[Pr]oposal to Shift the Federal Sales Tax to the Wholesale Trade Level

Issued by
the Honourable Allan J. MacEachen
Deputy Prime Minister and
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Canada

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This paper is designed to explain the main provisions set out in draft legislative proposals for shifting the federal sales tax to the wholesale level. Those persons who wish to comment on the draft legislation should write to the Minister of Finance, House of Commons, Ottawa, Ontario, K1A 0A6.

Technical explanation of the provisions in the draft legislation may be obtained by contacting Finance or Revenue officials at the following addresses:

Tax Analysis and Commodity Tax Division,
Department of Finance,
160 Elgin Street,
Ottawa, Ontario.
K1A 0G5

Tel. (613) 995-9981
996-8267

Excise Operations Division,
Revenue Canada, Customs and Excise,
191 Laurier Avenue West,
Ottawa, Ontario.
K1A 0L5

Tel. (613) 995-2691

Many of the provisions in the draft legislation are similar to those in the Excise Tax Act. For this reason, businesses are urged to direct questions of interpretation of the law, including its application in specific cases, to Revenue Canada, Excise Branch. Addresses and telephone numbers of regional offices across Canada are provided at the end of this paper.

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1 Introduction

In the November 12, 1981 budget the government proposed that the imposition of the federal sales and excise taxes be shifted from the manufacturer level to the wholesale trade level. This change will correct deficiencies which currently exist because of the application of the tax at the manufacturers' level including differences between imported and domestically produced goods. It also will correct inequities in the application of the tax among competing manufacturers who market their goods in different ways. The proposal has been under consideration for many years and is one of the most widely discussed and analysed tax initiatives undertaken by the government.

This paper provides an overview of the proposed legislation which would implement the shift of the tax to the wholesale trade level. It solicits comment from tax practitioners, the business community, and other interested persons to aid the government in the preparation of final legislation for submission to Parliament.

The proposed new Excise Tax Act will include the following parts:

Part I	Insurance Premiums Other Than Marine (present Part I)
Part II	Air Transportation Tax (present Part II)
Part III	Natural Gas and Gas Liquids Tax (present Part IV.1)
Part IV	General Sales Tax and Excise Taxes
Part V	Alcohol and Tobacco Taxes
Part VI	Large Retailer Tax
Part VII	Deductions and Refunds
Part VIII	Assessments and Appeals
Part IX	Administration
Part X	Transitional Provisions
Schedules	Exempt Goods, Goods Subject to Excise Tax, etc.

Parts IV, V and VI will be the main parts of the legislation relating to the imposition of the tax at the wholesale level. These parts define transactions that attract the federal sales tax and provide rules for determining the amount of tax liability. They are being published concurrently with this paper in draft form. Parts VII, VIII and IX will deal mainly with administration and enforcement, and will contain provisions similar to those found in the existing legislation. The current Parts I, II and IV.1 dealing with Insurance Premiums Other Than Marine, Air Transportation Tax, and Natural Gas and Gas Liquids Tax respectively, will remain essentially unchanged. The legislative provisions in Parts IV, V and VI are described in a narrative form in this paper. The paper also outlines the main features of the new administration and enforcement rules and transitional provisions for inclusion in Parts VII, VIII, IX and X. These details comprise all the essential elements of the proposed wholesale tax system.

In order to permit a timely preparation of the legislation, persons who wish to comment on the information presented in the following narrative and the proposed draft legislation should write to the Minister of Finance, House of Commons, Ottawa, Ontario, K1A 0A6, as soon as possible. Persons seeking technical clarification or explanations of the draft provisions are urged to contact Revenue or Finance officials at the addresses listed.

2 Background Information

An ideal sales tax is one that provides fiscal flexibility to the taxing authority while achieving the highest degree of neutrality and certainty with the least administrative burden. As stated in the 1977 Report of the Commodity Tax Review Group, this means that a good sales tax should:

- be neutral in its impact on competing taxable goods, and between imported goods and domestically produced goods[1];
- be imposed under a clear and concise statute, which requires only simple administrative procedures and includes a minimum number of exceptions so that taxpayers may determine their tax liability with certainty;
- impose the least possible compliance burden on both taxpayers and Revenue Canada; and
- be capable of, and quickly responsive to, change to achieve desired fiscal and other economic policies.

When the present system was implemented about 60 years ago, it met most of these criteria. At that time, both imported and domestically produced goods tended to flow through wholesalers and thus were taxed at a common point which was on acquisition by wholesalers.

Over time, however, major changes have occurred in the marketing of manufactured goods in Canada. For example, while imported goods continue to flow through wholesalers and are taxed on the wholesalers' acquisition cost, Canadian manufacturers now sell a large proportion of their goods directly to retailers (and users), and those goods are taxed on their sale price to retailers (and users). Marketing costs incurred by wholesalers at the wholesale level are generally not taxed although similar costs incurred by manufacturers who sell directly to retailers are taxed. Imported goods may enjoy a tax advantage over domestically-produced goods because advertising, warranty, and other marketing costs incurred in Canada, which are typically included in the taxable value of domestic goods, may not be reflected in the taxable value of imports. Inward freight costs incurred by domestic manufacturers on their raw materials are an element of the manufacturer's sale price and thus taxed, but comparable

[1] A sales tax is defined to be neutral if it results in a uniform ratio of tax to final consumer price for all goods. Competitive distortions may arise from a difference in the rate of tax on goods, e.g. when some items within a class of competing goods are exempt from tax or are taxed at a lower rate than other goods. Similar distortions may also result from application of the tax at different points in the production-marketing process so that a higher or a lower proportion of the final value is added after the application of the tax. The purpose of shifting the federal sales tax to the wholesale level is to minimize distortions of the latter type.

freight costs incurred in delivering imported fully manufactured goods to Canada are generally not included in the value on which the tax on imported goods is calculated.

Revenue Canada has adopted a number of administrative practices which attempt to minimize some of the deficiencies and inequities of the present system. They entail permitting manufacturers to calculate the tax on a notional value as opposed to the actual sale price. However, these notional values do not address the disparity between imports and domestic goods, and they are available only to certain domestic manufacturers in certain specified situations. Moreover, they do not have legal sanction and their appropriateness is not subject to judicial appeal.

In the past, several reviews of the commodity tax system have been undertaken to appraise these problems. After each review, the published report expressed serious concerns about the structure of the tax and the varying amounts of tax that may be borne by competing products depending upon their marketing pattern and whether they are of domestic or foreign origin. Each of these studies recommended significant changes.

The 1956 Report of the Sales Tax Committee recommended that the manufacturers tax be changed to a wholesale tax. The 1966 Report of the Royal Commission on Taxation (the Carter Commission) recommended a retail tax as an alternative to the manufacturers tax on the grounds that a retail tax was most neutral and would provide an opportunity to tax the sale of services as well as the sale of goods. That recommendation was coupled with a proviso that the federal and provincial retail tax systems would have a common base and the levies would be collected by the provinces. Crucial to the Carter Commission recommendation was the view that over time the federal government should negotiate a transfer of sales tax room to the provinces in exchange for a greater share of income tax room. Notwithstanding its preference for a federal retail tax, the Royal Commission report did compare the manufacturers tax and a wholesale tax and concluded that a wholesale tax was the better of the two as it would achieve greater certainty and simplicity without any increase in the cost of administration.

In 1975, the government published a green paper which described the problems of the existing system and identified alternative solutions. This was followed by a report prepared in 1977 by the Commodity Tax Review Group which identified three options — an improved manufacturers tax, a wholesale tax, and a retail tax. The report concluded that an improved manufacturers tax would be more complex and less effective than a wholesale tax because it would require the tax to be levied on a value other than the actual sale price for a substantial proportion of all taxable transactions. While agreeing that a retail tax achieves economic neutrality it expressed the view that a retail tax was not viable as it would require substantial uniformity among all 11 taxing jurisdictions as to the range of goods (and services) which attract the tax. As there are significant differences among the nine provinces that impose retail sales tax (Alberta does not have a retail sales tax) and between the provinces and the federal government, agreement is unlikely in the foreseeable future. In the light of these facts the Review Group concluded that a shift to a wholesale tax is the only viable alternative available to the federal government.

Since the 1977 Report of the Review Group was released, the government has introduced a number of structural changes. These include the imposition of sales tax on marginal manufacturers (persons who break bulk or otherwise prepare goods for sale), and the changes affecting cosmetics and motor vehicle fuels. These modifications amounted to introducing a wholesale tax for selected goods. While it might be possible to continue that pattern for additional categories of goods, such an approach would exacerbate the differences in tax burden between goods taxed at the wholesale level and those other goods still taxed at the manufacturers level. Furthermore, it would not address the obvious inadequacies in the area of appeals and administration. All of these facts have led the government to the conclusion that it is now appropriate to complete the shift of the system to the wholesale level.

Introduction of a wholesale tax will:

- remove the present bias against domestically produced goods;
- achieve a more uniform tax burden on competing domestic manufacturers marketing their goods in different ways in Canada;
- cause the tax to be calculated on the actual sale price in most instances, thereby obviating many of the discretionary adjustments in taxable values now made by Revenue Canada;
- permit the introduction of an effective appeal mechanism;
- facilitate the administration by eliminating many refund claims from wholesalers (and retailers) who have made sales of tax-paid goods to customers entitled to exemption;
- allow wholesalers to obtain their inventories exempt of tax and thus reduce their cost of inventories by an estimated $400 million; and
- permit a lowering of the general rate from 9 per cent to 8 per cent.

Many taxpayers and business sectors are not materially affected by the proposed changes.

The conversion of the manufacturers tax to a wholesale levy will have little direct consequence for manufacturers who are now licensed. While the change will entail adjustments for wholesalers who become new taxpayers, many of these firms are familiar with federal sales tax as they are already licensed as manufacturers, or they are regular refund claimants. To amplify this point:

- Manufacturers who now pay tax on their sales to retailers (and users) will experience little or no change apart from a lowering of the general rate from 9 per cent to 8 per cent six months after implementation.
- Existing licensed wholesalers who meet the new licensing criteria will experience little or no change apart from the fact that their sales will be taxable on sale price rather than on acquisition cost.

- Ordinary retailers will continue to acquire goods from their suppliers on a tax-paid basis although the tax content may decrease, increase, or remain the same depending upon the status of the supplier.

- Persons excluded from licensing under the Small Manufacturers Regulation will continue to be excluded. These include manufacturers whose sales of manufactured goods do not exceed $50,000 per annum, and persons such as barristers, accountants, and craftsmen. Also, the Regulation will be expanded to exclude from licensing any wholesaler whose sales by wholesale do not exceed $50,000 per annum.

- Building contractors and other tradesmen who supply and install goods on their customers' property will continue to acquire their goods on a tax-paid basis although the value for tax may change if the supplier is a wholesaler.

- Manufacturers of those building products which enjoy special status because they are in competition with similar goods produced on-site will continue to enjoy special status.

- Domestic transportation costs which are currently deductible before calculation of sales tax will continue to be deductible.

- Erection and installation costs incurred by manufacturers will continue to be deductible before calculation of sales tax.

3 Part IV: General Sales Tax and Excise Tax

Part IV outlines the basic structure of the wholesale tax system. Stated simply, all wholesalers and manufacturers will be licensed for sales tax and excise tax purposes, and goods will flow among manufacturers and wholesalers without tax. The sales tax (and excise tax, if applicable) will be payable only when goods are sold by manufacturers and wholesalers to retailers, or directly to users. When a wholesaler or a manufacturer sells directly to users, payment of the tax on the sale price will be required. However, if it can be established that similar goods are sold to retailers at relatively lower prices, the manufacturer or wholesaler will be permitted to calculate the tax on sales to users based on these lower established prices rather than on the actual price charged.

Imported goods which flow through wholesalers will be taxed on the same basis as domestic goods — that is, on the sale price to retailers. Direct importations by retailers and users will continue to be taxed on the duty-paid value. However, in the case of commercial importations, transportation costs to the Canadian border will be included in the tax base.

Part IV applies to all goods other than alcohol and tobacco products which will continue to be taxed at the manufacturer level under Part V of the new Excise Tax Act. Part VI imposes an additional tax on large retailers' purchases of taxable goods in recognition of the many wholesaling functions performed by these firms in the course of their operations.

The following sections provide an overview of the main provisions found in Part IV of the proposed legislation.

3.1 Definitions

The term "wholesaler" will be defined to mean any person who sells goods to retailers, whether or not he also sells goods directly to users. It will include a producer or a manufacturer.

Certain persons will be deemed to be wholesalers notwithstanding the fact that they are essentially retailers. This treatment is necessary to enable certain businesses to acquire their inventories on a tax-free basis or to achieve greater equity in the application of tax. Deemed wholesalers include, among others, duty-free sales outlet operators who sell goods to travellers departing from Canada, persons who sell goods which are principally marketed to users by manufacturers, and suppliers to contractors. Certain persons may elect to be treated as wholesalers. To illustrate, a retailer who makes sales primarily to users entitled to exemption from the tax (for example, hospitals and farmers with respect to purchases of farm machinery), may apply for classification as a wholesaler in order to acquire inventories exempt from tax.

A "retailer" will be defined to mean any person who sells goods to users. A "contractor" is considered to be a retailer; thus, persons who supply goods to contractors are wholesalers. Similarly, repair shops such as automobile service stations which supply and install tires, batteries and spark plugs, or repair vehicles damaged in accidents, will be defined to be retailers. This definition is appropriate because contractors and repair shops generally acquire their supplies from wholesalers at prices comparable to those charged to other retailers. Moreover, it is a common trade practice in most industries to treat sales to contractors as wholesale sales.

The term "user" will include both an individual who buys goods for personal use, and an industrial user who acquires goods for use in his commercial activities.

3.2 Exclusions from Licensing

The Excise Tax Act now excludes from licensing any small manufacturer whose annual sales of goods of his own production does not exceed $50,000. It also excludes certain persons, including barristers, public accountants, radio and television stations, theatre arts groups and craftsmen from licensing irrespective of their sales volume. This provision will be carried forward into the new legislation. Furthermore, it will be expanded so that persons whose annual sales by wholesale do not exceed $50,000 will also be relieved of any obligation to be licensed.

3.3 What Sales will be Taxable?

Sales by Wholesalers with Tax-Free Inventories

In general, all wholesalers with tax-free inventories will be required to account for tax on all sales to retailers and users. Wholesalers will *not* be required to account for tax on the following sales:

i) sales to manufacturers of taxable goods for further production into goods when the manufacturer has provided a valid exemption certificate and an "authorization number" (described in paragraph 3.8);

ii) sales to manufacturers of unconditionally exempt goods when the manufacturer has provided a valid exemption certificate that the goods are for use exclusively in the manufacture of identified tax-exempt goods;

iii) sales to other wholesalers who are authorized to buy goods exempt of tax when the wholesaler has provided an authorization number;

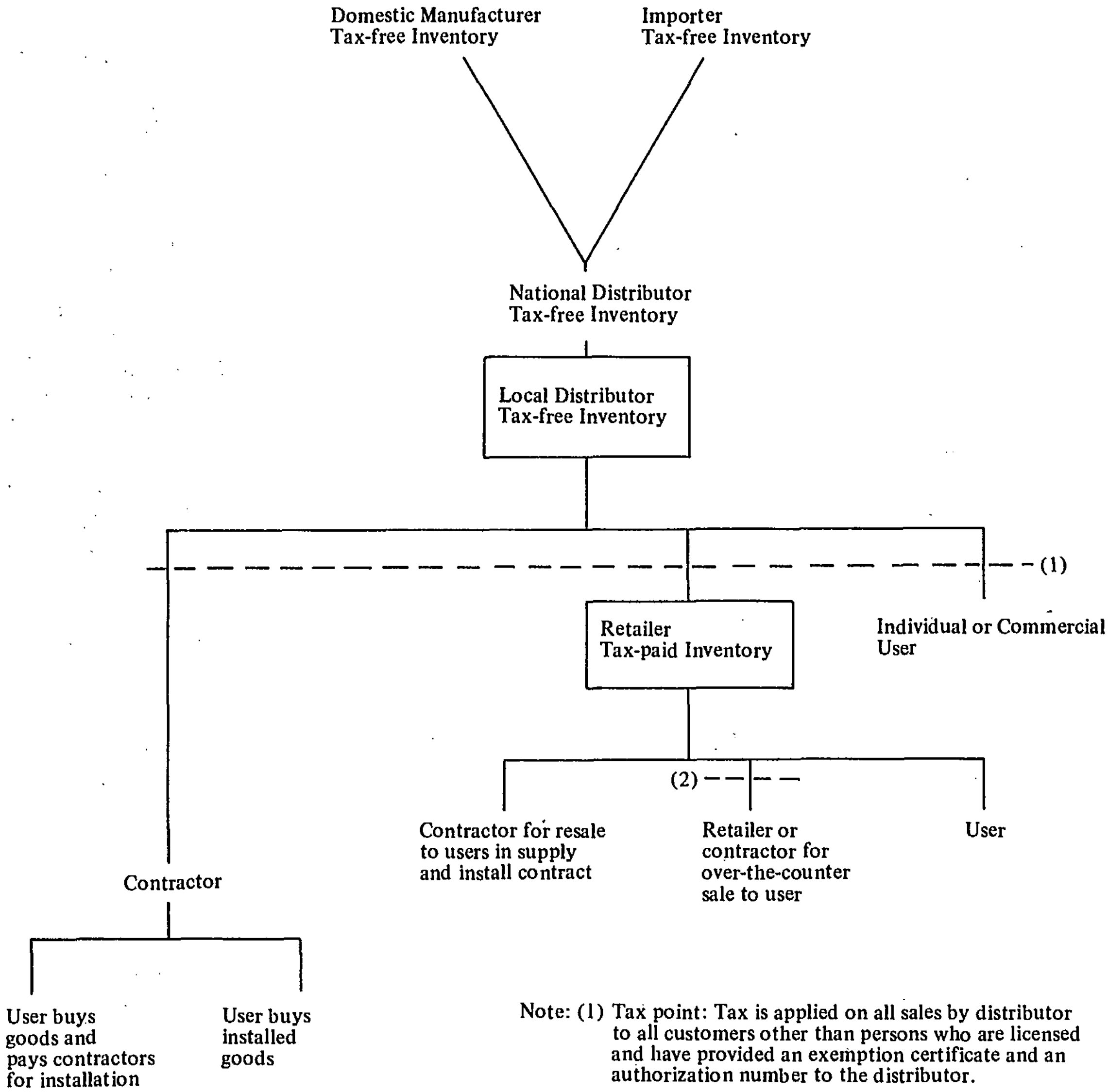
iv) sales of used goods, other than imported used goods that have not been previously subject to sales tax in Canada;

v) export sales;

vi) sales of goods unconditionally exempted from tax (e.g., food and clothing); and

vii) sales of taxable goods to users who are exempted from tax (e.g., hospitals) and have given the supplier a valid exemption certificate.

CHART 1



Note: (1) Tax point: Tax is applied on all sales by distributor to all customers other than persons who are licensed and have provided an exemption certificate and an authorization number to the distributor.

(2) Tax payable on the difference between the retailer's sale price and his purchase price, if such sales exceed $50,000 per annum.

Sales by Wholesalers with Tax-Paid Inventories

As described in Section 3.8 below, the draft legislation will permit those wholesaler-retailers who make sales primarily to users to acquire goods on a tax-paid basis. Such businesses will be treated as retailers and will not be liable for any further tax on their sales to users. When they make sales to other retailers they will be required to account for tax on the wholesale value added (i.e. sale price less acquisition cost). When they make sales under exempt conditions (e.g. export sales, or sales to other licensed wholesalers) they will be entitled to a refund of the tax paid at the time of purchase of the goods.

Special Rules Applicable to Sales to Contractors and Repair Shops

The treatment of sales to contractors (including repair shops) depends on whether the vendor holds inventories on a tax-paid or a tax-free basis. If the vendor is primarily a wholesaler, inventories will be acquired exempt of tax and all sales, including sales to contractors, will be subject to tax on the sale price. In contrast, if the vendor is primarily a retailer, inventories will be acquired on a tax-paid basis (i.e., tax will have been paid on the goods at the time of purchase). Sales to contractors from tax-paid inventories will be exempt from further tax provided that the contractor is buying the goods for installation under a supply-and-install contract or on a customer's property. Sales to contractors for over-the-counter resale to users are sales by wholesale and are subject to tax on the value added (i.e. the difference between the sale price and the purchase cost) if the total of such sales exceeds $50,000 per annum. Vendors whose sales by wholesale are less than $50,000 per annum will be relieved of obligation to account for tax on their value added under the small manufacturer provision.

Chart 1 provides an illustration of flow of goods in typical marketing situations, and indicates the point at which the tax will be imposed under the new system.

Deemed Sales by Wholesale

The draft legislation contains provisions which deem certain transactions to be taxable events. These include the cessation of business by a wholesaler who holds an inventory of goods on which the tax has not been paid, the leasing of goods which have not been previously subject to tax, the production of goods from articles or materials supplied by another person for delivery to that person, and the transfer by a wholesaler of goods to a retail outlet owned or operated by the wholesaler.

The deemed sale provisions contained in the draft legislation generally parallel those found in the present Excise Tax Act. However, the draft legislation also responds to a unique situation in the few industries where Canadian manufacturers sell goods directly to users in competition with multinational firms who also sell directly to users. Examples of goods in this category include large ships, aircraft, large computers, and certain specialized equipment such as ship-loading systems. As these domestically produced goods do not flow through independent wholesalers and retailers, Canadian manufacturers are generally required to compute the tax payable on the basis of their actual sale price to users.

On the other hand, in certain sectors, an importer who is a subsidiary of a foreign manufacturer may also sell goods to users in Canada. In the absence of a special provision, the subsidiary would be considered to be the retailer of the imported goods, and would pay tax at the time of importation, rather than at the time of sale to users in Canada which would be the norm for domestic manufacturers of similar goods. This could result in differences in the treatment of imported and domestic goods.

Therefore, the draft legislation will provide that where a given class of goods is generally marketed directly to users, all goods in the class will be taxable on the sale price to users. Importers of such goods will enter them into Canada without payment of sales tax, and the tax due will be paid when the goods are sold to users. Prescription of classes of goods for the purposes of this provision will be made only in those well-defined situations where domestically-manufactured goods are sold directly to users.

3.4 Value for Tax

A sale by a wholesaler to a retailer will be taxed on the price charged. When wholesalers also make sales to users, they will have the option of computing the tax on either the actual sale price to the user, or on a lower value equivalent to the price charged a retailer for the same goods. This equivalent price is a notional value and it may be determined by the wholesaler on his own initiative if goods are sold to retailers in representative quantities. In the case of industries where some wholesalers make sales to retailers while others make sales only to users, the notional value for those firms who make sales only to users could be arrived at by using such other procedures as may be prescribed by the Governor-in-Council.

Under the new system, most sales by manufacturers and wholesalers will either be exempt of tax (for example, when made to another wholesaler), or be taxable on the actual sale price. The need for notional value calculations will arise only in the case of sales by manufacturers and wholesalers to users at prices which are in excess of those charged to retailers. Even in this case, the vendor may prefer to calculate the tax on the actual sale price to users if that price is not significantly different from the price charged to retailers. For this reason the use of notional values is optional to vendors if it is to their advantage.

In recognition of the fact that wholesalers may follow different pricing practices for sales to retailers and users, the draft legislation provides alternative methods for calculating notional values. They are refinements of the options currently sanctioned by Revenue Canada which are called "established values" and "determined values". A brief description of these options is outlined below.

Values Established by the Wholesaler

A wholesaler must make sales to two or more independent retailers, and those sales must constitute at least 15 per cent of total sales before the wholesaler may use a notional value for tax on sales to users. Wholesalers who meet these criteria may use any of the alternatives outlined below to establish a notional value for their sales to users.

Alternative 1

The greater of,

(a) the average sale price of all like goods sold in the preceding month by the wholesaler to independent retailers; and,

(b) the average sale price of all like goods sold in the preceding three months by the wholesaler to independent retailers.

Alternative 2

Where a wholesaler sells goods to retailers at a standard discount from the price charged to consumers, that discount may be used to establish a value for tax on sales to consumers. If there is more than one discount which is used on sales to retailers, the vendor may use the discount which generates the highest dollar volume of sales to retailers, provided that at least 10 per cent of total sales of like goods are made at that discount.

For example, if a wholesaler sells a product for $18 to consumers, and provides a standard 40 per cent discount to all retailers, a value of $10.80 may be used for calculating tax on sales to consumers. If a wholesaler's product lists for $20, and 5 per cent of his sales are to retailers at a 35 per cent discount, while 75 per cent are sold to retailers at a 25 per cent discount, the wholesaler could use a value of $15 for calculating tax on the remaining 20 per cent of sales to consumers.

Where a wholesaler has established marketing regions, similar rules may be applied to determine a notional value for use in calculating the tax due on sales to users in each region.

Values Determined by Governor-in-Council Regulation

In selected industries there may be some firms who sell only to users, while other firms sell to both retailers and users. If, in a particular industry, two or more firms make sales to retailers, and those firms' sales to retailers are at least 15 per cent of the total sales of that class of goods, a notional value may be authorized by Governor-in-Council regulation for use by members of the industry who make sales only to users. The Governor-in-Council regulation will generally provide a percentage discount factor to be applied to the sale price to users to determine the notional value. The calculation of notional values under this option will be relatively easy once the discount factor is provided by the regulation.

3.5 Inclusions and Exclusions from the Sale Price for Purposes of Calculating the Tax Payable

The sale price of any goods sold by a wholesaler in Canada is the aggregate of the amounts charged for the goods, including the cost of the container, any amount charged for advertising, short term financing, servicing, storage, warranty, or commission, and the amount of any excise duty payable under the Excise Act. The taxpayer may deduct any discounts or rebates given (including volume and cash discounts), and certain amounts with respect to erection or installation costs and transportation costs. Allowances for erection and installation costs are to be determined in accordance with a Governor-in-Council regulation, and will generally follow the current administrative practice.

The treatment of transportation costs will differ from the current practice which results in inequities between domestically-manufactured goods and imported finished products. Imports of finished goods are now taxed on their duty-paid value which does not generally include the costs incurred in transporting the goods to Canada. In contrast, the sale price of domestically-manufactured goods (on which the tax applies) includes all transportation costs incurred by the manufacturer in moving raw materials to his factory.

The proposed wholesale tax system will place domestic and imported goods on an equal basis in terms of the tax treatment of inward transportation costs. In all cases, the freight costs incurred in getting goods to Canada from foreign sources will be taxed. In all cases, domestic freight costs incurred by taxpayers in Canada with respect to finished goods will generally not be taxed. Importers who are wholesalers will pay tax on their sales to retailers calculated on the sale price less the actual freight cost incurred in Canada (i.e. freight costs from the Canadian Customs reporting point to their warehouse and from their warehouse to the retailer's door). Importers who are retailers will pay tax on the duty-paid value of their imported goods plus the freight costs incurred in getting the goods to Canada. Revenue Canada may permit taxpayers to claim tax credits in respect of Canadian freight costs on a periodic basis rather than requiring them to isolate the freight cost element of each sale separately. Revenue Canada will soon provide further guidelines for calculating freight costs that may be excluded from the sale value.

Direct importations by individuals for personal use, and commercial importations of goods valued under $500, will be relieved from the requirement to include transportation costs in the value for tax.

All wholesalers will be permitted to exclude any *outward* transportation costs from the value for tax. This is similar to the current practice in the application of tax at the manufacturer level.

3.6 At What Rates are Goods Taxable?

Since the shift of the tax to the wholesale level is not intended to increase the revenue yield, the general rate will be reduced from 9 per cent to 8 per cent six months after implementation of the change. The rate decrease is delayed to offset the cost to the government of refunding about $400 million to new licensees, mainly wholesalers, to convert their inventories from a tax-paid to a tax-free basis to avoid double imposition of the tax. Goods which are taxed at the general rate include automobiles and auto parts, household furniture and appliances, office furniture and equipment, radios, televisions, sporting goods, and motive fuels.

Construction materials and equipment for buildings, for example, lumber, electrical wire, furnaces, plumbing fixtures, paint, glass and cement, are taxed at a special low rate of 5 per cent. No change is contemplated in this rate at this time for the following reasons.

First, most large contractors buy building materials directly from manufacturers who are currently liable for tax on the actual sale price. A shift to the wholesale level will have little or no impact on such sales. The same is true for other sales of building materials by manufacturers to retailers.

Second, approximately 25 per cent of building products sold in Canada (including prefabricated buildings, fabricated steel and precast concrete shapes) are taxed on their material content rather than on their sale price, under the provisions of Section 26(4) of the Excise Tax Act. Ready-mix concrete enjoys similar treatment under another provision. Introduction of a wholesale tax system will have little or no impact upon this category of construction materials as they will continue to be taxed on their material content under the new legislation.

Third, a significant portion of the sale price of those building materials which flow through wholesalers consists of outward transportation cost because such goods are bulky relative to their value. Examples include cement, lumber, plumbing materials, electrical materials and heating equipment. This freight cost has not been taxed in the past and the new legislation will continue that practice.

The construction industry has suggested that deeming contractors to be retailers could result in a significant increase of tax burden for this sector under the new system. While such concerns do not appear to be consistent with the marketing pattern of most building materials, the government is prepared to re-evaluate the revenue impact of the proposed change with industry representatives. Consideration will be given to making an appropriate adjustment to the 5-per-cent rate if concerns expressed by the industry are found to be valid.

Food, clothing and footwear, pharmaceuticals, newspapers, books, eyeglasses, hearing aids, prostheses and similar health goods, are now unconditionally exempt of tax and will continue to be exempt under the new system. Many other goods are exempt of tax when acquired by hospitals, educational institutions and manufacturers for use in their manufacturing and production activities. These exemptions are not affected by the proposal.

A narrow range of goods including alcoholic beverages, tobacco products, smokers' accessories, jewellery, clocks and watches, heavy automobiles, automobile air conditioners and gasoline for personal use are subject to excise taxes in addition to the sales tax. These excise levies will continue to apply under the new legislation. All of these excise levies, with the exception of the excise tax on goods such as jewellery and clocks and watches, are in the form of specific amounts per unit and thus are not affected by a change of the trade level at which the tax is imposed. The excise tax on jewellery and clocks and watches is 10 per cent of the sale price. A shift to the wholesale level would cause an increase in the burden of this tax in the absence of an offsetting adjustment of the rate. It is therefore proposed to lower the rate on jewellery and clocks and watches from 10 per cent to 8 per cent of the sale price. This reduction will come into effect six months after the date of implementation of the new system, at the same time as the general sales tax rate is reduced to 8 per cent.

3.7 Licensing Provisions

All wholesalers of taxable goods, whether currently licensed or not, will be required to apply for a wholesaler's licence. Revenue Canada will automatically convert manufacturers' sales tax licences now held by producers to wholesalers' licences. The existing exemption from the licensing requirement for small manufacturers with annual sales of less than $50,000 will be extended to persons whose annual sales by wholesale are less than $50,000. The current legislation also exempts certain designated persons such as barristers, accountants, and craftsmen from licensing irrespective of their sales volume. These persons will continue to be relieved from the obligation to be licensed under the proposed wholesale tax.

3.8 Authorizations and the Treatment of Wholesalers' Inventories

An authorization is formal authority for a licensed wholesaler to acquire an inventory of resale merchandise on a tax-excluded basis. However, certain persons (who sell some goods by wholesale) make a majority of their sales to users and thus are essentially retailers. These persons will be treated somewhat differently than persons who are exclusively or mainly wholesalers. The proposed legislation identifies three categories of persons who make sales both to retailers and users. These are outlined below.

(1) Persons whose sales by wholesale constitute 50 per cent or more of their total sales.

These persons will be licensed as wholesalers, allowed to acquire their resale merchandise exempt of tax, and required to account for tax on all their sales. Their sales to retailers will be taxed on the actual sale price. Sales to uses will be taxed on a value equivalent to the price charged a retailer for like goods. It is mandatory for such persons to apply for an authorization.

(2) Persons whose sales by wholesale do not exceed 30 per cent of their total sales.

These persons will be licensed, and required to acquire their resale merchandise on a tax-paid basis. No further tax is imposed on their sales to users. Their sales to retailers will be taxed on the difference between the sale price and the purchase price, i.e., on the wholesale value added. Such persons will not be entitled to an authorization.

(3) Persons whose wholesale sales are more than 30 per cent, but less than 50 per cent of total sales.

These persons will be licensed, and given the option of carrying inventories tax-free or tax-paid. Depending upon their election, the tax liability will be as outlined under (1) or (2) above.

Businesses will be classified in the above categories on the basis of their sales of all goods rather than on the basis of their sales of taxable goods alone. The legislation allows businesses an opportunity to obtain an authorization for a separate branch or division that makes sales primarily by wholesale. The same opportunity may also be available in respect of a distinct product line which is sold mainly by wholesale.

3.9 Retailers who make a Majority of Sales under Exempt Conditions

Under the current sales tax system, retailers who make a majority of sales of taxable goods under exempt conditions (to hospitals, for example) are allowed to be licensed as wholesalers and to hold inventories on a tax-excluded basis. When the goods are resold to customers who are not entitled to an exemption, the tax is payable by the licensed person calculated on his cost. This system simplifies administration for both taxpayers and tax collectors by eliminating refund claims arising from sales of tax-paid goods to customers who are entitled to exemption. However, it suffers from two serious flaws. First, licensees are not required to continue to meet the licensing prerequisites. Many existing licensees have altered their operations and could not currently qualify for a licence because only a small fraction of their sales are under exempt conditions. Second, licensees enjoy an advantage over competing unlicensed firms who are required to purchase inventories on a tax-paid basis. The advantage arises from the fact that a licensee does not have to pay the tax-included price of the inventories, thereby decreasing his inventory costs by the amount of the tax otherwise payable.

To the extent such firms are wholesalers, they will be able to acquire inventories on a tax-excluded basis under the general provisions of the new wholesale tax system irrespective of the proportion of their sales made under exempt conditions. If they are essentially retailers the new legislation will allow them to be licensed and to have tax-free inventories provided that they make more than 50 per cent of their sales of taxable goods under exempt conditions. The initial eligibility for the licence and authorization will be based on the proportion of tax-exempt sales to total sales during the three months prior to the date of application, and the legislation requires that this prerequisite be met on an ongoing basis. The licence and authorization will be cancelled automatically if the retailer fails to meet the prerequisite for three consecutive years.

Firms licensed under this provision will be required to account for tax on sales made under taxable conditions calculated on values whch are not less than 105 per cent of cost in the case of domestic goods and 105 per cent of duty-paid value plus freight to the border in the case of imports. This proposed tax base will ensure a more uniform treatment of licensed and unlicensed retailers.

4 Part V: Taxation of Alcoholic Beverages and Tobacco Products

Alcoholic beverages and tobacco products will continue to be taxed at the rate of 12 per cent at the time of sale by a domestic manufacturer, and on the duty-paid value in the case of imported goods. The excise tax on wine and tobacco products, and the excise duties on beer, spirits and tobacco products will remain unchanged.

These goods will continue to be taxed at the manufacturer level because their production is subject to bonding requirements and other administrative controls to prevent illicit activities. The current provisions work well and the collection of tax from a relatively few manufacturers simplifies administration.

Part V of the new legislation contains the provisions applicable to alcoholic beverages and tobacco products. These provisions are similar to those found in the current legislation, with two exceptions. First, the legislation will provide an explicit authority for the use of notional values by manufacturers when they make sales directly to retailers and users. The rules for the notional value calculations are similar to those provided in Part IV of the proposed legislation. However, as alcoholic products are distributed mainly through provincial liquor control agencies, the need for notional values will arise only in limited circumstances.

Second, the treatment of foreign and domestic transportation costs for these products will parallel that provided for other goods. In the case of imported alcohol and tobacco, the value for sales tax will include transportation costs to the point of reporting in Canada pursuant to the Customs Act. Domestic manufacturers will continue to be able to exclude outward transportation costs from their warehouses to customers' locations. In the case of alcoholic beverages, foreign transportation already forms a part of the value for sales tax where the alcohol is imported in bulk for blending and bottling in Canada. In this case, the sales tax is levied on the sale price of the bottled product, which includes all costs incurred to that point. Thus, the impact of the new transportation cost provision will be limited to imports of bottled alcoholic beverages.

5 Part VI: Purchases by Large Retailers

Some retailers are large enough to obtain significant price concessions on their purchases from manufacturers and wholesalers. The price concessions associated with large volume purchases are standard business practice and automatically result in a proportionate reduction of the sales tax since it is an *ad valorem* levy. Insofar as the discount represents savings due to volume purchases, this is appropriate. However, the price reduction may also reflect the fact that the large retailer has absorbed certain marketing functions more commonly performed by manufacturers and wholesalers. These include national advertising, the operation of centralized warehouses and distribution systems, and the provision of warranties, product design and quality control. To the extent that large retailers absorb these costs, the wholesale tax is applied on a smaller base than is the case for persons who purchase from wholesalers at prices which include all manufacturing and wholesale functions. In recognition of this fact, both the Royal Commission on Taxation (the Carter Commission) and the Department of Finance Commodity Tax Review Group recommended an additional tax on large retailers in conjunction with a move to a wholesale tax.

Part VI of the proposed legislation responds to this situation by requiring large retailers to pay an additional tax, called the Large Retailer Tax, on their purchases of taxable goods. The tax will be imposed at the rate of 15 per cent of the tax content (i.e. the *ad valorem* sales and excise taxes payable) of purchases by large retailers. This is equivalent to an additional tax of 1.2 per cent on goods taxable at 8 per cent, and 0.75 per cent on construction materials taxable at 5 per cent. The tax is expressed as a percentage of the regular tax content (as opposed to a percentage of the sale price) in order to obviate the necessity of setting different rates for goods taxable at various rates of sales and excise taxes.

The rate of the Large Retailer Tax is set keeping in mind the fact that a part of the price concession enjoyed by large retailers reflects economies of bulk purchasing, which should not be subject to any additional tax. While the degree of wholesaling functions performed by large retailers does vary among firms and product lines, the additional 1.2-per-cent tax should, on average, ensure a uniform application of the tax to large and small retailers.

For the purposes of this tax, large retailers are defined as retailers whose purchases have attracted more than $250,000 of sales and excise tax (excluding any specific excise levies and, of course, the large retailer tax) in a given year. This corresponds to total purchases of $3,125 million of goods taxable at 8 per cent, and $5 million of goods taxable at 5 per cent. Assuming an average retail mark-up of 25 per cent, these purchases would translate into gross sales of taxable goods of $4 million and $6.5 million respectively.

The following purchases by retailers will be exempted from the application of the Large Retailer Tax:

(i) purchases of goods produced in competition with on-site construction which will continue to be taxable on the cost of materials at the manufacturer level;

(ii) tobacco products and alcoholic beverages which will continue to be taxable at the manufacturer level;

(iii) purchases by contractors for use by them in real property contracts;

(iv) purchases of goods which are subsequently resold under exempt conditions;

(v) purchases of goods which are subsequently sold by wholesale (i.e. to another retailer); and

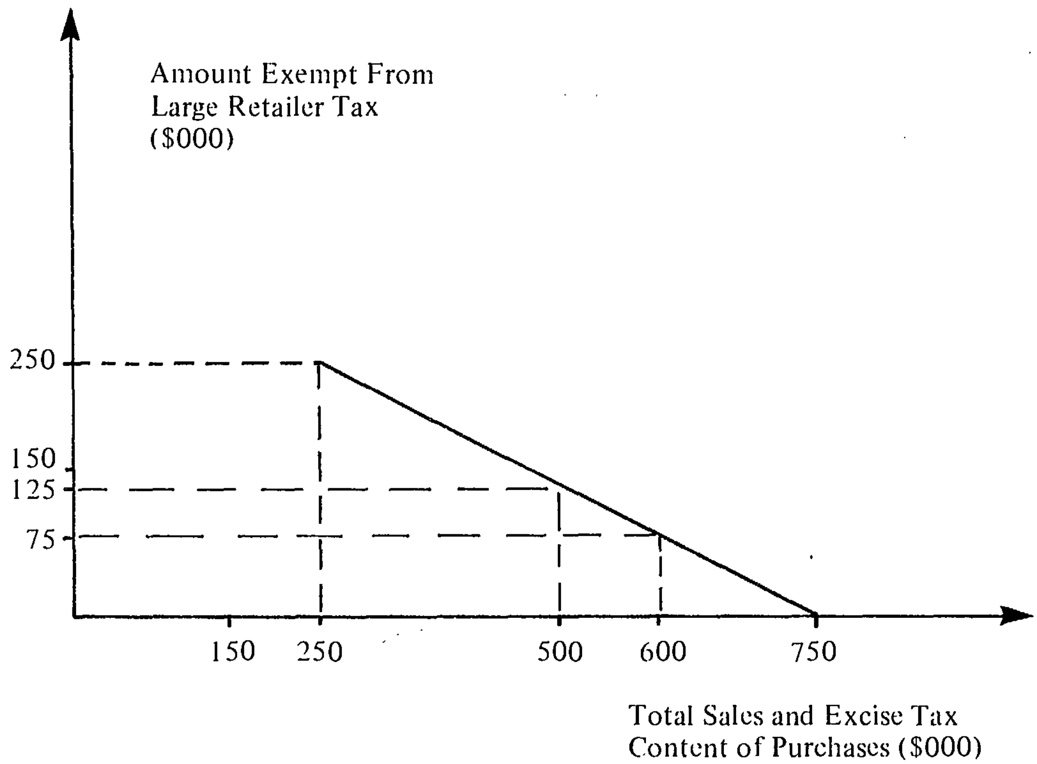
(vi) purchases by retailers who have elected to be licensed as wholesalers because more than 50 per cent of their sales of otherwise taxable goods are to users who are entitled to exemption.

Furthermore, authority will be provided to the Governor-in-Council to exclude purchases of certain other goods from the Large Retailer Tax. These exclusions will be mainly confined to "big ticket" items which do not flow through wholesalers, are sold at similar prices to all retailers, and belong to a readily identifiable class of goods or product line. To date, the goods identified for exclusion are automobiles, trucks and aircraft.

The draft legislation makes provision for a graduated tax liability to avoid a significant disparity between firms who are just above the threshold and firms who are just below it. Firms whose purchases of goods have a tax content of less than $250,000 in a given year will be completely exempt from the tax. Those who are above this threshold will be taxable on the tax content of their purchases less an exempt amount. As the retailer's tax content on purchases increases from $250,000 to $750,000 the exempt amount diminishes. The decrease is $1 for every $2 increase in total tax content of the firm's purchases. To illustrate, a firm whose purchases have a total tax content of $500,000 will be exempt from the Larger Retailer Tax on $125,000 of the tax content (that is, $250,000 less one-half of the difference between $500,000 and $250,000). The firm will pay the tax of 15 per cent on the balance of $375,000 tax content. A firm with a tax content of $600,000 will have an exempt amount of $75,000 (that is, $250,000 less one-half of the difference between $600,000 and $250,000) and pay tax on $525,000. The exempt amount will be reduced to zero for firms with a total tax content of $750,000 or more. Because of this gradual increase of the tax burden, only firms with purchases of taxable goods in excess of $10-$15 million dollars will be subject to the full impact of the Large Retailer Tax. Chart 2 illustrates graphically the relationship between total tax content and the amount exempt from the Large Retailer Tax. Chart 3 presents a numerical illustration of the calculation of the Large Retailer Tax.

The tax will be payable by retailers who will be required to make periodic instalment payments and to file an annual return to determine total tax liability for the year. Retailers who operate as separate legal entities, but are associated by virtue of common ownership, will be treated as a single entity for the calculation of this tax. The threshold amount of $250,000 may be apportioned among individual members of the group. The rules for defining associated groups and for determining instalment payments generally parallel those in the Income Tax Act. These rules are described in greater detail in an appendix to this paper.

CHART 2



Amount Exempt From
Large Retailer Tax
($000)
250
150
125
75
150
250
500
600
750
Total Sales and Excise Tax
Content of Purchases ($000)

CHART 3

LARGE RETAILER TAX: ILLUSTRATIVE CALCULATIONS

(1) Federal Sales and Excise Tax Payable by Retailer on his purchases (Tax Content) $	(2) Amount exempt from LRT*	(3) Amount subject to LRT (1) – (2)	(4) Amount of LRT Payable 15% of (3)
80,000	80,000	–	–
180,000	180,000	–	–
200,000	200,000	–	–
210,000	210,000	–	–
250,000	250,000*	–	–
260,000	245,000	15,000	2,250
370,000	190,000	180,000	27,000
400,000	175,000	225,000	33,750
750,000	0	750,000	112,500
800,000	0	800,000	120,000

*For retailers with an annual tax content of less than the threshold amount of $250,000, the amount exempt is equal to actual tax content. For retailers with an annual tax content between $250,000 and $750,000, the amount exempt may be determined by the formula: amount exempt = $250,000 – 1/2 (Col. (1) – $250,000).

6 Other Provisions

The previous sections described the provisions to be found in the draft legislation which is made available with this paper. As indicated earlier, the legislation to be tabled in Parliament will also include details of the enforcement and administrative provisions. While these will generally parallel the existing legislation, the shift to the wholesale level will permit the government to introduce certain important changes sought by the business community in the past. These are discussed below.

6.1 Appeals and Assessments

The amended structure contemplates a formal tax assessment system coupled with a formal appeal mechanism. A Notice of Assessment will be issued to the taxpayer upon completion of an audit by Revenue Canada. Except in cases of fraud, misrepresentation, evasion, or gross negligence, an assessment for tax arrears will be limited to those transactions that have incurred tax liability within four years of the commencement of an audit. Provision will also be made to extend the assessment period through a system of waivers in instances where the review of the taxpayer's records is unduly delayed or extends over a long time period.

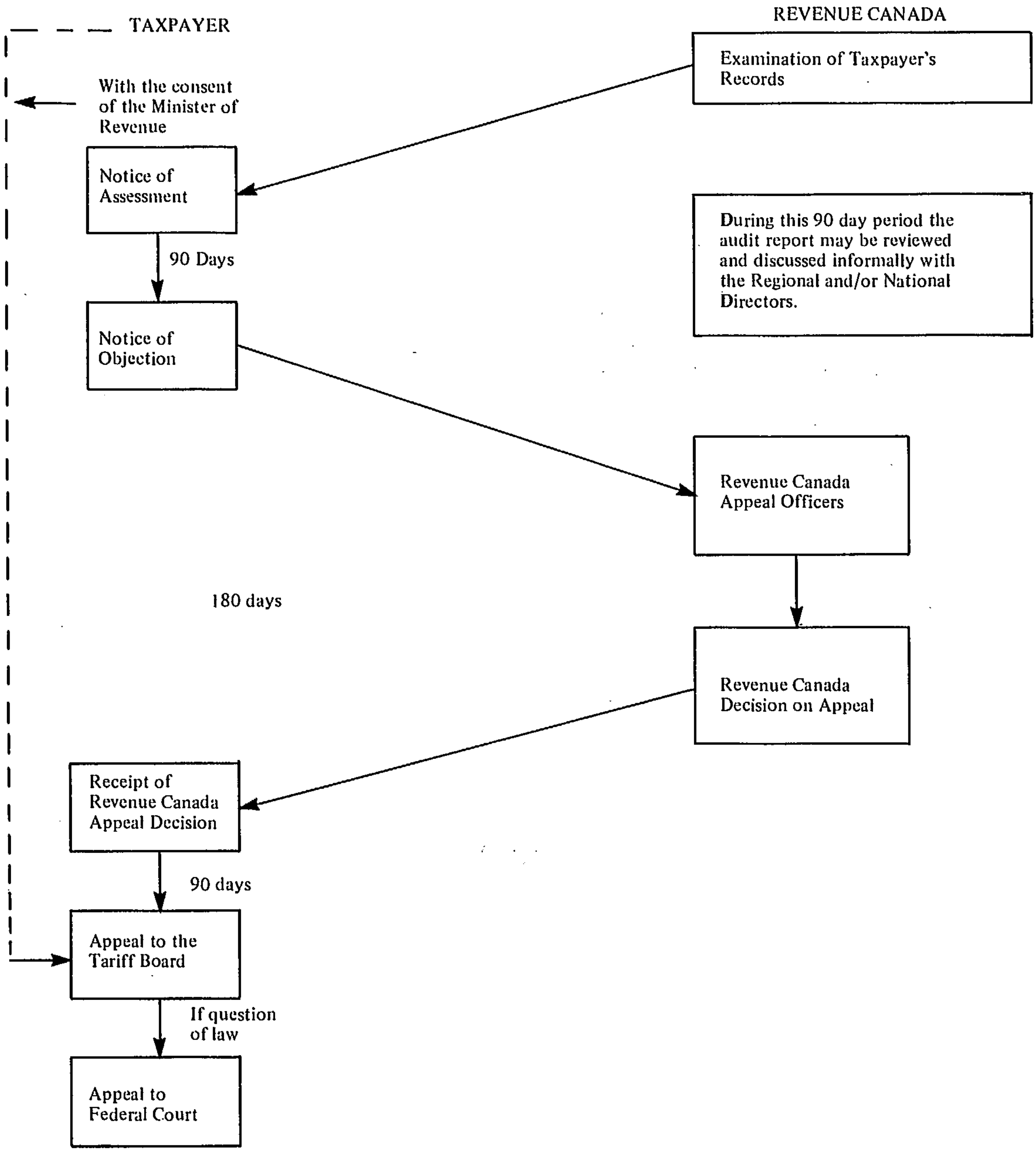
If the taxpayer disagrees with any assessment respecting tax arrears, or with the disallowance of all or a part of a refund claim, the taxpayer will have 90 days to file a Notice of Objection with Revenue Canada, Customs and Excise which must contain a brief statement of facts and reasons for the objection. After the taxpayer's objection has been considered, a written response will be given by Revenue Canada, vacating, varying or confirming the original assessment or disallowance. The taxpayer then will have 90 days to file an appeal with the Tariff Board.

The Excise Tax Act now provides for appeal to the Tariff Board from decisions of Revenue Canada when differences arise concerning tax exemptions or the appropriate tax rate. Representations from taxpayers and trade associations have supported continuation of recourse to an informal independent appeal body such as the Tariff Board, while suggesting that the provision be broadened to permit appeals on a wider range of issues.

Taxpayers will continue to be able to appeal to the Tariff Board on questions of exemption and tax rates. Its jurisdiction will be expanded to include the status of a person as a producer or a wholesaler, the determination of the sale price on which the tax rate is to be applied, and whether or not a taxpayer is entitled to use a value other than the actual sale price as the "value for tax" in prescribed situations. Taxpayers will also continue to have the opportunity to appeal Tariff Board declarations to the Federal Court on questions of law.

CHART 4

SIMPLIFIED SCHEMATIC OF APPEAL AND ASSESSMENT



The current administrative practice of informal negotiation between a taxpayer and Revenue Canada on issues in dispute is also continued. Past experience has shown that a substantial number of these disagreements can be resolved successfully by discussion without resort to formal appeals to an outside body or to the courts. Also, the existing practices, which allow taxpayers and their representatives to make direct representations to Revenue Canada concerning tax rulings and administrative procedures, will continue unchanged. Chart 4 is a schematic illustration of the proposed appeal system.

6.2 Interest on Refunds and Overpayments of Tax

While Revenue Canada does process large numbers of refunds, the great majority are routine claims arising from sales by unlicensed firms to customers entitled to tax exemption.

Verification and payment of these claims is normally achieved in six to eight weeks. Moreover, unlike the case for income taxes, overpayments of tax tend to occur infrequently under the Excise Tax Act because a taxpayer's liability can be readily ascertained given the volume of sales each month.

Nevertheless, several representations have been made by business associations that the government consider paying interest on refund claims and on overpayments of tax when the reimbursement is unduly delayed. As the proposed legislation further streamlines the administrative procedures with respect to the sales tax, the government is now prepared to pay interest on refunds and overpayments outstanding more than 60 days after a valid application for the refund or repayment, supported by adequate documentation, has been filed with Revenue Canada.

6.3 Bad Debts

The Excise Tax Act does not provide any relief for a taxpayer who has been unable to collect payment from an insolvent customer. When viewed from a technical perspective, no justification exists for a tax credit on account of a bad debt because the tax liability rests upon the taxpayer, rather than upon the customer. However, in response to representations received from the business community, the government is prepared to allow a credit of the tax otherwise payable on a bad debt to those taxpayers who account for tax on their sales. The tax credit may not be taken without the prior approval of Revenue Canada. Detailed instructions will be issued by Revenue Canada after the new legislation has been approved by Parliament.

7 Transitional Provisions

Transitional provisions will be needed in the new legislation with respect to the treatment of inventories in the hands of both new licensees and existing taxpayers whose licences will be cancelled.

New licensees, who will be authorized to hold inventories on a tax-free basis and account for tax on sale price, are entitled to recover sales and excise tax included in inventories on hand on the implementation date. A physical inventory of saleable merchandise should be taken on the implementation date to ascertain the amount of tax to be refunded. However, arrangements may be made prior to the implementation date for a physical inventory to be taken on another date, if adequate records are available to adjust the count to the implementation date. While Revenue Canada will be providing detailed guidelines for the determination of the tax refunds on inventories, the basic rules are outlined below.

The inventory must be valued at the lower of cost or fair market value. If the inventory on hand can be specifically related to purchase invoices (e.g. by serial number) then those specific invoices must be used to determine the cost. In all other instances, cost will be determined following the "first-in first-out" accounting method. If the tax originally paid cannot be ascertained from suppliers' invoices the formulas accepted currently by Revenue Canada, Excise Branch, for calculating refunds on exempt sales may be used. The basic formula is cost less 25 per cent, multiplied by 9/109ths (5/105ths in the case of building products). The 25-per-cent discount covers non-taxable cost elements including freight, discounts, and mark-ups of unlicensed suppliers which do not currently form a part of the value for tax.

New licensees will be able to apply inventory tax credit entitlements against tax due on sales made on or after the implementation date. Alternatively, the Minister of National Revenue may refund the tax credit directly to licensees 60 days after a valid entitlement has been established.

Those retailers currently licensed as wholesalers, but who do not make a majority of their sales under exempt conditions, will not be authorized to hold inventories on a tax-excluded basis. Their licences will be cancelled and they will be required to count and value inventories on the implementation date and account for taxes on their value. Special provisions will permit the tax due to be remitted by instalment payments. Further details will be provided by Revenue Canada prior to implementation.

Wholesalers, previously not licensed, whose sales are mainly to users, and who have elected to operate with a tax-paid inventory, are not under any obligation to count and/or value inventories on implementation date. However, accounting records should be maintained which identify the tax-included cost of goods sold by wholesale. This information is required to calculate the tax on the wholesale value added when goods are sold to retailers.

Most manufacturers who are already licensed will continue to be licensed and to hold their inventories on a tax-free basis. While the shift to the new system will change the method of accounting for tax for these persons in some instances, no other transitional provisions are needed.

Appendix A

The Large Retailer Tax

The purpose of this appendix is to explain the large retailer tax in detail and to provide examples illustrating its application.

1. Introduction

The large retailer tax is an annual levy imposed at the rate of 15 per cent on the annual tax content of purchases by large retailers. For the purposes of this tax, large retailers are defined as retailers whose purchases of taxable goods attract more than $250,000 of sales and excise taxes in a taxation year. Annual tax content is the total amount of sales and excise taxes paid on taxable goods acquired by a retailer.

The draft legislation provides for a graduated tax liability to avoid a significant disparity between firms just above the $250,000 threshold and others who are just below it. Firms that have an annual tax content of less than $250,000 on their purchases of goods in a given year will have no liability for this tax. Those above this threshold, but under $750,000 of annual tax content, will be taxable on their annual tax content less an exempt amount called the annual tax deduction. As a large retailer's tax content increases from $250,000 to $750,000, the exempt amount diminishes and is reduced to zero for an annual tax content equal to or greater than $750,000.

The tax will be payable by the retailer, who will be required to make periodic instalment payments and to file an annual return to determine total large-retailer-tax liability for the year. Retailers who operate as separate legal entities, but are associated by virtue of common ownership, will be treated as a single entity for the calculation of this tax. The threshold amount of $250,000 may be apportioned among individual members of the group. The rules for determining associated retailers and establishing instalment payments parallel those in the Income Tax Act.

The following sections provide further details concerning this tax and elaborate on the concepts discussed above.

2. Definitions

The following are the basic definitions which are developed and used throughout the draft legislation.

Annual Tax Content

Annual tax content is the total amount of sales and *ad valorem* excise taxes attributable to all taxable goods acquired by a retailer for resale to consumers (including deemed sales under the wholesale tax). This amount is used to determine whether a retailer is subject to the large retailer tax, and is the base on which the tax is calculated. Where retailers are "associated", the annual tax content is the aggregate of the annual tax content amounts for each member of the group. An associated retailer may not itself be large, but may be subject to the large retailer tax because of its association with other retailers who, together, have an aggregate annual tax content in excess of permissible thresholds. Generally any individual retailer or any group of associated retailers having an annual tax content in excess of $250,000 is subject to the large retailer tax.

The tax content does not include sales and excise tax payable:

(i) at the time of purchase of goods by the retailer where the tax is subsequently refunded to it because the goods were sold to an exempt user (e.g. hospitals);

(ii) on goods sold by wholesale (i.e. to another retailer) as opposed to by retail;

(iii) on retail sales by a wholesaler who is authorized to acquire inventories on a tax-excluded basis, as they are subject to the regular sales and excise taxes on the actual sale price or a notional value as opposed to on the purchase cost of the wholesaler;

(iv) on alcohol and tobacco products which are taxable at the manufacturer level;

(v) on goods produced in competition with on-site construction; and

(vi) on other goods as may be prescribed by regulation. It is anticipated that selected "big ticket items" such as automobiles, trucks and aircraft will be prescribed.

Contractors will also be relieved from the large retailer tax on purchases of goods for use in real property contracts.

The procedures to be followed by the retailer in determining the amount of sales and excise taxes are as follows:

(i) where the amount of tax is stated on the supplier's invoice, or the tax is paid by the retailer, for example, on an importation or on a deemed sale on the transfer of goods to a retail outlet, the actual tax amount is used; and

(ii) where goods are sold to a retailer on a tax-included basis and the tax is not separately identified, the tax content will be calculated by multiplying the tax-included price of the goods by the tax rate (expressed as a decimal) divided by one plus the tax rate. To illustrate, if a retailer is invoiced $540 tax-included for a good which is taxable at the 8-per-cent rate, the tax content is 8/108ths of $540, which is $40.

Tax Threshold

The tax threshold establishes the level of annual tax content on purchases by a retailer or group of associated retailers at which point liability for the large retailer tax commences. It is also used to provide a graduated tax liability for this tax for large retailers and groups of associated retailers with an annual tax content between the tax threshold and three times the tax threshold. For a single retailer, the threshold is $250,000 per annum. For a retailer who is one of a group of associated retailers, the threshold may be less than $250,000, though it is $250,000 in aggregate for all of the members of the group.

Annual Tax Deduction

The annual tax deduction is the amount of annual tax content of a retailer which is exempt from the tax. It is equal to the full amount of annual tax content for those retailers or groups of retailers who are below the $250,000 threshold. It is zero for those retailers or groups of retailers with annual tax content of $750,000 or more. For those with an annual tax content between $250,000 and $750,000, it starts with the base amount of $250,000 and decreases by $1 for every $2 increase in annual tax content. The annual tax deduction also applies to each retailer who is a member of a group of associated retailers. In this case, the group is required to file an agreement setting out the allocation of the tax threshold to each member of the group in order to take advantage of the annual tax deduction.

Annual Tax Advance

This concept is only relevant for retailers belonging to an associated group. Where a retailer in an associated group is allocated a tax threshold of less than one-third of its annual tax content, an annual tax advance will apply in order to ensure that the liability of the group is the same as the liability of a single retailer for a given annual tax content. In this case, the annual tax advance is added to the annual tax content of the retailer (in place of subtracting the annual tax deduction) to arrive at the base for the large retailer tax.

The annual tax advance applies only in those cases where a retailer in an associated group is being allocated a tax threshold equal to less than one-third of its annual tax content. This condition is based on the fact that the maximum threshold for any single retailer is $250,000 and the maximum tax content up to which a threshold is available is $750,000. For a single retailer the threshold will thus be equal to at least one-third of his tax content. If any retailer who is a member of a group of associated retailers is being allocated a threshold of less than one-third, then the threshold is in fact being over-allocated to other members of the group and an offsetting adjustment is required to ensure that the group as a whole pays the appropriate amount in large retailer tax.

Taxation Year

The large retailer tax utilizes the concepts in the Income Tax Act concerning fiscal periods and taxation years. For example, the 1983 taxation year includes all fiscal periods which end in the 1983 calendar year.

3. Imposition of Large Retailer Tax

The large retailer tax is imposed on individual retailers at a rate of 15 per cent of the annual tax content. The following examples illustrate the calculation of the large retailer tax.

Example 1: Single Retailer

The general tax liability formula for a single retailer is

$$LRT = 0.15\,(ATC - ATD)$$

where

LRT is the large retailer tax liability,
ATC is the annual tax content, and
ATD is the annual tax deduction.

The annual tax deduction formula is

$$ATD = TT - \tfrac{1}{2}\,(ATC - TT)$$

where

TT is the tax threshold.

Since for a single retailer the tax threshold is always $250,000, the formula becomes

$$ATD = 250{,}000 - \tfrac{1}{2}\,(ATC - 250{,}000)$$

When annual tax content is greater than or equal to $750,000, the annual tax deduction is reduced to zero. Thus, a single retailer with annual tax content of $750,000 or more pays the 15-per-cent large retailer tax on the full annual tax content. A single retailer with an annual tax content of less than $750,000 would have a positive annual tax deduction calculated according to the formula. To illustrate, a retailer with an annual tax content of $550,000 would calculate its liability for the large retailer tax as follows:

$$ATD = 250{,}000 - \tfrac{1}{2}\,(550{,}000 - 250{,}000) = 100{,}000$$
$$LRT = 0.15\,(550{,}000 - 100{,}000) = \$67{,}500$$

Example 2: Associated Retailers

A and B are associated retailers. Their combined annual tax content amounts to $550,000 for the 1984 calendar year and they are thus liable to pay the large retailer tax in respect of that year.

For purposes of illustration, assume retailer A has an annual tax content of \$330,000, and retailer B's annual tax content is \$220,000. The two retailers may file an agreement to allocate tax thresholds to each of them in any manner they wish, provided that the aggregate of the tax thresholds allocated does not exceed \$250,000. Two examples will be considered to illustrate the effects of alternate allocations of the tax threshold amounts on the liabilities of each of the associated retailers and the total liability of the group as an entity.

Assume first that A and B decide to allocate the total \$250,000 tax threshold proportionately to their respective annual tax content for 1984. A's threshold will thus be \$150,000 and B's tax threshold \$100,000.

In this case, the tax threshold is greater than one-third of the annual tax content for each of them and thus the annual tax advance calculation is not necessary. The annual tax deduction and the tax liability calculations will be the same as for a single retailer. Retailer A would calculate its liability for the large retailer tax as follows:

$$\begin{aligned} ATD &= 150{,}000 - \tfrac{1}{2}(330{,}000 - 150{,}000) = 60{,}000 \\ LRT &= 0.15\,(330{,}000 - 60{,}000) = 40{,}500 \end{aligned}$$

Similarly, retailer B's liability would be

$$\begin{aligned} ATD &= 100{,}000 - \tfrac{1}{2}(220{,}000 - 100{,}000) = 40{,}000 \\ LRT &= 0.15\,(220{,}000 - 40{,}000) = 27{,}000 \end{aligned}$$

The combined liability of the two retailers in the group is \$67,500, which is the same as it would be for a single retailer with an annual tax content of \$550,000.

Now assume that A and B decide to allocate the total \$250,000 tax threshold exclusively to A. Since A's threshold exceeds one-third of its annual tax content, it will again calculate its tax liability using the formulas applicable to a single retailer:

$$\begin{aligned} ATD &= 250{,}000 - \tfrac{1}{2}(330{,}000 - 250{,}000) = 210{,}000 \\ LRT &= 0.15(330{,}000 - 210{,}000) = 18{,}000 \end{aligned}$$

However, since in this example B's tax threshold is less than a third of its annual tax content, and it is associated with another retailer who has a tax threshold greater than zero, B will have to calculate its annual tax advance and use the alternative formulas to determine its liability for the large retailer tax. That is,

$$\begin{aligned} ATA &= \tfrac{1}{2}(ATC - TT) - TT \text{ and} \\ LRT &= 0.15\,(ATC + ATA) \end{aligned}$$

where

ATA is the annual tax advance.

B's annual tax advance and tax liability would be:

$$ATA = \tfrac{1}{2}(220{,}000 - 0) - 0 = 110{,}000$$
$$LRT = 0.15(220{,}000 + 110{,}000) = 49{,}500$$

Thus, in this example, retailer A has a liability of $18,000 and retailer B has a liability of $49,500. Their combined liability is $67,500 which is identical to the liability of a single retailer with the same annual tax content.

This example illustrates the necessity of the annual tax advance calculation. Given that the group has an annual tax content of $550,000, it is entitled to an exempt amount or annual tax deduction of $100,000. However, allocation of all of the $250,000 of the threshold to A entitles it to an annual tax deduction of $210,000. It is thus necessary to subject other members of the group, in this case B, to an offsetting adjustment in the form of an addition of $110,000 to the tax base. This is precisely the amount of annual tax advance for B.

4. Remittance of Tax

A single retailer must remit the large retailer tax monthly. The amount remitted may be an estimate of the amount owed, an amount determined by reference to the tax paid in the previous year (first instalment base) or, for the first two months, an amount determined by reference to the amount of tax paid in the second prior year (second instalment base) and thereafter amounts based on the previous year's tax. The balance of tax owing is payable within three months of the end of the taxation year.

These provisions are similar to current instalment payment provisions for corporate income tax.

An associated retailer will also be required to remit monthly instalment payments on the same basis as a single retailer. Two further payment options are available depending on the timing of the taxation years of the other associated retailers in the group and on the availability of information. These permit payments to be extended over longer periods or to be based on tax payments from as much as three years previously (third instalment base), where more recent information is not available.

Payment day and *tax make-up* are two concepts associated with the determination of instalment payments by members of a group of associated retailers. The payment day for members of an associated group is based on the taxation year of whichever member of the group has its taxation year-end the latest in the calendar year; the payment day falls three months after the end of that taxation year.

Example:

Assume that A and B are associated retailers, retailer A's taxation year ends on March 31, 1983, and retailer B's taxation year ends on August 31, 1983.

Under these circumstances, the payment day for the group is November 30, 1983. The legislation defines this to be the payment day for the 1984 taxation year although it is based on 1983 taxation years of the members of the group. It is the day on which the final tax payment must be made for the 1983 taxation year and the day after which instalments for the 1984 taxation year must be based on the tax make-up using the first instalment information.

Tax make-up is used to determine the amount of each monthly instalment payment to be made by the retailer after the payment day. It is calculated by dividing the first instalment base minus the amount already paid, by the number of months remaining in the year after the retailer's payment day.

The following examples illustrate the calculation of instalment payments.

Example 1: Single Retailer

For purposes of the example, assume that:

1. the retailer's taxation year for income tax purposes, and hence its taxation year for purposes of the large retailer tax, commences on April 1, 1983 and ends on March 31, 1984;
2. the retailer has been in business for several years and the tax has been in operation throughout that time; and
3. the following data apply:
   a) the retailer estimates its current year liability (i.e. for the period April 1, 1983 to March 31, 1984) for the large retailer tax will be $60,000;
   b) its first instalment base is $48,000;
   c) its second instalment base is $36,000; and
   d) its actual taxes owed are $67,500.

A tax remittance must be made at the end of each month from April, 1983 to March, 1984. The retailer may pay either

(1) $\frac{\$60{,}000}{12}$ = $5,000 each month (based on its estimated current year liability), or

(2) $\frac{\$48{,}000}{12}$ = $4,000 each month (based on its first instalment base), or

(3) $\frac{\$36{,}000}{12}$ = $3,000 for April and May (based on its second instalment base), and

$\frac{48{,}000 - 6{,}000}{10}$ = $4,200 for June through March (based on its first instalment base less payments already made).

In all cases, the balance of tax owing must be paid by June 30, 1984, three months after the end of the retailer's taxation year. This balance would be $7,500 if option (1) above were used, or $19,500 under options (2) or (3).

Example 2: Associated Retailers

Assume that:

1) A's taxation year commences on April 1, 1983 and ends on March 31, 1984 and B's taxation year begins on September 1, 1983 and ends on August 31, 1984; and
2) the following data for A and B apply:

	A	B
first instalment base	$30,000	$18,000
second instalment base	$24,000	$12,000
actual taxes owed	$40,500	$27,000

Then, A and B's payment day for their 1984 taxation years is November 30, 1983, which is three months after the end of B's 1983 taxation year. The first instalment base, which is the actual tax liability for the 1983 taxation year, is not known to the retailers at the time they are required to commence their instalments for the 1984 taxation year (i.e. on April 30, 1983 for A and on September 30, 1983 for B). It will be known only on November 30, 1983 when they make the final payment of tax for the 1983 taxation year. However, each does know the second instalment base and can therefore begin making monthly instalments on this basis. Retailer A will make instalment payments of $2,000 per month (equal to $24,000 ÷ 12) for the period April to October 1983. In November, A should know its first instalment base, and therefore the subsequent five instalment payments, based on its first instalment base of $30,000 less any amount already paid, would each be equal to:

$$1/5 \times (30{,}000 - (7 \times 2{,}000)) = \$3{,}200.$$

The balance of A's tax liability, equal to $10,500, must be paid by November 30, 1984.

Similarly, B can begin making instalment payments in September 1983 based on its second instalment base as follows:

$$\frac{12{,}000}{12} = \$1{,}000 \text{ each month, for September and October 1983.}$$

In November, B will begin making payments based on its first instalment base of $18,000, less any amount already paid, i.e.

$1/10 \times (18{,}000 - 2{,}000) = \$1{,}600$ each month from November, 1983 to August, 1984.

The balance of B's tax liability, equal to $9,000, must be paid on or before the payment day, November 30, 1984.

Both A and B could elect to use an estimate of the amount of tax owing as a basis for the monthly instalment payments as in the case of a single retailer.

B could also use its first instalment base for all 12 payments if this information is available in September.

5. Returns

Annual returns are required from all retailers who are liable to pay the large retailer tax or are members of a group of associated retailers where at least one group member is liable to pay this tax. A retailer required to file a return in any year will be required to continue to file returns in future years, although neither the firm nor any member of the group may be liable for tax in that year. The return will contain information relating to annual tax content and the computation of a retailer's liability. The Minister may waive that filing requirement in subsequent years if no further liability arises.

A single retailer is required to file returns within six months of the end of its taxation year. An associated retailer must file within six months of the end of the last taxation year ending in the calendar year of any member of the group.

6. Penalty and Interest

A penalty of 0.5 per cent and interest of 1 per cent per month are payable on any late tax instalments and on any taxes not remitted by the due dates.

Associated retailers who are permitted to defer payment of some taxes for a period beyond the normal remittance date because of the need to obtain information from other members of the group, are required to pay interest at the rate of 1 per cent per month on any taxes so deferred. This is to ensure that no advantage is conferred on an associated retailer, relative to a single retailer, with respect to the time of final payment of the large retailer tax liability.

Example: Associated Retailers

If A were a single retailer, in the example given earlier, it would be required to pay the full amount of the large retailer tax on June 30, 1984. Since A is associated with B, however, it is not required to remit the final payment until the November 30, 1984 payment day, but in such a case, the legislation requires payment of an additional amount in interest equal to 1 per cent per month for the five-month period, i.e. $535.60.

Appendix B

Revenue Canada Customs and Excise

Atlantic Region	Telephone Number	Mailing Address
Halifax, N.S.	902-426-3758 426-8116 426-8117 426-2780	2nd Floor, 6169 Quinpool Road, P.O. Box 1658, Halifax, N.S. B3J 2Z8
Fredericton, N.B.	506-452-3000	Chestnut Complex Bldg., 500 Beaverbrook Court, P.O. Box 1291, Fredericton, N.B. E3B 5C8
Moncton, N.B.	506-388-7015	MacSpear Bldg., 77 Vaughan Harvey Blvd., P.O. Box 1070, Moncton, N.B. E1C 8P2
Saint John, N.B.	506-648-4909 648-4405 648-4406	Customs Bldg., 189 Prince William St., P.O. Box 6865, Station "A", Saint John, N.B. E2L 4S3
Cornerbrook, Nfld.	709-639-8381 639-8741	5th Floor, Herald Towers Bldg., 4 Herald Avenue, P.O. Box 354, Cornerbrook, Nfld., A2H 4B7
St. John's, Nfld.	709-772-5333 772-5334 772-5572	Duckworth Street, P.O. Box 5500, St. John's, Nfld., A1C 5W4
Sydney, N.S.	902-564-4441	Cabot House, 500 Kings Road, Sydney, N.S. B1S 1B1

Charlottetown, P.E.I.	902-892-6100	Dominion Bldg., Queen Street, P.O. Box 1177, Charlottetown, P.E.I. C1A 7M8
Ottawa Region		
Ottawa, Ont.	613-993-0040	360 Coventry Road, P.O. Box 8257, Ottawa, Ontario. K1G 3H7
North Bay, Ont.	705-427-9270 1-800-461-1563	Room 455, 101 Worthington St. E., P.O. Box 477, North Bay, Ontario. P1B 8G8
Sault Ste. Marie, Ont.	705-949-2316	Bridge Plaza, 125 Huron Street, Warehouse Building, Sault Ste-Marie, Ont. P6A 1R3
Toronto Region		
Toronto, Ont.	416-966-6561	4th Floor, 25 St. Clair Ave. E., P.O. Box 100, Station "Q", Toronto, Ontario. M4T 2L7
Quebec Region		
Quebec, P.Q.	418-694-4376	7th Floor, 410 Charest Blvd. E., P.O. Box 2117, Postal Terminal, Quebec, P.Q. G1K 7M9
Chicoutimi, P.Q.	418-543-7988	2nd Floor, 282 Ste. Anne Ave., Chicoutimi, P.Q. G7J 2M4
Sherbrooke, P.Q.	819-565-4910	Room 330, 50 Couture St., P.O. Box 1177, Sherbrooke, P.Q. J1H 5L5

Trois-Rivières, P.Q.	819-375-5745	Room 200, 225 des Forges Street, P.O. Box 847, Trois-Rivières, P.Q. G9A 2G7

Montreal Region

Montreal, P.Q.	514-283-2836 283-2837 283-2838	7th Floor, 400 Youville Square, P.O. Box 6092, Station "A", Montreal, P.Q. H3C 3H3

London Region

London, Ont.	519-679-4141	3rd Floor, Dominion Public Bldg., 457 Richmond Street, P.O. Box 5548, Terminal "A", London, Ontario. N6A 4R3
Barrie, Ont.	705-726-3810	Suite 310, Federal Bldg., 48 Owen Street, Barrie, Ontario. L4M 3H2
Kitchener, Ont.	519-886-3030	3rd Floor, 75 King St. S., Waterloo Square Bldg., Waterloo, Ontario. N2J 1P2
Windsor, Ont.	519-252-5783	6th Floor, Federal Bldg., 185 Ouellette Ave., P.O. Box 360, Windsor, Ontario. N9A 6L7

Hamilton Region

Hamilton, Ont.	416-523-2321 523-2556	Suite 840, Stelco Tower, 100 King St., W., P.O. Box 588, Hamilton, Ontario. L8N 3K7

St. Catharines, Ont.	416-685-1347 685-5838	Canada Trust House, 60 James Street, P.O. Box 697, St. Catharines, Ont. L2R 6Y3

Winnipeg Region

Winnipeg, Man.	204-949-4012 949-4014 949-2208	13th Floor, Royal Bank Bldg., 220 Portage Ave., P.O. Box 1022, Winnipeg, Man. R3C 2W2
Regina, Sask.	306-359-5871	South Broad Plaza, 320-2045 Broad St., Regina, Sask. S4P 1Y4
Saskatoon, Sask.	306-665-4212 665-5069	Room 601, Federal Bldg., 101-22nd St. E., Saskatoon, Sask. S7K 0E1
Thunder Bay, Ont.	807-344-0781	Room 308, 33 Court St., S., Thunder Bay, Ont. P7B 2W6

Calgary Region

Calgary, Alta.	403-231-5678	Room 407, Federal Bldg., 220-4th Ave., S.E., P.O. Box 2525, Station "M" Calgary, Alta. T2P 3B7
Edmonton, Alta.	403-420-3420	6th Floor, Manulife Bldg., 10055-106th St., Edmonton, Alta. T5J 2Y2

Pacific Region

Vancouver, B.C.	Licensing 604-666-1794 666-1496 Tax Information 604-666-3753 666-3754 666-3755	460 Nanaimo St., P.O. Box 69090, Station "K", Vancouver, B.C. V5K 4X2

Vernon, B.C.	604-542-2317	Room 219, 3205-32nd St., Vernon, B.C. V1T 5M7
Victoria, B.C.	604-388-3377 388-3378 388-3379	3371 Oak Street, Victoria, B.C. V8X 1R2