The GST/HST has a significant impact on dental practices across Canada. What are some important implications of GST/HST and is there any way a practitioner can mitigate its effects or benefit from its application?

British Columbia (BC) is anticipating the transition from HST back to GST/PST as of April 1, 2013. What effect will this change have on practitioners in BC?

**GST/HST IN CANADA**

GST/HST is a value added tax. GST is a federal tax and is set at 5%. If a province harmonized their sales tax (turned their sales tax into a value added tax), it is added to the 5% GST to become HST. In BC, for example, the sales tax was tuned into a 7% value added tax in July 2010 and was added to the 5% federal GST to result in a 12% HST.

GST/HST applies to the sale of most tangible property and most services. There are few exceptions. The supply of dental services is one of these exceptions. Most dental services are categorized as an “exempt supply”, meaning no GST/HST is collected from the patient on the supply of the service. At first glance this seems like a good thing. Unfortunately the status of an “exempt service” also means the practitioner does not get to claim an input tax credit (refund) for GST/HST paid on its expenses. GST/HST on large expenses like rent or the acquisition of equipment can be significant. The inability of a practitioner to claim an input tax credit for GST/HST increases the cost of doing business.

Cosmetic services and sales of goods outside basic dental treatment are considered a “taxable supply”, meaning the practitioner must collect GST/HST from the patient if the practitioner is registered for GST/HST. The practitioner providing a taxable supply will be able to claim input tax credits to get a refund of the GST/HST paid with respect to the provision of those taxable supplies. (Registration is only required when sales of taxable supplies is greater than $30,000 in a year.)

The sale and rental of orthodontic appliances is a taxable supply but are zero-rated, meaning the practitioner does not collect GST/HST (the tax rate is 0%) but the practitioner can claim input tax credits on the portion of costs that relate to this particular practice area.

Dentistry is somewhat unique in that most practices can have a combination of exempt supplies and taxable supplies. (Zero rated supplies is less common.) Property planning and business structures can reduce the cost of operating a dental practice by minimizing GST/HST cost.

**THE MOST SIGNIFICANT IMPLICATIONS OF GST/HST TO THE DENTAL PRACTITIONER**

There are two aspects of a dental practice most impacted by GST/HST.

**REAL ESTATE AND LEASEHOLD IMPROVEMENTS ON A PRACTICE SALE OR ACQUISITION:** If one dental practice acquires all or substantially all of the assets of another dental practice there is generally no GST/HST on the sale of the business assets. Real estate and leasehold improvements are not part of this
exemption from GST/HST. Where one dental practitioner sells real estate or leasehold improvements to another dental practitioner, the seller is making a taxable supply and is required to collect and remit GST/HST from the purchaser on the sale. The seller may be able to claim a refund of GST/HST equal to the lesser of:

i. The GST/HST paid by the seller on the acquisition of the real estate and improvements to real property used in the business; or

ii. The GST/HST payable by on the sale of the real property or leasehold improvements.

The purchaser can get a full rebate for the GST/HST paid on the acquisition of the real property or leasehold improvements if it sets up a real estate company that is a GST/HST registrant with which to acquire just the real estate or leasehold improvements. That company can then rent the real estate or leasehold improvements to the practitioner. The rent must be at fair market value. The practitioner will have to pay GST/HST on the rent, likely resulting in a higher GST/HST cost in the long run. Analysis is needed to determine whether the GST/HST saved now is worth the higher GST/HST cost that may have to be paid in the future.

**Management Fees Paid to Related Parties:** Practitioners often set up management companies that own many of the business assets of the dental practice and may even hire some of the employees providing services to the dental practice. This management company then leases the equipment to the dental practice and charges a management fee for services of its employees. If the management fee and equipment lease exceeds $30,000 per annum the management company must register for GST/HST and the dental practice must pay GST/HST on the charges.

From the perspective of the management company, being a GST/HST registrant is beneficial in that it can claim input tax credits, getting back the GST/HST it pays. Unfortunately, such management companies typically pay very little GST/HST. Expenses such as salaries paid to employees, insurance and interest also have no GST/HST.

Too often the GST/HST paid by the dental practice on the lease and management fees is more than the GST/HST refund to the management company. For this reason careful analysis should be done before setting up a management company.

There are also possible income tax problems with the management company plan. If, for example, the Canada Revenue Agency (CRA) determines the management fees and equipment lease costs are higher than would be paid in a similar arrangement between arm’s length parties, the deduction to the dental practice could be reduced but the GST/HST on the fees may not be reduced. The adjustment by the CRA will likely be one-sided, meaning the management company will not have its revenue or income reduced. The result is lost tax deductions to the dental practice and higher income taxes while the income and income taxes in the management company remain the same – double tax.
If, on the other hand, the plan is to lower the lease and management fees paid by the dental practice in order to reduce the GST/HST paid by the dental practice to an amount less than the input tax credits being claimed by the management company, the CRA may unilaterally increases the revenue to the management company to fair market value and in so doing increase the GST/HST that should have been collected by the management company. At the same time the CRA could leave the expense low to the dental practice, resulting in no change to the deductible expenses of the dental practice but higher GST/HST to be paid by the dental practice as well as higher income and income taxes to the management company – double tax.

If the management company is employing the practitioner’s spouse and / or children, the CRA may challenge the reasonableness of the salary. The result is the income is still taxed in the hands of the spouse and / or children or maybe even in the hands of the practitioner and the management company will be denied the deduction for the salaries paid to the spouse and or children. The result is double tax or worse.

**TRANSITION TO GST AND PST IN BC**

In July 2010, BC abandoned its 7% BC Provincial Sales Tax (PST) and harmonized with the GST, resulting in 12% HST in which the 5% portion of the HST went to the Federal Government and the 7% portion of the tax went to the BC Government. In the summer of 2011 the BC electorate voted to dump the HST and to go back to 5% GST with 7% PST. This will happen April 1, 2013. What does this mean to the Dental practitioner?

To understand the impact of going back to GST and PST, it may be helpful to understand what GST and HST are and how they are different than PST. GST and HST are a form of value added tax - a tax on goods and services with few exceptions. (The most notable exceptions are goods and service provided by Canadian entities to non-residents, non-residents providing services outside of Canada to Canadian entities as well as medical and dental services.) GST or HST is paid at each step along the supply chain but GST or HST paid at the prior step is refunded at the next step (called an “input tax credit”) to prevent double tax or cascading of tax.

PST is a tax on tangible property (stuff) and generally not on services. Businesses are usually exempt from having to pay PST unless they are purchasing goods for resale.

**LOWER COSTS IN PRACTICE:** Because dental practitioners are primarily engaged in exempt activities, they generally do not collect GST or HST on their services or supplies and do not recover GST or HST paid. With HST the dental practitioner in BC pays 12%. With the return of GST and PST the dental practitioner will pay 12% (5% GST and 7% PST) which will not be refunded. The result is the costs will be about the same.
Because only GST (5%) and not PST (7%) applies to the supply of services the dental practitioner will generally see tax costs reduced by 7% on the following expenditures:

- Premise rents
- Equipment leases
- Purchases of real estate (property transfer tax will apply)
- Purchase of specific practice assets (i.e., patient lists) where the entire practice is not acquired
- Third party services for management, accounting and practice consultation

**NEGATIVE EFFECTS:** Where the practice is engaged in the sale of goods outside the scope of health care (not PST exempt), it must register for and collect PST. Unlike the $30,000 sales threshold for GST/HST, the PST has no threshold so even nominal sales of retail goods necessitate registration. Towards the end of the previous PST regime (prior to HST), BC Sales tax auditors had targeted the dental practices for incidental sales of taxable supplies such as cosmetic goods, toothbrushes and other merchandise. It is unlikely PST auditors will be engaged in such an initiative shortly after the introduction PST, but it is likely the BC Government will get around to it eventually.

You can register online, in person or by phone. The quickest way to register is online at www.etax.gov.bc.ca/btp/eservices/ /#1

**ARE YOU CONSIDERING A SIGNIFICANT EQUIPMENT PURCHASE BEFORE APRIL 1, 2013?** If a dental practice is considering a significant equipment purchase, a practice asset acquisition or the acquisition of land and building, consider using a real estate company or management company that is a HST registrant to make the purchase. The company can then lease the property to the dental practice, charging HST but obtain a refund of the 12% HST paid on the purchase (input tax credit). Come April 1, 2013, the 12% HST will be replaced by 5% GST, meaning the dental practice will pay 5% on the lease payments to the real estate or management company.

**CONTACT US**
Lachlan MacPherson has over 20 years experience offering tax, accounting, estate and succession advice to medical and dental practitioners. Initial consultations are free. “Let’s meet to discuss your needs and concerns.”

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