ITEM 4
MANAGER'S REPORT NO. 47
COUNCIL MEETING 89/07/10

RE: FEDERAL TAX REFORM EFFECT ON LOCAL GOVERNMENT
(ITEM 7, CORRESPONDENCE & PETITIONS, 1989 JUNE 19)

MUNICIPAL MANAGER'S RECOMMENDATION:

1. THAT the recommendations of the Director Finance be adopted.

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TO: MUNICIPAL MANAGER

1989 June 29
File: C3

FROM: DIRECTOR FINANCE

SUBJECT: FEDERAL TAX REFORM EFFECT ON LOCAL GOVERNMENT
(ITEM 7, CORRESPONDENCE & PETITIONS, 1989 JUNE 19)

PURPOSE: To advise Council on the current status of the proposed new Federal sales tax on local government.

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RECOMMENDATIONS

1. THAT this report be received for information purposes, and

2. THAT a copy of this report be sent to:
   - Mayor of Quesnel
   - Executive Director, U.B.C.M.

REPORT

BACKGROUND

The Federation of Canadian Municipalities (FCM) has monitored the implications of Federal sales tax reform on local government since the proposed tax was announced by the Minister of Finance in 1987 June. The Federation's Standing Committee on Municipal Finance has analyzed the impact of the proposed 9% new national sales tax and with the assistance of Clarkson Gordon, Chartered Accountants, made representations to the Minister to achieve a fair taxation burden for municipalities. Council was advised of this action on 1987 September 21. (Item 11, Report No. 57).

On 1988 January 18 (Item 4, Report No. 5), Council was also advised that the FCM had made representations to the Minister and received agreement from him "on the general principle that municipalities...should not bear a greater taxation burden under the national sales tax than they would under the existing tax regime."

CURRENT SITUATION

It is proposed that the municipalities would pay the national sales tax and then recover it through a system of rebates. This is a complex system requiring an exhaustive study, and the FCM have hired Price Waterhouse to assist them. The FCM press release dated 1989 May 01 (see Attachment 01) indicates that the FCM are consulting closely with Federal Finance officials about details of the rebate system.

The Executive Director of the U.B.C.M. is fully aware of the proposed sales tax system. He is in close contact with the FCM and its Standing Committee on Municipal Finance, who are liaisoning closely with the Federal Finance officals on this matter. We will advise Council of any further significant developments, once they have been announced.

TAX REFORM INFORMATION

Some general information on the proposed sales tax which describes what it is, what will be taxed, how it works, who is affected, etc., is available in a public release and consultant's analysis (see Attachment 02). Further detailed information is expected to be released by the Federal Government later this year. We will advise Council of this information once it is available.

It is recommended that this report be received for information purposes; and

That a copy of this report be sent to:
- Mayor of Quesnel
- Executive Director, U.B.C.M.

Howard Karras
DIRECTOR FINANCE

PWT:gw
Attach.

ITEM	4
MANAGER'S REPORT NO.	47
COUNCIL MEETING	89/07/10

ATTACHMENT 01

FCM

Federation of Canadian Municipalities | Fédération canadienne des municipalités

COMMUNIQUÉ

May 1, 1989

FOR IMMEDIATE RELEASE

FEDERAL BUDGET IMPACTS MUNICIPAL GOVERNMENTS

"This federal budget is a source of satisfaction, a cause for concern, and a reason for vigilance in Canada's municipalities," FCM President George Cuff declared today. Mayor Cuff reviewed the effects of the budget, intended or unintended, on the villages, towns and cities of the country, and on every Canadian who pays local taxes.

"For us, the important news is that the government has reaffirmed its earlier commitment to ensure that sales tax reform will not place a greater burden on municipalities. But this undertaking involves a potentially complex system of rebates for municipalities. We must be vigilant to ensure that it will work fairly without adding undue new administrative burdens on local government."

Mayor Cuff explained that part of the problem in ensuring the fairness of sales tax reform for municipalities is due to the difficulty in assessing the value of present exemptions and the fact that the amount of federal sales tax now paid by municipal governments is difficult to estimate. The FCM believes that close consultation with federal officials, and the advice of tax consultants, are essential to a fair resolution of this question. At a pre-budget consultation with FCM, Minister of State for Finance, John McDermid, gave a commitment that the Federation would be fully involved in the process. FCM has retained the services of Price Waterhouse to assist with an analysis of this issue.

"Not surprised, but disappointed" was Mayor Cuff's comment on the omission from the budget of any action plan to solve the deepening crisis in municipal infrastructure and related environmental and economic concerns. The FCM has been urging a joint federal/provincial/municipal commitment to roads, bridges, watermains and sewers before costs soar even higher, and before they cause serious economic loss or human tragedy. All provinces and territories have agreed with the FCM's position, but the federal government has so far refused to participate. Mayor Cuff said that the FCM would continue unabated its efforts toward a solution to this urgent national problem.

On Via Rail, the FCM had asked the government not to make significant decisions pending public comment on a business plan now nearing completion. There is a strong municipal interest in Via Rail's future, not only because in

111

.../2

many places its service is highly valued, but also because any cutback in rail passenger traffic is bound to increase road usage in congested urban areas and to increase road costs (some of which are paid by municipal taxpayers). "Cutbacks in rail passenger service could be detrimental to the tourist industry, particularly for communities in Western Canada," commented Mayor Hazel McCallion of Mississauga, Chairman of the FCM Standing Committee on Transportation.

The FCM is disappointed that the rental component of the Residential Rehabilitation and Assistance Program (RRAP) has been eliminated. In consultations with CMHC, FCM has supported improvements to all components of the RRAP program to ensure targeting of benefits to those most in need. Elimination of rental RRAP may mean that landlords will choose the wrecker's ball rather than rehabilitating their units for low-income renters. In overheated markets, loss of rental accommodation will add significantly to Canada's housing predicament. When the shortage of affordable housing is a crisis in many municipalities, the burden of the federal deficit should not be placed on the shoulders of low-income Canadians. Disappointment has been expressed as well over the limitation on funds for co-operative housing.

Civic leaders have also expressed grave apprehension about the changes in unemployment insurance which are predicted to add to local welfare bills. Concerning the decrease in federal transfer payments to the provinces, the effect on municipalities can be measured only by the experience of coming months. It may be expected to place greater pressure on the provinces to restrict grants to municipal governments. The federal decision is likely to affect municipalities differently in each province or territory.

The closing or reduction of military bases has been described as "potential disaster" for some communities whose economies have depended for decades on the military presence. If the decision to close bases is maintained, it is essential that adjustment measures be introduced to ease the transition.

Municipalities, which have given such strong support to race relations and multicultural programs, hope that cuts in the Secretary of State's budget will not materially affect the excellent work now underway by civic officials and volunteers.

"Budgets are bound to have long-term effects beyond anything that can be foreseen by the officials drafting them," Mayor Cuff said. "The FCM will continue to identify the fallout in its efforts to ensure that the burdens or benefits to municipalities are both fair and consistent with Parliament's intentions."

- 30 -

For further information, contact:

Alderman Ron Hayter, Edmonton
Chairman FCM Standing Committee on Municipal Finance
(403) 423-1821; 428-5457

OR

Sheila Keating-Nause or J.Jacques Lemire

Goods and Services Tax

What is it?

What will be taxed?

How does it work?

Who is affected?

How does the credit work?

What are the benefits?

113

Canada

1. What is the goods and services tax (GST)?

The goods and services tax (GST) is a 9 per cent consumption tax that will replace the existing federal sales tax on January 1, 1991. The current federal sales tax is hidden, badly flawed and harmful to Canada's economic performance. It is hurting our ability to grow and create jobs.

2. What is going to be taxed?

Virtually all goods and services will be taxed. However, consumers will not be charged tax on the following goods and services:

- basic groceries;
- prescription drugs;
- medical devices;
- residential rents;
- loans, mortgages and life insurance premiums;
- most health and dental services, including hospital care and nursing home services;
- day care services;
- legal aid services; and
- most education services.

3. How will the GST work?

There are two ways of looking at how the GST will work in practice.

Consumers

- For consumers, the GST will be similar to a retail sales tax. Unlike the present federal sales tax, however, consumers will be aware of the amount of GST they will be paying. Right now, there is no real way for consumers to know whether or not a federal sales tax is hidden in the price of something they buy.
- Under the GST, however, consumers will be aware of the federal tax portion of the full purchase price on all taxable goods and services. This will allow consumers to make better informed decisions about the products and services they purchase.

Business

- Businesses will collect tax on most of their sales and pay tax on most of the purchases they make to run their business.
- The amount of tax businesses will pay to the federal government will be the difference between the tax they have collected on their sales and the tax they have paid on their purchases.

ATTACHMENT 02

ITEM	4
MANAGER'S REPORT NO.	47
COUNCIL MEETING	89/07/10

4. Who will be affected by the GST?

The government wants to make the tax as fair and as simple to comply with as possible. For this reason, the government is proposing that:

Small business

- some may use a simple GST accounting method and have less frequent calculation requirements;
- will be paid a fee for collecting the tax;
- at least half a million very small businesses will not have to collect the GST.

Registered charities and substantially government-funded non-profit organizations

- will receive generous relief on the tax they pay on their purchases.

Farmers and fishermen

- will be tax free on their sale of food products.

Housing

- the government will provide a special measure to ensure that the GST will not pose a barrier to the affordability of new housing; and
- the sale of existing homes will not be taxed.

5. How will the refundable GST credit work?

The government is committed to ensuring that the new GST is fairer for lower income Canadians than the present system. To ensure greater fairness, the government will:

- introduce a new GST tax credit which will greatly expand benefits available now under the existing sales tax credit system;
- the new credit will be refundable. That means that low-income Canadians will receive the credit even if they don't pay income tax. All they will have to do is to file a tax return;
- pay the new credit four times a year – this means that low-income Canadians will receive a cheque on a regular basis;
- pay the new credit in advance of the start-up of the new system on January 1, 1991. As a result, those in need will receive a credit cheque before they have to begin paying the GST.

6. How will the GST benefit Canadians?

The GST will benefit Canadians in all regions of the country. Implementation of the GST will result in:

- a fairer tax system after sales tax reform than before. The government will achieve this by introducing the new GST Credit and by income tax reductions. The government's goal is to assure that, as a result of these measures, families earning less than $30,000 per year will be better off after the GST is in place;
- our international competitiveness will improve significantly: our export industries will be better off and domestic firms will be placed on a level playing field with importers;
- the Canadian economy will work more efficiently, attract more investment and create more jobs;
- an expansion of real economic output by about $9 billion a year.

A modern, stable source of revenue will help the government reduce the deficit and maintain the programs Canadians value.

114

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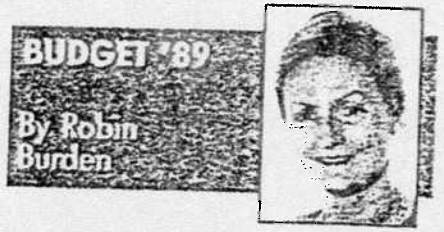
ITEM 4
MANAGER'S REPORT NO. 47
COUNCIL MEETING 89/07/10

The nuts and bolts of the GST

REPLACING the old manufacturer's tax with an entirely new and completely foreign consumption tax system will involve a bundle of complex issues that will have a significant impact on all individuals, organizations and businesses across Canada.



The introduction of the new "Goods and Services Tax" (GST) will be no small undertaking. Everyone must begin to understand and tackle the accounting and other planning issues if there is to be a smooth and workable transition. True to his word, Finance Minister Michael Wilson confirmed the government's intention to proceed with a new federal-only sales tax, with implementation scheduled for January 1991.

The government has opted for a GST that is comparable to value-added taxes currently imposed in more than 40 countries. The GST is a multi-stage sales tax on consumption, is levied and collected at all stages in the production and distribution process, and is ultimately borne by the end purchaser.

A detailed technical paper will be released by the government in early summer, with draft legislation to follow shortly thereafter.

The government is seeking consultation in a number of areas to ensure that the interests of the consumers are reflected in the final design of the tax and, in particular, to protect the visibility of the tax. At the same time, it wants to find ways to maintain the simplicity of the system while minimizing the compliance burden. This is a particularly crucial issue that will need to be addressed by small business.

Basic Calculation

Taxable Sales

times

Tax Rate

equals

Tax Charged on Sales

minus

Tax Paid on Purchase
(Input Tax Credit)

equals

Tax Payable (if possible)		Tax Refundable (if negative)	
e.g.	Tax*	e.g.	Tax*
Sales $200,000	$18,000	Sales: $180,000	$16,200
Purchases: $150,000	(13,500)	Purchases: $200,000	(18,000)
Tax Payable	$ 4,500	Tax Refund	($ 1,800)

*Tax rate of 9%

How it will work

Virtually all goods and services will be taxed a proposed rate of 9%. In the most straightforward situation, businesses will be required to calculate and collect the tax on taxable sales and will claim a credit for tax paid on purchases. The difference between the tax collected on sales and tax paid on purchases will be remitted. The end result is to tax the value added at each stage.

The two accompanying charts illustrate the detailed mechanisms of the tax.

As illustrated in the chart on the GST's operation, tax is collected at each level and is fully refunded at the next stage in the production process until the final sale to a customer. In the example in the second chart, the tax amounts to $54 — the same amount derived by calculating tax at 9% on the final retail sale.

Goods and Services Tax: Basic Operation

		Tax on sales	Tax credit on purchase	Net tax
Mine	$100 Sales*	$ 9	-	$ 9
Steel maker	$100 Purchases $300 Sales*	$27	$ 9	$ 18
Appliance manufacturer	$300 Purchases $400 Sales*	$36	$27	$ 9
Washing machine dealer	$400 Purchases $600 Sales	$54	$36	$18
		Total		$54

*Excludes tax

While virtually all goods and services will be taxed, certain exclusions have been proposed. The exclusions come in two ways: "tax-free" and "tax-exempt" items.

"Tax-free" means no tax is charged on sales, and a credit can be taken for all taxes paid on purchases or inputs. It is proposed that basic groceries, prescription drugs and medical devices will be given tax-free status.

"Tax-exempt" means that, although tax is not charged on sales, no input tax credits can be claimed on purchases. It is proposed that tax-exempt goods and services include residential rents, most health and dental services (including hospital and nursing home services), daycare services, legal aid services and most educational services.

Imports will be taxable at time of importation. No tax will be charged on export sales, and exporters will be permitted to claim full input tax credits for purchases related to their exports.

Partial rebates will be provided to public-sector institutions such as hospitals, school boards, municipalities, libraries, colleges and universities to ensure that these institutions will not assume a greater tax burden than under the existing system.

Government-funded organizations such as registered charities and non-profit organizations will receive a 50% rebate of GST paid on purchases.

The government has also reiterated its intention to provide direct assistance to home-buyers who might, as a result of the tax, find it difficult to buy a home. No indication has been given as to what form this assistance might take.

The complex proposals to tax all financial services under the new regime will not proceed as outlined in the June 1987 White Paper. Instead, financial institutions will have to pay tax on their purchases. Intermediation services, such as loans, deposits, mortgages, life insurance and related services will not be taxable. Most other remaining services, such as trust administration, advisory and data processing, will be taxed in the same manner as other businesses.

Shifting to an entirely new system will not be without difficulties. It will be imperative for everyone to prepare for the changes. Future articles in *The Bottom Line* will discuss all aspects of the GST, including planning steps to be taken when it comes to accounting and dealing with the implementation of the GST.

• Robin Burden is director, commodity taxation, at Toronto-based Mintz & Partners.

ITEM 4
MANAGER'S REPORT NO. 47
COUNCIL MEETING 89/07/10