



GST Transitional Rules for Construction Contractors June 30, 2006

Effective July 1, 2006, the Goods and Services Tax ("GST") rate is reduced from 7% to 6%, and the Harmonized Sales Tax ("HST") rate is reduced from 15% to 14%.

The general transitional rule for the implementation of the GST reduction to 6% is based upon the time at which the GST in respect of a transaction becomes **payable**. Generally, GST is **payable** on the consideration for a supply on the earlier of the day payment is made and the day the supplier issues an invoice. The general transitional rules are as follows:

- If GST becomes **payable or is paid** before July 1, 2006, the rate of 7% will apply.
- If GST becomes **payable** after June 30, 2006, the rate of 6% will apply.

Often construction contracts extend over a period of time in accordance to a written contract. The contract usually stipulates that a customer will make progress payments as the work on the project proceeds. These payments are usually for work completed or in anticipation of work to be completed. The terms of when the progress payments are **payable** pursuant to the contract will determine when the GST liability arises.

When the contract stipulates that the payments are **payable** on specific dates for predetermined amounts, the GST is **payable** by the customer on the earlier of the day the payment becomes **payable** or the day the customer makes the payment. This rule holds true even if the customer does not make a payment or makes a payment for less than the full amount. As well, when a contract stipulates payments are **payable** when certain parts of a contract are complete, the GST becomes **payable** when the stated work has been completed.

When a contract states that payments are to be **payable** within a certain number of days after the work is certified by a third party (such as a consultant, engineer or architect), a construction contractor's request for payment is not considered to be an invoice, as it is merely a request that a certificate for payment be issued as stipulated in the contract. Consequently the GST becomes **payable** by the customer on the amount shown on the certification on the earlier of the day the customer makes the payment or the day the customer is required to pay the amount in accordance with the terms of the contract. For example, a contractor issues a monthly progress application on June 25, 2006 for work completed in the previous 30 days. The contract stipulates that the amount is not **payable** until 10 days after certification by the engineers. If the work is certified by the engineers on July 5, 2006, the amount becomes **payable** by the customer on July 15, 2006 in accordance to the contract (assuming the customer does not make the payment earlier). Consequently, since the amount becomes **payable** after June 30, 2006, the GST should be charged at the rate of 6%.

Holdbacks pursuant to a written contract do not generally become **payable** until the earlier of the day that the holdback is paid or the day the holdback period expires in accordance with federal or provincial laws, or under a written agreement. Consequently, if a construction contract is subject to a statutory holdback and the holdback period expires after June 30, 2006, the rate of GST that should be charged on the holdback is 6%, regardless of when the work was performed (assuming the customer does not make the payment earlier).

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If you would like to discuss these issues further, please contact your advisor at Goldfarb, Shulman, Patel & Co. LLP.