

Consumer Taxes

TVQ. 1-8 **Supply of property or services at direct cost**
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Reference(s): *An Act respecting the Québec sales tax* (R.S.Q., c. T-0.1), sections 1, 138.6 and 148

This bulletin explains how the *Act respecting the Québec sales tax* (hereinafter referred to as the “Act”) applies with regard to the supply, made at direct cost, of corporeal movable property or of services. This bulletin takes into account the amendments to the Act contained in bill 34. Introduced on June 19, 2001, bill 34 modifies the definition of “direct cost” and amends sections 138.6 and 148 of the Act.

RELEVANT PROVISIONS OF THE ACT

1. According to section 1 of the Act, “charity” means a registered charity within the meaning of section 1 of the *Taxation Act* (R.S.Q., c. I-3) or a registered Canadian amateur athletic association within the meaning of that Act, but does not include a public institution.
2. Under section 1 of the Act, a “public institution” is a registered charity, within the meaning of section 1 of the *Taxation Act*, that is a school authority, a public college, a university, a hospital authority or a local authority determined to be a municipality under paragraph 2 of the definition of “municipality” in section 1 of the Act.
3. According to section 1 of the Act, a “public service body” means a non-profit organization, a charity, a municipality, a school authority, a hospital authority, a public college or a university. However, section 139 of the Act stipulates that a “public service body” does not include a charity for the purposes of Division VI of Chapter III of the Act.
4. Under section 16 of the Act, every recipient of a taxable supply made in Québec shall pay to the Minister of Revenue the Québec sales tax (QST) on the value of the consideration for the supply, except where the supplier is a small supplier.
5. According to section 52 of the Act, the consideration for a supply includes any duty, fee or tax imposed on the recipient or the supplier by the federal government, a Canadian province or territory, except the QST and the duties, fees or taxes prescribed in section 52R1 of the *Regulation respecting the Québec sales tax* (O.C. 1607-92, as amended). Generally speaking, the consideration for a supply includes the tax paid or payable under Part IX of the *Excise Tax Act* (R.S.C. 1985, c. E-15), that is, the goods and services tax (GST) but not the QST.

6. Under section 1 of the Act, the direct cost of a supply of corporeal movable property or a service means the total of all amounts each of which is the consideration paid or payable by the supplier

- (1) for the property or service, if it was purchased by the supplier for the purpose of making a supply by way of sale of the property or service; or
- (2) for an article or material, other than capital property of the supplier, that was purchased by the supplier, to the extent that the article or material is to be incorporated into or is to form a constituent or component part of the property, or is to be consumed or expended directly in the process of manufacturing, producing, processing or packaging the property.

For the purposes of this definition, the following rules apply:

- (1) The consideration paid or payable by the supplier for property or a service is deemed to include the QST payable by the supplier in respect of the acquisition or bringing into Québec of the property or service, excluding the portion of this tax that is (or can be) recovered by the supplier, except the tax that was payable by the supplier who was a registrant at the time the supply was made.
- (2) The consideration is established without taking into account the portion of the duties, fees or taxes referred to in section 52, except the GST that is (or can be) recovered by the supplier.

7. The “direct cost,” as defined in section 1 of the Act, can be summarized as follows:

Direct cost = purchase price + GST + QST - PQSTR⁽¹⁾

(1) The partial QST rebate (PQSTR) applies only where an organization that is not registered for the QST is entitled to a PQSTR.

8. Sections 138.6 and 148 of the Act set out the conditions under which a charity or a public service body can make an exempt supply of corporeal movable property or of a service based on the direct cost.

9. According to sections 138.6 and 148 of the Act, the supply by way of sale made by a charity or by a public service body to a recipient of corporeal movable property, other than capital property of the organization, or of a service purchased by the organization for the purpose of making a supply by way of sale of the service is exempt, where the total charge for the supply is equal to the usual charge by the organization for such supplies to such recipients and

- (1) if the organization does not charge the recipient any amount as tax in respect of the supply, the total charge for the supply does not, and could not reasonably be expected to, exceed the direct cost of the supply; and
- (2) if the organization charges the recipient an amount as tax in respect of the supply, the consideration for the supply determined without taking into account the GST, does not, and could not reasonably be expected to, equal or exceed the direct cost of the supply determined without taking into account the GST and without taking into account the QST that became payable when the organization was a registrant.

APPLICATION OF THE ACT

10. Under the provisions of the Act that pertain to direct cost, charities and public service bodies can make exempt supplies of property and services, as long as a certain number of conditions are met, particularly where such supply is made at or under direct cost.

General provisions

Supplies

11. Under section 1 of the Act, direct cost applies to supplies of services or corporeal movable property purchased in order to be supplied by way of sale.

11.1 The direct cost does not apply to the supply by way of lease, licence or similar arrangement. Similarly, it does not apply to the supply by way of sale of capital property or of incorporeal movable property.

11.2 With regard to the supply of a service, the direct cost applies only if the service is purchased by the organization in order to be supplied by way of sale. Therefore, the service acquired by the organization and the service that it subsequently supplies by way of sale must be identical. In other words, the service must be supplied in the same form as the form in which it was acquired.

For example, an organization that acquires several services in order to supply by way of sale a new service made up of all these different services does not qualify for the exemption with regard to direct cost. In this case, the services that are brought together constitute a new service and are not provided in their original form.

Price charged to the recipient

12. The direct cost applies if the total price charged for the supply corresponds to the usual charge by the organization for such supply to such recipient. For example, the “usual charge” in consideration for corporeal movable property or for a service may take the form of a rate that varies according to the quantity or the volume provided. The “usual charge” may also vary according to the type of recipient to whom the corporeal movable property or service is provided.

13. If the organization wants to apply the direct cost exemption, the total price charged for the supply must not exceed the reasonable direct cost of the corporeal movable property or of the service. The organization must be able to calculate the direct cost of the corporeal movable property or of the service and bill the recipient accordingly.

Factors to consider in establishing the direct cost

14. For the application of the definition of “direct cost” provided in section 1 of the Act, the direct cost will vary depending on whether or not the organization is registered for the QST and whether or not the organization is entitled to a PQSTR.

15. Regardless of whether the organization is registered, the partial GST rebate amount is not subtracted in calculating the direct cost of corporeal movable property or of a service. However, where the organization is not registered for the QST, only the PQSTR should be subtracted when calculating the direct cost.

16. Under section 1 of the Act, within the definition of “direct cost”, “the total of all amounts” means the total consideration paid or payable for the property or for the service, whether paid in a single amount or in several instalments.

17. In the case of corporeal movable property that was manufactured or produced by the organization, the direct cost of the corporeal movable property corresponds to the total consideration paid or payable by the organization for the articles and material that are to be incorporated into or are to form a constituent or component part of the property, or are to be consumed or expended directly in the process of manufacturing, producing, processing or packaging the property.

18. For both corporeal movable property and a service, the direct cost does not include the following: salaries paid to the employees of the organization; general and administrative expenses incurred by the organization to supply the corporeal movable property or the service; the cost of articles and material expended by the organization in order to supply the service; the cost of a service acquired by the organization in order to manufacture or produce the corporeal movable property.

Exemption on the basis of the direct cost

Organization registered for the QST

A) The registered organization does not charge QST to the recipient under the 1st paragraph of section 138.6 or of section 148 of the Act.

- **Determination of direct cost**

Direct cost = purchase price + GST + QST

- **Condition for the supply to be exempt**

19. If the total charge for the supply is less than or equal to the direct cost, the supply is exempt under the 1st paragraph of section 138.6 or of section 148 of the Act.

If the total charge ≤ the direct cost ⇒ Exemption

Example 1: Corporeal movable property acquired for supply by way of sale by a public institution registered for the QST

A public educational institution that is registered for the QST purchases calculators for supply by way of sale to its students. The institution pays \$100 for each calculator, plus taxes, and expects to pay administration costs of \$2.50 per calculator. The institution decides to make an exempt supply to students who purchase the calculators.

For the institution, the cost price of a calculator is as follows:

- purchase price:	\$100.00 + \$7.00 (GST) + \$8.03 (QST) =	\$115.03
- administration costs:	\$2.50	\$2.50
TOTAL :	\$102.50 + \$7.00 (GST) + \$8.03 (QST) =	\$117.53

Under section 1 of the Act, the direct cost of the calculator is equal to the purchase price of the calculator, plus taxes:

$$\$100.00 + \$7.00 \text{ (GST)} + \$8.03 \text{ (QST)} = \$115.03$$

The administration costs of the institution are not part of the direct cost of the calculator.

The public institution sets the price of each calculator at \$115.03. The supply of the calculator is exempt if the total price charged to the recipient is equal to or less than its direct cost.

- The direct cost of the calculator is,	\$115.03
- The total price charged to the student is,	\$115.03

Since the total price of the supply for the student is equal to the direct cost of the calculator, the supply is exempt under the 1st paragraph of section 148 of the Act. The supply would also be exempt if the total price charged by the public institution was under \$115.03.

Example 2: Corporeal movable property manufactured for supply by way of sale by a non-profit organization registered for the QST

A non-profit organization that is registered for the QST manufactures tables with the intent to sell them. The organization decides to make exempt supplies to recipients.

The cost of manufacturing a table is the total of the following amounts:

- the services of a carpenter:	
\$25.00 + \$1.75 (GST) + \$2.01 (QST) =	\$28.76
- the value of the services of a volunteer carpenter,	\$2.00
- the following materials:	
- lumber, nails, glue and varnish:	
\$80.00 + \$5.60 (GST) + \$6.42 (QST) =	\$92.02
- packing material:	
\$5.00 + \$0.35 (GST) + \$0.40 (QST) =	\$5.75
- other manufacturing costs:	
- electricity, premises, machinery, etc.:	
\$2.50 + \$0.18 (GST) + \$0.20 (QST) =	\$2.88
- salary paid to the employees of the non-profit organization:	\$3.00
Total manufacturing cost:	\$134.41

Under section 1 of the Act, the direct cost of the table is equal to the purchase price of the material, plus taxes:

- lumber, nails, glue and varnish:	
$\$80.00 + \$5.60 \text{ (GST)} + \$6.42 \text{ (QST)} =$	\$92.02
- packing material:	
$\$5.00 + \$0.35 \text{ (GST)} + \$0.40 \text{ (QST)} =$	\$5.75
$\$85.00 + \$5.95 \text{ (GST)} + \$6.82 \text{ (QST)} =$	\$97.77

The services of a carpenter, the value of the services of a volunteer carpenter and the other manufacturing costs are not part of the direct cost of the table.

The non-profit organization decides to charge \$95.00 for each table. The supply of the table is exempt if the total price charged to the recipient is less than or equal to the direct cost of the table.

- The direct cost of the table is	\$97.77
- The total price charged to the recipient is	\$95.00

Since the total price of the supply charged to the recipient is less than the direct cost of the table, the supply is exempt under the 1st paragraph of section 148 of the Act.

B) The registered organization charges QST to the recipient under the 2nd paragraph of section 138.6 or of section 148 of the Act.

• Condition of the direct cost

Direct cost = purchase price + GST + QST

• Condition for the supply to be exempt

20. The supply of corporeal movable property or of a service is exempt under the 2nd paragraph of section 138.6 or of section 148 of the Act when the consideration for the supply, without taxes, is less than the direct cost before GST and QST.

If the consideration < direct cost - GST - QST ⇒ exemption

21. Where the organization charged the tax to a recipient on a supply that is exempt under the 2nd paragraph of section 138.6 or of section 148 of the Act, the QST so charged is considered to have been erroneously collected.

22. Section 447 of the Act provides that the organization can refund, directly to the recipient, an amount of QST overpaid by the recipient on the acquisition of corporeal movable property or a service. The organization has two years from the day the amount was charged or collected in which to refund the amount.

23. Where the organization does not refund the QST billed in error, the recipient may, under section 400 of the Act, apply to the Minister for a rebate of the QST paid in error. This section of the Act authorizes the Minister to refund any amount of tax overpaid, regardless of whether the overpayment was due to an error. Under section 401 of the Act, the recipient has two years

following the day on which the amount was paid in which to file such an application with the Minister.

Example 3: Corporeal movable property acquired for supply by way of sale by a public institution registered for the QST

A public educational institution that is registered for the QST purchases calculators for supply by way of sale to its students. The institution pays \$100 for each calculator, plus taxes, and expects to pay administration costs of \$2.50 per calculator. The institution decides to make taxable supplies to students who purchase the calculators.

For the institution, the cost price of a calculator is as follows:

- purchase price:

$$\$100.00 + \$7.00 \text{ (GST)} + \$8.03 \text{ (QST)} = \$115.03$$

- administration costs

$$\$2.50 = \$2.50$$

$$\text{TOTAL} \quad \$102.50 + \$7.00 \text{ (GST)} + \$8.03 \text{ (QST)} = \$117.53$$

The direct cost of the calculator is:

$$\$100.00 + \$7.00 \text{ (GST)} + \$8.03 \text{ (QST)} = \$115.03$$

The administration costs of the institution are not part of the direct cost.

The public institution decides to charge \$95.00 for each calculator, plus taxes. The supply of the calculator is exempt if the consideration for the supply is less than the direct cost (before taxes) of the calculator.

- The direct cost of the calculator is \$115.03

$$\$100.00 + \$7.00 \text{ (GST)} + \$8.03 \text{ (QST)} =$$

- The total price charged to a student is

$$\$95.00 + \$6.65 \text{ (GST)} + \$7.62 \text{ (QST)} = \$109.27$$

Since the consideration for the calculator without taxes (\$95.00) is less than the direct cost before GST and QST (\$100), the supply is exempt under the 2nd paragraph of section 148 of the Act. Since the QST was added to the invoice, it is considered to have been in error. Under section 447 of the Act, the public institution can either adjust the amount of QST overcharged (if it has not yet been collected) at the time the calculator is acquired, or refund the amount of QST that the recipient of the calculator overpaid.

Example 4: Corporeal movable property manufactured for supply by way of sale by a non-profit organization registered for the QST

A non-profit organization that is registered for the QST manufactures tables with the intent to sell them. The organization decides to make taxable supplies to recipients.

The cost of manufacturing a table is the total of the following amounts:

- the services of a carpenter:	
$\$25.00 + \$1.75 \text{ (GST)} + \$2.01 \text{ (QST)} =$	\$28.76
- the value of the services of a volunteer carpenter	\$2.00
- the following materials:	
- lumber, nails, glue and varnish:	
$\$80.00 + \$5.60 \text{ (GST)} + \$6.42 \text{ (QST)} =$	\$92.02
- packing material:	
$\$5.00 + \$0.35 \text{ (GST)} + \$0.40 \text{ (QST)} =$	\$5.75
- other manufacturing costs:	
- electricity, premises, machinery, etc.:	
$\$2.50 + \$0.18 \text{ (GST)} + \$0.20 \text{ (QST)} =$	\$2.88
- salary paid to the employees of the non-profit organization:	\$3.00
Total manufacturing cost:	\$134.41

Under section 1 of the Act, the direct cost of the table is equal to the purchase price of the material, plus taxes:

- lumber, nails, glue and varnish:	
$\$80.00 + \$5.60 \text{ (GST)} + \$6.42 \text{ (QST)} =$	\$92.02
- packing material:	
$\$5.00 + \$0.35 \text{ (GST)} + \$0.40 \text{ (QST)} =$	\$5.75
$\$85.00 + \$5.95 \text{ (GST)} + \$6.82 \text{ (QST)} =$	\$97.77

The services of a carpenter, the value of the services of a volunteer carpenter and the other manufacturing costs are not part of the direct cost of the table.

The organization decides to charge \$85.00 for each table, plus taxes. The supply of the table is exempt if the consideration charged is less than the direct cost of the table, before taxes.

- The direct cost of the table is	
$\$85.00 + \$5.95 \text{ (GST)} + \$6.82 \text{ (QST)} =$	\$97.77
- The total price charged to the recipient is	
$\$85.00 + \$5.95 \text{ (GST)} + \$6.82 \text{ (QST)} =$	\$97.77

Since the consideration for the table (\$85.00) is equal to direct cost of the table before GST and QST (\$85.00), the supply does not qualify for the exemption under the 2nd paragraph of section 148 of the Act. Therefore, it is taxable under section 16 of the Act. It would also be taxable if the non-profit organization were to charge consideration of more than \$85.00.

ORGANIZATION NOT REGISTERED WITH THE QST

A) Under the 1st paragraph of section 138.6 or of section 148 of the Act, an organization that is not a registrant does not charge the QST.

• Determination of the direct cost

Direct cost = purchase price + GST + QST - PQSTR⁽¹⁾

(1) The partial QST rebate (PQSTR) applies only where an organization that is not registered for the QST is entitled to a PQSTR.

24. According to the Act, the organization is not required to subtract the partial GST rebate to which it is entitled.

• Condition for the supply to be exempt

25. If the total price charged for the supply is less than or equal to the direct cost, the supply is exempt under the 1st paragraph of section 138.6 or of section 148 of the Act.

If the total charge \leq the direct cost \Rightarrow Exemption

26. However, if the organization charges to the recipient a price that is higher than the direct cost, the supply becomes taxable. Although the non-registrant organization is not required to collect the QST, it must take into account the price of the supply in calculating the threshold for small suppliers.

B) The organization, not registered for the QST, charges an amount of QST under the 2nd paragraph of section 138.6 or of section 148 of the Act.

• Determination of the direct cost

Direct cost = purchase price + GST + QST - PQSTR⁽¹⁾

(1) The partial QST rebate (PQSTR) applies only where an organization that is not registered for the QST is entitled to a PQSTR.

• Condition for the supply to be exempt

27. The supply of corporeal movable property or of a service is exempt under the 2nd paragraph of sections 138.6 and 148 of the Act when the consideration for the supply, without taxes, is less than the direct cost before GST.

If the consideration $<$ direct cost - GST \Rightarrow Exemption

28. However, if the non-registrant organization charges to the recipient a price that is higher than the direct cost, the supply becomes taxable. In this case, the organization must take into account the price of the supply in calculating the threshold for small suppliers.

29. Where a non-registrant organization bills QST to the recipient, the amount of QST charged is considered to have been collected erroneously. Section 447 of the Act provides that the non-registrant organization can refund, directly to the recipient, an amount of QST overpaid by the recipient on the acquisition of corporeal movable property or a service. The organization has two years from the day the amount was charged or collected in which to refund the amount.

30. Where the non-registrant organization does not refund the QST billed in error, the recipient may, under section 400 of the Act, apply to the Minister for a rebate of the QST paid in error. This section of the Act authorizes the Minister to refund any amount of tax overpaid, regardless of whether the overpayment was due to an error. Under section 401 of the Act, the recipient has two years following the day on which the amount was paid or collected in which to file such an application with the Minister.