Canadian Tax Reform: BTT has Major Implications for the Construction Industry

The Business Transfer Tax promises to change the way federal sales tax is assessed and collected

By Robert Bradford
President, Bradcom Ltd.

The signals have been coming out of Ottawa loud and clear for over a year now and there is no doubt left in any Canadian's mind that finance minister Michael Wilson is not just testing the waters anymore when he says tax reform is right around the corner. It won't be just minor tinkering either, because what Wilson and the Conservative government have in mind promises to fundamentally change the way federal sales tax is assessed and collected.

Until the government tips its hand of course, one can only speculate as to the exact details. However, most government watchers are in agreement that the new tax system to be announced will revolve around the introduction of a completely new form of federal sales taxation—the Business Transfer Tax (BTT).

Currently federal sales tax at varying rates is applied at the manufacturing level on a limited number of goods. The BTT however will be a multi-stage sales tax collected at a set rate on all goods and services, based on the "value added" at each level of the manufacturing, distribution and construction chain.

Many companies in the construction industry—especially service-related firms—have never had to deal directly with federal sales tax. With the BTT though, every company, partnership, joint venture and individual which adds value to a product or service will be involved.

An example...

To get an idea how the concept of the BTT works in an oversimplified form, consider the structural steel erected on a construction site as the end product. When the iron ore to make the steel was sold to the steel mill, the mining company would apply the BTT rate to the difference between its selling price and its costs to get the ore from the ground-or to the "value added" at the first stage in the process of producing steel products. As the emerging steel product made its way through the fabricator and the erector, at each new stage more value is added to the eventual final product and the BTT is added each time.

In theory, any given company should be able to calculate its BTT liability from existing accounting systems by taking the difference between its total taxable sales and the cost of its purchases which have been subject to the BTT, and multiplying the new amount (value added) by the BTT tax rate. In practice, some experts are predicting that the new BTT will not be nearly so straightforward in its application as the government has suggested it will be.

Payments in respect of wages, employee benefits and dividends will not be deductible under the BTT system. Less clear as yet is the treatment of costs such as interest on business borrowings, insurance, business and other taxes, fringe benefits and others.

It is expected that as the BTT is basically a tax on domestic consumption, it will be computed on Canadian business revenues only, less the cost of taxpaid inputs. In other words, if purchases are included in the BTT taxbase of the Canadian supplier, then the costs should be deductible in determining BTT liability.

The BTT will affect construction-related companies as it will those in all other industries by creating new tax liabilities for some and new record-keeping and reporting responsibilities for all. It could also have a more specific impact on the construction industry though, in the effect of its application as opposed to the mechanics of the new system.
Increased construction activity . . .

If the BTT is applied as is most generally anticipated, it is reasonable to assume that the costs of construction to private sector purchasers will go down. Not much, maybe two or three percent, but historically enough to stimulate a measurable increase in construction activity. Following the logic through to the end, it is also reasonable to assume that the cost of federal government construction is likely to increase by a similarly small, but still significant, amount.

The reason that the cost of private sector construction would go down under the BTT system is that an owner would be able to have a building erected basically tax-free. While the owner would pay a BTT on top of the general contractor’s invoice price, they would be able to offset that tax liability by claiming the amount paid as a credit against the BTT they will collect for the services they provide. And because the BTT is expected to be set at a lower rate than the current federal sales tax, the owner will have paid a couple of percent less for the building than under the current system.

Conversely, the federal government cannot charge the public a BTT on the services it provides so it would have to pay the full BTT on all of its building projects.

The effect . . .

The first person to publicly make these observations about the possible effect of the BTT on the construction industry is Bill Nevins, Chief Economist for the Canadian Construction Association.

Nevins is quick to emphasize that “you can only speculate right now.”

Continued on page 30
but he says that “unless they really change the basic rules” the scenarios outlined are realistic ones.

Offsetting the government’s BTT disadvantage when purchasing construction from the private sector however, Nevins points out that another effect of the system would be to give the government back a two or three percent advantage when it uses its own in-house forces to do construction work. This would arise because the government would not be required to pay a BTT on the labour it uses to do the work, unlike the labour component of private sector work.

Nevins can see a rise in the trend to the use of in-house government construction forces, particularly in sectors such as road building and engineering construction where substantial in-house capabilities already exist and could be expanded fairly easily. It is less likely to affect building construction he noted, because less in-house capability has been developed there.

The residential construction sector is another one where Nevins can see a direct impact from the BTT. By the time all of the labour, materials and products which go into building a house have been assessed a BTT at every stage of their production, the selling price of the new house is certain to rise by an amount which will have an affect on the residential industry’s ability to sell their product.