmonton, $4,700 in Vancouver, to $9,200 in Toronto.

> "With price increases in these ranges, the affordability of home purchase, contrary to the Minister of Finance's commitment, will be negatively affected by sales tax reform."
>
> Canadian Homebuilders Association
> Brief to the Finance Committee
> page v

The Finance Committee also heard that the GST proposal would raise monthly rents by $40 to $60 and cut the supply of deperately-needed new rental units:

> "The affordability of all rental housing (both existing and new) provided by the private sector will also be negatively affected by the proposal to exempt residential rents from the GST."
>
> Canadian Homebuilders Association
> Brief to the Finance Committee
> page vi

In addition to the alarming fact that fewer Canadians would be able to purchase a new house or find affordable rental accomodation, the impact of the GST on the construction industry would be severe.

The Federation of Canadian Municipalities expressed strong reservations about the Finance Minister's assurances that the GST would not cause any hardship for individual municipalities:

> "How can the Minister ensure that the reform of the federal sales tax system imposes no greater tax burden than before reform, when in fact that tax burden cannot be calculated with any degree of accuracy?"
>
> Canadian Federation of Municipalities
> Brief to the Finance Committee
> page 3

The Sports Federation of Canada expressed concern about what applying the GST to minor hockey registrations and other athletic activities would do to amateur sports in small communities across Canada:

> "The application of the GST, in its current form, could have devastating effects on the activities of amateur sport."
>
> Sports Federation of Canada
> Brief to the Finance Committee
> page 10

The Finance Committee heard how the GST proposal would devastate the publishing industry and further contradict the government's stated goal of eradicating illiteracy in Canada:

> "The impact of this tax on education and on the government's own program to combat illiteracy will be negative in the extreme. For a government that believes in universal free education and that promises to combat and eliminate illiteracy, it is a sad irony that it will now put a tax on reading, on books, on magazines, on newspapers, on the essential building blocks of these programs." (42:39)
>
> Mr. Dan Mozersky
> Don't Tax Reading Coalition

The Finance Committee heard from representatives of the arts communities about their concern that the GST would put great strain on the arts and cultural communities in Canada, forcing many groups to seek more government funding to continue operating:

> "What we look for is that the work done until now will not be jeopardized by a tax that will severely handicap organizations which have done everything they can - within the cultural role served by non-profit organizations - to go beyond a reliance on government subsidies." (64:37)
>
> Joyce Zemans
> Director of the Canada Council

The Finance Committee heard of the difficulties that the GST would cause farmers:

> "I think it is fair to say that organizing your line of credit at a bank is for many, many farmers a very touchy and tight situation, and there is no question that adding a 9 percent requirement to that each spring is going to be felt by many farmers. It is going to be a big factor in trying to line up their line of credit." (74:9)
>
> Brigid Pyke
> Canadian Federation of Agriculture

The Canadian Independent Adjusters Association told the Committee how the flawed design of the GST would decimate its part of the insurance industry:

> "I think that as many as half our members would virtually be out of business." (68:28)
>
> Michael Lowthian
> Canadian Adjusters Association

All in all, the GST will cause severe hardship in many industries, particularly the labour-intensive service sector which employs a disproportionate number of women. The GST would make housing less affordable and put further strain on municipalities, universities and colleges, schools, hospitals and many non-profit and charitable organizations that are already under financial duress.

Canadians from all regions of Canada working in different industries and representing diverse social interests are united in their opposition to the GST.

4.0 THE FAILURE OF THE CONSERVATIVE GOVERNMENT TO UNDERTAKE REAL TAX REFORM

4.1 Conservative Record: Unfairness

Since the Conservative government came to power in September 1984, individual Canadians have been subjected to an unprecedented number of tax increases. A list of these tax increases is included in Appendix 1.

Several studies have been completed recently on the fairness of these tax increases:

1. The Canadian Council on Social Development (CCSD)

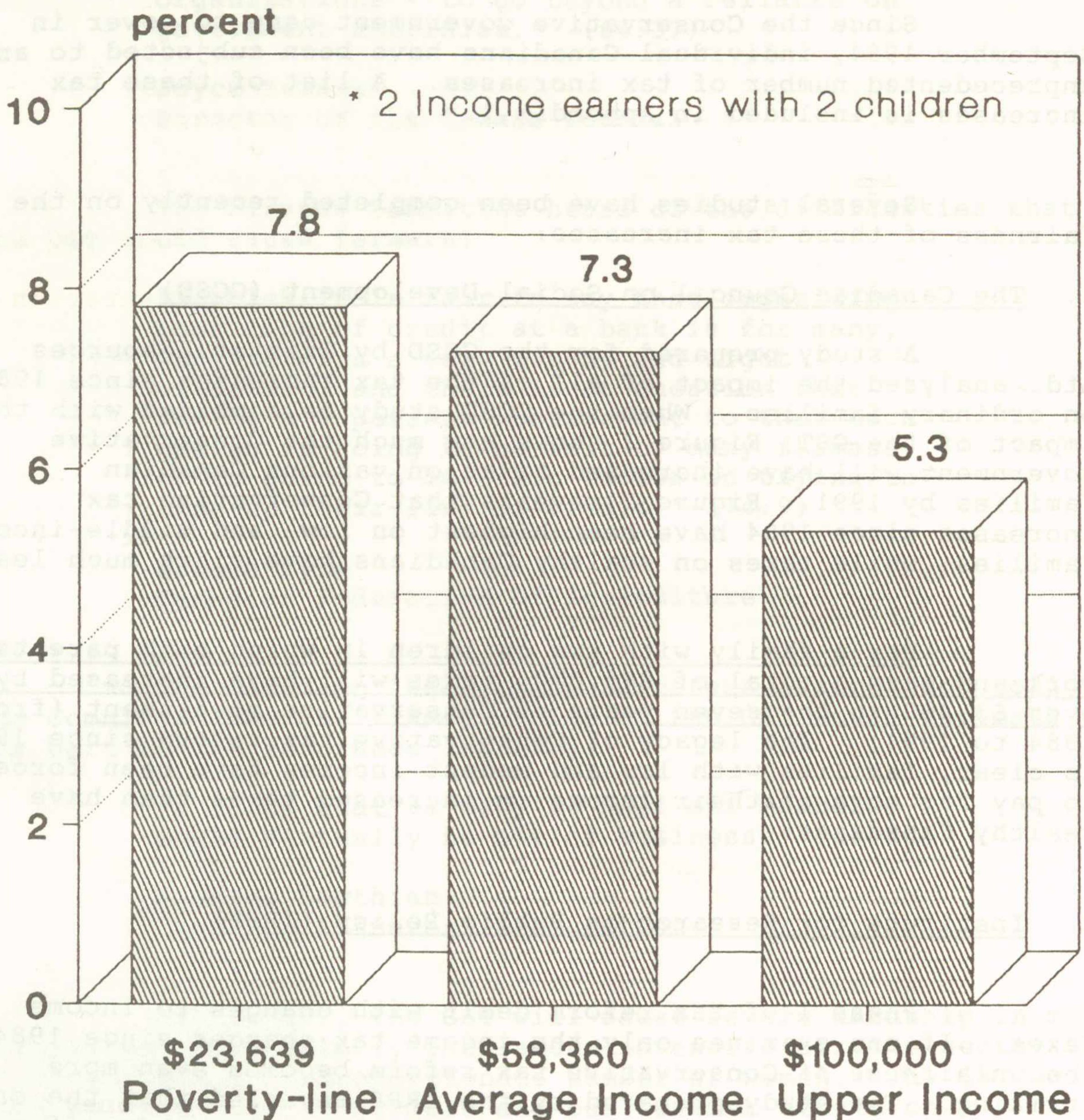
A study prepared for the CCSD by Tristat Resources Ltd. analysed the impact of all of the tax increases since 1984 on ordinary families. When the CCSD study is combined with the impact of the GST, Figure 2 shows how much the Conservative government will have increased taxes on various Canadian families by 1991. Figure 2 reveals that Conservative tax increases since 1984 have been highest on low- and middle-income families, while taxes on wealthy Canadians have risen much less.

For a family with two children in which both parents work and earn a total of $45,000, taxes will have increased by over $3,400 in the seven years of Conservative government (from 1984 to 1991). The legacy of Conservative tax reform since 1984 is clear; families with low and modest incomes have been forced to pay far more of their income in increased taxes than have wealthy Canadians.

2. Institute for Research on Public Policy (IRPP)

Phase I of tax reform dealt with changes to income taxes. If one examines only the income tax changes since 1984 the unfairness of Conservative tax reform becomes even more striking. The study prepared by the IRPP revealed that the only groups who have benefitted from Conservative income tax reform have been the very poor and the very wealthy.

FIGURE 2



The results of the IRPP study are summarized in Figure 3. The top-earning one percent of Canadians (incomes over $114,000) is one of the only groups to actually pay lower income taxes after tax reform than before. Figure 3 reveals that while income taxes on wealthy Canadians have been reduced, low-income and middle-class Canadian families have had their income taxes raised dramatically. Phase I of tax reform has not been fair tax reform at all.

The author of the IRPP study suggests that Phase II of Conservative tax reform (sales tax reform) will only reinforce the unfairness created by Phase I:

> "[The GST] is no different than the Tory tax measures of the last five years. Since that time, it has been the middle class that has carried the heaviest tax load and watched as their disposable income dropped."
>
> Professor Allan Maslove
> Carleton University School of Public Administration
> Winnipeg Free Press
> October 12, 1989

Central to the issue of tax fairness is how the tax burden is shared between individuals and corporations. Figure 4 shows how the distribution between personal income taxes, sales and excise taxes (consumption taxes) and corporate taxes has changed over the last thirty years.

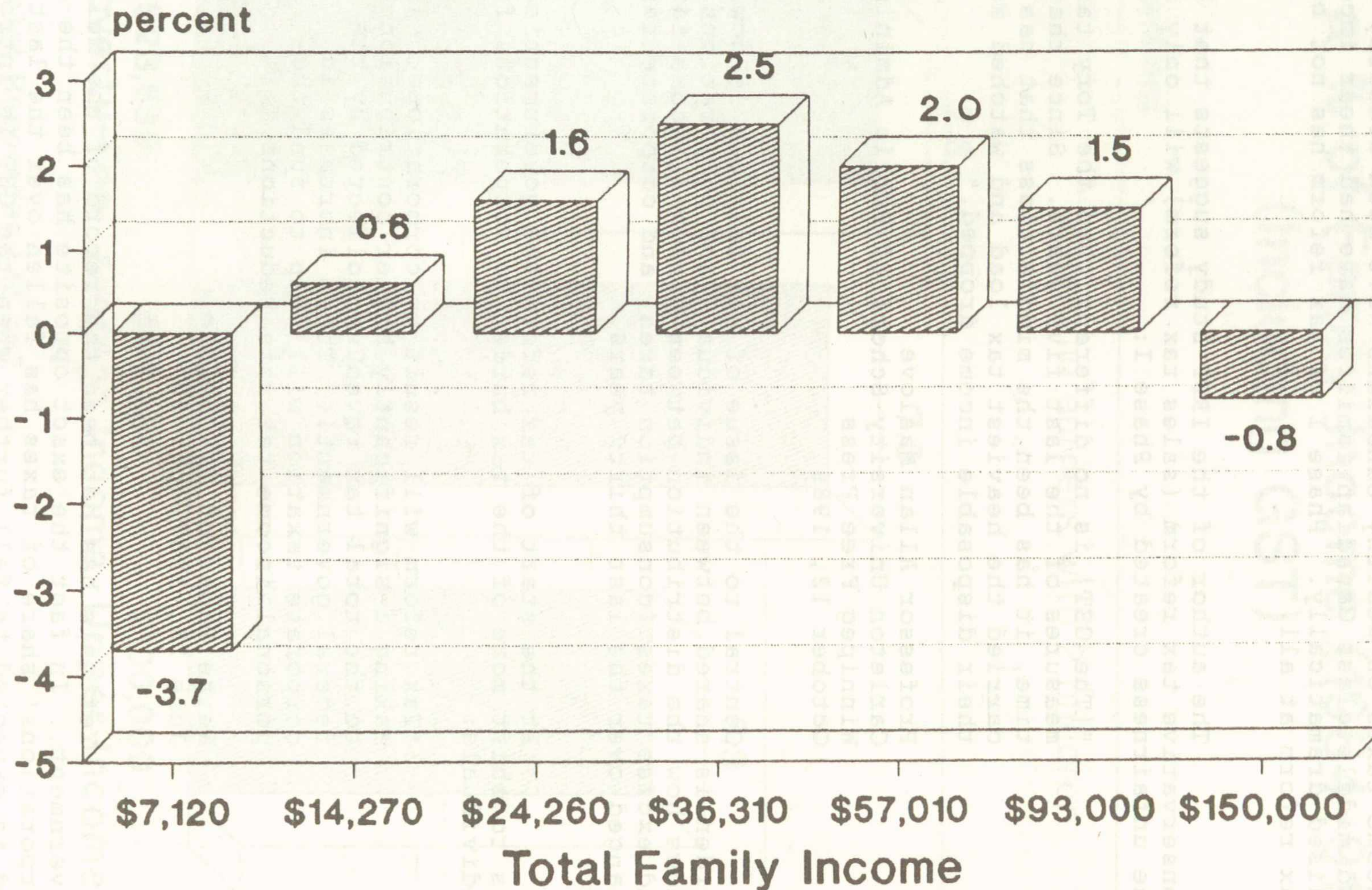
At the start of tax reform the government's commitment was to shift more of the tax burden to corporations from individuals:

> "Tax reform will result in corporations making a significantly higher contribution to the total tax revenues collected by the federal government... These increases in corporate taxation will help to fund the personal income tax rate reductions."
>
> White Paper on Tax Reform
> June 18, 1987, pg. 50

Yet this has not been the record of the Mulroney government. In fact the exact opposite has been the case; corporations' share of taxes has fallen over the last five years and is expected to fall further when the GST is introduced.

FIGURE 3

Increase in Income Taxes as a % of Disposable Income (1984-88)



Source: Tax Reform in Canada; The Process and Impact , Allan Maslove Institute for Research on Public Policy

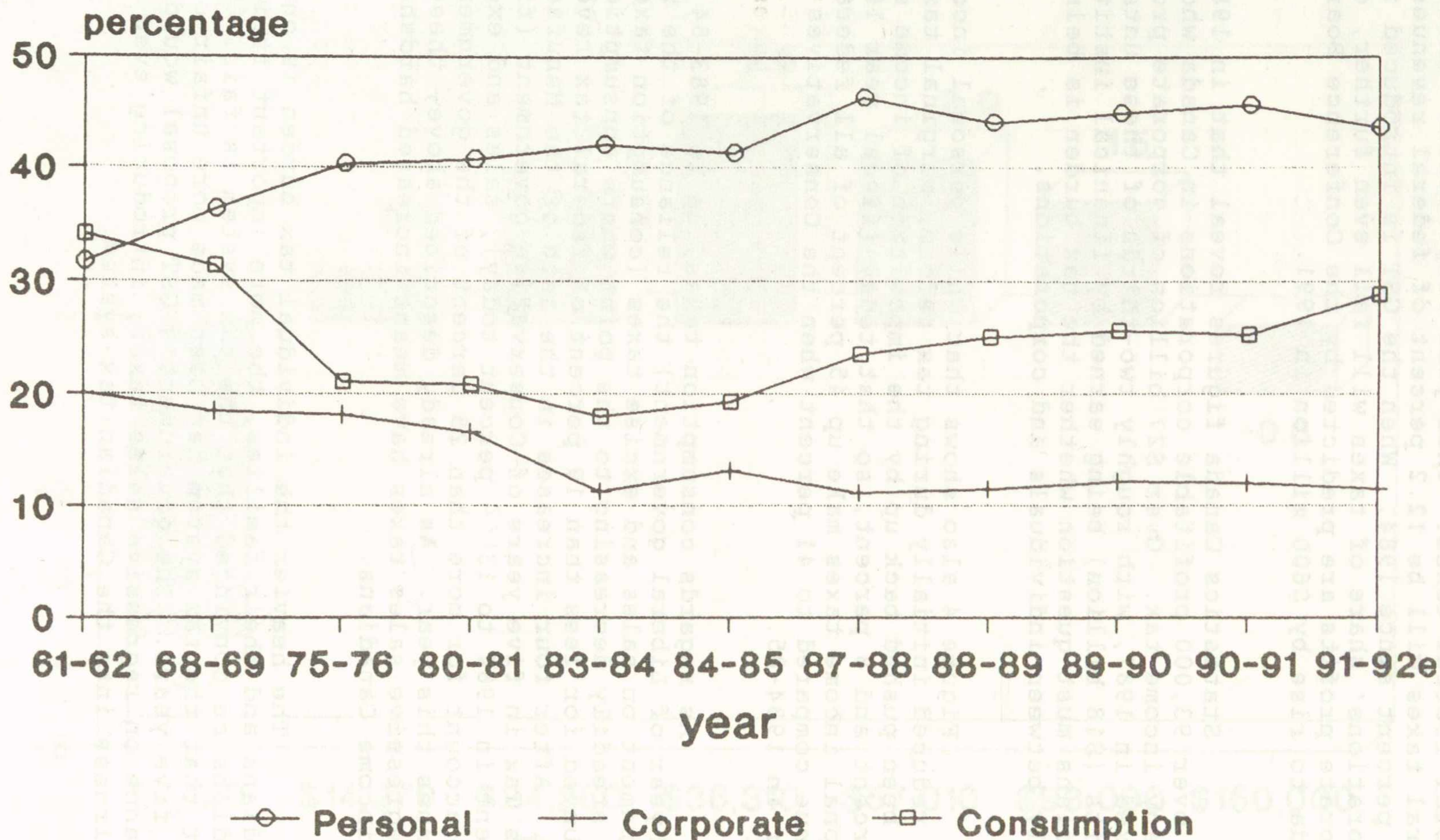
As Figure 4 shows, when the Conservative government took power in 1984, corporate taxes accounted for 13.2 percent of total federal taxes. This year corporations' share of federal taxes will be 12.2 percent of federal revenues, a drop of 1 percent since 1984. When the GST is introduced in 1991, corporations' share of taxes will fall even further, even though corporate profits are predicted by the Conference Board of Canada to rise by $600 million in 1991.

Statistics Canada figures reveal that in 1987 there were over 93,000 profitable corporations in Canada who did not pay any income tax. Over $27 billion of corporate profits went untaxed in 1987, with roughly two-thirds of these untaxed profits ($18 billion) being earned by finanical institutions. Canadians must question whether the tax burden is being shared fairly between individuals and corporations.

Figure 4 also shows that while personal income rates were reduced initially during tax reform, marginal tax rates have been pushed back up by the imposition of income surtaxes of 5 percent and 8 percent, so that today (fiscal year 1989-90) personal income taxes make up 45 percent of all federal tax revenue compared to 41 percent when the Conservatives came to power in 1984-85.

As regards consumption taxes, up to 1983-84 (the last full year of Liberal government) the reliance of the federal government on sales and excise taxes (consumption taxes) had been steadily decreasing to the point where consumption taxes accounted for less than 19 percent of federal tax revenue in 1984. After four increases in the rate of the Manufacturers Sales Tax in five years of Conservative government (from 9 percent in 1984 to 13 1/2 percent today), sales and excise taxes will account for more than 25 percent of the government's revenues this year. As already described above, these increases in regressive sales taxes have meant increased hardship for low-income Canadians.

The heavier the individual tax burden is on average Canadians and their families, the more important it is that Canadians be convinced that the tax system is fair. There is no doubt that the tax system has been made more unfair over the last five years. The government's GST proposal would increase reliance on regressive sales taxes, introducing even more unfairness into the Canadian tax system.


Tax Revenues as a Percentage
of Total Government Revenues
percentage
50
40
30
20
10
0
61-62
68-69
75-76
80-81
83-84
84-85
87-88
88-89
89-90
90-91
91-92e
year
Personal
Corporate
Consumption
Source: 1989 Budget, Fiscal Plan

The Liberal Members of the Finance Committee believe Conservative tax reform to date has been unfair. It is time for a complete overhaul of the tax system, so that Canadians can have confidence that every individual and corporation is paying a fair share of tax.

4.2 The conservative government has created a financial mess, necessitating a review of all government finances and sources of revenue

In the five years since the Conservative government came to power, the public debt of the government of Canada has doubled. In the last two federal budgets presented by Finance Minister Wilson the government has increased the deficit. The record of the Conservative government has been one of economic mismanagement and incompetence.

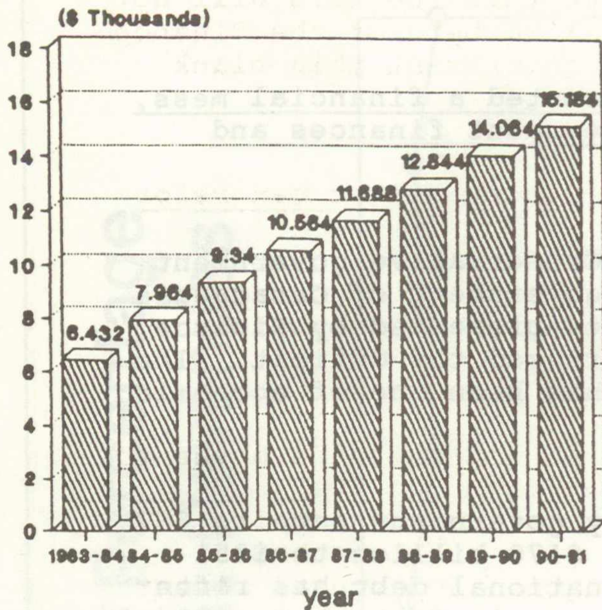
Since 1984 (when the Mulroney government came to power), the public debt has risen from $170 billion to $351 billion. On an individual basis, the national debt has risen from roughly $16,000 per Canadian taxpayer in September, 1984 to over $25,000 per taxpayer in 1989 (See Figure 5). If this debt is financed at an average interest rate of 10 percent, each taxpayer in Canada must now pay $2,500 a year in taxes just to pay the interest on the public debt.

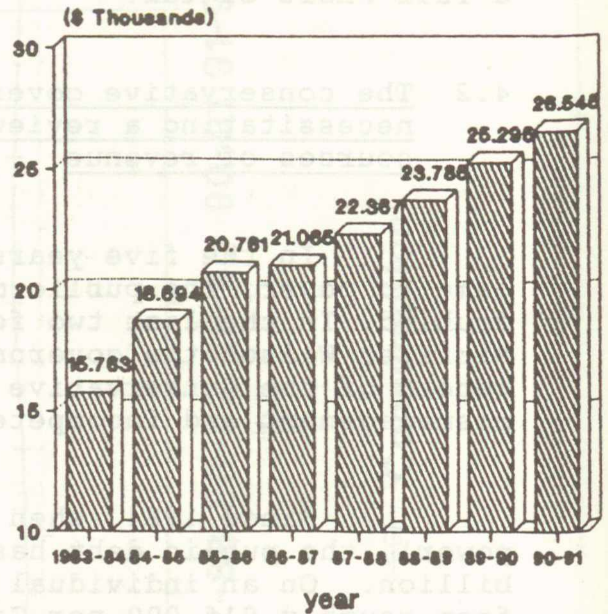
Much of the increase in the public debt is a result of the government's policy of high interest rates. Because more and more of this Conservative debt is financed at high interest rates, the interest charges on the debt now account for 28 percent of the federal government's expenditures.

The first step in getting control of the nation's finances would be for the government to accept the unanimous recommendation of the Finance Committee, made in the spring of 1989, to lower Canadian interest rates by two percent. This would reduce the deficit immediately by $3.2 billion and by $6.6 billion in 1992-93.

In spite of the Finance Minister's earlier promises that the GST would be "revenue-neutral", it is clear that the GST is a Conservative tax-grab. By raising the rate in the future and not having fully indexed the credits for low-income Canadians, the Conservative government would seek to reduce the deficit by increasing taxes on those Canadians least able to pay. The Liberal Members of the Finance Committee completely reject this attempt to push more of the burden of deficit reduction onto the poor and disadvantaged members of Canadian society.

FIGURE 5





THE FEDERAL DEBT
PER CANADIAN, PER TAXPAYER

Year	Public Debt	Per Canadian[1]	Per Taxpayer[2]
	($ billions)	($)	($)
1983-84	160.8	6,432	15,763
1984-85	199.1	7,964	18,694
1985-86	233.5	9,340	20,761
1986-87	264.1	10,564	21,065
1987-88	292.2	11,688	22,367
1988-89[e]	321.1	12,844	23,785
1989-90[e]	351.6	14,064	25,295
1990-91[e]	379.6	15,184	26,545

[1] Calculated by dividing Public Debt by Canadian Population. Population based on 1986 Census data of approximately 25 million Canadians.

[2] Calculated by dividing Public Debt by total number of Taxable Returns Source: Taxation Statistics, (1985 to 1989).

[e] Based on a projected growth of taxpayers by 3 percent each year.

By refusing to give a solid commitment that they will not raise the rate in the future, the government is asking Canadians to give them a blank cheque. The Conservative government proposes to introduce the GST at a given rate, but will provide Canadians with no assurance that the rate will not be increased in the future. The Liberal Members of the Finance Committee are not prepared to give the government this blank cheque.

4.3 <u>Canadians have not been adequately consulted on tax reform</u>

Before any reform of the tax system is undertaken, Canadians must be consulted. They have not been adequately consulted on the GST proposal.

The Liberal Members deplore the government's moves to limit debate on the GST proposal. After ignoring its commitment, made in the 1989 Budget Speech, to present its GST proposal by June, the date for release of the GST Technical Paper was pushed back first to July and then to August. After these missed deadlines and delays, the government then proposed to give Canadians one month (until September 15, 1989) to prepare detailed comments for the Finance Committee on the GST proposal.

Finance Committee hearings were intially scheduled to conclude in a few weeks, after visiting only a few provinces and neither of the Territories. The Liberal Members of the Finance Committee fought to have the deadline for submitting intentions to file briefs to the Finance Committee extended by thirty days and to have the Committee travel to all the western provinces and the Territories, as well as all four of the Atlantic provinces. Although the Liberal Members would have liked to spend more time in the regions listening to Canadians' views on tax reform, it was clear that the government was not prepared to listen or to give Canadians adequate time to evaluate or comment on the GST proposal.

Having given Canadians virtually no time to read or understand a complicated GST proposal that took two years to produce, and giving Canadians barely one month to review the GST Technical Paper, the Conservative Members of the Finance Committee then proceeded to patronize and chastise Canadians during the public hearings for their alleged lack of understanding of the details of the proposed tax.

Now the government claims that, in order to combat what it terms public ignorance about the GST, it needs to spend $9 million of taxpayers' money to educate them about the GST.

with it, leaves Canadians to question the government's priorities and to wonder if the government is doing all it can to reduce spending and to eliminate senseless waste.

Canadians will not tolerate being patronized or lied to by their government. Canadians are willing to do their share to solve the deficit problem, but they demand open, fiscally-responsible government. The government should allow Canadians enough time to comment on the GST proposal and should listen to taxpayers' views on tax reform, rather than spending Canadians' own money to convince them that they should pay higher taxes.

The Liberal Members believe that a fair and comprehensive reform of the tax system must begin with an open dialogue with Canadians. Canadians should be listened to, not lectured to, by their elected representatives.

5.0 RESPONSE TO THE GST PROPOSAL

5.1 Reforming the Manufacturers Sales Tax

The Liberal Members accept the evidence of several witnesses that the Manufacturers Sales Tax is in need of reform. However, Liberals cannot support the replacement of a flawed tax with an unacceptable tax. The Liberal Members cannot understand how the members of the Conservative majority on the Finance Committee can support the GST in the face of evidence from an overwhelming number of witnesses that the GST is an even worse tax than the Manufacturers Sales Tax.

The Finance Committee heard from witnesses about the economic distortions sometimes caused by the Manufacturers Sales Tax and how it may discriminate against domestically-produced goods thus hurting our exports. The Finance Committee also heard from witnesses that the Manufacturers Sales Tax may lower the competitiveness of Canadian exports by 1 percent, but that this is offset by billions of dollars of Canadian government subsidies to exporters.

Even if one accepts the argument that the Manufacturers Sales Tax disadvantages Canadian manufacturers, clearly the high value of the Canadian dollar and high interest rates are far more important determinants of international competitiveness than is the Manufacturers Sales Tax.

Canadian exporters currently face the competitive disadvantage of Canadian interest rates which are more than four percent higher than American interest rates and a Canadian dollar which has appreciated 13 percent since 1984 vis-à-vis the U.S. dollar (from 75 cents U.S. in 1984 to more than 85 cents U.S. in 1989). A one-percent disadvantage from the Manufacturers Sales Tax pales in comparison to the competitive disadvantages resulting from a high dollar and high interest rates.

The Liberal Members note with interest that at the same time as the Finance Minister has termed the Manufacturers Sales Tax a "silent killer of jobs" because it damages the competitiveness of Canadian exports, he has not hesitated to increase the rate. In five years the Finance Minister has raised the rate of the Manufacturers Sales Tax on four separate occasions from 9 percent in 1984 to $13^{1/2}$ percent today. The Finance Minister cannot have it both ways. If the Manufacturers Sales Tax is such a great evil that it desperately needs to be replaced by the GST, then how can he justify such increases in its rate?

The government has also argued that the Manufacturers Sales Tax is an administrative problem for the government, requiring 22,000 special provisions and administrative arrangements. The GST proposal would certainly eliminate the government's administrative problems, but only by imposing these administrative problems on over 1 million small businesses who will have to cope with over 4,000 new tax collectors at a cost of billions of dollars. The GST does not eliminate the administrative problem; it just privatizes it.

Liberals acknowledge that there is a need for the government to create a fair and reliable tax system that can generate the tax revenues needed to pay for the government services which Canadians have come to expect. However, a climate of desperation has taken over the government as it rushes to get its hands on this large money-machine, the Goods and Services Tax. The Liberal Members believe that Canadians should not be railroaded into accepting a flawed GST proposal; if the Manufacturers Sales Tax is to be reformed, we must insist that it is done correctly.

Liberals have always supported reform of the Manufacturers Sales Tax if it can be done in a fair and equitable way. However, while consultations on a fair and broad-based tax reform are undertaken, the Auditor-General has pointed out in his 1989 report that there are several immediate measures which the government could undertake to address some of the flaws of the Manufacturers Sales Tax in the short term.

Regarding the need to reform the Manufacturers Sales Tax, the Liberal Members found themselves in agreement with the statement made to the Finance Committee in Winnipeg by Mr. Bob Sparrow, Chairman of the Hotel Association of Canada:

> "We have always agreed the existing tax system should be reformed, but do not reform it with another monstrosity that will plague Canadians for years to come. Take the time to get it right. This means going back to the drawing board with the provinces." (57:24)
>
> Bob Sparrow
> Chairman of the Hotel Association of Canada

5.2 Liberal Principles on Tax Reform

Acknowledging that overall tax reform will be a complex and delicate process, it is important for Liberals to make clear the principles upon which tax reform should be based.

1. **Fairness - A Tax System Based on the Ability to Pay**

   The Liberal Party has always stood for and defended a fair and progressive tax system. Reform must respect the principle that the burden of paying taxes should be based on the ability to pay.

2. Simplicity

   Tax reform must be designed to make the tax system easier for Canadians to understand and thus ensure compliance.

   Voluntary compliance has always been the foundation of our tax system. But for how long will Canadians continue to comply voluntarily with a system that is beyond comprehension, even by experts?

3. Integrated

   Sales tax reform cannot be undertaken independent of income tax reform, corporate tax reform, social welfare reform or independently of the other levels of government. Canada is in need of an overall tax reform that encompasses all forms of taxation and all levels of government. An integrated tax reform must recognize that while there are several levels of government in Canada, they all look to the same person to pay their bills -- the taxpayer.

4. Visibility

Canadian taxpayers have a right to know what taxes they are paying. Any reform of the tax system should be designed to help Canadians understand exactly how much and to which level of government they are paying their taxes.

5. Revenue neutrality

Tax reform should not be a smoke-screen for raising taxes. Rather, tax reform should be undertaken with the goal of improving the tax system.

If a flawed tax can be replaced with a better tax, then it should be done in a way that does not raise the revenues of the government. In this way the new tax would be less likely to affect the economy adversely and Canadians would be better able to judge whether the new tax is working fairly and effectively.

5.3 Suggested Alternatives to the GST

The government's strategy going into the Finance Committee hearings was to try and convince Canadians that unless they could come up with a better idea, Canadians would be stuck with the government's 9 percent GST. Virtually every witness who came before the Committee to oppose the GST faced the same question from the government members, "Well if you are opposed to the GST, what would you suggest be done instead?" The government is asking Canadians to do what it, with all of the resources at its disposal, has failed to do; that is to come up with a fair and comprehensive tax reform plan.

Of course, the Conservatives are not truly interested in alternatives to the GST. What they are seeking is a strategic opportunity to attack someone else's proposal instead of defending their own. The premise of their argument is that the Manufacturers Sales Tax is so bad that it needs to be replaced immediately, in spite of widespread opposition from Canadians. This premise has not been proven and Canadians should not be diverted from the real issue, which is - Is the GST proposal a measurable improvement over the status quo?

Many witnesses who came before the Finance Committee as well as others commenting on the GST have suggested alternatives and Canadians should not be misled into believing that there is no option but to adopt the GST. However, in the

opinion of the Liberal Members, the most desirable alternative was that so succinctly suggested by Ontario Premier David Peterson:

> "The alternative is Mr. Wilson can resign. The alternative is that he could change his fiscal policy."
>
> Premier David Peterson
> Financial Post
> August 24, 1989

The Liberal Members believe that this is one recommendation that should be seriously considered if the government continues to proceed with the GST despite the opposition of Canadians.

6.0 CONCLUSION

After listening to Canadians and studying the GST proposal, the Liberal Members of the Finance Committee reiterate their recommendation:

That the Conservative Goods and Services Tax proposal be withdrawn and that the federal government immediately begin consultations with Canadians and provincial governments on the creation of a fair and integrated reform of the entire tax system.

The Liberal Members of the Finance Committee reject the position of the Conservative majority on the Committee, that the government's GST proposal can be repaired in a way that would be acceptable to Canadians and that it should be implemented.

The GST proposal would: create economic disruption; increase taxes on average families; introduce an unprecedented level of complexity into the tax system; impose further hardship on low-income Canadians; remain hidden from taxpayers; shift the tax burden in several important ways in Canadian society without the government fully understanding the long-term effects of these shifts; cause financial difficulties for provincial governments; and harm many sectors of the Canadian economy. The GST proposal is fundamentally flawed and must be withdrawn.

Liberals support fair tax reform. But what the Conservatives call tax reform has proven to be unfair. The

unfairness of the tax system and the financial mismanagement of the government has made necessary a complete review of the government's finances and sources of revenue.

Canadians have not been adequately consulted on tax reform and should be listened to carefully before fair tax reform proceeds. The government should undertake an open dialogue with Canadians to solicit their views on tax reform.

The Liberal Members believe that the Manufacturers Sales Tax is in need of reform, but that the government's GST proposal is unacceptable and should be scrapped. Any reform of the tax system must be designed to make the tax system more fair; to make the tax system simpler; to be integrated, taking into consideration all forms of taxation and the needs and practices of other levels of government; to make taxes visible to Canadians; and in a manner that is revenue neutral.

The GST proposal violates all of these basic Liberal principles of tax reform and therefore must be rejected.

APPENDIX 1

MAJOR TAX INCREASES FOR INDIVIDUALS INTRODUCED BY THE CONSERVATIVE GOVERNMENT (1984-1989)

A - INDIRECT TAXES (sales and excise taxes)

	EFFECTIVE DATE	ANNUAL REVENUE
- Increases in federal sales tax:		
a) Increase from 9% to 10%	Oct '84	$ 1 billion
b) Increase from 10% to 11%	Jan '86	$ 1 billion
c) Increase from 11% to 12%	Apr '86	$ 1 billion
d) Increase from 12% to 13 1/2%	Apr '89	$ 1.6 billion
- Extensions of the federal sales tax to new items:		
a) candies, soft drinks, pet food	July'85	$ 400 million
b) snack foods	July'87	$ 60 million
c) 10% federal sales tax on long distance telephone calls and cable services	Jan '88	$ 945 million
- Increase in federal sales tax on long distance calls and cable services from 10% to 11%	June'89	$ 110 million
- Increase in the federal sales tax from 8% to 12% on paint, wallpaper, toys and handicrafts	Jan '88	$ 60 million
- Increase in federal sales and excise taxes on gasoline:		
a) 2 cents a litre	Sept'85	$ 900 million
b) 1 cent a litre	Jan '87	$ 450 million
c) 1 cent a litre	Feb '87	$ 450 million
d) Increase in federal sales tax on leaded gasoline to equal sales tax on unleaded gasoline	Apr '87	$ 30 million
e) 1 cent a litre	Apr '88	$ 450 million
f) 1 cent a litre	Apr '89	$ 320 million
g) 1 cent a litre on leaded gasoline	Apr '89	$ 35 million
h) 1 cent a litre	Jan '90	$ 320 million

.../2

A - INDIRECT TAXES (cont'd)

	EFFECTIVE DATE	ANNUAL REVENUE
- Increase in federal sales and excise taxes on alcohol and tobacco:		
a) first increase	May '85	$ 340 million
b) second increase	Feb '86	$ 150 million
c) third increase	Feb '86	$ 70 million
d) fourth increase	Jan '88	$ 175 million
e) fifth increase	Apr' 89	$ 1 billion

B - DIRECT TAXES (income taxes)

	EFFECTIVE DATE	ANNUAL REVENUE
- a) elimination of Registered Homeownership Savings Program	May '85	$ 105 million
- b) elimination of federal tax reduction for low income Canadians	Jan '86	$ 650 million
- c) deindexation of the personal income tax system, family allowances, tax credits	Jan '86	$ 635 million
- d) temporary 5% and 10% surtaxes on personal income taxes	from Jul'85 to Dec '86	$ 500 million
- e) permanent general 3% surtax on all personal income taxes	Jul '86	$ 1.2 billion
- f) changes to marital exemption	Jan '86	$ 20 million
- g) increase in general surtax from 3% to 5% on all personal income taxes	Jul '89	$ 1.1 billion
- h) high income surtax of 8% for high income Canadians	Jul '89	$ 165 million
- i) claw-back of old age security pensions and family allowances	Apr '89	$ 500 million

APPENDIX B

DISSENTING OPINION – NEW DEMOCRATIC PARTY

NEW DEMOCRATS

MINORITY REPORT ON THE GOODS AND SERVICES TAX

"The roots of the public's discontent with Canada's tax system are many, and they run deep. Each particular class of taxpayer has its own grievance against the peculiar way taxes are levied upon it. Any consideration of tax reform must consider the grievances of not only the wealthy, high income and corporate taxpayers; it must also consider the grievances of ordinary Canadians, who without doubt, shoulder the largest share of the tax burden."

Raymond Koskie
Dissenting Comment in "Road Map for Tax Reform" A Statement by the Economic Council of Canada, 1987
p. 32-33

"But the rich have declared that option closed, out of bounds. And so we are now engaged in a massive national debate on the future of our tax system - a debate in which the most important question in taxation is off-limits."

Linda McQuaig, Behind Closed Doors, Penguin Books, 1987,
p. 350

The most important question in taxation is "who pays?" Raising revenue needed to provide public goods and services necessary in civilized society is the technical job of the tax system. But the heart of every country's economic system is the distribution of the resources that its citizens collectively produce. To address the questions of who bears the burdens in our society, and who reaps the rewards, is to address the central issue of what we, as a nation are all about - what values we cherish, what aspirations we hold. The tax system is the government's most important

policy instrument ensuring that our aspirations of an equitable economic system are achieved.

In the minds of the Canadian public, tax fairness or equity has never meant that everyone should pay the same amount or the same percentage of their income in tax. Instead, equity has been measured on the basis of ability to pay. Everyone has basic needs which require a certain amount of income. Above and beyond that, income should be taxed at increasing rates to support the broader needs of society. Our whole notion of progressive income tax has been based on this understanding.

At present we are engaged in what is called "Tax Reform - Phase II'' - and yet there appears to be no common understanding between the governors and the governed about what "tax reform'' means, much less how to go about doing it.

Although the public perception is that the existing tax system is unfair (i.e., that the rich and multinational corporations are not paying their fair share) - the government's perception is that the only problem with the system is that it is inefficient. Its main concerns are that the tax system doesn't raise enough revenue, that some of the sources of that revenue are elusive and unpredictable, and that the well-to-do allege that the existing system diminishes their incentive to work and to save.

The government is keenly aware that earlier proposals to produce genuine progressive reform of the system ran into implacable opposition from wealthy vested interests - who were able to successfully block the major tax reform effort ushered in by the Carter Commission in the mid-sixties, and subsequent attempts in the late 1960s and the early 1980s.

Knowing however that any momentum for tax reforms must play to the public perception that the system is unfair, the Mulroney government has launched its pitch for public support of "Tax Reform'' in the language of progressive reform.

> "(The rich) ... should pay tax, and it should be a handsome tax.''
>
> Brian Mulroney
> Televised Debate
> 1984 Election Campaign

> "We all know that the tax system allows many profitable corporations to avoid paying a fair share of tax, year after year. We all know that it allows some people with very high incomes to pay less tax than the average Canadian wage earner, year after year. We all know that it

allows those who are able to use special tax breaks to shift the burden to others less able to carry it.''

Michael Wilson
House of Commons
June - 1987 - on
launching Tax Reform -
Phase I

"The GST will improve the overall fairness of the tax system.''

Michael Wilson
Goods and Services Tax:
Technical Paper, p. 3
August 1989

"...families earning less than $30,000 per year ... will be better off...b-e-t-t-e-r off as a result of ... sales tax reform.''

Michael Wilson
House of Commons
May 5, 1989

But the reality of tax reform has been the antithesis of the rhetoric. Under the Conservatives, the whole notion of tax reform has been perverted to put in place a system that reduces the progressivity of the income tax, consolidates the benefits secured by the upper-income class and powerful corporations, and shifts the burden of taxation even further onto the backs of middle and lower income Canadians. The question of equity - of fairly distributing the burdens and benefits of society - will be pushed even further "off limits'' if Phase I of Tax "Reform'' is not corrected and Phase II goes ahead.

This result will not happen by accident. The Conservatives' objective is to shift the tax burden away from income and towards consumption - and therefore away from those with most ability to pay and onto those least able to pay. Consumption taxes are inherently regressive. Poor people have to spend all the money they have on the necessities of life. Middle-income people spend most of what they earn, often all of it, on basic living expenses. But rich people have plenty of money left over after they have purchased all the goods and services they need. Thus, when savings are largely tax exempt - and consumption is fully taxed - the rich become richer, the poor, poorer. That's what "regressive'' is all about. The workings of this system are not hard to fathom - only the logic that would justify it.

Michael Wilson hinted at elements of his overall design in 1984 when he pledged to "reward success, rather than effort"; and questioned whether money for social programs could be better spent.

This is the approach of the supply-siders. The poor have too much money, and the rich have too little. If the poor have even less, it will spur them to work; if the rich are given even more, it will encourage them to work and invest. Both of these outcomes are thought to make us more productive, and more competitive; thus larger players on the stage of international trade and finance.

This theory is mean spirited. It is also wrong. Giving more money to the rich and to wealthy corporations has resulted in a frenzy of corporate cannibalism in North America over the past decade, an orgy that was financed by junk bonds and tax credits (no rich individual or corporation uses its own money for investment, after all), and resulted in massive job losses and depletion of productive assets. Tax money has been diverted from more productive uses, like upgrading the human resources which are the key to any long term competitiveness strategy. More importantly, the belief among the upper-income class that only the poor and middle class - the "drones", as one former Imperial Oil President characterized us - should be required to pay taxes has become more entrenched.

Ordinary Canadians, who are bearing increasingly heavy tax burdens to finance tax holidays for the well-to-do, think otherwise. Low and middle-income workers, struggling to make ends meet, are discouraged by tax laws that permit a few individuals to dine extravagantly at the expense of government revenues. They know instinctively what studies of the tax system, including the Carter Commission of over 20 years ago, have consistently shown — that honest reform of the tax system means making the system more progressive, ensuring that the rich pay their fair share.

Phase I of Michael Wilson's "Reform" accomplished the reverse. Phase II, if it proceeds, will entrench favouritism for the privileged, including big business and the rich, and undo the basic principle of our tax system - ability to pay.

Since the middle of August, this Committee has been studying the technical details of the Goods and Services Tax - otherwise referred to as Phase II of Tax Reform - in a philosophical vacuum. While it was generally agreed that the Manufacturers' Sales Tax was discriminatory and needed to be replaced, the question of whether Canada should replace it with another consumption tax or raise the revenue in some other way was never seriously considered by the Committee, in spite of massive public opposition to the GST and in spite of the fact that numerous alternatives were presented to the Committee by labour organizations, social policy groups, women's organizations and others.

From the outset, it was clear that the majority members of the Committee accepted without question the inevitability of much higher consumption taxes. Their only concern was to make the imposition of these taxes more palatable. In fact, the whole notion of situating the debate about the GST in a broader context of overall tax reform was so foreign to the Chairman that in the first day of committee hearings he berated Finance officials soundly for including in the package a tax credit proposal which would ease the burden temporarily on those least able to pay.

> "You indicated that in many cases people would be considerably better off. Why did you organize a system to make some citizens considerably better off? Is this a tax department, or an income redistribution department? Are you also Deputy Minister of National Health and Welfare?"
>
> Don Blenkarn
> Finance Committee Hearings
> August 15, 1989

The Chairman's clear conviction was that the tax system exists - not to improve equity among Canada's citizens - but merely to raise revenue in a way that does not burden the rich and powerful corporations.

And, in the main, the Committee restricted its inquiry to this concern.

This Report goes beyond the majority's self-imposed terms of reference and examines Conservative Tax Reform - Phase I and II - from the point of view of ordinary Canadians. In addition, New Democrats on the Committee will answer Finance Minister Wilson's question:

> "What is your alternative?"

Tax Reform: Phase I - "Reform" of the Personal and Corporate Income Tax

The 1987 "Tax Reform" proposals can't be considered separately from tax changes introduced by the Conservatives since their election in 1984. Each step in tax reform is an integral part of the Conservative's overall agenda. It is important to get a sense of where that agenda is leading - and how it is affecting Canadian lives.

Setting the Stage for "Tax Reform"

From the moment they took office in 1984, the Conservatives set about to dismantle the basic structure of Canada's progressive tax system.

A) The Shift from Income to Consumption

On October 1, 1984, the Conservatives reneged on their election promise not to hike the MST from 9-10% as the Liberals had proposed in their last budget before the election. Subsequent budgets would take the tax to 11%, to 12% and finally to 13.5% and more goods would become subject to the tax. The result would be an increase in the sales tax burden for average families of some $800 to $1,000 between 1984-1990. Sales tax credits for the very poor would compensate for some of the burden, but in general the poor would be pushed further into poverty by sales tax increases.

B) Elimination of the Federal Tax Reduction

Again taking their cue from the Liberals, who had cut this tax break designed to assist middle and low-income families by 75%, the Conservatives eliminated the federal tax reduction completely in 1985. This provision had allowed the average family a tax break of $100 a year. Its elimination, combined with deindexation, added about 1,000,000 poor Canadians to the tax rolls.

C) Deindexation of the Tax System and of Family Benefits

This change has been the most blatant tax grab of all. Since 1985, the exemptions, credits, and the marginal tax rate brackets have been indexed only for inflation above 3%. For taxpayers, this means that the real value of these credits and exemptions erodes at the rate of 3% per year. Each year, more poor Canadians find themselves pushed above the tax threshold, and wage earners whose salaries are merely keeping pace with inflation find themselves pushed into higher tax brackets.

At the same time family allowances were de-indexed and the dependent child exemption sharply reduced. The result - far less disposable income for ordinary families.

D) Lifetime Capital Gains Exemption and RRSP Top-Ups

In its first budget, in a gesture indicative of its disdain for progressive taxation, the Conservatives introduced a $500,000 lifetime exemption on income earned from capital gains. Capital gains, as everyone knows, are acquired largely by the rich. They were handed the equivalent of a $125,000 cheque in the same budget that added 1,000,000 poor Canadians to the tax rolls. Public outrage eventually resulted in the cheque being reduced to $25,000 in 1987 when the lifetime exemption was reduced to $100,000.

In addition, the 1985 Budget announced a tripling of RRSP deduction limits - another tax break designed specifically for upper-income earners. These two changes emphasized the Conservative belief that different kinds of income should be treated differently - i.e., capital gains income was more worthy than wage income and savings were to be more favoured than consumption.

E) Surtaxes

To help reduce the deficit, two new surtaxes were introduced. The surtax on all income earners was permanent. The surtax on the wealthy was temporary.

1987 Tax Reform - Phase I

Individuals

A) Converting Deductions to Credits

In this pre-election year, the Conservatives introduced their Income Tax Reform package. It was cleverly designed to appeal to tax reformers who had been urging the government for years to convert deductions (which favoured upper-income taxpayers) into tax credits (which provided the same dollar value to every taxpayer). In and of itself, this change would have made the tax system more progressive. But it was coupled with a major reduction in marginal tax rates for the wealthy, and thus the positive effect of this change was nullified.

B) Broadening the Tax Base

In order to give the appearance of engaging in a tax reform exercise, the Conservatives proposed a few measures to broaden the tax base, but most of these were half-hearted at best. For example, the $500,000 capital gains exemption was reduced to $100,000 - still leaving a handsome gift to high-income taxpayers. The inclusion rate for capital gains was to be increased - but only to 75%. The deduction for business meals and entertainment was reduced - but only by 20 percent. The large implicit subsidy for investors who borrow money in order to invest in assets not yielding a current return was restricted - but only by deferring their ability to claim the lifetime capital gains exemption. Many of the tax loopholes for the wealthy remained untouched.

C) Rate Reduction

The most significant change in the Phase I of tax reform was the lopping off of the top half of the progressive tax rate structure. The ten rates of the progressive income tax system were reduced to only three rates and the top marginal rate

was reduced from 34% to 29%. Under this "reformed" system a skilled craftsperson earning $30,000 pays tax at only 5 percentage points less than the rate paid by a corporate executive earning 10 times as much. To place this change in some perspective, it might be noted that during the 1960s, a period during which Canada experienced some of its highest rates of economic growth and lowest rates of unemployment, the income tax had 17 rate brackets, with a top bracket of 82% commencing (in today's dollars) at about $1 million. This rate compares to the current combined federal-provincial top rate of 44%, commencing at an income of about $55,000.

Whatever tax reform was achieved by converting deductions to credits and broadening the tax base was more than undone by these large and unjustified rate reductions.

D) Distributional Impacts

To make it saleable, the reform package took $3.1 billion out of the income tax system. But the division of these savings was far from neutral. The bottom group - 26% of all households received 8%; the top group - 2% of all households - received 12% of the tax cut.

The effect on families within these groups also defied any real commitment to a more progressive system. As Allan Maslove pointed out in a recent study for the Institute for Research on Public Policy:

> "The effect of the reform was not evenly felt...if it had not been for the reforms, all families except those earning less than $9,010 (the lowest 20%) would have had less disposable income than they had in 1984. After the reforms, two income groups were better off than in 1984: the lowest 30% and the top 1%."
>
> "The largest gains in disposable income accrued to the top 1%, averaging $3,570, and to the lowest 10%, averaging $90."

The 1987 Tax Reform was supposed to eliminate tax liability on 850,000 poor Canadians. But 1,000,000 had become taxable since 1984 because of Conservative tax hikes, and many of the very poor would remain on the tax rolls in spite of tax reform. A two parent family with two children living at only 72% of the poverty line would have to pay taxes after tax reform. Before the Conservatives were elected that family would not have been taxable. For singles the tax threshold would hit even lower - at 54% of the poverty line.

Overall, according to statistics compiled by the National Council on Welfare (Social Spending and the Next Budget, April 1989) Conservative "reforms"

between 1984 and 1988 would cost a working poor family 60% more; a middle income family 17.4% more; and a wealthy family 6.4% less in income taxes in 1991. (All families have 2 parents, 2 children. The working poor family earns $24,000; the middle income family, $49,000; and the wealthy, $122,000.)

Corporations

A) Shifting the Tax Burden

On the corporate side, Tax Reform 1987 was supposed to ensure that "corporations would carry a bigger share of the total tax load", but the extent of the proposed increase, about $5 billion over 5 years would be roughly equivalent only to a 1% increase in the federal sales tax over 5 years. (Sales tax hikes under the Conservatives had raised almost five times more revenue by the time this reform package was introduced.) Furthermore, a number of the proposed reforms have yet to be enacted.

B) Eliminating Tax Preferences

A few of the changes to the corporate tax system were significant - including the tightening up of fast write-offs for investments in machinery and equipment, and the elimination of special tax breaks in the resource sector. Of course these changes were "balanced" by a major cut in the corporate tax rate - from 36% to 28%, and from 30% to 23% for manufacturing, and many corporate tax preferences remained in place.

C) Absence of a Corporate Minimum Tax

The reform of the corporate tax was also undermined by the failure of the government to introduce a corporate minimum tax - especially since the White Paper concluded that 60,000 profitable corporations would continue to evade taxes even when the reform proposals were fully implemented. While the 1989 Budget introduced a new corporate capital tax - the Conservative version of a corporate minimum tax - Finance officials estimated that it would catch only about 3,600 firms.

Statistics Canada tax data released earlier this month by New Democrats indicates that the need for a corporate minimum tax has not disappeared. In 1987, 93,405 profitable corporations, with profits of $27 billion were able to avoid paying a single penny in tax. These figures have risen dramatically through the '80's. In 1980, 63,000 profitable corporations paid no tax on profits of $10 billion. By 1984, 85,000 corporations paid no tax on profits of $15 billion. The level of corporate profit earned by corporations that do not pay one cent in tax

in any given year has almost doubled while the Conservatives have been in power. One can assume that the amount of corporate profits that bears a disgracefully low rate of tax of between, say, one to ten percent has also increased dramatically.

Tax Reform - Phase II : "Reform of" the Federal Commodity Tax

Selling the GST

"We will proceed with the sales tax, not because it is popular, but because it is right for the country."

Brian Mulroney
CBC — The National
August 23, 1989

Thus Brian Mulroney launched the selling of the sales tax in Canada. Much of what this Committee has been engaged in over the past three months amounts to the same thing.

Witness after witness appeared before the Committee to point out that the debate about the GST should be placed in the broader context of overall tax reform. In addition critics argued that the GST would harm the economy, cost thousands of jobs, burn a huge hole in ordinary Canadians' pocketbooks and push more Canadians into poverty.

But the Conservatives majority had already accepted the proposition that the GST was inevitable. In fact they embraced the idea. Once that become clear, all that was left, in their view, was how to work out the details of the package.

And so, despite many valid criticisms, the primary concern of the majority on this Committee was not whether we should have this tax or why, but how to broaden the base and lower the rate. The Committee thus effectively derailed any real discussion of tax reform - and the central question was again pushed off-limits.

Increasing Poverty by Design

When the government of New Zealand introduced the GST, consumers were told that they "must accept the existence of economic inequality because it is the engine which drives the economy."

Conservative politicians in Canada are more subtle. They tell us unpopular ideas are "in the national interest" or "right for the country". One Conservative member of the Committee told New Democrats that the GST is "your Medicare Tax".

The message couldn't be clearer. If ordinary Canadians want to protect their treasured social programs they will be forced to pay, and pay handsomely. If the GST proceeds, the notion that the rich and wealthy corporations should share the burden for the benefit of our whole society may be lost entirely. Moreover, if our social programs are dependent upon a regressive tax base they could slowly erode and disappear. It is far from inconceivable that this could happen.

With the government's withdrawal from financing the UI program, the entire cost of a major social program will soon be borne by a regressive payroll tax (UI premiums). Not surprisingly, this is how social programs are financed in the U.S.

Furthermore, the GST package is designed to establish that principle in the tax system. Canadians have been told that the GST rate had to be set at 9% in order to finance income redistribution through the tax credits. But why should this be the case? If income is actually being redistributed to the poor, it should be funded through an increase in taxes on the rich - not through a consumption tax which is inherently regressive.

As it stands, the GST "package" contains a tax credit to ease the burden of higher sales tax on the poor. Three fundamental problems plague the credit:

* it is inadequate to cover the increase in sales taxes through the GST, especially for large families

* it begins to phase out below the poverty line in major Canadian cities

* it is only partially indexed and thus its value will be diminished gradually over time.

Partial indexation means that thousands of Canadians lose the credit every year. In year two of the GST, 100,000 families will lose the tax credit entirely. By year five, that figure will reach 700,000. Another 400,000 families will lose partial eligibility.

Meanwhile the cost of the credit to the government will decline in real terms, so that in year five, the government will be spending $700 million less to assist the poor.

What is more, the credit does little to ameliorate the real problem with the sales tax - that it hurts the poor much more than it burdens the rich and distorts the whole notion of a tax system based on ability to pay.

The following example illustrates how regressive sales taxes are compared to income taxes: The government plans to raise $18.5 billion through the GST (net of

credits). For a family earning $20,000, the share of that $18.5 billion would be $695 (net of credits). If the government were to collect $18.5 billion through the income tax system, that family would have to pay $70. Thus, the GST imposes 10 times the burden on this poor family as the income tax.

For the $100,000 family, the picture is considerably different. Raising $18.5 billion through the income tax system would cost this family $8,155. With the GST the family would pay $4,875, or 40% less.

The following table, based on Finance Department Statistics, was compiled by Nate Laurie of the Toronto Star (October 12, 1989), and compares the tax burdens on families in various income classes when the same revenue ($18.5 billion) is raised through the income tax and the GST.

Comparable GST and

Income Tax Burdens Needed to Raise $18.5 Billion

(one-earner couple, 2 children)

1991

Income	GST*	Income Tax
$ 20,000	$ 695	$ 70
30,000	1,405	747
45,000	2,475	2,303
60,000	3,115	3,953
100,000	4,875	8,155

* Net of Refundable Sales Tax Credit

Canadians have been led to believe that the damaging impact of the GST could be reduced if the rate were lowered and the base broadened. But this is simply not the case. The reality is that for more than half of Canadian families living below the poverty line, the GST will worsen their condition. The poor will start out poorer, and their situation will gradually deteriorate, because the tax credits will erode with time. Large families will be particularly hard hit.

The impact of the GST on housing costs will also harm Canadian families. As the most expensive item in any family's budget, the proposal to add 4.5% to the cost of new housing should alarm all Canadians. If the tax base is broadened to include purchases of all housing instead of just new housing, the primary victims will be first time homebuyers, who will find the dream of owning their own home pushed even further beyond their reach.

Ordinary Canadians and particularly the poor will be big losers under Michael Wilson's GST. Who are the winners?

The GST and Big Business

The group which has lobbied hardest and will profit most from the elimination of the MST is big business - the alleged victim of the discriminatory MST, and the group which pays for half the tax, according to Finance Department estimates. This means that half of the MST revenue is collected on business inputs. Although it is unclear how much of this cost business is able to shift to consumers, at least $2.5 billion of it is levied on inputs for products destined for export. Under the GST, no tax will be imposed on exports. This means that Canadian consumers will be asked to pay roughly $2.5 billion more in taxes in order to cover the revenue losses on goods sold abroad.

Even if the basic price on some domestic goods goes down when the MST is eliminated, Canadians will still be paying higher prices for most goods after the 9% GST is applied. One thing that is certain is that Canadians will pay more for our products than Americans. This includes energy goods like oil, natural gas, electricity - which could not be sold in the U.S. at a lower price prior to the signing of the FTA. The trade deal ensured that we could not discriminate in favour of our own consumers. The GST ensures that we discriminate against them.

Opponents of the Free Trade Agreement have always claimed that the GST would be one of the many costs that Canadians would have to pay for the trade deal - since more tax revenue would be needed to offset the loss of tariffs, which collected about $2 billion a year.

But the GST will do more than recoup lost tariff revenues. Both the Mulroney government and big business organizations have argued that the MST discriminates against exporters. By providing full rebates for business input costs the GST will ensure that Canadian goods can be sold more cheaply abroad.

This may give Canadian producers a short term advantage in world markets - but experience with VAT's introduction in other nations has not shown any significant effect on exports. As Alan Tait points out in "Value Added Tax: Practices and Problems" (pp. 224-6)

> "The argument that a VAT would increase exports only works if a real cut in domestic factor returns can be engineered. .... The evidence is that fluctuations in exchange rates and world demand make the effects of VAT ... pall into insignificance."

In simple language, if a Value Added Tax is accompanied by lower domestic wage rates - it might increase exports. But the value of the dollar and a market for products produced in Canada are far more important considerations.

It should come as no surprise to Canadians that the only group in Canada which has consistently supported the GST - the big business community - is advocating a tax change which will only work to their advantage if it is accompanied by lower wages. Nor is it a coincidence that the government which launched this tax change said it would work best if ordinary Canadians agreed to accept a "one time" drop in their real wages. Big business has been inordinately successful in selling Canadians on the idea that their own agenda is identical to Canada's "national interest". But Canadians should be very wary of this. The group which is now trying to sell us the GST is the same one which brought us the trade deal, deficit hysteria, and meaner social programs.

GST and Small Business

In contrast to the Canadian Manufacturers' Association, the Business Council on National Issues, the Canadian Exporters' Association, and the usual loud voices, many in the small business community oppose the GST.

A number have kept considerable pressure on the government to withdraw the tax on the grounds that

* the only acceptable retail tax for small business is a harmonized, single rate federal-provincial tax

* cost of compliance and complexity of administration would be a "nightmare" for both small retailers and the government, imposing additional costs of up to $2 billion

* the tax will be hidden

* economic costs of higher inflation, job loss, and a wage price spiral could turn a slowdown into a full blown recession

* provinces with the weakest economies and the highest retail sales taxes could be most hurt by it

* the government is indulging in a "con" game with its numbers and misleading Canadians about the GST effects.

These are the standard concerns raised by most economic forecasters and many interest groups about the GST, and not one of them has been effectively answered by the Government or the GST salesmen on this Committee. Attention to these valid concerns, however, has been deflected to the Committee's more pressing interest in designing a GST package with a lower rate and a broader base.

GST and Farmers

Canadian farmers have raised serious concerns about the impact of the GST on their financial stability since major input costs (such as machinery) will increase, and there is a time lag between payment of these costs and receipt of refunds. Moreover, inputs eligible for rebates will be subject to dispute, since the government is still unclear about what is taxed and what is not. Administration will be costly and cumbersome. The Canadian Federation of Agriculture has estimated that the costs to small farmers for administration alone will be between $1500 and $2000, and for farmers across Canada, the compliance costs will be in the neighborhood of $150 million.

Shifting the Tax Base from Income to Consumption

If the GST goes forward, Canadians will see their whole tax system shifted further from an income to a consumption base. In 1984, sales and excise taxes made up 19.3% of federal revenues; by 1989 they were providing close to 25%; and by 1991, if the GST is in place, that figure will rise to almost 30%.

Because consumption taxes take so much more from low income Canadians than taxes on income, the introduction of the GST will mean that a major instrument of national policy — the tax system — is being used to produce a more divided society. Under the government's proposal, the poor will become even poorer. The rich will become even more powerful, and the wealthiest corporations will receive a large windfall. The only "reform" will be to Michael Wilson's balance sheet.

On the whole Canada will be a poorer and less equitable society.

NDP ALTERNATIVE TO THE GST

Over the years, the New Democratic Party has consistently argued for fundamental reform of our tax laws. Fundamental reform is necessary in order to achieve a pattern of economic growth that is steady, sustainable, and non-inflationary; but it is also necessary in order to achieve a distribution of income and wealth that is fair and just.

After five years of tax policies designed to benefit corporations and wealthy individuals, in the so-called Phase II of its "Tax Reform", the Conservative government is proposing a massive shift in the federal tax system from income to consumption. With a broad based federal consumption tax, the Conservatives will have the lever they need to raise revenues in every budget to solve the problem they have identified as the most crucial for Canada — the federal deficit. During the election campaign, Michael Wilson had promised not to raise "one more penny in tax" from sales tax reform, but by August 1989 when the GST was introduced, deficit reduction had become a key objective.

GST, Interest Rates and Deficit Reduction

International experience has demonstrated that once a VAT style tax (like the GST) is introduced, the sales tax rate is the most convenient vehicle to correct government balance sheets. Very few Canadians would accept the government's view that a regressive consumption tax is the best way to reduce the deficit. New Democrats, economists, small business, social policy groups, and virtually every Premier in the country have been urging the government to take action to bring down the deficit by reducing interest rates. According to Michael Wilson's own estimates, a 2% reduction in interest rates would bring the deficit down by $3.2 billion in the first year alone, and several more billion could be shaved from the deficit in future years as well. This approach to deficit reduction would save the government billions on the expenditure side, and also provide the stimulus needed to encourage investment, increase job growth, reduce transfers through UI and welfare programs, and raise personal and corporate income tax revenues. The government has consistently refused to take such action, and has instead allowed interest rates to rise significantly. This means that this year's budget deficit will be much higher than forecast and that poor and middle income earners will be asked to pay much higher federal sales taxes to cover the shortfall.

But average Canadian families are already paying much higher federal taxes than they did five years ago. These hard-pressed families, who by and large have watched their wages and income stagnate, are not the cause of the government's financial problems. High-income families and corporations have watched their

incomes and wealth grow by leaps and bounds, even while the country that makes their way of life and profits possible remains saddled with debt.

The NDP has always insisted that in order to ensure the rich and corporations pay their fair share of the tax burden, the government should place less reliance on inherently regressive consumption taxes and more reliance on progressive income taxes. Our alternative to the GST rests on this fundamental premise of fair taxation. It is the kind of alternative that numerous groups urged upon the Committee during its hearings, including, for example, the Canadian Labour Congress, the United Steelworkers of America, the Pro-Canada Network, the National Council of Welfare, the National Anti-Poverty Organization, One Voice Seniors' Network and the National Action Committee on the Status of Women. The Conservative majority members of the Committee chose to ignore the arguments of these groups.

NDP Alternative to the GST

New Democrats would establish a new Royal Commission whose key objective is to redesign the tax system to one based on ability to pay. As part of its mandate, the Royal Commission would also be asked to determine how the system can best be used to secure necessary government revenues and promote the goals of full employment and a more equitable society.

The tax system is such an important instrument of national policy that, like the Bank Act, it should be subject to periodic review. The last Royal Commission on taxation was established more than 25 years ago. Since that time, the tax system has changed significantly. New Democrats believe that it is time for another major review of the tax system to study the direction tax "reform" efforts have taken over the past two decades, and to propose a sensible alternative to the manufacturers' sales tax.

In the interim, we would proceed with the following proposals as an alternative to the GST, and to restore needed elements of fairness to the tax system.

The government's GST proposal is expected to raise $18.5 billion (net) and to spend an additional $2.4 billion on tax credits to the poor. New Democrats would retain the tax credit, and raise the additional $18.5 billion through the following measures:

* roll MST back to 1984 rate of 9% (a cut of 33%) on an interim basis (Revenue: approximately $12.3 billion)

* implement the enhanced tax credit and index it to the rate of inflation to compensate low income Canadians for the regressive changes to the tax system. (Cost $2.4 billion)

* increase the excise tax on alcohol, cigarettes, and gasoline to ensure that existing revenues from these sources are not diminished. (Revenue: approximately $1.5 billion)

* impose a "green tax" - an excise tax - to discourage production and use of environmentally hazardous goods.

* reform the individual income tax to limit or eliminate tax preferences used by the rich to avoid paying their fair share of the tax burden. (Revenue: approximately $3 billion)

* reform the corporate income tax to limit corporate tax breaks and introduce a corporate minimum tax. (Revenue: approximately $2.5 billion)

* introduce a tax on transfers of wealth. (Revenue: approximately $1.5 billion)

Excise Tax Changes

The government seems intent on taxing all goods and services at the same rate. However, there are a number of valid justifications for differential tax treatment of particular commodities: to discourage over-consumption of certain goods that might be harmful to society, and to pay for public costs incurred by certain consumption activity.

"Sin" Taxes and Sales Tax on Gasoline

At present alcoholic beverages and tobacco products are taxed at a rate of 19% under the MST. The government proposes to reduce this rate to only 9% under the GST. We see no reason to reduce the tax burden on these products. We would either leave the MST on these products at 19%, or increase the excise tax on them to make up the difference. Also, we would not reduce the present federal sales tax burden on fuels.

A "Green" Tax

Environmentally sound products often cost more than products that are sustainable. The GST only widens this gap, making it more difficult for consumers to choose "greener" products. We would impose special excise taxes on selected products to ensure that the Canadian public was adequately compensated for the environmental damage that accompanied the production, marketing and eventual disposal of these products. Thus, for example, products made out of styrofoam, aerosal

cans, and similar products would bear a special tax to reflect the damage they impose on our environment and the burden to our landfill and waste disposal system.

A special excise tax would be assessed on the sale or use by a manufacturer of certain ozone depleting chemicals, and the import into Canada of such chemicals in products containing them. Ozone depleting chemicals include chlorofluorocarbons and halons.

Furthermore, an additional tax would be imposed on products that produce carbon emissions. Not only are carbon emissions contributing to the greenhouse effect, but they combine with sunlight to produce ground level ozone which has serious impacts on our health. A "carbon tax" would encourage energy conservation and raise revenues for research and development of alternative energy sources. The Canadian government should be using all of the policy instruments at its disposal, including the tax system, to assist the global community in fending off the impending catastrophe.

Income Tax Reform

Individuals

The individual income tax is potentially the fairest and most visible tax in the federal tax system. Its base ought to be broadened so that the rich are not able to "shelter" their high incomes from tax and deduct the costs of their extravagant living styles, and its rate structure ought to be made more progressive. The following are indicative of the changes that should be made.

Capital Gains

Capital gains are realized exclusively by high-income taxpayers. Over 80% of capital gains are received by the top 20% of taxpayers, and roughly 35% by the top 1% of taxpayers. Yet they are subject to very favourable tax treatment. At present only two-thirds of capital gains, and in 1991 three-quarters of capital gains, have to be included in income and $100,000 of a taxpayers' lifetime capital gains are exempted from income tax entirely. Although we would retain the $500,000 exemption for small businesses and farmers, and the exemption for principal residences we would tax capital gains at the same rate as other income, and eliminate the $100,000 lifetime exemption. Providing preferential tax treatment for capital gains violates every criteria of a good tax system: it distorts economic choices, it greatly complicates the tax system, and it is grossly unfair.

Excess Interest Expense

The ability of taxpayers to deduct their interest expense in excess of their investment income amounts to a huge negative income tax for the wealthy. In 1981 the government reported that taxpayers who earned over $50,000 and paid not one penny in tax claimed, on average, over $40,000 of interest deductions in excess of their investment income. If a taxpayer is able to borrow money in one year and deduct the interest expense, but not pay tax on the related income until some future year, they are better off because of the time value of money, even though their interest expense only equals or even exceeds their investment income. Such a rule is not only inequitable, it promotes inefficient investment. Interest on money borrowed to invest should not be deductible to the extent that it exceeds a taxpayer's investment income.

Entertainment Expenses

Under the present tax law, business people can deduct 80% of the cost of business meals and entertainment. Currently the government is spending almost as much on this tax break as it spends on the entire sales tax credit for the poor — about a billion dollars a year. At a time when 378,000 Canadians including over 150,000 children are dependent on food banks for survival, our tax system should not allow deductions for entertainment expenses or expensive business meals. Moreover, the deductibility of luxury travel costs such as first class air fare and luxury hotel accommodation should be limited. Experience in other countries that have limited the deductibility of these types of expenses, such as the United Kingdom and Australia, has shown that when the subsidy for extravagant expense account living is removed the effect on total employment in the restaurant industry is minimal. Business people continue to live extravagantly in these countries, but they have to pay their own way.

Contributions to RRSPs

The tax subsidy for contributions to RRSPs continues to take the form of a tax deduction. Thus high-income taxpayers receive a larger subsidy for saving the same amount of income for retirement as low-income taxpayers. The deduction for contributions to RRSPs should be converted into a tax credit. Also, naturally, high-income taxpayers can afford to save much more for their retirement than low-income individuals. The government should not be subsidizing the wealthy for retirement incomes that ordinary workers cannot even dream about. The government has proposed that the amount that qualifies for favourable tax treatment be increased from $7,500 a year to $15,500. It does not make any sense to shift the tax burden to the poor so that more can be spent subsidizing the retirement savings of the rich. We

would freeze the amount of retirement savings that qualify for a tax credit at its current level.

Withholding Tax on Income from Capital

Employees have all of their tax withheld at source. However, high-income individuals who earn income from dividends, interest income and capital gains only pay the tax on this income in the year following that in which they receive it. Indeed, there is substantial evidence that much of this form of income goes unreported. We would require that 10% of all dividends, interest, and other forms of income from capital be withheld at source and remitted in the same way that a portion of salary and wages are withheld and remitted to Revenue Canada on behalf of employees. Low-income elderly individuals would be able to apply for an exemption from this withholding requirement.

Tax Rates

It is a scandal that the income tax structure has been nearly flattened, there are only three brackets and only 3 percentage points separate the middle and the top brackets. We would introduce another tax bracket at 34% for incomes between $75,000 and $100,000 and add a fourth bracket for individuals earning over $100,000 of 40%. In Phase I of Tax Reform, by eliminating many rates at the same time that they broadened the tax base, the Conservatives simply legitimized all of the inequities that were in the Act. The government made much of the fact that by reducing the rate structure from 10 brackets to 3 they were simplifying the tax system. In fact they were only making it more regressive. The number of brackets has no bearing on simplification. Most taxpayers use government provided tax tables in computing their tax payable and thus never see the rate schedules, and those who do not use the tax tables must make two calculations to arrive at their tax payable whether the tax structure has 52 brackets or only 3.

Corporations

Even before the Conservatives reduced the general federal corporate tax rate from 36% to 28% in 1988, corporations paid a much smaller part of the tax burden than they did at any time in the recent history of Canadian income tax. Moreover, many corporations continue to pay tax at low effective rates and continue to have large outstanding deferred tax liabilities. We would collect at least an additional $2 billion from corporations through base broadening measures. Thus not only would corporations pay more of their fair share but the tax system would distort corporate investments less. Taxing capital gains at full rates, and disallowing the deductions of business meal and entertainment would both serve to broaden the corporate tax base,

but there are a number of other obvious base broadening measures that could be taken on the corporate side to raise revenue.

Manufacturing and Processing Profits Deduction

Manufacturing firms are generally entitled to a lower rate of taxation than are non-manufacturing firms of the same size. They are entitled to a manufacturing and processing profits deduction that effectively reduces their federal rate of tax from 28% to 23%. One justification for this lower rate of tax has always been that manufacturing firms had to bear the discriminatory manufacturers' sales tax. If this tax is rolled back in 1991 as we propose, from collecting an estimated $18.5 billion to only collecting $12.3 billion, this special privileged income tax rate can be phased out. Moreover, study after study has shown that the special rate is not effective in increasing investment and employment in the Canadian manufacturing sector.

Real Estate Developers

Corporations that engage in real estate development, which includes some of Canada's largest corporations, consistently pay tax at low effective rates and often make huge profits and pay no taxes. A number of tax rules relating to these companies should be tightened. For example: developers are able to claim huge amounts of depreciation for office, industrial and apartment buildings. Yet these buildings seldom depreciate in value. Indeed, huge profits are routinely made selling them for more than their original cost, and to the extent that there is any reduction in the value of the buildings, it is usually more than offset by an increase in the value of the underlying land. These deductions should be drastically restricted. Also, when a building has appreciated in value, often by 2 or 3 times its original cost, developers are able to borrow money against the appreciated value of the building without recognizing any of the gain in value as income. When corporations borrow money against the appreciated value of their assets, they have in effect realized the gain on those assets and should have to include it in their income.

Curbing Tax Incentives for Mergers and Acquisitions

The wave of mergers and leveraged buyouts in Canada that appear to be preoccupying our corporate managers and executives to the exclusion of productive investment is significantly spurred by our tax policies. The deduction of interest on money borrowed to purchase shares in another corporation is a large unjustified tax subsidy which among other things subsidizes foreign corporations buying up Canadian assets. Limiting the deductions on debt incurred to finance acquisitions and stock buyouts should be part of any tax reform exercise.

Dividend Tax Credit

At present, dividend income is taxed at a lower rate than ordinary income because of the dividend tax credit. Shareholders who receive dividends are entitled to claim a credit equal to about 25% of the dividend. This credit is a windfall to high-income taxpayers. The irony of the Canadian dividend tax credit is that even though it is allegedly intended to reduce the so-called double taxation on corporate-source income, shareholders receive the credit even though the corporation paying the dividend did not pay any corporate tax.

Advertising and Lobbying Expenses

At present, corporations, but not other groups, receive a massive subsidy from the public purse in order to assist them in pursuading the public to purchase their products, and to persuade legislators to enact laws that are in their self-interest. Advertising expenses, (even though their benefits in many cases extend over a number of years), can be deducted by corporations as current expenses. Advertising expenses, or some portion of them, should be required to be deducted over a three year period. This would result in a better matching of expenses with the income generated by them.

Businesses can also deduct as a current business expense all of their cost of lobbying the government for special treatment. Why should the public be subsidizing businesses lobbying efforts, when the efforts of those who lobby in the public interest are normally not subsidized? Lobbying expenses incurred by businesses should be non-deductible.

In addition, advertising which is political in nature should not be subsidized by the taxpayer. Furthermore, if advertising does not relate directly to the firm's products, it should be disallowed.

Clamping Down on Corporate Cheaters

Revenue Canada audits of corporations has declined dramatically. In 1974 Revenue Canada audited over 7% of all corporate tax returns. In 1981-82 it audited 4%, in 1983-84 2.6%, and in 1989-90 Revenue Canada will audit 1.8%. This dramatic decline in the auditing of corporate tax returns has occurred despite the fact that for every $1 Revenue Canada spends auditing corporate tax returns it recovers $17.

Corporate Minimum Tax

Many large corporations continue to pay tax at extremely low effective rates. And even if the above reforms were enacted, some might still find ways to avoid

paying tax on large portions of their profits. In order to ensure that all corporations are paying their fair share of tax, and that all businesses bear about the same amount of tax, a tough alternative minimum tax based on corporate "book profits" should be enacted. In their tax reform, the Conservatives did not even go as far as their "conservative" counterparts in the United States. In 1986 the United States substantially toughened its corporate minimum tax. Corporate tax payments which in the middle of the 1980s accounted for less than 8% of the federal budget increased so that they covered almost 12%. The average effective tax rates on 250 of the largest American companies increased from under 15% to over 25%. At the same time, illustrating that the fair taxation of corporations does not deter productive investment, real business fixed investment has grown at an annual rate of 6 percent since 1986, almost triple the rate of growth over the previous five years.

New Democrats would introduce a corporate minimum tax at a rate of 20%, equal to the rate in the United States. This would ensure comparable levels of taxation for businesses operating on both sides of the border.

Deferred Taxes

Through much of this decade, the accumulated value of deferred taxes has been approximately the same level as the federal deficit. Each year, corporations in Canada "defer" roughly $2 billion more in taxes. These deferrals should decline in value with the elimination of a number of tax breaks but in the meantime deferred taxes act like a permanent source of interest-free financing for business. Some analysts have noted that deferred taxes should more appropriately be called equity instead of debt - especially since the size of unused corporate tax credits (deferrals) is often the bait which attracts merger bids. (Dome Petroleum was $6 billion in debt when it was taken over, but it had $1 billion in tax losses - as well as valuable resource holdings - to sell). Prospective suitors can use unused credits or tax losses to reduce their own income tax burden. In order to reduce the advantage of these tax "loans" to business the government should begin to charge interest of 10% on taxes deferred by big businesses.

Wealth Tax

The most obvious and tragic omission from the government's tax reform exercise is the failure to implement a wealth transfer tax. Wealth is many times more concentrated than income. For example,

* ranked by wealth, the bottom 40% of Canadian families own virtually nothing, the top 5 percent own nearly 50 percent of the wealth

* Canada's 32 wealthiest families, along with five conglomerates, control about one-third of the country's non-financial assets, nearly double what they controlled just four years before. (In the United States the 100 largest firms owned only one-third of the non-financial assets.)

* the combined wealth of Canada's 32 wealthiest families has been estimated at over $132 billion

* of Canada's 400 largest corporations, only 20 are widely held. The other 380 are controlled by one of Canada's wealthiest families.

At present the tax system does nothing to reduce these enormous concentrations of wealth. This means that if nothing is done, the country will be run by a royalty of rich families, ensconced for generations if they wish.

Canada is one of the few industrialized countries that does not impose a tax on wealth transfers. Since 1972, when the federal government abolished its estate and gift tax, it has been estimated that Canadians gave a gift of over $10 billion to Canada's wealthiest families. It is time to begin collecting part of the returns on that gift.

Conclusion

In the government's view, the most important objective of tax reform has been to shift the tax burden from high-income individuals and powerful corporations to lower-income individuals. A key element in achieving this objective is to shift the tax burden from progressive income taxes to regressive consumption taxes. So intent is the government on achieving this objective that in introducing its new GST it is prepared to incur the wrath of small businesses by imposing complicated and expensive new compliance costs on them, jeopardize relationships between the federal and provincial governments by occupying tax room traditionally occupied by the provinces, and run the risk of high inflation, high interest rates and high unemployment.

The Conservatives have sought to justify this move in terms that appear to transcend the self-interest of the immediate beneficiaries. They have suggested that unless the tax burden is shifted from progressive income taxes to regressive sales taxes the rich will not save and invest, and our industries will not be able to compete in the global economy. Nobody believes this — that if we sacrifice the standard of living of the vast majority of Canadians in order to make the rich richer and corporations more powerful, at the end of the day, we will all benefit. Common knowledge is against it, and there are no studies to support it.

Indeed, in making these arguments the government proves itself to be not only mean-spirited but foolish. Virtually every country in the Western world experienced

its greatest rates of economic growth during periods when personal and corporate income tax rates were much higher than they are today and much higher than we are proposing to make them. There is absolutely no correlation between the extent to which countries in the industrialized world rely upon regressive consumption taxes to raise revenue and their national rates of savings.

Increasing disparities in income and wealth will ultimately only serve to make Canada a poorer country. In a country blessed with natural resources like Canada, the increasing incidence of hunger, homelessness, welfare, and low paying jobs is not an economic necessity. It reflects a fundamental value choice.

In the long run, the quality of life that the Conservatives and their friends are denying to middle and lower income Canadians will include their own.

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The Committee regrets that it was unable to receive more witnesses. The following is a list of briefs, letters and submissions to the Committee from organizations and individuals from whom the Committee could not receive personal testimony.

ORGANIZATIONS

ADAMOVICZ, L.

ADVOCACY RESOURCE CENTRE FOR THE HANDICAPPED

AHRONHEIM, GERALD A.

AIR B.C.

AIR TRANSPORT ASSOCIATION OF CANADA

ALBERTA ASSOCIATION OF SOCIAL WORKERS

ALBERTA CATTLE COMMISSION

ALBERTA FEDERATION OF LABOUR

ALBERTA LAW FOUNDATION

ALBERTA NEW DEMOCRAT CAUCUS

ALBERTA SHUFFLEBOARDS (1986) INC.

ALBERTA WEEKLY NEWSPAPERS ASSOCIATION

ALEXANDER, DAVID

ALEXANDER, L.L.

ALFRED DALLAIRE INC.

ALLIANCE OF CANADIAN CINEMA, TELEVISION AND RADIO ARTISTS (ACTRA)

ALLIANCE OF CANADIAN TRAVEL ASSOCIATIONS

ALTERNATIVE HOME MARKETING TEAM INC.

ALTIMAS, ANNA & JOHN

AMERICAN FEDERATION OF MUSICIANS OF THE UNITED STATES AND CANADA

ANCTIL, NORMAN J.

ANPROP INVESTMENTS INC.

ANSPACH, R. CAMERON

ANTIQUARIAN BOOKSELLERS' ASSOCIATION OF CANADA

ART GALLERY OF GREATER VICTORIA

ARTHUR, M.D.

ASSEMBLY OF FIRST NATIONS

ASSOCIATION DES CAMPS DU QUÉBEC

ASSOCIATION DE LA CONSTRUCTION DU QUÉBEC

ASSOCIATION DES CENTRES HOSPITALIERS ET DES CENTRES D'ACCUEIL PRIVÉS DU QUÉBEC INC.

ASSOCIATION DES ÉDITEURS

ASSOCIATION DES ÉDITEURS DE LA PRESSE HEDBOMADAIRE RÉGIONALE FRANCOPHONE

ASSOCIATION DES ÉDITEURS ET DE LA SOCIÉTÉ DES ÉDITEURS DE MANUELS SCOLAIRES DU QUÉBEC

ASSOCIATION DES PROFESSEURS DE MUSIQUE DU QUÉBEC INC.

ASSOCIATION OF AMERICAN PUBLISHERS INC.

ASSOCIATION OF CANADIAN BISCUIT MANUFACTURERS

ASSOCIATION OF CANADIAN DISTILLERS

ASSOCIATION OF CANADIAN INSURERS

ASSOCIATION OF CANADIAN ORCHESTRAS

ASSOCIATION OF CANADIAN REAL ESTATE SYNDICATORS INC.

ASSOCIATION OF CONSULTING ENGINEERS OF CANADA

ASSOCIATION OF KINSMEN AND KINETTE CLUBS

ASSOCIATION OF MUNICIPALITIES OF ONTARIO

ASSOCIATION OF NEWFOUNDLAND PSYCHOLOGISTS

ASSOCIATION OF ONTARIO MOTELS, MOTOR INNS, AND MOTOR HOTELS

ASSOCIATION OF PSYCHOLOGISTS OF NOVA SCOTIA

ASSOCIATION OF REGISTERED INTERIOR DESIGNERS OF ONTARIO

ASSOCIATION OF UNIVERSITIES AND COLLEGES OF CANADA

ASSOCIATION OF YUKON COMMUNITIES

ASSOCIATION PROFESSIONNEL DES STÉNOGRAPHES JUDICIAIRES ET OFFICIELS DU QUÉBEC

ASSOCIATION PROVINCIALE DES CONSTRUCTEURS D'HABITATIONS DU QUÉBEC

ATLANTIC BUILDING SUPPLY DEALERS ASSOCIATION

ATLANTIC MUNICIPAL PURCHASING ASSOCIATION

ATLANTIC PROVINCES FEDERATION OF LABOUR

ATLANTIC PROVINCES TRANSPORTATION COMMISSION

ATLAS TOURS LTD.

ATMOSPHERIC DYNAMICS CORPORATION

ATTRACTIONS ONTARIO

AUTOMOTIVE INDUSTRIES ASSOCIATION OF CANADA

AVON CANADA INC.

AXA INSURANCE GROUP OF CANADA

BABIJ AND SLADE CHARTERED ACCOUNTANTS
BAFFIN REGIONAL CHAMBER OF COMMERCE
BAGNELL'S LAUNDERERS AND CLEANERS LIMITED
BAILLARGEON, MARIE CLAIRE
BAIN, DAVID B.
BAKERY COUNCIL OF CANADA
BANFF WORKERS FOR IMPROVED CONDITIONS
BANK STREET PROMENADE
BANKS, BONNIE
BARZA, SUSAN
BASEBALL NOVA SCOTIA
BEAULIEU, GUY P.
BEAUVAIS, M.
BECKETT, W.T.
BEDNARCZYK, GEORGE S.
BELLEROSE, S.
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BERNSTEIN, R. PETER
BERRY, SUSAN
BERTOIA, CARL
BERWICK INVESTMENTS LTD. - BERWICK HOUSE
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BISAILLON, GUY
BLAMAUER, M.F.
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BLISKE, SHIRLEY
BLUMENTHAL, TYA
BOAKE, W.R.
BOARD OF TRADE OF METROPOLITAN TORONTO
BOLSTER, STUART
BOOK SHELF OF GUELPH LIMITED
BOUDREAU, MRS.
BOULANGERIE JEAN-CLAUDE FORTIN INC.
BOWLING PROPRIETORS' ASSOCIATION OF BRITISH COLUMBIA
BOWLING PROPRIETORS' ASSOCIATION OF CANADA

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BOWLING PROPRIETORS' ASSOCIATION OF NORTHERN ONTARIO
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BRAWLEY, JOSEPH V.
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BREWERS ASSOCIATION OF CANADA
BRIAN HULL AND ASSOCIATES
BRISSON, L.
BRISTOL PLACE HOTEL
BRITISH COLUMBIA AND YUKON HOTELS' ASSOCIATION
BRITISH COLUMBIA ASSOCIATION OF PRIVATE CARE
BRITISH COLUMBIA ASSOCIATION OF SOCIAL WORKERS
BRITISH COLUMBIA ASSOCIATION OF SPEECH/LANGUAGE PATHOLOGISTS AND AUDIOLOGISTS
BRITISH COLUMBIA CHAMBER OF COMMERCE
BRITISH COLUMBIA FEDERATION OF LABOUR
BRITISH COLUMBIA LIBRARY ASSOCIATION
BRITISH COLUMBIA MEDICAL ASSOCIATION
BRITISH COLUMBIA MOTELS, CAMPGROUNDS, RESORTS ASSOCIATION
BRITISH COLUMBIA MOTION PICTURE ASSOCIATION
BRITISH COLUMBIA PROVINCIAL COUNCIL OF CARPENTERS
BRITISH COLUMBIA PSYCHOLOGICAL ASSOCIATION
BRITISH COLUMBIA REAL ESTATE ASSOCIATION
BRITISH COLUMBIA REGISTERED MUSIC TEACHERS' ASSOCIATION
BRITISH COLUMBIA VETERINARY MEDICAL ASSOCIATION
BROOKER, BARRY H.
BROSSARD WOMEN'S GROUP
BROWN, CHARLES K.
BROWN RIGGS AND DONEN, CHARTERED ACCOUNTANTS
BRYDON, JAMES
BUCH, MARY I.
BUFFEY, JOAN
BUILDING AND CONSTRUCTION TRADES DEPARTMENT AFL-CIO

BUILDING OWNERS AND MANAGERS ASSOCIATION BRITISH COLUMBIA
BUILDING SYSTEMS DESIGN LIMITED
BUREAU DE COMMERCE DE MONTRÉAL
BUSINESS ASSOCIATION OF NEWFOUNDLAND AND LABRADOR
BUSINESS COUNCIL ON NATIONAL ISSUES
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BYERS, JOHN
C.H. DOUGLAS SOCIAL CREDIT
CABLEPROJECT RMB LTD.
CADRAIN, PENNY
CALGARY CHAMBER OF COMMERCE
CALGARY TENT AND AWNING LTD.
CAMBRIAN BOWLING LANES
CANADA COUNCIL
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CANADIAN ADVANCED TECHNOLOGY ASSOCIATION
CANADIAN APPLIANCE MANUFACTURERS ASSOCIATION
CANADIAN ART MUSEUMS DIRECTOR ORGANIZATION
CANADIAN ARTISTS' REPRESENTATION
CANADIAN ASSOCIATION FOR UNIVERSITY CONTINUING EDUCATION
CANADIAN ASSOCIATION OF BROADCASTERS
CANADIAN ASSOCIATION OF DATA AND PROFESSIONAL SERVICE ORGANIZATIONS
CANADIAN ASSOCIATION OF JAPANESE AUTOMOBILE DEALERS
CANADIAN ASSOCIATION OF NUMISMATIC DEALERS
CANADIAN ASSOCIATION OF OPTOMETRISTS
CANADIAN ASSOCIATION OF SMELTER AND ALLIED WORKERS, LOCAL NO. 4
CANADIAN ASSOCIATION OF SPEECH-LANGUAGE PATHOLOGISTS AND AUDIOLOGISTS
CANADIAN ASSOCIATION OF UNIVERSITY TEACHERS
CANADIAN ASSOCIATION OF WOMEN EXECUTIVES AND ENTREPRENEURS
CANADIAN AUTOMOBILE ASSOCIATION
CANADIAN AUTOMOTIVE LEASING ASSOCIATION
CANADIAN BANKERS' ASSOCIATION
CANADIAN BAR ASSOCIATION
CANADIAN BUSINESS PRESS

CANADIAN CAR WASH ASSOCIATION
CANADIAN CARPET INSTITUTE
CANADIAN CHAMBER OF COMMERCE
CANADIAN CHEMICAL PRODUCERS ASSOCIATION
CANADIAN CO-OPERATIVE CREDIT SOCIETY
CANADIAN CO-OPERATIVE HOUSING MOVEMENT
CANADIAN COMMUNITY NEWSPAPERS ASSOCIATION
CANADIAN CONFERENCE OF THE ARTS
CANADIAN CONSTRUCTION ASSOCIATION
CANADIAN COUNCIL OF GROCERY DISTRIBUTORS
CANADIAN COUNCIL ON SOCIAL DEVELOPMENT
CANADIAN CRAFTS COUNCIL
CANADIAN DAILY NEWSPAPER PUBLISHERS ASSOCIATION
CANADIAN DEHYDRATORS ASSOCIATION
CANADIAN ELECTRICAL DISTRIBUTORS ASSOCIATION
CANADIAN EXPORTERS' ASSOCIATION
CANADIAN FARM AND INDUSTRIAL EQUIPMENT INSTITUTE
CANADIAN FEDERATION OF AGRICULTURE
CANADIAN FEDERATION OF BUSINESS AND PROFESSIONAL WOMEN'S CLUBS
CANADIAN FEDERATION OF FARM EQUIPMENT DEALERS ASSOCIATION
CANADIAN FEDERATION OF INDEPENDENT GROCERS
CANADIAN FEDERATION OF INDEPENDENT BUSINESS
CANADIAN FEDERATION OF LABOUR
CANADIAN FEDERATION OF STUDENTS
CANADIAN FEDERATION OF UNIVERSITY WOMEN
CANADIAN FEED INDUSTRY ASSOCIATION
CANADIAN FEED INDUSTRY ASSOCIATION (SASKATCHEWAN DIVISION)
CANADIAN FIGURE SKATING ASSOCIATION
CANADIAN FIGURE SKATING ASSOCIATION (SASKATCHEWAN DIVISION)
CANADIAN GAS ASSOCIATION
CANADIAN GIFT AND TABLEWARE ASSOCIATION
CANADIAN HARDWARE AND HOUSEWARES MANUFACTURERS ASSOCIATION
CANADIAN HOME BUILDERS' ASSOCIATION
CANADIAN HORSE COUNCIL
CANADIAN HOSPITAL ASSOCIATION

CANADIAN HOUSING AND RENEWAL ASSOCIATION
CANADIAN INDEPENDENT ADJUSTERS' ASSOCIATION
CANADIAN INSOLVENCY ASSOCIATION
CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS
CANADIAN INSTITUTE OF PLUMBING AND HEATING
CANADIAN INSTITUTE OF PUBLIC REAL ESTATE COMPANIES
CANADIAN JEWELLERS ASSOCIATION
CANADIAN JEWISH CONGRESS
CANADIAN LABOUR CONGRESS
CANADIAN LIBRARY ASSOCIATION
CANADIAN LIFE AND HEALTH INSURANCE ASSOCIATION INC.
CANADIAN MAGAZINE PUBLISHERS ASSOCIATION
CANADIAN MANUFACTURERS' ASSOCIATION
CANADIAN MEAT COUNCIL
CANADIAN MEDICAL ASSOCIATION
CANADIAN MOTION PICTURE DISTRIBUTORS ASSOCIATION
CANADIAN MUSEUMS ASSOCIATION
CANADIAN NATIONAL INSTITUTE FOR THE BLIND
CANADIAN NURSES ASSOCIATION
CANADIAN OPERA COMPANY
CANADIAN ORGANIZATION OF SMALL BUSINESS INC.
CANADIAN PARAPLEGIC ASSOCIATION
CANADIAN PARAPLEGIC ASSOCIATION (NEWFOUNDLAND DIVISION)
CANADIAN PARAPLEGIC ASSOCIATION (PRINCE EDWARD ISLAND)
CANADIAN PETROLEUM PRODUCTS INSTITUTE
CANADIAN PRESTRESSED CONCRETE INSTITUTE
CANADIAN PSYCHOLOGICAL ASSOCIATION
CANADIAN REAL ESTATE ASSOCIATION
CANADIAN REGISTER OF HEALTH SERVICE PROVIDERS IN PSYCHOLOGY
CANADIAN RESEARCH COMMITTEE ON TAXATION
CANADIAN RESTAURANT AND FOODSERVICES ASSOCIATION
CANADIAN RETAIL HARDWARE ASSOCIATION
CANADIAN SENIORS HOUSING GROUP
CANADIAN SKI AREA OPERATOR'S ASSOCIATION
CANADIAN SKI COUNCIL

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CANADIAN SOFT DRINK ASSOCIATION
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CANADIAN TEACHERS' FEDERATION
CANADIAN TRUCK TRAILER MANUFACTURERS ASSOCIATION
CANADIAN TRUCKING ASSOCIATION
CANADIAN VETERINARY MEDICAL ASSOCIATION
CANADIAN WINE INSTITUTE
CANADIANS FOR GREATER GOVERNMENT ACCOUNTABILITY
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CAPP, GEOFFREY B.
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CHARETTE, GERARD P.
CHARLOTTETOWN DRIVING PARK AND PROVINCIAL EXHIBITION ASSOCIATION
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CITY OF TORONTO
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CITY OF WHITEHORSE
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CLARKSON GORDON CHARTERED ACCOUNTANTS
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COALITION OF PROVINCIAL ORGANIZATIONS OF THE HANDICAPPED
COHEN, SHIRLEY
COLLEGE OF FAMILY PHYSICIANS OF CANADA, ONTARIO CHAPTER
COLLEGE OF PSYCHOLOGISTS OF NEW BRUNSWICK
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COMMITTEE CONCERNED ABOUT THE CONVENTION INDUSTRY
COMMITTEE ON MONETARY AND ECONOMIC REFORM
CONFECTIONARY MANUFACTURERS ASSOCIATION OF CANADA
CONFÉDÉRATION DES CAISSES POPULAIRES ET D'ÉCONOMIE DESJARDINS DU QUÉBEC
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CONFEDERATION OF NATIONAL TRADE UNIONS
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CONNOR, KIRSTEN F.
CONSEIL QUÉBÉCOIS DU THÉÂTRE

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CONSUMER AID SERVICES
CONSUMERS' ASSOCIATION OF CANADA
CONSUMERS' ASSOCIATION OF CANADA, NORTHWEST TERRITORIES DIVISION
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COOPERS & LYBRAND
CORBER, J.W.
CORNWALL, ANDREW
CORNWALL, ANNE
CORPORATION DU GROUPE LA LAURENTIENNE
CORPORATION PROFESSIONNELLE DES PSYCHOLOGUES DU QUÉBEC
CORPORATION SPORTS QUÉBEC
COSMETOLOGIST ASSOCIATION OF SASKATCHEWAN
CÔTÉ, GERARD E.
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COUNCIL OF FOREST INDUSTRIES OF BRITISH COLUMBIA
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COUNCIL OF YUKON INDIANS
COUNCIL ON AGING
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DE JARDIN, ALAN
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ECONOMIC DEVELOPMENT CORPORATION OF OSOYOOS AND AREA
ÉDITEURS DE PÉRIODIQUES DU QUÉBEC
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EDMONTON FEDERATION OF COMMUNITY LEAGUES
EDMONTON NORTHLANDS
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ELBOW VALLEY CYCLE CLUB

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EQUIPMENT LESSORS ASSOCIATION OF CANADA
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FAYOLLE, ROGER
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FÉDÉRATION DES CÉGEPS
FÉDÉRATION DES DAMES D'ACADIE INC.
FÉDÉRATION NATIONALE DES ASSOCIATIONS DE CONSOMMATEURS DU QUÉBEC
FEDERATION OF AUTOMOBILE DEALER ASSOCIATIONS OF CANADA
FEDERATION OF CANADIAN MUNICIPALITIES
FEDERATION OF INDEPENDENT SCHOOLS OF CANADA
FEDERATION OF PRINCE EDWARD ISLAND MUNICIPALITIES
FEDERATION OF SASKATCHEWAN INDIAN NATIONS
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FIREMAN'S FUND
FIRST BAPTIST CHURCH
FISHERMEN FOOD & ALLIED WORKERS' UNION
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FLYNN, F.G.
FOOD BANK

FORBES, G.S.
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FORD, WILLIAM H.
FORTIN, PHILIP
FORUM DES CITOYENS AGÉS DE MONTRÉAL INC.
FOUR SEASONS HOTELS
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FRASER INSTITUTE
FRASER VALLEY INDEPENDENT SHAKE & SHINGLE PRODUCERS ASSOCIATION
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FUND RAISING CONSULTANTS INC.
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GAGNÉ, MARTIN
GATEWAY STATUS OF WOMEN COUNCIL
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GEROW, GRANT
GESTION DEVTEL MANAGEMENT INC.
GIRL GUIDES OF CANADA
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GODDARD, WILLIAM R.
GOEBEL, ALLAN
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GOLDEN AGE ASSOCIATION
GOLDEN, JUDITH
GONSALVES, LOUIS
GOODFELLOW INC.
GOODMAN AND CARR
GOODMAN, WOLFE D.

GOVERNMENT OF THE NORTHWEST TERRITORIES
GOVERNMENT OF YUKON
GOW, JAMES D.
GRAY, N.
GREATER VANCOUVER LIBERTARIAN ASSOCIATION
GREENE, DONALD F.
GRINDSTEAD, BERNIE
GROUP HEALTH CENTRE
GRUSON, LINDA M.
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GUTBRODT, ERIKA
GUTSCHE, ED
GYRA, DR. JOHN C.
HADDEN, ELEANOR
HADDOW, YVETTE
HAGGERTY, M.B.
HALIBURTON FIGURE SKATING
HALIFAX BOARD OF TRADE
HAMBLEY, JANICE M.
HAMBLEY, W.D.
HAMILTON, WILLIAM
HARRIS, PITCHER, KENNEDY, RYAN, CHARTERED ACCOUNTANTS
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HAYEK, ALBERT
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HEALE, NANCY
HEATHER'S HERITAGE HAVEN
HELWIG, DR. C. VINCENT
HEMMING, TIMOTHY C.S.
HERON, GEORGE
HILCHEY, GRACE
HILTON INTERNATIONAL TORONTO
HINDS, GERALD E.
HOFFMAN, L.A.
HOLIDAY INN TORONTO AIRPORT

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HOTEL SELBY
HOUGH, C.
HUDSON'S BAY NORTHERN STORES INC.
ILLES, S.
INDEPENDENT PETROLEUM ASSOCIATION OF CANADA
INFORMATION TECHNOLOGY ASSOCIATION OF CANADA
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INSTITUTE OF CHARTERED ACCOUNTANTS OF NEWFOUNDLAND
INSTITUTE OF CHARTERED ACCOUNTANTS OF THE NORTHWEST TERRITORIES
INSURANCE BUREAU OF CANADA
INTERNATIONAL BROKER ASSOCATION OF CANADA
INTERNATIONAL CARE CORPORATION
INUVIK CHAMBER OF COMMERCE
IQALUIT CHAMBER OF COMMERCE
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KAPROWY, E.A.
KARAL, MONICA
KAY BROWN ENTERPRISES INC.
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KELEHER, GARY R.
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KEN WILSON AIRCRAFT SALES LTD.
KENWORTHY, ALAN
KEOGH, ANN
KERBEL GROUP
KILGOUR, DAVID
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KUMAR, N.

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LAWSON ADJUSTMENT SERVICES (1984) LIMITED
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LEVIN, SANFORD
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LIFELINE SYSTEMS (CANADA) INC.
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LUMBER AND BUILDING MATERIALS ASSOCIATION OF ONTARIO INC.
LUTHERAN SUNSET HOME OF SASKATOON INC.
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MACINTOSH, JOSEPHINE
MACLEAN HUNTER
MACLEAN, DOUG & MARY LYNN
MACNEILL, JOHN A.
MAGAZINE PUBLISHERS OF AMERICA, INC.
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MANITOBA FEDERATION OF LABOUR
MANITOBA LAW FOUNDATION
MANITOBA LIBERAL CAUCUS
MANITOBA PSYCHOLOGICAL SOCIETY
MANITOBA REGISTERED MUSIC TEACHERS ASSOCIATION
MANITOBA RESTAURANT AND FOOD SERVICES
MANITOBA SOCIETY OF SENIORS INC.
MANITOBA TEACHERS' SOCIETY
MANITOBA VETERINARY MEDICAL ASSOCIATION
MANUGE, ELIZABETH
MARATHON FORD SALES LTD.
MARCHANT GROUP

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MATHIEU, ROGER
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McINTYRE, CATHERINE
McINTYRE, DAVID
McMASTER STUDENTS UNION
McMULLIN, BETTY
MEDING, HEIDEMARIE
MERSON, BEN
METRO FAMILY COUNSELLING
METROPOLITAN TORONTO AND REGION CONSERVATION AUTHORITY METRO UNITED WAY
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MILLER, RICKEY S.
MINING ASSOCIATION OF BRITISH COLUMBIA
MINING ASSOCIATION OF CANADA
MISSISSAUGA POLICY ADVISORS ASSOCIATION
MITCHELL WAECHTER, IRENE
MOFFAT INN, NIAGARA-ON-THE-LAKE
MOLLENHAUER HOLDINGS CORPORATION
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MONTGOMERY, RHODA
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MORDEN & HELWIG GROUP INC.
MORIN, GERTRUDE
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MOTION PICTURE THEATRE ASSOCIATION OF AMERICA, INC.
MOTION PICTURE THEATRES ASSOCIATION OF CANADA
MOUNT SAINT JOSEPH HOSPITAL
MOUNT SINAI HOSPITAL
MUNICIPAL ELECTRIC ASSOCIATION
MUSIC FOR YOUNG CHILDREN
MYERS, CARL

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NATIONAL ACTION COMMITTEE ON THE STATUS OF WOMEN
NATIONAL ANTI-POVERTY ORGANIZATION
NATIONAL ASSOCIATION OF FRIENDSHIP CENTRES
NATIONAL ASSOCIATION OF TOBACCO AND CONFECTIONERY DISTRIBUTORS
NATIONAL ASSOCIATION OF WOMEN AND THE LAW
NATIONAL BALLET OF CANADA
NATIONAL COUNCIL OF WELFARE
NATIONAL FARMERS' UNION
NATIONAL FEDERATION OF NURSES' UNIONS
NATIONAL FLOOR COVERING ASSOCIATION
NATIONAL VOLUNTARY ORGANIZATIONS
NATIVE WOMEN'S ASSOCIATION OF THE NORTHWEST TERRITORIES
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NEW BRUNSWICK ECONOMIC COUNCIL
NEW BRUNSWICK FEDERATION OF AGRICULTURE
NEW BRUNSWICK NEW DEMOCRATIC PARTY
NEW BRUNSWICK PRO-CANADA NETWORK
NEW DEMOCRAT PARTY OF NEWFOUNDLAND AND LABRADOR
NEW POPULIST PARTY OF BRITISH COLUMBIA
NEWBERRY, ROGER
NEWFOUNDLAND AND LABRADOR BUILDING CONSTRUCTION TRADE COUNCIL
NEWFOUNDLAND AND LABRADOR CHAMBER OF COMMERCE
NEWFOUNDLAND AND LABRADOR FEDERATION OF MUNICIPALITIES
NEWFOUNDLAND REGISTERED MUSIC TEACHERS' ASSOCIATION
NEWFOUNDLAND AND LABRADOR HOME BUILDERS ASSOCIATION
NEWFOUNDLAND CONVENIENCE STORES ASSOCIATION
NEWFOUNDLAND SYMPHONY ORCHESTRA
NICKERSON, MICHAEL
NIXON, DEBORAH
NOAKES, THERESA
NORRIE, GEORGE C.
NORTHERN CLAIMS SERVICES LIMITED
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NORTHWEST TERRITORIES CHAMBER OF COMMERCE
NORTHWEST TERRITORIES CHAMBER OF MINES
NORTHWEST TERRITORIES CONSTRUCTION ASSOCIATION
NORTHWEST TERRITORIES COUNCIL OF FRIENDSHIP CENTRES
NORTHWEST TERRITORIES FEDERATION OF LABOUR
NORTHWEST TERRITORIES SENIORS' SOCIETY
NORTHWOOD HOMECARE LIMITED
NORTON, DIANE
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NOVA SCOTIA FEDERATION OF AGRICULTURE
NOVA SCOTIA LIBERAL CAUCUS
NOVA SCOTIA NEW DEMOCRATIC PARTY
NOVA SCOTIA REGISTERED MUSIC TEACHERS' ASSOCIATION
NOVA SCOTIA RESTAURANT AND FOODSERVICES ASSOCIATION
NOVA SCOTIA SOCIETY OF OCCUPATIONAL THERAPISTS
NOVA SCOTIA VOLUNTARY PLANNING
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OAK BAY MARINE GROUP
OAKVILLE CHAMBER OF COMMERCE
OATES ANDERSON & ASSOCIATES
OLD AGE PENSIONERS ORGANIZATION
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ONTARIO ASSOCIATION OF LANDSCAPE ARCHITECTS
ONTARIO ASSOCIATION OF PROFESSIONAL SOCIAL WORKERS
ONTARIO ASSOCIATION OF SPEECH-LANGUAGE PATHOLOGISTS AND AUDIOLOGISTS
ONTARIO BASEBALL ASSOCIATION
ONTARIO CHINESE RESTAURANT ASSOCIATION
ONTARIO COALITION OF SENIOR CITIZENS' ORGANIZATIONS
ONTARIO COFFEE SERVICE ASSOCIATION
ONTARIO FEDERATION OF AGRICULTURE

ONTARIO FEDERATION OF LABOUR
ONTARIO GRAIN & FEED DEALERS ASSOCIATION
ONTARIO GYMNASTIC FEDERATION
ONTARIO MOTOR COACH ASSOCIATION
ONTARIO PSYCHOLOGICAL ASSOCIATION
ONTARIO RACING AND BREEDERS COUNCIL
ONTARIO VETERINARY ASSOCIATION
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POMEROY, EDWARD
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POUNDEN, MR. & MRS. H.
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PRINCE EDWARD ISLAND COUNCIL OF LABOUR
PRINCE EDWARD ISLAND COUNCIL OF THE ARTS
PRINCE EDWARD ISLAND COUNCIL OF THE DISABLED
PRINCE EDWARD ISLAND DEPARTMENT OF AGRICULTURE
PRINCE EDWARD ISLAND DRAFT HORSE ASSOCIATION
PRINCE EDWARD ISLAND FEDERATION OF AGRICULTURE
PRINCE EDWARD ISLAND FEDERATION OF LABOUR
PRINCE EDWARD ISLAND FEDERATION OF MUNICIPALITIES
PRINCE EDWARD ISLAND POTATO MARKETING COMMISSION
PRINCE EDWARD ISLAND PRO CANADA NETWORK
PRINCE EDWARD ISLAND RESTAURANT AND FOOD SERVICE ASSOCIATION
PRINCE EDWARD ISLAND TRUCKERS' ASSOCIATION
PRINCE EDWARD ISLAND VETERINARY MEDICAL ASSOCIATION
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PRIVATE SECTOR SUPPLY TO GOVERNMENT
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PROFESSIONAL ART DEALERS ASSOCIATION OF CANADA INC.
PROFESSIONAL ASSOCIATION OF CANADIAN THEATRES
PROGRESSIVE CONSERVATIVE YUKON CAUCUS
PSYCHOLOGICAL ASSOCIATION OF MANITOBA
PSYCHOLOGICAL ASSOCIATION OF PRINCE EDWARD ISLAND
PSYCHOLOGISTS ASSOCIATION OF ALBERTA
PUBLIC SERVICE ALLIANCE OF CANADA
PURCELL, SHEILA
PYE, ARTHUR
QUADRINI, FERNANDO
QUEBEC BAR
QUEBEC EMPLOYERS COUNCIL
QUEBEC FEDERATION OF RECREATION ASSOCIATIONS

QUEBEC FEDERATION OF TEACHERS' UNIONS
QUEBEC INTERPROFESSIONAL COUNCIL
RACETRACKS OF CANADA INC.
RADIOCOMM ASSOCIATION OF CANADA
RAMADA HOTEL
RAND, GEORGE
RAPPAPORT, P.H.
RASO, WILLIAM
RAY, A.K.
REAL ESTATE BOARD OF GREATER VANCOUVER
REGINA CHAMBER OF COMMERCE
REGIONAL MUNICIPALITY OF OTTAWA-CARLETON (SOCIAL SERVICES)
REGISTERED NURSES ASSOCIATION OF NOVA SCOTIA
RENTAL HOUSING COUNCIL OF BRITISH COLUMBIA
RESTAURANT & FOODSERVICES ASSOCIATION OF BRITISH COLUMBIA
RETAIL COUNCIL OF CANADA
RETAIL MERCHANTS' ASSOCIATION OF BRITISH COLUMBIA
REW, DORENE A.
ROBERTSON, IAN M.
ROBERTSON, R.G.
ROBERTSON, R.S.
ROBINSON, PAUL J.
ROBY, CLAUDE-BERNAND
RODRIGUE, GUY
RONALD, PAUL
ROONEY, DORIS
ROSLIN, ALEX
ROTH, JEAN
ROYAL CANADIAN GOLF ASSOCIATION
ROYAL VICTORIA - ROTARY LIFELINE
RUPERT, GARY
SABRE ENERGY LTD.
SAINT JOHN BOARD OF TRADE
SALVATION ARMY
SASKATCHEWAN ACTION COMMITTEE, STATUS OF WOMEN

SASKATCHEWAN ARTS ALLIANCE
SASKATCHEWAN CHAMBER OF COMMERCE
SASKATCHEWAN FEDERATION OF LABOUR
SASKATCHEWAN LEADER OF THE OPPOSITION
SASKATCHEWAN PSYCHOLOGICAL ASSOCIATION
SASKATCHEWAN UNION OF NURSES
SASKATOON CHAMBER OF COMMERCE
SATTERLY, MARK P.
SAVIDANT, JOHN S.
SAXBY, ISLA & NELSON
SAXBY, LORIE
SCHACKLETON, PETER D.
SCHARF, JOHN S.
SCHOOL BUS OPERATORS ASSOCIATION
SCHWARTZ, KEN
SCOTT, JAMES GUTHRIE
SCOTT, JOHN D.
SCRAP-IT (SINCERE CANADIANS REVOLTING AGAINST PAYING INCREASED TAXES)
SEL-WIN CHEMICALS LIMITED
SEXTON, CHRISTINE S.
SHANTZ COACH LINES LTD.
SHAW, DAVID
SHEA, CHAUNCAY
SHELL CANADA LIMITED
SHEPEL, LARRY F.
SHEPHARD, U.E.
SHERBROCK, K.V.
SHERWOOD PARK AND DISTRICT CHAMBER OF COMMERCE
SHRIMPTON, A.J.
SIGAL, JOHN S.
SIGN ASSOCIATION OF CANADA
SIGN GROUP (JIM PATTISON)
SILVER TRAIL TOURISM ASSOCIATION
SIMCOE ERIE INVESTORS LIMITED

SIMMONDS, FRANK
SINCLAIR, COLEMAN
SINGLE MOMS
SINOTES, SUZANNE
SMITH, LYONS, TORRANCE, STEVENSON & MAYER BARRISTERS, SOLICITORS
SMITH, REGINALD & PAULINE
SMITTY'S PANCAKE HOUSE RESTAURANT
SNAETH, MURIEL
SOCIAL ACTION COMMISSION, DIOCESE OF CHARLOTTETOWN
SOCIAL JUSTICE COMMISSION
SOCIAL PLANNING COUNCIL OF KITCHENER-WATERLOO
SOCIAL PLANNING COUNCIL OF WINNIPEG
SOCIAL SCIENCE FEDERATION OF CANADA
SOCIETY OF MANAGEMENT ACCOUNTANTS OF CANADA
MANAGEMENT DU CANADA
SOCIETY OF ONTARIO VETERINARIANS
SODARCAN INC.
SOLIDARITÉ POPULAIRE QUÉBEC
SPEERS PETROCHEMICALS LTD.
SPEIRAN, PENNY
SPORT PRINCE EDWARD ISLAND
SPORTS FEDERATION
SPORTS HOLDINGS LTD
SPORTS-QUÉBEC
SPRAGUE, ANN M.
ST-JEAN, DANIEL
ST-ONGE, VICTOR
ST-THOMAS UNIVERSITY STUDENTS UNION
ST. JOHN'S BOARD OF TRADE
ST.MICHAEL'S HOSPITAL
STAGER, DAVID A.A.
STAMBULA, ROBERT
STEEVES, L.H.
STEHR, HUBERT O.
STRICKLAND, J.W.

STUDENTS' UNION OF ST. THOMAS UNIVERSITY
SUDBURY & DISTRICT CHAMBER OF COMMERCE
SUTHERLAND ROCHE, DORIS
SWEENEY, JAMES E.
SZELISKI, Z.L.
TA'AN KWACH'AN INDIAN COUNCIL
TAX EXECUTIVES INSTITUTE, INC.
TAX GROUP, THE
TAXPAYERS COUNCIL ON NATIONAL ISSUES
TAYLOR, ANNE
TEA AND COFFEE ASSOCIATION OF CANADA
THIBAULT MARCHAND PEAT MARWICK
THIBAULT, J.E. AND E.
THOMAS, W. DAVE
THORPE, JUNE
TODD, WILLIAM G.
TOLHURST, RUTH J.
TOMASI, LOU F.
TORONTO AIRPORT HILTON INTERNATIONAL
TORONTO BOARD OF EDUCATION
TORONTO HOME BUILDERS' ASSOCIATION
TORONTO REAL ESTATE BOARD
TORONTO TRUCKING ASSOCIATION
TOURISM INDUSTRY ASSOCIATION OF ALBERTA
TOURISM INDUSTRY ASSOCIATION OF CANADA
TOURISM INDUSTRY ASSOCIATION OF NOVA SCOTIA
TOURISM INDUSTRY ASSOCIATION OF PRINCE EDWARD ISLAND
TOURISM INDUSTRY ASSOCIATION OF THE NORTHWEST TERRITORIES
TOURISM INDUSTRY ASSOCIATION OF THE YUKON
TOURISM ONTARIO INC.
TRENT INVESTMENTS INC.
TRIDEL CORPORATION
TRIGG, C.M.
TRUDEAU, LILLIAN M.
TRUST COMPANIES ASSOCIATION OF CANADA

TSANG, H.M., CO. LTD.
TURNBULL, J.A.
TYLER, MR. & MRS. S.
UNIFARM
UNION DES MUNICIPALITÉS DU QUÉBEC
UNION OF NORTHERN WORKERS
UNITED AGRI PRODUCTS (WEST)
UNITED BUSINESS OF NOVA SCOTIA LIMITED
UNITED CHURCH OF CANADA
UNITED FISHERMEN FOOD & ALLIED WORKERS UNION
UNITED STEELWORKERS OF AMERICA
UNIVERSITY OF TORONTO INSTITUTE FOR POLICY ANALYSIS (PROFESSOR JOHN BOSSONS)
UNIVERSITY OF TORONTO INSTITUTE FOR POLICY ANALYSIS (PROFESSORS PETER DUNGAN AND THOMAS A. WILSON)
URBAN DEVELOPMENT INSTITUTE
VAISH, SHIV & USHA
VANCOUVER BOARD OF TRADE
VANCOUVER HOTEL ASSOCIATION
VANCOUVER PUBLIC AQUARIUM
VANCOUVER TAXI CAB OWNERS ASSOCIATION
VANCOUVER YWCA
VANDENBOS, PIETER J.
VEINOT, PHILIP
VEITH HOUSE
VICTORIA FAULKNER WOMEN'S CENTRE
VICTORIA GENERAL HOSPITAL
VICTORIA VISUAL ARTS ADVOCACY
VOLUNTARY PLANNING BOARD OF NOVA SCOTIA
WAHEED, K.M.
WALKER, CLÉMENCE
WALKER, DAVID
WASHBURN, HARRY T.
WATT, MR. & MRS. ROLLAND
WATT LEPAGE, MARGARET
WANG, PAUL L.

WARNER, L.E.
WATERS, BRYCE
WEALL & CULLEN NURSERIES LTD.
WESTERN BARLEY GROWERS ASSOCIATION
WESTERN CANADIAN WHEAT GROWERS ASSOCIATION
W.G. CLARK COMPANY LIMITED
WHITE, CHER
WHITEHORSE CHAMBER OF COMMERCE
WIGEN, RAE V.
WILCOX, J.H.
WILLIS CONSULTING GROUP
WILSON, ALLAN R.
WILSON BANWELL & ASSOCIATES
WILSON, THOMAS A.
WINNIPEG CHAMBER OF COMMERCE
WOLVERINE AIR (1988) LTD.
WOMEN EXECUTIVES & ENTREPRENEURS
WOMEN'S EDUCATION AND SOCIAL ACTION ASSOCIATION
WOMEN'S PLACE
WOOD, RICHARD
WOODHEAD, T.
WRIGHT, THELMA
WRITERS' FEDERATION OF NOVA SCOTIA
WORKING CLASS TAX PAYING CANADIANS (QUÉBEC)
YACHIMEC, MIKE
YELLOWKNIFE CHAMBER OF COMMERCE
YORKE, BRUCE
YUKON ASSOCIATION FOR COMMUNITY LIVING
YUKON CHAMBER OF MINES
YUKON CHILD CARE ASSOCIATION
YUKON FEDERATION OF LABOUR
YMCA CANADA
YWCA OF CANADA/YWCA DU CANADA

VARIOUS PETITIONS

MINUTES OF PROCEEDINGS

TUESDAY, JUNE 27, 1989
(30)

[*Text*]

The Standing Committee on Finance met at 3:36 o'clock p.m. this day, in Room 371 (West Block) the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Audrey McLaughlin, Jerry Pickard, Lee Richardson, Pat Sobeski and Douglas Young.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward, Consultant.

By unanimous consent, at 5:10 o'clock p.m., the Committee proceeded to sit *in camera*.

By unanimous consent, in accordance with its mandate under Standing Order 108(2), the Committee commenced consideration of the Goods and Services Tax to be introduced by the Minister of Finance.

At 5:29 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, AUGUST 15, 1989
(34)

The Standing Committee on Finance met at 7:40 o'clock p.m. this day, in Room 253-D (Centre Block) the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Murray Dorin, Audrey McLaughlin, Lorne Nystrom, Lee Richardson, Pat Sobeski and Douglas Young.

Acting Members present: Jack Shields for Yvon Côté; Harry Chadwick for Clément Couture; David Berger for Jerry Pickard and Louise Feltham for René Soetens.

Other Members present: Fernand Jourdenais and John Rodriguez.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Michel Coderre and Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the technical document on the goods and services tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

At 9:35 o'clock p.m., in accordance with this day's Committee's decision, the sitting resumed *in camera.*

The Committee proceeded to the consideration of its order of business in relation to the Technical Document on the Goods and Services Tax.

At 10:29 o'clock p.m., the Committee adjourned to the call of the Chair.

WEDNESDAY, SEPTEMBER 20, 1989
(42)

The Standing Committee on Finance met *in camera* at 9:42 o'clock a.m. this day, in Room 253 Centre Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Murray Dorin, Alfonso Gagliano, Lorne Nystrom, Jerry Pickard, Lee Richardson, Pat Sobeski, René Soetens and Douglas Young.

Acting Member present: John Manley for Hon. Roy MacLaren.
Other Members present: David Berger, Diane Marleau.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Michel Coderre; Cheryl Knebel; Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26.*)

The Committee proceeded to the consideration of its future business.

At 11:47 o'clock a.m., the Committee adjourned to the call of the Chair.

MONDAY, OCTOBER 30, 1989
(92)

The Standing Committee on Finance met *in camera* at 3:38 o'clock p.m. this day, in Room 269 West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Diane Marleau, Lorne Nystrom, Jerry Pickard, Lee Richardson and Pat Sobeski.

Acting Member present: Ronald Duhamel for Alfonso Gagliano.

Other Member present: Jack Whittaker.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Cheryl Knebel; Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Service Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26.*)

It was agreed,—That, the dissenting "Minority Reports" opinions from the Liberal Party and the New Democratic Party, be appended to the Committee's Report and that the Committee will be responsible for translation of the texts.

It was agreed,—That, all documents distributed at *in camera* meetings dealing with the Technical Document on the Goods and Services Tax be picked up at the end of each meeting.

The Committee proceeded to the consideration of certain guidelines for the Draft Report to the House.

At 5:53 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, NOVEMBER 2, 1989
(93)

The Standing Committee on Finance met, *in camera* at 9:44 o'clock a.m. this day, in Room 269 West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Lorne Nystrom, Jerry Pickard, Lee Richardson and René Soetens.

Acting Member present: John Manley for Douglas Young.

Other Member present: Jack Whittaker.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee resumed consideration of certain guidelines for the Draft Report to the House.

At 1:00 o'clock p.m., the Committee adjourned to the call of the Chair.

MONDAY, NOVEMBER 6, 1989
(94)

The Standing Committee on Finance met, *in camera* at 1:37 o'clock p.m. this day, in Mont Ste-Marie (Québec), the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Alfonso Gagliano, Diane Marleau, Lorne Nystrom, Jerry Pickard, Lee Richardson, Pat Sobeski and René Soetens.

Other Member present: Jack Whittaker.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee resumed consideration of guidelines for the Draft Report to the House.

At 4:01 o'clock p.m., the sitting was suspended.

At 4:10 o'clock p.m., the sitting resumed.

Consideration of guidelines for the Draft Report to the House resumed.

At 5:28 o'clock p.m., the Committee adjourned to the call of the Chair.

MONDAY, NOVEMBER 6, 1989
(95)

The Standing Committee on Finance met, *in camera*, at 7:57 o'clock p.m. this day, in Mont Ste-Marie (Québec), the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Alfonso Gagliano, Diane Marleau, Lorne Nystrom, Jerry Pickard, Lee Richardson, Pat Sobeski, René Soetens and Douglas Young.

Acting Member present: Jack Whittaker for Audrey McLaughlin.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Michel Coderre; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on

Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee resumed consideration of guidelines for the Draft Report to the House.

At 9:50 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, NOVEMBER 7, 1989
(96)

The Standing Committee on Finance met, *in camera*, at 9:08 o'clock a.m. this day, in Mont Ste-Marie (Québec), the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Alfonso Gagliano, Diane Marleau, Lorne Nystrom, Jerry Pickard, Lee Richardson, Pat Sobeski and René Soetens.

Acting Member present: Jack Whittaker for Audrey McLaughlin.

In attendance: *From the Committee's staff*: Sean Aylward; Michael Cassidy; Michel Coderre; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee resumed consideration of guidelines for the Draft Report to the House.

At 10:39 o'clock a.m., the sitting was suspended.

At 10:45 o'clock a.m., the sitting resumed.

Consideration of guidelines for the Draft Report resumed.

At 11:56 o'clock a.m., the Committee adjourned to the call of the Chair.

TUESDAY, NOVEMBER 7, 1989
(97)

The Standing Committee on Finance met, *in camera*, at 2:07 o'clock p.m. this day, in Mont Ste-Marie (Québec), the Acting Chairman, Murray Dorin, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Alfonso Gagliano, Diane Marleau, Lorne Nystrom, Jerry Pickard, Lee Richardson, Pat Sobeski and René Soetens.

Acting Member present: Jack Whittaker for Audrey McLaughlin.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee resumed consideration of guidelines for the Draft Report to the House.

At 2:10 o'clock p.m., the Chairman took the Chair.

At 3:27 o'clock p.m., the sitting was suspended.

At 3:38 o'clock p.m., the sitting resumed.

Consideration of guidelines for the Draft Report resumed.

At 5:28 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, NOVEMBER 7, 1989
(98)

The Standing Committee on Finance met, *in camera*, at 8:11 o'clock p.m. this day, in Mont Ste-Marie (Québec), the Acting Chairman, Murray Dorin, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Alfonso Gagliano, Diane Marleau, Lorne Nystrom, Jerry Pickard, Lee Richardson, Pat Sobeski and René Soetens.

Acting Member present: Jack Whittaker for Audrey McLaughlin.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee resumed consideration of guidelines for the Draft Report to the House.

At 8:56 o'clock p.m., the Chairman took the Chair.

At 9:47 o'clock p.m., the Committee adjourned to the call of the Chair.

WEDNESDAY, NOVEMBER 8, 1989
(99)

The Standing Committee on Finance met, *in camera*, at 9:06 o'clock a.m. this day, in Mont Ste-Marie (Québec), the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Alfonso Gagliano, Diane Marleau, Lorne Nystrom, Lee Richardson, Pat Sobeski and René Soetens.

Acting Member present: Jack Whittaker for Audrey McLaughlin.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee resumed consideration of guidelines for the Draft Report to the House.

At 10:35 o'clock a.m., the sitting was suspended.

At 10:40 o'clock a.m., the sitting resumed.

Consideration of guidelines for the Draft Report to the House resumed.

At 11:59 o'clock a.m., the Committee adjourned to the call of the Chair.

WEDNESDAY, NOVEMBER 8, 1989
(100)

The Standing Committee on Finance met, *in camera*, at 1:39 o'clock p.m. this day, in Mont Ste-Marie (Québec), the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Alfonso Gagliano, Diane Marleau, Lorne Nystrom, Lee Richardson, Pat Sobeski and René Soetens.

Acting Member present: Jack Whittaker for Audrey McLaughlin.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee resumed consideration of guidelines for the Draft Report to the House.

At 2:35 o'clock p.m., the sitting was suspended.

At 3:03 o'clock p.m., the sitting resumed.

Consideration of guidelines for the Draft Report to the House resumed.

At 5:27 o'clock p.m., the Committee adjourned to the call of the Chair.

WEDNESDAY, NOVEMBER 8, 1989
(101)

The Standing Committee on Finance met, *in camera*, at 7:07 o'clock p.m. this day, in Mont Ste-Marie (Québec), the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Alfonso Gagliano, Diane Marleau and René Soetens.

Acting Member present: Jack Whittaker for Audrey McLaughlin.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee proceeded to the consideration of guidelines for the Draft Report.

At 9:38 o'clock p.m., the Committee adjourned to the call of the Chair.

THURSDAY, NOVEMBER 9, 1989
(102)

The Standing Committee on Finance met, *in camera*, at 9:05 o'clock a.m. this day, in Mont Ste-Marie (Québec), the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Alfonso Gagliano, Diane Marleau, Lee Richardson, Pat Sobeski and René Soetens.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee resumed consideration of guidelines for the Draft Report to the House.

At 12:13 o'clock p.m., the Committee adjourned to the call of the Chair.

MONDAY, NOVEMBER 20, 1989
(103)

The Standing Committee on Finance met, *in camera*, at 3:43 o'clock p.m. this day, in Room 269 West Block, the Acting Chairman, Murray Dorin, presiding.

Members of the Committee present: Yvon Côté, Clément Couture, Murray Dorin, Alfonso Gagliano, Lorne Nystrom, Pat Sobeski, René Soetens and Douglas Young.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Blake Murray, Consultant.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee proceeded to the consideration of its Draft Report to the House.

At 4:31 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, NOVEMBER 21, 1989
(104)

The Standing Committee on Finance met, *in camera*, at 9:54 o'clock a.m. this day, in Room 269 West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Pat Sobeski and René Soetens.

Acting Members present: John Cole for Lee Richardson; Jean-Guy Hudon for Bill Attewell.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Michel Coderre; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee proceeded to the consideration of its Draft Report to the House.

At 10:19 o'clock a.m., the Committee adjourned to the call of the Chair.

TUESDAY, NOVEMBER 21, 1989
(105)

The Standing Committee on Finance met, *in camera*, at 8:40 o'clock p.m. this day, in Room 269 WestBlock, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Don Blenkarn, Yvon Côté, Clément Couture, Murray Dorin, Pat Sobeski and René Soetens.

In attendance: *From the Research Branch of the Library of Parliament*: Basil Zafiriou, Senior Analyst and Richard Domingue, Research Officer. *From the Committee's staff*: Sean Aylward; Michael Cassidy; Michel Coderre; Cheryl Knebel, Blake Murray, Consultants.

Pursuant to Standing Order 108(2), the Committee resumed consideration of the Technical Paper on the Goods and Services Tax released by the Minister of Finance on Tuesday, August 8, 1989. (*See Minutes of Proceedings and Evidence, Tuesday, August 15, 1989, Issue No. 26*).

The Committee proceeded to the consideration of its Draft Report to the House.

On motion of Murray Dorin, it was agreed,—That, the Draft Report, as amended, be adopted as the Committee's Second Report to the House of Commons; and

— That, the Chairman be authorized to make such typographical and editorial changes as may be necessary without changing the substance of the Draft Report; and

— That, the Chairman be instructed to present the said Report to the House of Commons.

At 9:51 o'clock p.m., the Committee adjourned to the call of the Chair.

Marie Carrière

Clerk of the Committee

A copy of the relevant Minutes of Proceedings and Evidence of the Standing Committee on Finance (*Issues no. 26 to 84 inclusive and issue no. 85 which includes this report*) is tabled.

Respectfully submitted,

Don Blenkarn, M.P.
Chairman

A copy of the relevant Minutes of Proceedings and Evidence of the Standing Committee on Finance (Issues nos. 26 to 64 inclusive and issue no. 65 which includes this report) is tabled.

Respectfully submitted,

Don Blenkarn, M.P.
Chairman

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