TaxNewsFlash Canada

Retailers — Coping with the Changing HST Environment

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Retailers in Canada are contending with the latest round of indirect tax rate changes, including HST tax rate increases in New Brunswick, Newfoundland and Labrador and Prince Edward Island. These changes add to an already wide range of indirect tax challenges that retailers must meet in their daily operations. As retailers' activities evolve with new products, expanding markets, new forms of payment and ever changing reward programs, the related sales tax issues around these activities also become more complex. With one or more indirect taxes applying to most retail transactions, any errors in systems and sales processing can multiply quickly and become very expensive if not addressed in time.

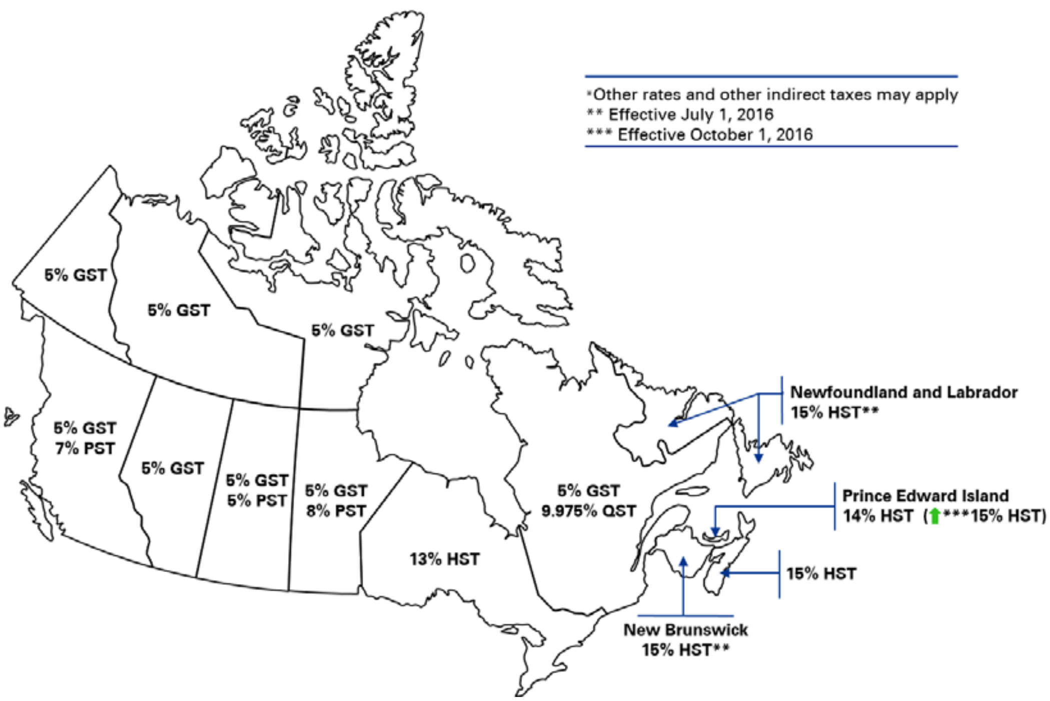
Stay on top of important indirect tax risks and opportunities
Retailers may want to review, among others, the following areas of their businesses to assess tax risks and opportunities, especially in light of the upcoming HST changes:

- Tax status of products, related stock keeping units (SKUs) and tax policy changes
- Interprovincial sales, purchases and transfers of goods
- Goods imported and exported and customs compliance requirements
- Reward programs and coupons
- Credit and debit notes
- Recaptured input tax credit rules, the related upcoming changes and restricted input tax refund rules
- Intercompany transactions, including closely related group elections
- PST exemptions on sales and purchases
- PST self-assessment rules and environmental levies
- Employee taxable benefits, registered pension plans and payroll obligations

- Costs related to reorganization transactions

The indirect taxes across Canada range from a low of 5% in Alberta and the territories to a high of 15% in Nova Scotia and soon in other Atlantic provinces, as illustrated below.

Overview of Indirect Tax Rates in Canada as of July 1, 2016*



Sales and your customers

Retailers must ensure that their systems and processes properly account for all the indirect taxes they are required to collect and remit under the tax rules. However, some retailers may find this difficult due to the many variables involved, which can include maintaining proper documentation, transactions straddling tax changes' effective dates, unexpected tax policy changes, indirect tax exemptions, evolving reward programs and even indirect tax rules in other provinces and countries. Making errors can result in tax costs, as many retailers simply cannot recover uncollected taxes from hundreds of individual customers. Overcharging tax can also be costly for customer relations.

Upcoming HST rate changes

Specifically, retailers must prepare and test their systems and processes for upcoming indirect changes. They must ensure that all the departments, including AP and IT departments, are working together to identify all the required changes. With the upcoming HST rate changes in New Brunswick, Newfoundland and Labrador and Prince Edward Island, retailers must carefully determine which tax rate applies to transactions in those provinces that straddle the effective dates of the changes, including the effect on credit and debit notes, and returns and exchanges of products.

Tax status of products

Retailers, particularly those that sell both taxable and zero-rated products such as pharmacies and grocery stores, must ensure they manage their point-of-sale risks including ensuring that their SKUs reflect the correct tax status of all their products. For example, where a retailer mistakenly codes a 13% HST taxable product as a zero-rated product, this can turn out to be an expensive error. Retailers must also stay current regarding administrative tax policy changes that could affect the tax status of some of their products. Tax status can be difficult to determine, and in some cases, two similar products may sometimes have different tax status (e.g., one taxed at 15% HST and one taxed at 0% HST).

Rebates and exemptions

Point-of-sale rebates on certain products, PST-exempt products and PST exemptions can also cause indirect tax issues. Retailers must effectively manage these types of transactions to ensure that they can support why they did not collect this tax.

Reward programs and coupons

Many retailers also offer reward programs and coupons to their clients. These programs and coupons have raised various indirect tax issues for retailers over the last few years, including determining the tax status of reward points purchased and offered to customers. Retailers must understand the related indirect tax rules in order to determine the proper tax costs of these programs.

Taxes in various jurisdictions

Retailers that ship products across Canada and around the world must ensure that they properly register and collect the right taxes for each jurisdiction. Tax rules and obligations, may differ from one type of tax to another, including GST/HST, QST and PST as well as sales taxes in the United States or elsewhere. These retailers must understand also all their obligations as an exporter or an importer of goods in Canada and in any other country.

Operations and corporate structure

Most retailers are carrying on commercial activities and are generally entitled to claim input tax credits (ITCs) and input tax refunds (ITRs) for the GST/HST and QST paid on most of their inputs. However, the complexity of all the indirect tax rules and requirements can still result in unrecoverable tax costs for some of these entities.

Retailers, like other GST/HST and QST registrants, are subject to strict documentation requirements before they are eligible to claim ITCs and ITRs. Documentation requirements continue to be a recurrent audit issue for many businesses across Canada. In general, tax authorities will assess previously claimed ITCs and ITRs if the registrants cannot provide the required documentation.

Recaptured ITCs

Under the Ontario HST, retailers that qualify as “large businesses” must repay to the CRA the provincial component of the Ontario HST claimed as ITCs on a number of specified property and services. These retailers must prepare for Ontario’s welcome reduction of the recaptured rate to 50% (from 75%) on July 1, 2016 as part of the province’s continued RITC phase out under the Ontario HST. Similar recaptured ITC rules apply for Prince Edward Island HST. However, its phase-out period is only scheduled to begin on April 1, 2018. For QST purposes, retailers that qualify as large businesses are simply not entitled to claim any ITRs related to the QST paid on the specified property and services.

Some retailers may also have to pay or self-assess PST on certain costs if they operate in a province that applies a PST or if they ship products, such as promotional materials, in a PST province.

Intercompany transactions

Intercompany transactions in a corporate group can also raise important indirect tax issues. For example, many corporate group file closely related group elections between qualifying members of the groups to help manage GST/HST and QST on intercompany transactions. However, these members must ensure that these elections meet all the conditions and are filed on time. Errors can create uncollected taxes between the closely related corporations. Some retailers also face various indirect tax challenges resulting from reorganization transactions, including acquisitions and system changes.

Environmental levies

In recent years, a number of customer products and other types of products became subject to new environmental levies. Many retailers are required to pay these levies to provincial entities. Retailers should ensure that they review all the provincial environmental levies to help them meet all their related obligations and not overpay such levies.

Employee benefits

Retailers that offer employee taxable benefits and registered pension plans may have additional related GST/HST and QST obligations and unrecoverable tax costs. Also, retailers must apply specific GST/HST and QST rules to employee allowances and expense reimbursements if they are eligible to claim related ITCs and ITRs. They must also ensure that they meet their payroll tax obligations related to all their employees across Canada.

Your tax audits

Retailers often face simultaneous tax audits from various tax authorities which can consume valuable time from their teams. This trend is likely to continue as tax authority audit activities appear to be increasing across Canada in all areas of indirect tax. However, businesses can help ease the disruption and stress brought by these tax audits by planning ahead and having guidelines and processes to work with the various tax authorities.

During an audit, businesses are generally given a period of time to review and validate the tax auditor's calculations. These businesses should take this opportunity to review their data to identify potential tax recoveries that can often help reduce potential tax assessments and interest. Some tax recoveries may only be available as deductions at the time tax authorities are assessing certain older reporting periods.

Your future plans

Retailers that plan to expand to new markets or new sale strategies must remember that indirect taxes apply in numerous countries and the rules and tax compliance obligations can vary significantly from one jurisdiction to another. These businesses must ensure that they apply the rules correctly.

Businesses that are planning certain reorganization transactions should also remember that they may be able to recover all or part of the GST/HST and QST paid on certain reorganization costs if they meet all the related conditions.

We can help

KPMG can help you with your various indirect tax challenges and review how the indirect tax rules apply to your specific facts and circumstances. KPMG's Indirect Tax professionals can help you determine if you are fulfilling your tax obligations as required. We can also help you determine if you have missed eligible ITCs, ITRs and other credits and adjustments as well as help you identify areas where risks and tax costs may be managed