Indirect
TAX FLASH

COLLINS BARROW

Share now

October 2017

The ins and outs of the simplified net tax calculation for charities

Daryl Hooley, MBA, CPA, CGA, *is a senior manager, indirect tax, in the Toronto office of Collins Barrow*
Serene Lee *is an associate, indirect tax, in the Toronto office of Collins Barrow*

Canada has more than 170,000 charitable and not-for-profit organizations, 85,000 of which are registered with the Canada Revenue Agency (CRA). For these registered charities, their supply of property and services is often exempt from GST/HST. Charities that also make taxable supplies of property and services are required to collect GST/HST on those supplies where they are GST/HST registrants (i.e. not small suppliers or small suppliers that have chosen to voluntarily register for GST/HST purposes).

Charities are required to pay GST/HST on their taxable inputs acquired to operate their organizations. However, unlike other registrants, charities are restricted in the input tax credits (ITCs) they may claim as they are required to use the simplified net tax calculation (SNTC) to determine their net tax. While the SNTC is generally mandatory, there are circumstances in which a charity may elect not to use this method. This Tax Alert focuses on the conditions for opting out and analyzes the benefits and drawbacks of doing so.

What is the SNTC?

Under the SNTC, registered charities are required to charge GST/HST on all of their taxable supplies. In addition, with certain exceptions, they are required to report 60 per cent of the GST/HST collectible on their taxable supplies, which means they can retain 40 per cent of the GST/HST they collect.

Further, with certain exceptions, charities are not permitted to claim ITCs on their taxable inputs under the SNTC. However, charities may claim the federal PSB rebate for charities (and in HST provinces, the applicable provincial PSB rebate for charities) of the GST/HST paid or payable on taxable purchases and expenses, to the extent that the charity cannot claim ITCs. The entitlement to such PSB rebates is not affected by the charity retaining 40 per cent GST/HST collected on taxable supplies.

Certain supplies and acquisitions are effectively excluded from the SNTC. Consequently, the registrant charity must report 100 per cent of the GST/HST on those excepted taxable supplies, and is eligible to claim ITCs on those excepted taxable acquisitions to the extent that they are acquired for the purpose of making taxable supplies.

The excepted supplies and acquisitions are:

- sales/acquisitions of real property or capital property;
- certain deemed supplies for warranty reimbursements, manufacturers rebates, and seizures or repossessions of personal property;
- certain appropriations by a registrant that is a corporation, partnership, trust, charity, public institution, or non-profit organization for the benefit of a shareholder, partner, beneficiary or member of the registrant or any individual related to such a person, except where the appropriation is a supply to that person for consideration equal to fair market value;
- certain employee or shareholder benefits; and
- certain supplies deemed to have been made by an agent or an auctioneer.

Generally, the most common of these excepted supplies and acquisitions would be sales and purchases of real property and capital property.

Opting out of the SNTC

A charity may file an election to opt out of the SNTC if it meets one of the following conditions:

- it makes supplies outside of Canada in the ordinary course of its business;

An independent member of BAKER TILLY INTERNATIONAL

Clarity Defined.
collinsbarrow.com

COLLINS BARROW

October 2017

The ins and outs of the simplified net tax calculation for charities

- it makes zero-rated supplies in the ordinary course of its business; or
- all or substantially all (generally 90 per cent or more) of the supplies it makes are taxable supplies.

Does it make sense to opt out?

Under the SNTC, the ability to retain 40 per cent of the GST/HST collected can be thought of as a proxy for the ITCs that charities are not permitted to claim. The federal government likely came up with the 40 per cent figure based on an overall approximation for the activities of charities across Canada. Consequently, there will be "winners" and "losers" under the SNTC.

Generally speaking, if the margin between taxable outputs and taxable inputs is less than 40 per cent (excluding the excepted supplies and acquisitions noted above), opting out of the SNTC would result in an overall decrease in net tax. In this case, charities keeping 40 per cent of the GST/HST collected under the SNTC will see less GST/HST recovery than if they opt out and claim ITCs under the normal rules.

Thus, charities that are eligible to file an election to opt out of the SNTC should compare their net tax calculated under the SNTC to their net tax calculated under the general method over a representative sample period (e.g. one fiscal year). If the general method yields a lower net tax, the SNTC is effectively resulting in unclaimed ITCs.

The opt-out process

When opting out, a charity determines its net tax under the ordinary rules that apply to most registrants for those reporting periods in which the election to opt out of the SNTC is in effect. In other words, the charity reports 100 per cent of the GST/HST charged on all of its taxable supplies and claims ITCs on all of its taxable inputs to the extent that those inputs are acquired for the purpose of making taxable supplies.

For annual filers, the election must be filed on or before the first day of the second fiscal quarter of the fiscal year for which the election will be in effect. For charities filing more frequently (i.e. on a quarterly or monthly basis), the election must be filed on or before the date the GST/HST return is required to be filed for the first reporting period in which the election is in effect.

The CRA has legislative discretion to allow the election to be filed late. However, there does not appear to be published administrative guidelines setting out the circumstances under which the CRA will allow a late-filed election. Absent such specific guidance, it is likely that the guidelines for other late-filed elections and applications will apply.

Contact your Collins Barrow advisor to determine if you are eligible to opt out of the SNTC and to discuss whether it is beneficial to do so.

Daryl Hooley, MBA, CPA, CGA, *is a senior manager, indirect tax, in the Toronto office of Collins Barrow.*

Serene Lee *is an associate, indirect tax, in the Toronto office of Collins Barrow.*

An independent member of BAKER TILLY INTERNATIONAL

Clarity Defined.
collinsbarrow.com

COLLINS BARROW

Collins Barrow periodically publishes *Indirect Tax Flash* for its clients and associates. It is designed to highlight and summarize the continually changing tax and business scene across Canada with respect to indirect tax issues. While *Indirect Tax Flash* may suggest general planning ideas, we recommend professional advice always be sought before taking specific planning steps.