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BRIEF

THE IMPACT OF THE GOODS AND SERVICES TAX (GST) AND THE PROPOSED HARMONIZED SALES TAX (HST) ON CANADIAN PHYSICIANS

Brief Submitted to the House of Commons Standing Committee on Finance

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For further information: Public Affairs Directorate

CANADIAN MEDICAL ASSOCIATION

The Canadian Medical Association (CMA) is the national voice of Canadian physicians. Founded in 1867, CMA's mission is to provide leadership for physicians and to promote the highest standard of health and health care for Canadians.

On behalf of its members and the Canadian public, CMA performs a wide variety of functions, such as advocating health promotion and disease/accident prevention policies and strategies, advocating for access to quality health care, facilitating change within the medical profession, and providing leadership and guidance to physicians to help them influence, manage and adapt to changes in health care delivery.

The CMA is a voluntary professional organization representing the majority of Canada's physicians and comprising 12 provincial and territorial divisions and 38 affiliated medical organizations.



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I. INTRODUCTION

The Canadian Medical Association (CMA) commends the federal government for its clear and open process, and for encouraging a dialogue in areas of tax policy and economics. Canadians from all walks of life look to the government for strong and constructive leadership in this area. The CMA therefore appreciates the opportunity to present its views to the House of Commons Standing Committee on Finance as it considers Bill C-70 *"An Act to amend the Excise Tax Act, the Federal-Provincial Fiscal Arrangements Act, the Income Tax Act, the Debt Servicing and Reduction Account Act and related Acts."*

The CMA has appeared before the Committee on several occasions when it has considered matters pertaining to federal tax policy in Canada. In addition to our submissions, as part of the government's pre-budget consultation process, the CMA appeared before the Committee when it examined a number of tax policy alternatives to the Goods and Services Tax (GST) in 1994.¹

At that time, the CMA clearly articulated the medical profession's concerns about the need to implement a federal sales tax system that is simplified, fair and equitable for all. The CMA remains strongly committed to the principles that underpin an efficient and effective sales tax system. However, it is of the strong view that there is, on the one hand, a need to review the relationship between sales tax policy and health care policy in Canada, and between the sales tax policy and the physicians as providers of services, on the other.

Canada's health care system is a defining characteristic of what makes Canada special. It is no secret that funding for the health care system is under stress and all providers, including physicians, are being asked to shoulder their responsibility in controlling costs and responding to this fiscal challenge. However, physicians have had their costs of providing medical services increased by the federal government through the introduction of the GST.

Specifically, the introduction of the GST as it applies to physicians serves as a constant reminder that there still remain some tax policy anomalies - that, without amendment, their consequences will be significantly magnified with the introduction of a proposed harmonized sales tax (HST) on April 1, 1997, as was the case with the introduction of the Quebec Sales Tax (QST) on July 1, 1992.

The tax anomaly is a result of the current categorization of medical services as "tax exempt" under the *Excise Tax Act*. As a consequence, physicians are, on the one hand, in the unenviable position of being denied the ability to claim a GST tax refund (that is, denied the ability to claim input tax credits - ITCs), on the medical supplies (such as medical equipment, medical supplies, rent, utilities) necessary to deliver quality health care, and on the other, cannot pass the tax onto those who purchase such services (i.e., the provincial and territorial governments). Physicians, from coast to coast, are understandably angry that they have been singled out for unfair treatment under the GST, QST and the soon to be implemented HST.

II. BACKGROUND

¹ the Goods and Services Tax: Fairness for Physicians, Presentation to the House of Commons Standing Committee on Finance, Ottawa, Ontario, March 15, 1994. The Canadian Medical Association.

The GST was designed to be a "consumer-based tax" where the tax charged for purchases during the "production process" would be refunded - with the consumer, not producer of a good or a service, bearing the full burden of the tax. As a result, self-employed individuals and small businesses are eligible to claim a tax refund of the GST from the federal government on purchases that are required in most commercial activities. It is important to understand that those who can claim a tax refund under the GST in most commercial activities will still be able to do so with the proposed introduction of a harmonized sales tax in Atlantic Canada. The rate is proposed to be set at 15% (7% federal tax, 8% provincial tax).

In the case of medical services, the consumer (i.e., the one who purchases such services) is almost always the provincial and territorial governments. Since the provincial and territorial governments do not pay GST (due to their Constitutional exemption), one would have expected the cost of providing medical services to be free of GST. However, this is not the case. It is difficult to reconcile federal health care policies to preserve and protect publicly funded health care with tax policy which singles out and taxes the costs of medical services.

Regrettably, physicians find themselves in an untenable situation of "double jeopardy". This is patently unfair and on the basis of the fundamental principles of administering a fair and equitable tax system should be amended accordingly.

In an effort to document the impact of the federal government's decision to designate medical services as tax exempt, an independent study by the accounting firm KPMG estimated that physicians' costs increased by \$60 million of GST per year.² Since 1991, this total is now in excess of \$360 million.

The recent agreement between the federal government and Atlantic provinces (except Prince Edward Island) to harmonize their sales taxes will make matters significantly worse for physicians as the HST broadens the provincial tax base to essentially that of the GST in those provinces. With no ability to claim a tax refund on the GST they currently pay (and the proposed HST effective April 1, 1997), physicians once again will have to absorb the additional costs associated with the practice of medicine.

In assessing the impact of the proposed HST, KPMG has estimated that physicians in New Brunswick, Nova Scotia, and Newfoundland will be out-of-pocket an additional \$4.7 million each year because they are not eligible for a tax refund for their purchases.³

The medical profession, is not looking for special treatment. What we are asking for is to be treated no differently than other self-employed Canadians and small businesses who have the

² Review of the Impact of the Goods and Services Tax on Canadian Physicians, KPMG, June, 1992.

³ Review of the Impact of a Provincial Value Added Tax on Physicians in New Brunswick, Nova Scotia, and Newfoundland and Labrador, KPMG, August, 1996.

opportunity to claim ITCs, and to be placed on the same footing with other health care providers who have the ability to recoup GST costs.

Physicians, as self-employed individuals are considered small businesses for tax purposes, therefore, it seems entirely reasonable that they should have the same tax rules that apply to other small businesses. This is a question of fundamental fairness.

III. POLICY CONTEXT

Prior to the introduction of the GST, the federal sales tax (FST) was included in the price of most goods (not services) that were produced in, or imported to, Canada. Therefore, when goods were purchased by consumers, the FST was built into the price. At that time, physicians, and other self-employed Canadians and small businesses, were essentially on a level sales tax playing field. Since 1991, however, the introduction of the GST has tilted the table against physicians.

Unless this situation is rectified, with the introduction of the HST, physicians in Atlantic Canada will join those in Quebec who experience additional costs due to the GST and their provincial sales tax using the same rules.

(i). The Impact of the GST on Good Tax Policy and Good Health Care Policy

When it reviews Bill C-70, the Standing Committee on Finance should look for opportunities where tax policy and health care policy go hand-in-hand. The principle of aligning good health policy with sound tax policy is critical to managing change while serving to lay down a strong foundation for future growth and prosperity. Unfortunately, the current GST policy introduces a series of distortions that have tax policy and health policy working against one another. Tax policies that do not reinforce health policy are bad tax policies. Consider, for example:

1. Under the current system, hospitals (under the "MUSH" formula - Municipalities, Universities, Schools and Hospitals) have been afforded an 83% rebate on GST paid for purchases made while physicians must absorb the full GST cost on their supplies. At a time when health policy initiatives across Canada are attempting to expand community-based practices, the current GST policy (and now harmonized sales tax policy) which taxes supplies in a private clinic setting while rebating much of the tax in a hospital setting acts to discourage the shift in emphasis;
2. Prescription drugs are zero-rated. The objective was to ensure that pharmaceutical firms are no worse off than under the previous federal sales tax regime. Recognizing that medical services can play an equally important role as drugs, it appears inconsistent that the government would choose to have drugs as tax free, and medical services absorbing GST;
3. In the current fiscal climate, the current GST policy, and now the proposed harmonized sales tax in Atlantic Canada, is threatening to harm the important role when it comes to

recruitment and retention of physicians across Canada, and in particular, the Atlantic provinces - where they are already experiencing difficulty; and,

4. It is estimated that the 55,000 physicians employ up to 100,000 Canadians. Physicians play an important role in job creation. The disproportionate effects of the GST policy could have an adverse effect on the number of individuals employed by physicians.

With these issues at hand, it is apparent that good tax policy and good health policy are themselves not synchronized and are working at cross purposes. At this point, when the Standing Committee is reviewing Bill C-70, it is the time to address this situation based on the fundamental principle of fairness in the tax system, while ensuring that good tax policy reinforces good health care policy.

(ii). Not All Health Care Services Are Created Equal under the GST/HST

Physicians are not the only group of health care providers whose services are placed under the category of "tax exempt", with the result that they incur increased GST costs. For example, the services of dentists, nurses, physiotherapists, psychologists and chiropractors are categorized as "tax exempt".

However, there is an important distinction between whether the services are government funded or not. Health care providers who deliver services privately and which are not publicly funded do have the opportunity to pass along the GST in their costs through their fee structures.

For these services that are government funded there are no opportunities for physicians to recover the tax paid for purchases unless a specific rebate has been provided (e.g., hospitals). To date, in negotiations with the medical profession, no provincial/territorial government has agreed to provide funding to reflect the additional costs associated with the introduction of the GST. Their position has been that this is a "federal" matter. This becomes important when one considers that under the Canadian Constitution one level of government cannot tax another, and the provincial governments are not prepared to absorb the cost of the GST.

It is critical to point out that since doctors receive 99% of their professional earnings from the government health insurance plans,⁴ they have absolutely no other option when it comes to recovering the GST - they must absorb it!

In summary, while a number of health care services are categorized as tax exempt, it must be emphasized that some providers "are more equal than others" under the GST - contrary to other health care providers, physicians do not have the ability to claim ITCs. This distinction becomes readily apparent when one considers the sources of (private and/or public) funding for such services.

IV. THE SEARCH FOR A SOLUTION

Like many others in Canadian society, physicians work hard to provide quality health care to

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National Health Expenditures, 1975-1994, Health Canada, January 1996.

their patients within what is almost exclusively a publicly-financed system for medical services. Physicians are no different from Canadians in that they, too, are consumers (and purchasers).

As consumers, physicians pay their fair share of taxes to support the wide range of valued government services. By the same token, as providers of health care, physicians have not accepted, nor should they accept, a perpetuation of the fundamental injustices built into the current GST, QST and proposed HST arrangements.

To date, the CMA has made representations to two Ministers of Finance and their Department Officials. We have discussed several ways to address a situation that is not sustainable, with no resolution to date. We look to this Committee and the federal government for a fair solution to this unresolved issue.

V. RECOMMENDATION

This unfair and discriminatory situation can be resolved. There is a solution that can serve to reinforce good economic policy with good health care policy in Canada. An amendment to the *Excise Tax Act*, the legislation which governs the GST (and proposed HST) can make an unfair situation fair to all Canadian physicians.

In its recent submission to the Standing Committee as part of the 1997 pre-budget consultation process, the CMA recommended "*that medical services be zero-rated, in order to achieve a fair and equitable GST policy for physicians.*" In order to achieve this objective all health care services, including medical services, funded by the provinces could be zero-rated.

This recommendation serves to place physicians on a level playing field with other self-employed Canadians and small businesses. In addition, from a health care perspective, this would treat medical services in the same manner as that of prescription drugs. This is a reasonable proposition, as in many instances, medical treatments and drug regimens go hand-in-hand.

Furthermore, this recommendation would ensure that medical services under the GST and proposed HST would be no worse off than other goods or services that provincial governments' purchase and where suppliers can claim a tax refund (i.e., ITCs).

While the recommendation is an important statement in principle of what is required to address the current inequities under the GST, and soon to be HST, the CMA offers a more specific recommendation to the Standing Committee as to how the principles can be operationalized within the context of Bill C-70 and the *Excise Tax Act*.

The CMA respectfully recommends the following:

1. "THAT HEALTH CARE SERVICES FUNDED BY THE PROVINCES BE ZERO-

RATED."

CMA has been advised that this would be accomplished by amending Bill C-70 as follows:

- (1). *Section 5 of Part II of Schedule V to the Excise Tax Act is replaced by the following:*
 5. *"A supply (other than a zero-rated supply) made by a medical practitioner of a consultative, diagnostic, treatment or other health care service rendered to an individual (other than a surgical or dental service that is performed for cosmetic purposes and not for medical or reconstructive purposes)."*
- (2). *Section 9 of Part II of Schedule V to the Excise Tax Act is repealed.*
- (3). *Part II of Schedule VI to the Excise Tax Act is amended by adding the following after section 40:*
 41. *A supply of any property or service but only if, and to the extent that, the consideration for the supply is payable or reimbursed by the government under a plan established under an Act of the legislature of the province to provide for health care services for all insured persons of the province.*

VI. SUMMARY

By adopting the recommendation above, the federal government would fulfil, at least two overarching policy objectives, they are:

1. Strengthening the relationship between good economic policy and good health policy in Canada; and,
2. Applying the fundamental principles that underpin our taxation system (fairness, efficiency, effectiveness), in all cases.