Canadian Tax Reform

While opposition mounts, the federal government steps up the campaign to sell tile country on the new GST

Tax reform or tax grab? That is the question being asked by consumer and business groups across Canada this fall as, one by one, they voice their mounting opposition to the federal government's plans to introduce a sweeping new tax called the Goods and Services Tax (GST), in 1991.

While nobody but the tax lawyers and accountants really understand the detail of the tax, what the various interest groups which have been appearing before the House of Commons Finance Committee do understand is that the GST represents a brand new tax of nine percent.

It's not that simple of course. The GST will indeed add nine percent at the retail level to most consumer goods, as well as to services which have thus far escaped federal taxation. But at the same time as the nine percent goes on at the consumer level, a 13.5 percent manufacturers sales tax which is currently collected on goods used in manufacturing will be removed.

Finance Minister Michael Wilson says the net result will be an average zero increase in prices to consumers, but that assumes that the manufacturing sector will pass along the 13.5 percent tax that it will no longer have to pay. Skeptics say 'fat chance,' while manufacturers say that competition will dictate that nobody will be pocketing a windfall.

Wilson also says the GST will be "revenue neutral"; that it will not increase the overall federal tax burden. That will be accomplished by redistributing extra revenues collected through a new system of tax credits and rebates.

John Bullock, the outspoken president of the Canadian Federation of Independent Business, disagrees. He told the Commons Finance Committee on September 20 that the GST is nothing more than a "huge tax grab," indicating that the federal government intends to deal with its budget deficit problems through higher taxation instead of making some hard decisions about its own spending habits.

One of the fears about the GST is that it is akin to giving the government a blank check when a percentage point or two increase is all it would take to raise billions more tax dollars.

Many were shocked when the government finally announced that nine percent is its operative figure for the tax. Initial discussion on tax reform three or four years ago was based on a five or six percent figure. Some believe the tax will be more like 11 percent by the time it goes into effect, while others think the government might have gone in high purposely so that they can come back with a lower figure if the country demands concessions.

In fairness, few people will answer in the affirmative if asked whether they favor a new tax. The GST is a complex new system which will take some time to get operating smoothly and the reaction being heard now is largely an uninformed one.

Whether you like the GST or not depends upon where your bread is buttered. Manufacturers generally like the idea of moving taxation from the production level to the consumer level. Retailers don't like it because they will have to collect the new tax, along with the provincial sales taxes they now collect. The service industries are naturally opposed because they didn't pay a federal tax before and now they will have to become tax collectors too.

There are very few exemptions to the GST. Food is one because Canadians would revolt if any government tried to tax food. Residential mortgages also escape the new tax, but not other financial services. Professional services such as engineering and design will also be taxed for the first time, as will a wide range of things from postage stamps and bus tickets to cars and new homes.

Home Builders Cry Foul

The construction industry in Canada isn't quite sure where it stands on the GST and tax reform. Officially, the industry supports the changes, but there are a lot of qualifications to that support.

Last year the Canadian Home Builders Association (CHBA) believed it had a commitment from the government that tax reform would not have a net negative impact on housing affordability. They were told that any new federal tax would have to be applied to housing, but were assured that

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the new tax credit system would nullify the impact.

On September 21, CHBA president Tom Cochren was in Ottawa to suggest to the federal Finance Committee that they have not lived up to their commitment in the details of the technical paper on tax reform.

Cochren said the GST will increase the price of a typical new home in Canada by $3,000, more than six times the cost estimated in the technical paper. The increase will vary in different markets, from about $1,000 in Trois Rivieres, Quebec and Charlottetown, P.E.I., to a high of $9,200 in Toronto (a market where the average price of a new home already exceeds $260,000).

"With price increases like these the affordability of home purchases will be negatively affected by sales tax reform," said Cochren. "This is a direct conflict with the commitment given to our association and to home buyers across the country by Finance Minister Michael Wilson . . ."

The home builders' research shows that to counter the effect of a nine percent tax on new homes, the government will have to rebate 6.2 Percent of the purchase price. The proposal is for a 4.5 Percent rebate on houses under $310,000. The rebate remains constant in dollar terms between $310,000 and $350,000, and it declines sharply to zero at $400,000.

Cochren says the GST, as proposed, will disrupt housing markets across Canada and discriminates against buyers in markets where land values are high (i.e., Toronto, Vancouver). He predicts a surge in buying in 1990 to beat the new tax, and then a sharp reversal in 1991 after the tax becomes effective.

Already there are disruptions in the condominium market where units are being sold for 1991 occupancy. As pro posed, the GST will hit condo buyers much harder than those purchasing single-family homes.

ICI Contractors Qualify Support

The issues are a bit different in the

industrial, commercial and institutional sector of the construction industry. But like the home builders, the Canadian Construction Association (CCA) has qualified its support for tax reform with a number of concerns it wants addressed.

Bill Nevins, chief economist for the CCA, believes the GST will result in a net decrease in the cost of construction, occuring with the removal of the manufacturers sales tax on building products and materials.

"The view that manufacturers won't pass along the tax (savings) says that there is no competition and the industry is in a monopoly price situation," says Nevins, and if you believe that maybe you should try being in the manufacturing business for awhile.

"Markets work and I think, prices will reflect that," he adds.

That said, there are a number of "uncertainties" about tax reform which has the CCA watching developments closely.

In particular, contractors bidding work now that will carry over or begin after 1991 may have trouble collecting the nine percent tax for which they will become responsible. Standard form CCA construction contract documents, which are used extensively across the country, have wording which appears to rule out a contractor being able to collect any new or increased taxes which arise during the term of the contract.

CCA is pressing the government to begin now making allowances for the GST in instructions to bidders on federal projects. Without this sort of concession from purchasers of construction, contractors have to choose whether to add a GST allowance to their tenders and risk having them thrown out as qualified bids, or to bid without the GST in and risk not being able to collect it when the time comes.

"You'd be well advised to meet with your customer right now to discuss the GST," suggests Nevins.

Another unresolved issue arises from a law which has been on the books since Canadian Confederation in 1867 which restricts the federal government from imposing or collecting any tax from a provincial government or Crown agency, and vice-versa.

The provincial governments are big buyers of construction, responsible for schools, hospitals, universities, utilities and more. For practical reasons the federal government would like to see the provincial governments and agencies pay the GST to the contractor and recover it through a federal rebate.

How likely is this cooperation from the provinces, given that they are now lining up against the federal government on the whole concept of tax reform? Contractors face the possibility of having to pay the GST to the federal government and not being able to collect it from their provincial government customers.

Other questions also arise for contractors. Simple ones like will bidding be done with the GST included or with the new tax out and shown separately?

There are also more complicated issues to be resolved such as the provinces' new role in setting notional values for the application of their own retail sales taxes on products like asphalt for road building, and on services such as the transportation of ready-mixed concrete.

Traditionally, the federal government has set these notional or “determined” values on which to base tax, but with their new GST they won’t need this system any more. The provinces do need them though for their tax collection system and now there will probably be different sets of values for tax in each province rather than one uniform set of national values.

Tough Battle Ahead

There is still over a year to go before the GST is enacted into law and by that time many of the grey areas should become a lot more clear.

It is also possible though that the new tax system will not survive in its present form.

Prime Minister Brian Mulroney and his finance minister have dug in their heels and vowed that the GST will go forward without significant change, regardless of the opposition to it. They are bracing for a tough fight. But public, and to a lesser degree, private sector opposition are gaining momentum. If the federal government is to be successful in introducing its idea of tax reform, they are going to have to do it in the face of a majority of voters who don’t appear willing to cooperate.