



# THE SCHOOL OF PUBLIC POLICY

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## MASTER OF PUBLIC POLICY CAPSTONE PROJECT

Evaluating Canada's Tax Policy on the Second-Hand Marketplace

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## Capstone Executive Summary

The growth of the second-hand marketplace over the last decade has shaped the way individuals buy and sell personal-use property in Canada. With the establishment of internet services such as Kijiji, individuals are able to advertise their used, second-hand personal-use property to a mass audience and sell to a specific buyer quickly and easily. These non-commercial transactions are commonplace in Canada and therefore each jurisdiction administering a sales tax maintains some form of guidance for these transactions as well as when and how sales tax is collected.

Governments in Canada implement and maintain tax policies for transactions in the second-hand economy despite limited discussion in the academic literature. Therefore, it is worthwhile to investigate what guidance the academic literature provides, and compare these understandings to what is currently practiced in Canada's sales tax jurisdictions. Through this comparison of the literature with a jurisdictional scan of policies throughout Canada, this paper will investigate how adequately aligned Canadian sales taxes are with the recommendations provided in the literature.

The results of this investigation conclude that current tax policies in each jurisdiction administering a sales tax are supported by the literature. Academic findings describe the risks of multiple taxation and cascading tax that can occur if appropriate measures are not taken. In

response to these risks, the following two conditions are imposed by all sales tax jurisdictions throughout Canada:

- Non-commercial, casual transactions between individuals are exempt from sales tax if below a certain threshold
- When a non-registered individual sells a used item to a registered used-goods dealer, the entity accepting the trade-in is to collect tax on the net amount of the subsequent sale

Due to Canada's varied landscape of sales tax authorities, each jurisdiction approaches these conditions with a varying degree of specificity. For this reason, the policy implications of the research can help encourage knowledge sharing of taxation practices across different authorities in Canada. The GST /HST system provides the most comprehensive set of explanation and guidelines for individuals to follow when transacting in the second-hand economy. Of the provinces that maintain independent sales taxes, Quebec puts forth the most similarly detailed policies as the GST /HST system. The provinces of BC, Saskatchewan and Manitoba lack the educational detail provided by the GST /HST and QST, but these jurisdictions impose slightly more aggressive thresholds on restricting casual sales than all other jurisdictions in Canada. Despite these slight variations, all jurisdictions achieve the same end result for taxing transactions in the second-hand economy.

Regardless of these minor differences in jurisdictional approach, the research herein answers the question, do approaches in Canada align with the academic understanding and theoretical findings in the relevant tax literature? The research confirms that Canadian approaches across all sales tax jurisdictions are in alignment with the respective literature. The research also provides the opportunity to promote more academic study and policy discussion regarding the taxation of the second-hand economy.

## 1.0 Introduction

The second-hand marketplace, otherwise referred to as the second-hand economy, encompasses the transactions of acquiring and disposing of used items by both individuals and businesses. These transactions can be conducted through monetary means such as buying, selling and renting, as well as non-monetary means such as donating, lending and swapping.<sup>1</sup> Second-hand transactions have a robust history as individuals and businesses have relied on consignment stores, community centres, garage sales, thrift stores, and public auctions, among others, to facilitate the acquisition and disposition of used items.<sup>2</sup> In recent years however, transactions between individuals buying and selling used personal-use property have realized a considerable increase in traffic due to the emergence of internet-based platforms (e.g. Kijiji, Craigslist).

Kijiji released their inaugural report titled *The Kijiji Second-Hand Economy Index* in 2015 alongside a team of academics.<sup>3</sup> This report was derived from a sample of 2,003 respondents representative of the Canadian public and provided a novel investigation into the informal habits of individuals buying, selling, and trading used personal-use property.<sup>4</sup> The intention of this inaugural report was meant to shed light on “[the] acquiring and disposing of second-hand items [which] remain an informal, grass roots type of activity”.<sup>5</sup> March of 2016 marked the second iteration of this report. Over the 12-month period between the two reports, Canadians

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<sup>1</sup> “The Kijiji Second-Hand Economy Index,” last modified March 1, 2016,

<http://secondhandeconomy.kijiji.ca/wp-content/uploads/2016/02/Kijiji-Index-Report-2016.pdf>

<sup>2</sup> Jennifer Robinson, “The Kijiji economy and what it says about Canadian households,” *Maclean’s*, March 1, 2016,

<sup>3</sup> Ibid.

<sup>4</sup> Ibid.

<sup>5</sup> “The Kijiji Second-Hand Economy Index”, last modified February 25, 2015

on average realized an increase of 24.9 million more used-products being exchanged in 2015 when compared to the previous year.<sup>6</sup> In absolute terms, the estimated transaction of second-hand items within Canada totaled 1.85 billion objects exchanged in 2015.<sup>7</sup>

In addition to the notable year-over-year growth in transactions, the 2016 Kijiji Index Report highlights the pervasiveness of the second-hand economy in the Canadian context. Each Canadian spent on average \$960 on used products and earned an average of \$883 through the sale of used products in 2015.<sup>8</sup> Nearly 70 percent of Canadians participated in the second-hand economy by buying or selling used personal-use property in the last year.<sup>9</sup> When this figure is compared to other measures of Canada's national economy, such as the participation rate in the labour market of 66 percent, the second-hand economy becomes a significant economic topic.<sup>10,11</sup>

The Kijiji Index Report addresses the scale and continuing growth of the second-hand market in Canada. However, despite the size and pervasiveness of this marketplace, the issue of taxing the second-hand economy is not comprehensively addressed in academic literature. As a result of this minimal academic coverage amidst a new and emerging marketplace for second-hand transactions, governments run the risk of imposing policies which may not align with the theoretical understandings of best practice taxation for non-commercial and commercial

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<sup>6</sup> "The Kijiji Second-Hand Economy Index", last modified February 25, 2015

<sup>7</sup> Hollie Shaw, "Canada's second-hand economy worth \$28 billion; report," *Financial Post*, March 1, 2016, <http://business.financialpost.com/news/retail-marketing/canadas-second-hand-economy-worth-28-billion-report>

<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

<sup>10</sup> Statistics Canada, *Labour Force Characteristics* (Ottawa: Minister of Industry, 2016) CANSIMTABLE 282-0002, last modified 2016-01-08 (Shaw 2016) (Statistics Canada 2016)

<sup>11</sup> Gregory Mankiw, Ronald Kneebone & Kenneth McKenzie, *Principles of Macroeconomics* (Toronto: Nelson Education, 2014), 104

transactions in the second-hand economy. As more individuals engage in second-hand transactions it is necessary to assess whether the activity within Canada's second-hand marketplace aligns with the tax theory that is available to guide these transactions.

The research herein intends to describe the literature and theory of taxing second-hand transactions and secure an understanding of the degree of applicable tax and under what conditions second-hand transactions are to receive taxation. In addition, a jurisdictional scan intends to describe current practices in Canada regarding the taxation of this marketplace and which governing body collects the respective tax after certain activity thresholds are surpassed.

Public information does exist to inform individuals engaging in transactions of second-hand items, but this information is not common knowledge at present. Therefore, it is worthwhile to investigate the discrepancy between the popularity of the second-hand economy and the minimal coverage of how transactions in the market are taxed. In order to address this discrepancy, the research will begin the investigation by presenting a primer on sales taxes in Canada in Section 2.0. With a primer in place, the research will layout the methodologies for the investigation. After the direction of the research is outlined by the methodologies section, a description of the tax literature and theory will be provided in Section 4.0. Supplementing this will be a description of the current taxation practices in Canada regarding transactions in the second-hand economy provided in Section 5.0. These descriptions sections will inform the discussion in Section 6.0 which compares and contrasts existing rules in Canada to the theory of taxing second-hand transactions.

The academic literature addressing transactions in the second-hand economy is minimal however theory does exist to inform government policies. Currently in Canada, each jurisdiction

administering a sales tax acknowledges second-hand transactions, either directly in legislation or through public tax information bulletins. These jurisdictions account for the common scenarios of second-hand transactions. One common scenario for transactions in the second-hand economy, also referred to as casual transactions /casual sales, is the act of an individual not registered to collect sales tax (non-registered individual) selling used personal-use property to a non-registered buyer. A sales tax is not imposed on the casual sale in this instance because the transaction occurs between two non-registrants and therefore is a non-commercial transaction. Another common scenario for these casual sales is the act of a non-registered individual selling their used personal-use property to a registered business via trade-in transaction or selling used property to a registered used-goods dealer without collecting tax on the casual sale. These types of transactions are common in Canada and each jurisdiction administering a sales tax operates legislation and tax bulletins which provide guidance on exempting qualifying casual sales from collecting a sales tax.

The aggregation of information and analysis presented in the subsequent sections of this report investigates how current approaches to taxing second-hand transactions in Canada align with the theory of taxing second-hand transactions. This investigation begins with a review of the literature and requires answering the question, what are the academic understandings regarding non-commercial and commercial transactions involving second-hand items? Understanding the tax theory will then provide more informed analysis of the second component of the investigation which is the jurisdictional scan within Canada. This scan requires answering the question, what are the current criteria throughout Canada's sales tax jurisdictions for exempting casual sales from tax?

Once the two description components of the investigation are provided, the research will then integrate these findings and provide a discussion section. This section requires answering the question, how do approaches in Canada align with the academic understanding and theoretical findings in the relevant tax literature?

## **2.0 Background: Federal and Provincial Sales Taxes**

It is worthwhile to supplement the research with a background primer on sales taxes in Canada. This primer will introduce the multiple authorities which maintain jurisdiction throughout certain regions within Canada and help inform the description and discussion sections provided later in the research.

The various jurisdictions operating a sales tax in Canada are categorized in Table 1 below. The federal government derives its authority to raise money by any system or mode of taxation under Section 91 of *The Constitution Act, 1867*.<sup>12</sup> The current sales tax administered by the federal government is the Goods and Services Tax (GST) which was implemented in 1991. Currently the GST is collected at a rate of 5 percent and is charged on the provision of taxable goods and services at each stage of the distribution process throughout all subnational jurisdictions in Canada (Table 1). Therefore the GST operates as a value-added tax (VAT) and it replaces the previous federal sales tax which was imposed on manufacturers and certain licensed entities at a general rate of 13.5 percent of sales revenues.<sup>13</sup> This previous federal sales tax remained hidden in the price of goods as the cost of the tax was passed on to retailers and

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<sup>12</sup> Harvey Rosen, Jean-François Wen & Tracy Snoddon, *Public Finance in Canada* (Toronto, ON: McGraw-Hill Ryerson, 2012), 4

<sup>13</sup> Certified General Accountants of Ontario, *Toronto: Harmonized Sales Tax in Canada, 2009* (Toronto, ON: Ontario's CGA), 3

consumers in the product's price. In contrast, the GST taxes the incremental value added to a product at each stage in the production or import process.<sup>14</sup> This approach of taxing the marginal increase in value by use a VAT system is used by more 130 countries worldwide.

In addition to the federal sales tax, Section 92 of *The Constitution Act, 1867* provides the authority for the provincial legislatures to use direct taxation within the province as a means of raising revenue for provincial interests.<sup>15</sup> Some provinces have signed over their authority to impose a sales tax to the federal government. This is referred to as a Harmonized Sales Tax (HST) and has been implemented in New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland & Labrador, and Ontario (Table 1). Since the HST combines the federal GST with a provincial component (provincial component varies depending on the province) the HST operates like a value-added tax and is applied to the same base of goods and services as the federal GST.

Certain provinces levy a Retail Sales Tax (RST) also referred to as a Provincial Sales Tax (PST). This type of sales tax is currently levied in British Columbia (BC), Saskatchewan, and Manitoba. Each of these subnational jurisdiction independently administers their respective provincial sales tax (Table 1). Thus, there are varying rates of provincial sales tax and different criteria in each jurisdiction for exempting goods and services from collecting a sales tax. The RST administered in these provinces differs from the federal government's value-added GST since the RST is imposed once on the use or consumption by the end consumer.

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<sup>14</sup> Certified General Accountants of Ontario, *Toronto: Harmonized Sales Tax in Canada, 2009* (Toronto, ON: Ontario's CGA), 4

<sup>15</sup> The Constitution Act, 1867, 30 & 31 Vict, c 3 from: <http://canlii.ca/t/ldsw>; Retrieved on August 21, 2016

The province of Quebec maintains a provincial sale tax system that differs from all other subnational jurisdictions in Canada. Quebec operates the Quebec Sales Tax (QST) which is a value-added tax that applies to the same tax base as the GST. Quebec also assumes responsibility for administering the GST as it has taken over federal administration within the province. Although the QST and GST may appear similar, the province imposes exclusive restrictions on the application and exemption of sales tax which characterizes their system as independent from the GST system.

In addition to the nationally applicable GST and the regionally applicable RST, the jurisdictions of Alberta as well as the Canadian Territories do not raise regional revenues through the use of a sales tax. Therefore, in these jurisdictions the GST is the only applicable sales tax (Table 1).

*Table 1: Tax rates per province /territory*

	Type	Province/Territory	GST (%)	PST (%)	Total Tax Rate (%)
Combined Federal and Provincial Authority	HST	New Brunswick	5	10	15
	HST	Nova Scotia	5	10	15
	HST	Prince Edward Island	5	9	14
	HST	Newfoundland & Labrador	5	8	13
	HST	Ontario	5	8	13
Federal and Provincial Authority	GST+QST	Quebec	5	9.975	14.975
	GST+PST	Manitoba	5	8	13
	GST+PST	British Columbia	5	7	12
	GST+PST	Saskatchewan	5	5	10
Jurisdictions Neglecting a Sales Tax	GST	Alberta	5	0	5
	GST	Northwest Territories	5	0	5
	GST	Nunavut	5	0	5
	GST	Yukon	5	0	5

### 3.0 Methodology

The research will first describe the literature as well as each jurisdiction's approach in Canada regarding the taxation of the second-hand economy. With these descriptions in place, the culmination of the research will integrate the literature and jurisdictional approaches and discuss the alignment of policies in Canada to the theory of taxation and the second-hand economy. Therefore, the research seeks to answer these two questions in Section 4.0 and 5.0 respectively:

- What are the academic understandings regarding non-commercial and commercial transactions involving second-hand items?
- What are the current criteria throughout Canada's sales tax jurisdictions for exempting second-hand transactions from sales tax?

Once these questions are addressed, the research then engages in a discussion section which answers the question, "do approaches in Canada align with the academic understanding and theoretical findings in the relevant tax literature"?

In order to ultimately reach this discussion, the research findings will begin with a review of the existing literature regarding the theory of taxing second-hand goods. These forms of literature include peer-reviewed academic journals found in economic, tax accounting and tax law periodicals. In addition, economic, tax accounting, and tax law literature published in textbooks will assist the research by grounding understanding in longstanding theory. This description of the established theory will ensure validity of the research by providing the necessary theoretical application.

Grey literature will supplement the theoretical understanding of taxation by addressing casual transactions in society. Currently, transactions in the second-hand economy are areas of research not widely analyzed nor addressed by peer-reviewed academia. For this reason,

publications by private institutions such as Kijiji will provide the research with general guidance on the characteristics of the second-hand economy. Further, grey literature provided by industry publications on behalf of accounting firms will provide guidance and interpretation of tax legislation and tax rules. These forms of literature validate the analysis by aligning tax theory with a practical understanding of the second-hand economy.

The research will then provide an aggregation and description of the relevant regulation and tax bulletins from each applicable jurisdiction administering a sales tax in Canada. Jurisdictions will be organized into three groups: provinces and territories that operate no provincial sales tax and only the federal Goods and Services Tax (GST) applies, provinces participating in a Harmonized Sales Tax (HST), and lastly, provinces operating their own Provincial Sales Tax (PST). This context will provide the description of the current practices throughout Canada regarding the accounting for and taxation of casual transactions. This information will be taken from tax bulletins, government websites and provincial legislatures to ensure validity of the research design.

After the description of the theory and jurisdictional approaches are provided throughout Sections 4.0 and 5.0, the research will discuss how the existing regulation and bulletins align with the literature and theory in Section 6.0. Through this discussion, the research design intends to provide an understanding of how Canadian jurisdictions are dealing with taxation of the second-hand economy and evaluate this performance against what is known in the theoretical context of best practice taxation.

The design of the research seeks to advance the study of tax in the second-hand economy modestly through the process of description and discussion. The theoretical

underpinnings that gauge the performance of the federal and provincial taxation practices are taken from established sources of tax theory and literature. Further, the descriptions of each jurisdiction's taxation practices regarding casual transactions are derived from current and publicly available sources of data. For these reasons, the research design provides the academic literature as well as tax policy administrators with appropriate interpretations and guidance for addressing casual transactions in the second-hand economy.

The results from this research design will provide a valid and appropriate collection of the applicable rules in the Canadian context. It is reasonable that these results can be interpreted by provincial tax policy administrators since the research design simply aggregates, describes and discusses the current realities of provincial tax landscapes. Appropriate interpretation of the results would be the use of the findings to provide general guidance for updating and revising existing tax codes and practices within Canadian.

The limitations of the proposed approach are modest. There is minimal support and primary data from academic and industry literature which restricts the breadth and depth of the research. Fortunately, the proposed approach intends to advance fairly modest results and recommendations and simply offer a description and discussion of the current state of affairs throughout the provinces regarding taxation criteria. The research presented herein may encounter shortcomings with its modest recommendations for tax policy. Due to such a nascent field of study, the results and recommendations of the research cannot provide in-depth guidance for tax policy administrators or sufficient assistance in the updating and revision of tax legislation or tax codes. However, the research does offer a preliminary accumulation of the relevant literature and an exhaustive search of the relevant tax information. For this reason, the

limitations and shortcomings of the research are acknowledged but do not negatively impact the merit of the proposed research.

#### 4.0 Literature Review

The literature review will describe the current state of affairs regarding tax and the exchange of used personal-use property among individuals and between individuals and business entities. Academic analyses as well as industry publications will be relied upon to form the basis of the literature review. This component of the research seeks to describe the academic understandings regarding non-commercial and commercial transactions involving second-hand items.

##### 4.1 Used Personal-Use Property Sales: Registered and Non-Registered Entities

An important consideration for this literature review is the distinction between the business-to-business sales of used property and the casual sales of used property between two non-tax-registered entities. This distinction is important because the former must be subject to taxation since it is a commercial transaction, whereas the latter is a casual, non-commercial sale. Schenk, Thuranyi & Cui highlight that under the Tax Credit VAT, if a registered business sells a portion of its assets that were originally purchased to conduct taxable sales, then the sale of those used assets are taxable.<sup>16</sup> This is required regardless of that firm selling to another firm, a registered used-goods dealer, or a private consumer.

Conversely, a private-non-registered individual is able to sell used personal-use property to any entity (firm, used-goods dealer, another private consumer) and those transactions would

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<sup>16</sup> Alan Schenk, Victor Thuranyi, & Wei Cui, *Value Added Tax: A Comparative Approach* (New York, NY: Cambridge University Press, 2015), 179

not be subject to VAT.<sup>17</sup> These casual sales are not subject to VAT because the item being sold by the person has already collected tax when it was originally sold. The non-registrant selling the item does not add value to the item and therefore cannot collect a VAT on the transaction.

Schenk, Thuryoni & Cui highlight areas of concern when private consumers sell used personal-use property to registered used-goods dealers. If the used-goods dealer subsequently sells this used property in a taxable transaction and there is non-creditable VAT included in the selling price, then the value added tax is imposed more than once which creates a cascading effect of VAT.<sup>18</sup>

Schenk et. al. provide an excerpt from the ABA Model Act to illustrate cascading VAT with an example of a 'casual' transaction between an individual seller and a used-product dealer. The individual seller had purchased a product brand new for \$1,000 plus a 10 percent VAT. The individual decides to sell that product to a used-product dealer after some years of use for \$200 plus the 10 percent VAT of \$20. Tax issues occur when the used-product dealer sells that product to a third party.<sup>19</sup> Buried in the dealer's selling price is the \$20 (10 percent VAT) that gets included in the dealer's cost. Therefore, since the registered dealer must charge the 10 percent VAT on their selling price and they do not receive any reimbursement from the \$20 VAT charged on the item when it was bought from the individual seller that initiated the transaction, then two issues result.<sup>20</sup> The first is multiple VAT charged on the item when it was

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<sup>17</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 179

<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid.*, 180

<sup>20</sup> *Ibid.*

priced at \$200.<sup>21</sup> Second is the cascading VAT, since a VAT will be imposed on top of the \$20 VAT that is already included in the dealer's selling price.<sup>22</sup>

Contrary to the example above, the real value added by the dealer is represented by the difference between the dealer's VAT-exclusive purchase price of the item and their VAT-exclusive selling price.<sup>23</sup> When this appropriate value added is not defined, the corresponding multiple taxation and cascading effect present legitimate theoretical and economic complications as shown in table 2 below. Schenk et. al. highlight, "[Multiple tax and cascading tax] may further encourage the private sale of [used personal-use items] through the internet, newspaper advertisements or garage sales, thus creating a disadvantage for [registered] dealers in used consumer durable goods".<sup>24</sup> (Table 2).

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<sup>21</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 180

<sup>22</sup> *Ibid.*

<sup>23</sup> *Ibid.*

<sup>24</sup> *Ibid.*

Table 2: Multiple Tax and Cascading Tax

Consumer		
Transaction #	Description	Price
1	Original purchase of item	(\$1,000)
2	10% VAT paid on original item	(\$100)
3	Sale of this item to Used-Goods Dealer after X years of use	\$200
4	VAT attributable to this portion of the original purchase price	\$20
Used-Goods Dealer		
1	Purchase price of used item	(\$220)
2	Price Used-Goods Dealer sells item to third party *This price includes the \$20 VAT that is buried in the Used-Goods Dealer's cost for the item	\$350
3	Used-Goods Dealer Charges 10% VAT *If Used-Goods Dealer charges a 10% VAT on the 350 selling price & does not obtain a VAT benefit for the \$20 VAT element in the \$220 purchase price, then: <ul style="list-style-type: none"> <li>• VAT will be imposed a second time on the \$200 VAT exclusive cost of the item (multiple tax)</li> </ul> <p style="text-align: center;">AND</p> <ul style="list-style-type: none"> <li>• VAT will be imposed on the \$20 VAT included in the Used-Goods Dealer's \$350 selling price (cascade effect)</li> </ul>	\$35

Note. Table modified from Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*: 180)

Presumably these effects could have disincentives for the first-hand economy and present hurdles for retailers selling new durable goods as well. This presumption is supported by the characteristics of buyers in the second-hand economy defined by the 2016 Kijiji Index Report. It is becoming more common to see consumers turning to other non-registered individuals to buy used personal-use property and ignoring the first-hand market all together.<sup>25</sup> Catalyzing this growing dependence on the second-hand market is the notion of avoiding the

<sup>25</sup> "The Kijiji Second-Hand Economy Index," last modified March 1, 2016, 29

tax in the first-hand economy. Schenk et. al. bring to light the ability to avoid multiple taxation and cascading taxation in the established second-hand economy by transacting only with non-registered individual sellers. These types of non-registered to non-registered transactions will be further discussed in Section 3.4 of the literature review.

Industry publications such as EY's Global Sales Tax Guide develop upon the work of Schenk et. al. This industry publication describes transactions between a non-registered individual and a registered used-goods dealer as an emerging, niche issue and therefore is accounted for in most countries by a special charge scheme.<sup>26</sup> A study conducted by Nicolae Ecobici, Lucia Popa Paliu and Ionela-Claudia Dina discusses the operation of one of these special schemes in the context of Romania.

Ecobici et. al. analyze the behaviour of Romanian citizens which rely on pawn shops to deposit their used personal-use property for cash. Since many of these goods are not bought by the original seller at the termination of the pawn agreement, the country of Romania maintains a sizeable market for second hand goods being sold by pawn shops (a mixture of non-appreciable goods and appreciable goods such as gold and fine jewelry).<sup>27</sup> Thus, a considerable amount of inventory at Romanian pawn shops is obtained through non-taxable transactions, yet is subsequently required to be sold by the registered pawn shop through a taxable transaction.

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<sup>26</sup> EY Global: *Worldwide VAT, GST and Sales Tax Guide, 2015* (London, UK: EY Global)

<sup>27</sup> Nicolae Ecobici, Lucia Popa-Paliu, & Ionela-Claudia Dina, "Tax and Accounting Implications of the Use of Special Charge Schemes for Second-Hand Goods to the Pawn Shops in Romania" *Annals of the University of Petrosani, Economics* 10 (2010): 137

In an effort to address the cascade of VAT, Ecobici et. al. refer to Romania's Fiscal Code [1] article 152 which permits pawn shops to apply the special VAT scheme for second hand goods if the used goods are purchased within the community and meet one of the following conditions:<sup>28</sup>

- Are purchased by the pawn shop from a non-taxable person  
OR
- Are purchased by the pawn shop from a taxable person (a VAT registrant):
  - selling a good that has been exempt from VAT  
OR
  - previously charged under the special scheme from small enterprises  
OR
  - fall into the category of capital goods

The special scheme is referred to as, "special arrangements for second-hand goods, works of art, collectors' items and antiques" and ensures the taxable base of supplies for Romania pawn shops is the profit margin obtained from the sale of the respective goods, exclusive of VAT.<sup>29</sup>

The analysis of Romania's approach to the second-hand market by Ecobici et. al. is further developed by Schenk et. al. with a comparison of special schemes that account for cascading tax as well as tax evasion in Europe, Canada and Australia. The EU's VAT directive upholds Romania's approach and requires all other member countries to tax only the profit margin on supplies by a taxable dealer of second-hand goods that were acquired from a non-taxable person.<sup>30</sup>

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<sup>28</sup> Ecobici, Paliu, & Dina, *Tax and Accounting Implications of the Use of Special Charge Schemes for Second-Hand Goods to the Pawn Shops in Romania*, 138

<sup>29</sup> EY Global: *Worldwide VAT, GST and Sales Tax Guide, 2015* (London, UK: EY Global), 808

<sup>30</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 180

In Canada, the GST system in the past permitted a credit for the cost of used goods purchased from an unregistered person.<sup>31</sup> This was referred to under the federal sales tax as the “Notional Input Tax Credit (ITC)”.<sup>32</sup> Through this, Canada aimed to remove the embedded tax in used goods when they are resold.<sup>33</sup> According to the Department of Finance Canada, “a registrant [could] claim an input tax credit equal to 7/107ths of the price paid for a good when the good is purchased from someone who is not required to charge tax”.<sup>34</sup> Due to the burdensome use of these ITC’s however, a trade-in approach was introduced in 1996 and the notional input tax credit was eliminated.<sup>35</sup> Canada introduced a Notice of Change: TIB B-084 – Treatment of Used Goods in 1997 and amended the approach in 1999. Titled, “The New Trade-In Approach” the federal government focuses on individuals selling their used personal-use property to a dealer as a means of payment or partial payment for new property from that same dealer (e.g. used refrigerator, used automobile). The approach operates as follows:

Where a person who is not required to be registered for purposes of the GST (e.g., a consumer) supplies used tangible personal property (e.g., a used vehicle, used household product, used clothing) to another person: no GST is charged on the used property and where that other person is registered for the GST, no notional ITC is available to that person if the supply is made after April 23, 1996

Schenk et. al. highlight how Canada’s trade-in approach addresses the issues of multiple taxation and cascading taxation when a used-goods dealer sells used inventory obtained from

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<sup>31</sup> Ibid., 181

<sup>32</sup> Canada Revenue Agency, *Notice of Change: TIB B-084 – Treatment of Used Goods* (Ottawa: Canada Revenue Agency, 1997)

<sup>33</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 181

<sup>34</sup> Towards Replacing the Goods & Services Tax: 4, Finance Canada, last modified April 1, 2014, [http://www.nlc-bnc.ca/eppp-archive/100/200/301/finance/other\\_pubs/html/towardsGST/gstov4e.html](http://www.nlc-bnc.ca/eppp-archive/100/200/301/finance/other_pubs/html/towardsGST/gstov4e.html)

<sup>35</sup> Ibid.

one non-registrant and sells to separate non-registrant.<sup>36</sup> The entity accepting the trade-in from the non-registrant must collect tax on the net amount of their sale (the sale price of the new item less the amount allowed for the trade-in).<sup>37</sup> This approach ensures the correct amount of consumption is being taxed and items do not received multiple taxation on the original selling price.<sup>38</sup>

In Australia, a registered purchaser is granted an ITC for all second-hand goods purchased for the precise purpose of resale or exchange throughout the daily business activities of that used-goods dealer. The Australian GST law requires that an entity will be excluded from receiving an ITC on its acquisition of second-hand goods if those goods were purchased with the intention of being sold at some point and those goods were used in the entity's business operations. However, this credit system has shown it is susceptible to tax evasion by, "breaking the credit chain". According to the Australian Taxation Office, the break in the credit chain exists when the dealer of the used goods receives an input credit without a tax invoice. This discrepancy presents the dealers with an opportunity for VAT evasion.<sup>39</sup> The Australian system has discussed means to reduce the opportunity for evasion or avoidance such as requiring used-goods dealers to record and manage receipts from their consumers purchasing the used inventory. However, since consumers would not be subject to VAT audits, the administration of

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<sup>36</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 181

<sup>37</sup> PST-GST Harmonization – How Will it Affect Your Business, KPMG, last modified April 1, 2009, <https://www.kpmg.com/Ca/en/IssuesAndInsights/ArticlesPublications/Documents/QAOntHST.htm#q8>

<sup>38</sup> PST-GST Harmonization – How Will it Affect Your Business, KPMG, last modified April 1, 2009, <https://www.kpmg.com/Ca/en/IssuesAndInsights/ArticlesPublications/Documents/QAOntHST.htm#q8>

<sup>39</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 181

this type of program as well as the authenticity of the respective receipts present hurdles for deterring VAT evasion or avoidance.<sup>40</sup>

The concept of tax evasion is not comprehensively addressed by academic or industry sources throughout this review of the literature. However, Schenk et. al. briefly note Uganda’s “extreme” approach to tax the full selling price of used goods that were purchased in transactions not subject to tax.<sup>41</sup> This approach offers Uganda a means to combat tax evasion because the seller of the used goods is not granted any adjustment (e.g. ITC) to account for the input VAT paid when the dealer purchased the used personal-use property from the non-registered seller.<sup>42</sup>

Schenk et. al. also address the issue of a used-goods dealer selling inventory for greater than cost. If a non-registered individual sells to a used-goods dealer and the dealer sells that good for more than its cost, then Schenk. et. al. state the appreciation will go untaxed.<sup>43</sup> The authors claim the appreciation in value can be left out of the VAT base because, “the appreciation represents economic rent that will not affect the price of consumption”.<sup>44</sup> In contrast to this statement, authors Richard Pomp and Oliver Oldman argue that if a used-goods dealer increases the value of a good (e.g. repair, enhancement, etc.) then, “the state is entitled to a sales tax on this new increment in value because it represents future consumption”.<sup>45</sup>

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<sup>40</sup> Ibid., 182

<sup>41</sup> Ibid.

<sup>42</sup> Ibid.

<sup>43</sup> Ibid.

<sup>44</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 182

<sup>45</sup> Richard Pomp, Oliver Oldman, “A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins,” *National Tax Journal* 43 (1990): 429

## 4.2 Non-registrants and Taxation of Second-hand Items

In addition to discussing transactions between a non-registered individual selling to a registered dealer, Pomp and Oldman also discuss how transactions between two non-registered individuals ought to operate. At the time of their study, Pomp and Oldman state there had been little theoretical analysis on these ‘casual sales’ and any existing rules were shaped largely by administrative considerations and not by normative concerns.<sup>46</sup> In other words, exempting casual sales of used property between non-registered individuals was the appropriate method, assuming that individuals will sell their items at a price point that accounts for the tax they paid when the item was new and in turn, the seller will receive, “reimbursement for the unused consumption” (table 3).<sup>47</sup>

*Table 3: Net Cash Positions of Parties Without a Tax on Casual Sales*

Person A		
Transaction #	Description	Price
1	Original purchase of item	(\$1,000)
2	Sales tax paid on original item	(\$100)
3	Cash received from Person B after sale of property	<u>\$550</u>
4	Net cash position of Person A	<u>(\$550)</u>
Person B		
1	Purchase price of used item	<u>(\$550)</u>
2	Net cash position of Person B	<u>(\$550)</u>
Government		
1	Sales tax received on Person A’s original purchase	<u>\$100</u>
2	Net Sales received	<u>\$100</u>

Note. Table as shown in Pomp & Oldman, “A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins,”: 428)

Pomp and Oldman also provide insight into what a tax on casual sales between non-registered individuals would look like. The state would step in to tax the sale of a used item from person A to person B. In order to avoid over-taxation, the state will reimburse person A

<sup>46</sup> Ibid., 427

<sup>47</sup> Ibid., 429

for their unused consumption.<sup>48</sup> When this method of taxation-reimbursement occurs, all parties involved (person A, person B, and the government) remain the same after the transaction as they were before the transaction (table 4).<sup>49</sup>

*Table 4: Net Cash Positions of Parties With a Tax on Casual Sales,*

Person A		
Transaction #	Description	Price
1	Original purchase of item	(\$1,000)
2	Sales tax paid on original item	(\$100)
3	Cash received from Person B after sale of property	\$500
4	Sales tax reimbursement from government on sales of used item to Person B	\$50
5	Net cash position of Person A	<u>(\$550)</u>
Person B		
1	Purchase price of used item	(\$500)
2	Sales tax paid on purchase of used item	(\$50)
3	Net cash position of Person B	<u>(\$550)</u>
Government		
1	Sales tax received on Person A's original purchase	\$100
2	Sales tax received on Person B's purchase of used item	\$50
3	Sales tax refund to Person A on sale of used stereo to Person B	(\$50)
4	Net sales tax received	<u>\$100</u>

Note. Table as shown in Pomp & Oldman, "A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins," 429)

The difference between table 3 and table 4 is which individual pays the tax to the government.<sup>50</sup> In table 3, the entire \$100 of tax is collected from Person A. In table 4, the government first collects \$100 from Person A, and then collects \$50 from Person B. With this tax revenue of \$150, the government then reimburses Person A for an amount of \$50.

If the government were to continue to tax these casual sales but stop reimbursing Person A for their 'unused consumption' then Pomp and Oldman suggest the government will

<sup>48</sup> Pomp & Oldman, *A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins*, 428

<sup>49</sup> *Ibid.*

<sup>50</sup> Pomp & Oldman, *A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins*, 429

collect more sales tax than the amount of consumption that will occur.<sup>51</sup> In the example shown in table 4, the government collects \$150, if \$50 is not distributed back to the individual selling their used property, then the government retains \$50 more than the actual total consumption that occurs between Person A and Person B.

Through these examples of non-registered individual to non-registered individual casual sales, Pomp and Oldman conclude that in an efficient market, “normatively correct results are achieved either by exempting casual sales or by taxing casual sales the reimbursing the original owner of the used item for sales taxes paid on enjoyed consumption”.<sup>52</sup>

Schenk et. al. argue that a pseudo taxation example such as the example put forth by Pomp and Oldman, would conflict with the small business exemption threshold most jurisdictions maintain.<sup>53</sup> In the Canadian context, as long as a non-registered individual maintains sales less than or equal to \$30,000 annually, they will not be required to register and collect GST / HST.<sup>54</sup> Being under this threshold in Canada classifies an entity selling items as a small supplier and allows them to volunteer to register and collect tax. Volunteering would provide them a means to claim ITCs for the GST / HST they pay on their supplies to operate their selling activities.<sup>55</sup>

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<sup>51</sup> Ibid., 433

<sup>52</sup> Pomp & Oldman, *A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins*, 429

<sup>53</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 183

<sup>54</sup> GST/HST registration, collection and remittance, Grant Thornton, last modified January 20, 2016, <http://www.taxplanningguide.ca/tax-planning-guide/section-1-businesses/gsthst-registration-collection-remittance/>

<sup>55</sup> Ibid.

Despite the small business exemption and the small supplier classification, according to the research put forth by the 2016 Kijiji Index Report, most casual sellers do not behave like businesses. The Report illustrates that individuals making casual are simply making modest transactions throughout the year and the inventory / supplies they rely on are their own used personal-use items that are sold.<sup>56</sup> Therefore, market participants in the second-hand market would not seek classification as a small supplier, since this would not improve their financial standing. Schenk et. al. put forth normative tax considerations, if for whatever reasons these particular interests are taxed. In agreement with the normative tax considerations advanced earlier in this literature review, Schenk et. al. state that if the casual seller is taxed on the margin (the difference between the sale price and the cost of the item) then the seller should be required to substantiate the claimed cost with supporting documentation (e.g. invoice).<sup>57</sup> To limit the opportunity for casual sellers to take advantage of the administration of casual sales, Schenk et. al. argue the seller should be exempt from receiving a refund from any ITC's resulting from the sale.<sup>58</sup>

Therefore, both Pomp & Oldman as well as Schenk et. al. agree that a tax on the sale between two non-registered individuals selling used personal-use property is not necessary based on administrative and economic understandings of normative taxation. Schenk et. al. put forth an alternative approach which seeks to tax casual sales if the sale itself exceeds a threshold amount.<sup>59</sup> This approach is stated in the Model Act developed by the American Bar

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<sup>56</sup> "The Kijiji Second-Hand Economy Index," last modified March 1, 2016

<sup>57</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 184

<sup>58</sup> *Ibid.*

<sup>59</sup> *Ibid.*

Association and imposes a VAT on high priced casual sales. Administratively it is less burdensome, and economically, “it allows the casual seller to claim an [ITC] for VAT paid on the asset sold in a taxable casual sale”.

#### 4.3 Literature Review Direction

The literature review began with a primer on sales taxes in Canada. From this primer came an understanding of the federal-provincial cooperation that is required for revising and updating the respective tax regimes at the national and subnational levels. Further, the literature review discussed the attributes and operation of VAT and most notably, its use regarding the sale of used personal-use property. Sales between non-registered individuals and registered used-goods dealers were discussed as well as sales exclusively between non-registered individuals.

Valuable understandings from this literature review will be relied upon throughout the description in the Findings section and the Discussion section. Most notably is the understanding that each provincial jurisdiction that operates its own provincial sales tax regime has the express authority to implement their own regulations and codes. Subsequently, the normative taxation considerations put forth by academia and industry publications will be used to gauge the performance of each Canadian jurisdiction. Moving forward, in order to provide the Canadian context with an enhanced understanding of the patchwork of tax legislation administering casual sales in each province, the various criteria, thresholds and exemptions for the sale of used personal-use property will be discussed.

## 5.0 Jurisdictional Scan

The central tenant of the research presented herein is the description of current practices throughout Canada's jurisdictions regarding the taxation of second-hand goods through casual sales. There are three categories of jurisdictions which maintain policies addressing second-hand transactions: the federal government through the GST, provinces participating in the HST, and provinces participating in PST. The federal government as well as provinces participating in the HST present a list of tax jurisdictions that maintain the same approach for exempting second-hand transactions. The four tax jurisdictions operating a PST present the only regions in Canada that deviate from the federal government's criteria for exempting second-hand transactions from sales tax.

The federal government's GST/HST "Small Supplier" exemption is a policy offering guidance for individual non-registrants engaging in casual sales. This regulation was briefly addressed in Section 4.2 by Schenk et. al. The details of this exemption are stated in the *Excise Tax Act RSC 1985, c E-15 s. 148 (1)* and define a Small Supplier as, "a supplier whose worldwide annual GST/HST taxable supplies, including zero-rated supplies and including the supplies (sales) of all associates, are less than \$30,000".<sup>60</sup> The annual taxable sales figure is not simply an aggregation of sales over a discrete calendar year. Instead, the figure is achieved through a perpetual quarterly assessment of the total taxable sales for the preceding 12 months. If this floating total exceeds \$30,000 at any point, the entity making these sales must register to start collecting the GST.<sup>61</sup>

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<sup>60</sup> Government of Canada, *Excise Tax Act (R.S.C., 1985, c. E-15)* (Ottawa: Justice Laws Website, 2016), s. 148 (1)

<sup>61</sup> *Ibid.* s. 148 (2)

In addition to the federal government’s “Small Supplier” exemption, the Canada Revenue Agency also relies on the “New Trade-In Approach” (described in Section 4.1) to address the sale of used property as a trade-in. This represents a second policy the federal government uses to regulate the transaction of used property (personal use, listed personal property and commercial alike). Aside from these two approaches, the federal government does not specifically address the subject of second-hand transactions by non-registered individuals. The only criteria guiding individuals transacting in the second-hand economy is whether or not they are engaging in business activity. If individuals are not surpassing the threshold of activity, then they are not classified as a business and therefore are able to engage in transactions of used personal-use property without collecting sales tax.

In addition to federal approaches to the second-hand economy, certain subnational jurisdictions maintain approaches as well. Provinces that have signed over the authority of administering a sales tax to the federal government operate a harmonized tax system (HST). Provinces with an HST operate the same tax rules that the federal government maintains. However, provinces that have not harmonized the sales tax and instead maintain authority over administering regional sales a tax impose different criteria for addressing second-hand transactions. The following subsections of Section 5.0 will describe each of Canada’s subnational jurisdictions by categorizing each province according to their respective HST, PST, or solely GST sales tax systems. Each category will describe the current approaches carried out by the provinces to exempt the sale of used personal-use property through casual sales.

### 5.1 Jurisdictions with Goods and Services Tax

The province of Alberta along with Northwest Territories, Nunavut and Yukon territories do not administer either a regional sales tax or a harmonized sales tax. The applicable sales tax

in these jurisdictions is the federal GST.<sup>62</sup> Therefore, the HST/GST “small supplier exemption” stated in the *Excise Tax Act* is the most applicable provision regulating casual transactions in the second-hand economy.<sup>63</sup> In the event of regulating used property as trade-ins, the federal government’s Trade-In Approach applies in these jurisdictions as well. There are no provincially or federally issued tax bulletins or notices addressing casual sales in the second-hand economy in these jurisdictions.

## 5.2 Jurisdictions with Harmonized Sales Tax

The provinces of New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario and Prince Edward Island maintain Harmonized Sales Tax (HST) under the Government of Canada’s *Excise Tax Act RSC 1985, c E-15*.<sup>64</sup> The HST is a value-added tax and is comprised of the federal GST (5 percent) and a provincial component dependent on the province (ranging from 8 percent – 10 percent).<sup>65</sup> New Brunswick implemented an HST system on October 18<sup>th</sup> 1996.<sup>66</sup> New Brunswick currently maintains an HST of 15 percent (10 percent provincial component on top of the GST).<sup>67</sup> The provinces of Newfoundland and Labrador and Nova Scotia harmonized provincial sales tax with the federal GST in 1997.<sup>68</sup> Currently Newfoundland and Nova Scotia

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<sup>62</sup> Certified General Accountants of Ontario, *Toronto: Harmonized Sales Tax in Canada, 2009* (Toronto, ON: Ontario’s CGA), 7

<sup>63</sup> “The Kijiji Second-Hand Economy Index,” last modified March 1, 2016, 29

<sup>64</sup> EY Global: *Worldwide VAT, GST and Sales Tax Guide, 2015* (London, UK: EY Global), 140

<sup>65</sup> *Ibid.*

<sup>66</sup> Department of Finance New Brunswick, Government of New Brunswick, last modified February, 2016, <http://www2.gnb.ca/content/gnb/en/departments/finance/taxes/hst.html>

<sup>67</sup> *Ibid.*

<sup>68</sup> Certified General Accountants of Ontario, *Toronto: Harmonized Sales Tax in Canada, 2009* (Toronto, ON: Ontario’s CGA), 8

maintain an HST rate of 15 percent (10 percent provincial component).<sup>69,70</sup> The province of Ontario abolished its retail sales tax on July 1, 2010 for an HST which currently equates to 13 percent (8 percent provincial component).<sup>71</sup> Lastly, the province of Prince Edward Island implemented an HST on April 1, 2013 and maintains a rate of 14 percent (9 percent provincial component).<sup>72</sup>

Under the harmonized system, the respective provinces allow the Government of Canada to administer the sales tax in their jurisdiction.<sup>73</sup> Therefore, the HST applies to all goods and services the GST applies to under the federal *Excise Tax Act*.<sup>74</sup> Since the HST applies to the same base of goods and services as the GST, the HST/GST “Small Supplier” exemption stated in the *Excise Tax Act* is the most applicable provision in all HST provinces regulating casual transactions in the second-hand economy.<sup>75</sup> In the event of regulating used property as a trade-in, the federal government’s “New Trade-In Approach” applies in these jurisdictions as well. There are no provincially issued tax bulletins or notices in any of the HST provinces addressing casual sales in the second-hand marketplace.

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<sup>69</sup> Harmonized Sales Tax, Department of Finance Newfoundland and Labrador, last modified July 19, 2016, [http://www.fin.gov.nl.ca/fin/tax\\_programs\\_incentives/personal/hst.html](http://www.fin.gov.nl.ca/fin/tax_programs_incentives/personal/hst.html)

<sup>70</sup> Harmonized Sales Tax & Rebates, Finance and Treasury Board of Nova Scotia, last modified January 5, 2015, <http://www.novascotia.ca/finance/en/home/taxation/tax101/harmonizedsalestax/default.aspx>

<sup>71</sup> Harmonized Sales Tax, Ministry of Finance Ontario, last modified July 6, 2016, <http://www.fin.gov.on.ca/en/tax/hst/>

<sup>72</sup> Tax and Land Information, Department of Finance Prince Edward Island, last modified June 29, 2016, <http://www.taxandland.pe.ca/index.php3?number=76948>

<sup>73</sup> Certified General Accountants of Ontario, *Toronto: Harmonized Sales Tax in Canada, 2009* (Toronto, ON: Ontario’s CGA), 7

<sup>74</sup> *Ibid.*, 8

<sup>75</sup> “The Kijiji Second-Hand Economy Index,” last modified March 1, 2016, 29

### 5.3 Jurisdictions with a Provincial Sales Tax

The provinces of British Columbia (BC), Saskatchewan, Manitoba and Quebec maintain a system of PST, RST and QST respectively, that are charged separately from the federal government's GST. Since provincial sales tax fall under the province's jurisdiction, each of the respective provinces maintain various levels of taxation along with certain requirements for applying or exempting tax from goods and services. In order to discuss the various regulations and tax codes pertaining to transactions in the second-hand economy, this section will rely on the *Provincial Sales Tax Act* for BC, Saskatchewan and Quebec as well as Manitoba's *Retail Sales Tax Act*.

#### British Columbia

British Columbia's *Provincial Sales Tax Act SBC 2012, c 35* defines the province's PST as a retail sales tax that is required to be paid when, "a taxable good, software or service is acquired for personal use or business use, unless a specific exemption applies".<sup>76</sup> As of July 2016, the general PST rate is 7% percent and is charged on the sale price of an item before the GST is applied.<sup>77</sup>

Disclosed in PST Bulletin 003 as well as in the Act's definitions, BC qualifies when a non-registered individual making sales is exempt from charging and collecting PST.<sup>78</sup> Therefore, an individual can engage in selling their used personal-use property in BC without charging or collecting PST if they satisfy the criteria listed in Table 5.<sup>79</sup>

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<sup>76</sup> Provincial Sales Tax Act, Statutes of British Columbia (2012). Retrieved from the Queen's Printer website: [http://www.bclaws.ca/civix/document/id/complete/statreg/12035\\_00](http://www.bclaws.ca/civix/document/id/complete/statreg/12035_00)

<sup>77</sup> Tax Alert – Canada: British Columbia budget 2016-17, EY Canada, last modified February 16, 2016, [http://www.ey.com/Publication/vwLUAssets/Tax\\_Alert\\_2016\\_No\\_06/\\$FILE/TaxAlert2016No06.pdf](http://www.ey.com/Publication/vwLUAssets/Tax_Alert_2016_No_06/$FILE/TaxAlert2016No06.pdf)

<sup>78</sup> Provincial Sales Tax Bulletin 003 – Small Sellers, Ministry of Finance, British Columbia, last modified February 2016, [http://www.sbr.gov.bc.ca/documents\\_library/bulletins/pst\\_003.pdf](http://www.sbr.gov.bc.ca/documents_library/bulletins/pst_003.pdf)

<sup>79</sup> Ibid.

Table 5: Qualifying as a Small Seller in British Columbia

1) Located in BC but do not maintain established commercial or business premises (e.g. you do not sell goods from a shop, including a home-based shop)
2) You sell eligible goods, software or services
3) You have \$10,000 or less in gross revenue from all retail sales of eligible goods, software and services for the previous 12 months, and your estimated gross revenue from all retail sales of eligible goods, software and services for the next 12 months is \$10,000 or less
4) You do not sell: <ul style="list-style-type: none"> <li>a) Vehicles, boats, or aircraft in the ordinary course of your business</li> <li>b) Accommodation</li> <li>c) Liquor (except under a special occasion license or at an auction)</li> </ul>
5) You are not: <ul style="list-style-type: none"> <li>a) A lessor</li> <li>b) An independent sales contractor</li> <li>c) A contractor who acquires goods for the purpose of fulfilling contracts to supply and affix or install, affixed machinery or improvements to real property</li> <li>d) Maintaining an established business premises as defined in PST Bulletin 003</li> <li>e) Regularly selling eligible goods, software, services or lease goods from established commercial premises</li> </ul>

Note. Table as shown in Provincial Sales Tax (PST) Bulletin 003, Small Sellers. Retrieved from [http://www.sbr.gov.bc.ca/documents\\_library/bulletins/pst\\_003.pdf](http://www.sbr.gov.bc.ca/documents_library/bulletins/pst_003.pdf)

If the individual qualifies as a small seller, then clarification is provided under Part 3, Division 10 of the *Provincial Sales Tax Act*.<sup>80</sup> According to subsection 89, if the small seller purchases personal property eligible for tax in BC with the express intent of reselling that property, then the small seller must pay tax as stated under section 37 of the Act.<sup>81</sup> In addition, duties of the small sellers are provided in Part 8, Division 2 of the Act. According to subsection 183, a small seller is explicitly instructed to not levy or collect tax under the Act if sales are made casually without the express intent of resale.<sup>82</sup> Further, if sales are casual, the small seller must maintain records as required by the Act's regulations.<sup>83</sup>

<sup>80</sup> Provincial Sales Tax Act, Statutes of British Columbia (2012). Retrieved from the Queen's Printer website: [http://www.bclaws.ca/civix/document/id/complete/statreg/12035\\_00](http://www.bclaws.ca/civix/document/id/complete/statreg/12035_00)

<sup>81</sup> Provincial Sales Tax Act, Statutes of British Columbia (2012). Retrieved from the Queen's Printer website: [http://www.bclaws.ca/civix/document/id/complete/statreg/12035\\_00](http://www.bclaws.ca/civix/document/id/complete/statreg/12035_00)

<sup>82</sup> Ibid., 8, D.2 (183)

<sup>83</sup> Ibid.

The *Provincial Sales Tax Act* offers further clarification for exempting individuals buying used personal-use property through casual transactions in Part 3 Division 10 (91). This subsection states that an individual purchasing tangible used personal-use property from a small seller is exempt from paying tax imposed under section 37 of the Act.<sup>84</sup> Therefore, an individual can engage in buying used personal-use property in BC from small sellers without the burden of paying PST. There are no stated thresholds on how much an individual can purchase from small sellers in BC and there is no requirement of buyers to maintain records of their purchases from casual transactions.<sup>85</sup>

The province of BC briefly provides clarification on used property being traded-in. If used personal-use property is accepted at the time of sale by the seller as payment or partial payment for a new item, then the purchase price of the new item is, “equal to the initial price of the tangible personal property sold less the amount of the credit allowed for the [traded-in item].”<sup>86</sup> Therefore, the applicable tax would be imposed on the selling price of the new item, less the value of the traded-in item.<sup>87</sup> The province of BC does not specify how value is calculated on used tangible personal property when traded-in.

### **Saskatchewan**

Saskatchewan’s *Provincial Sales Tax Act RSS 1978, c P-34.1* defines the province’s PST as a sales tax that applies to the purchase, importation or rental of eligible goods and services

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<sup>84</sup> Ibid., 3, D.10 (91)

<sup>85</sup> Ibid.

<sup>86</sup> Provincial Sales Tax Act, Statutes of British Columbia (2012). Retrieved from the Queen’s Printer website: [http://www.bclaws.ca/civix/document/id/complete/statreg/12035\\_00](http://www.bclaws.ca/civix/document/id/complete/statreg/12035_00), Section 1 D.2 (24)

<sup>87</sup> Ibid.

used in Saskatchewan.<sup>88</sup> As of July 2016, the PST rate is 5 percent and is charged on the sale price of eligible goods and services exclusive of the GST.<sup>89</sup> Saskatchewan does not directly address the application or exemption of tax on used personal-use property through casual transactions in its Provincial Sales Tax Act.<sup>90</sup> Saskatchewan also neglects any definition or qualification of a smaller seller and therefore the Act itself offers minimal guidance for transactions in the second-hand economy.

Saskatchewan issued an initial Provincial Sales Tax Bulletin (Bulletin 58) in March of 2000 regarding the taxation of used goods. This bulletin received revision in February 2013 and recent amendments briefly address transactions in the second-hand economy among registered and non-registered entities.<sup>91</sup> With respect to the sale of used assets, a business is required to charge and collect PST when their used assets are sold.<sup>92</sup> If a business sells used assets as a result of ceasing operations, it is expected that the individual purchasing the used asset(s) will pay the respective PST on the purchase price.<sup>93</sup> In addition, the buyer has the responsibility of filing a Business Assets Declaration Form in order to report and remit the tax within 30 days of the purchase of the used business asset(s).<sup>94</sup>

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<sup>88</sup> Provincial Sales Tax, Government of Saskatchewan Ministry of Finance, last modified February 15, 2015, <http://finance.gov.sk.ca/commonquestionsPST?Anc=e5f80742-9ab3-416c-88c4-f9aa1da73998&Pa=fb1c459c-2e24-46a9-9c2d-b4937c2bb571>

<sup>89</sup> *Ibid.*

<sup>90</sup> Provincial Sales Tax Act, Revised Statutes of Saskatchewan 1978, c P-34.1. Retrieved from: <http://canlii.ca/t/h7bv>; Retrieved on August 11, 2016

<sup>91</sup> Provincial Sales Tax Bulletin 58 – Information on the Taxation of Used Goods, Ministry of Finance, Saskatchewan, last modified February 2013, <http://finance.gov.sk.ca/revenue/pst/bulletins/PST058UsedGoods-Survey.pdf>

<sup>92</sup> *Ibid.*

<sup>93</sup> *Ibid.*, 2

<sup>94</sup> *Ibid.*

If a business or individual receive an item in trade and tax had been paid on the trade-in item, then tax is collected on the cash difference between the selling price of the item and the value of the item accepted in trade by the seller (profit margin).<sup>95</sup> If tax was not paid on the trade-in item, then tax must be charged on the entire selling price of that item. In addition, if the trade-in item is to be sold in the future, PST is required on that transaction.<sup>96</sup>

Saskatchewan addresses purchases between non-registered individuals in the second-hand economy in Bulletin 58. When a non-registered individual purchases used goods for personal use, PST applies to the selling price of those used goods less a deduction of \$300 per item.<sup>97</sup> This deduction applies regardless of that individual purchasing used goods privately or from a business.<sup>98</sup> Therefore, as the PST rate is 5 percent, individuals can purchase used personal-use property valued up to \$6,000 and have any tax owed on their purchase cancel out due to the respective \$300 deduction.

Similarly, if a non-registered individual engages in a trade-in for their used personal-use property with a registered business, then the business as the purchaser is permitted the greater of a \$300 deduction or the value of the trade-in.<sup>99</sup> However, the \$300 deduction is not granted for sales of used items for commercial use and the deduction also cannot apply to used goods purchased from outside of Canada.<sup>100</sup>

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<sup>95</sup> Ibid.

<sup>96</sup> Ibid.

<sup>97</sup> Ibid.

<sup>98</sup> Provincial Sales Tax Bulletin 58– Information on the Taxation of Used Goods, Ministry of Finance, Saskatchewan, 2

<sup>99</sup> Provincial Sales Tax Bulletin 58– Information on the Taxation of Used Goods, Ministry of Finance, Saskatchewan, 2

<sup>100</sup> Ibid.

## Manitoba

Manitoba's Retail Sales Tax (RST) is applied to the retail sales or rental of eligible goods and services in Manitoba and thus operates identically to the PST systems of BC and Saskatchewan.<sup>101</sup> As of July 2016, the general RST rate is 8% percent and is calculated on the selling price of eligible goods and services before the GST is applied.<sup>102</sup> Manitoba's *Retail Sales Tax Act, CCSM c. R130* deviates from the Provincial Sales Tax Act of Saskatchewan as it addresses transactions in the second-hand economy directly within the Act.<sup>103</sup>

The province of Manitoba discusses exempt tangible personal property in Section 3(1) of the Act. Clause (z) of subsection (1) states, "used clothing, including footwear, having a fair value of \$100 [per item] or less" is exempt from tax under the Act.<sup>104</sup> Further, clause (bb) addresses the broad category of used furniture and "other used household items having a fair value of \$100 [per item] or less" as being exempt from tax under the Act.<sup>105</sup> Section 3(2) provides further clarification and defines the term "used" in clauses (z) and (bb) as, "[an item] previously used or owned by a consumer".<sup>106</sup>

These specific exempted personal property items and dollar values introduce areas of ambiguity around the sale of used personal-use property when sold by one individual to another. For example, the *Retail Sales Tax Act* does not distinctly address the tax implications

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<sup>101</sup> Retail Sales Tax, Manitoba Finance, last modified June 2016, <https://www.gov.mb.ca/finance/taxation/taxes/retail.html>

<sup>102</sup> Ibid.

<sup>103</sup> The Retail Sales Tax Act, Continuing Consolidation of the Statutes of Manitoba c. R130. Retrieved from: <http://canlii.ca/t/52krh>; Retrieved on August 12, 2016

<sup>104</sup> The Retail Sales Tax Act, Continuing Consolidation of the Statutes of Manitoba c. R130. Retrieved from: <http://canlii.ca/t/52krh>; Retrieved on August 12, 2016

<sup>105</sup> The Retail Sales Tax Act, Continuing Consolidation of the Statutes of Manitoba c. R130. Retrieved from: <http://canlii.ca/t/52krh>; Retrieved on August 12, 2016., s.3(1) (bb)

<sup>106</sup> Ibid., s. 3(2)

when a used household item is sold by one individual to another for a fair value of \$500. However, through tax bulletin #050 issued by Manitoba Finance, it is stated that as long as tangible used personal-use property is exchanged through non-commercial transactions (e.g. Kijiji transaction), then items are exempted entirely from the tax under the Act.<sup>107,108</sup>

Manitoba's Act also relies on tax bulletins for clarification regarding the applicable threshold for selling tangible used personal-use property in the second-hand economy. According to Section 9 (2.3) of the Act, individuals qualifying as a small business are exempt from collecting and remitting tax on their retail sales.<sup>109</sup> This section of the Act is supplemented with qualification from Manitoba's tax bulletin RST15-01 which states, "small businesses with annual taxable sales under \$10,000 are not required to register and collect Manitoba retail sales tax (RST) ... Registered businesses under the \$10,000 threshold may cancel their RST number".<sup>110</sup>

Therefore, in conjunction with the Act, tax bulletin No. 050, and tax bulletin RST 15-01 it is reasonable to assume a "consumer" is able to sell their used personal-use property through non-commercial transactions and disregard charging and collecting RST as long as their taxable retail sales of tangible personal property do not exceed \$10,000 in a calendar year.<sup>111</sup> However, after sales exceed the \$10,000 annual threshold, the sales will classify the individual as a

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<sup>107</sup> Bulletin No. 050– Exemption on Used Furniture, Manitoba Finance, last modified July 2013, <https://www.gov.mb.ca/finance/taxation/pubs/bulletins/050.pdf>

<sup>108</sup> Tax Information Officer, Manitoba Finance Office, phone call with author, August 15, 2016

<sup>109</sup> The Retail Sales Tax Act, Continuing Consolidation of the Statutes of Manitoba c. R130 s. 9(2.3)

<sup>110</sup> Notice RST15-01 – Registration Requirement Eliminated for Small Businesses, Manitoba Finance, last modified June 2016, <https://www.gov.mb.ca/finance/taxation/pubs/bulletins/noticerst1501.pdf>

<sup>111</sup> Tax Information Officer, Manitoba Finance Office, phone call with author, August 15, 2016

business.<sup>112</sup> Once receiving this classification, a system for collecting and remitting the RST on sales will be required within the span of one month of breaking that threshold.<sup>113</sup>

The province of Manitoba addresses the issue of used personal-use property in trade-in transactions in Section 2(9) of the Act. The Act states that when tangible personal property is received and accepted at the time of sale by a registered business as a means of payment or partial payment, the purchaser offering the trade-in must pay tax based on the difference between the value of the property being sold and the credit allowed for their property being traded-in.<sup>114</sup> In addition, Manitoba further clarifies the trade-in transaction in Section 2(9.2) by stipulating that what was set out in Section 2(9) can only apply if the property accepted in trade-in was acquired at a retail store.

### Quebec

The Quebec Sales Tax (QST) is calculated at a rate of 9.975 percent as of August 2016 and applies to the sale or supply of most goods and services.<sup>115</sup> The QST is calculated on the price of these goods and services before the GST and it is the responsibility of Quebec to administer both the federal and provincial sales taxes within the jurisdiction of Quebec.<sup>116</sup>

With respect to the second-hand economy, Quebec's sales tax act titled, *An Act Respecting the Québec Sales Tax, CQLR c T-01* offers similar guidance as BC's *Provincial Sales Tax Act* and Manitoba's *Retail Sales Tax Act*. Chapter 6, Division 3 (294) of Quebec's Act

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<sup>112</sup> Notice RST15-01 – Registration Requirement Eliminated for Small Businesses, Manitoba Finance

<sup>113</sup> Ibid.

<sup>114</sup> The Retail Sales Tax Act, Continuing Consolidation of the Statutes of Manitoba c. R130 s. 2(9)

<sup>115</sup> Tables of GST and QST Rates, Revenue Quebec, last modified September 2015, <http://www.revenuquebec.ca/en/entreprises/taxes/tpstvhtvq/reglesdebase/historiquetauxpstvtq.aspx>

<sup>116</sup> Revenue Quebec, *General Information Concerning the QST and the GST/HST, 2005* (Quebec, QC: Revenue Quebec), 8

qualifies an individual as a “Small Supplier” if, “in the course of a given calendar quarter, the total worldwide taxable supplies [do] not exceed \$30,000”.<sup>117</sup> The Act further qualifies that, “the cumulative total of [an individual’s] worldwide taxable supplies for the four quarters preceding the given calendar quarter [must] not exceed \$30,000”.<sup>118</sup> The act defines “supplies” as sales, leases, trades, and barter transactions. Therefore, if an individual maintains sales less than \$30,000 over the course of a year plus a calendar quarter then that individual is not required to register for or collect the GST and QST in the province of Quebec.<sup>119</sup>

In addition to defining and qualifying a small supplier in the province of Quebec, the province also addresses the sale of used property in general through a “special case – tax bulletin”. The province upholds, “as a rule, the sale of used property (including property seized or repossessed by a creditor) is taxable [at the respective HST and QST rates]”.<sup>120</sup> The common example of a registered antique dealer is therefore required to collect taxes on items sold. However, the province of Quebec clarifies that if used personal-use property (exclusive of road vehicles) is sold by a person, “not engaged in commercial activities” then the used personal-use property is not taxable.<sup>121</sup>

The province of Quebec also addresses the trade-in of used property. The province does not clarify whether there are different rules for trade-ins depending on the type of property (personal-use property, listed personal property, commercial property). However, the province

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<sup>117</sup> An Act Respecting the Québec Sales Tax, Compliance of Québec Laws and Regulations. cT-0.1. Retrieved from: <http://canlii.ca/t/52p6r>; Retrieved on: August 16, 2016

<sup>118</sup> Ibid.

<sup>119</sup> Ibid.

<sup>120</sup> Purchases or Trade-Ins of Used Property, Revenue Quebec, last modified February 2015, <http://www.revenuquebec.ca/en/entreprises/taxes/tpstvhtvq/casparticuliers/biensdoccasion.aspx>

<sup>121</sup> Ibid.

does state different rules depending on whether the entity trading-in property (the vendor) is a registrant. If the vendor is not a registrant for the GST and QST, then the vendor does not collect GST and QST on the value of their traded-in property.<sup>122</sup> The entity accepting the trade-in (assuming they are a registrant) is required to, “calculate the taxes on the net amount of the sale ... the sale price of the item minus the trade-in value.”<sup>123</sup>

If the entity trading-in property (the vendor) is a registrant and trades-in property as payment or partial payment to another registered entity, then both parties must collect GST and QST from each other (Table 6).<sup>124</sup> The vendor must collect the GST and QST on the value of the property they are trading-in. The province of Quebec states the value of traded-in property is equal to “[how] much the property was used in the course of the vendor’s commercial activities.”<sup>125</sup> In addition, the entity accepting the property as a trade-in will collect the GST and QST from the full sale price of the property they sell since they are registered and required to do so.<sup>126</sup>

Therefore, when a registered entity sells used property to another registered entity there are two separate transactions. This special case is displayed in the table below, as a registered business sells \$50,000 worth of equipment to the vendor trading-in used property.

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<sup>122</sup> Purchases or Trade-Ins of Used Property, Revenue Quebec, last modified February 2015, <http://www.revenuquebec.ca/en/entreprises/taxes/tpstvhvtq/casparticuliers/biendsoccasion.aspx>

<sup>123</sup> Ibid.

<sup>124</sup> Ibid.

<sup>125</sup> Ibid.

<sup>126</sup> Ibid.

The business grants the vendor \$20,000 as the value of the trade-in and the respective transactions and taxes are accounted for (Table 6).<sup>127</sup>

*Table 6: Registered Vendor Trading-In Used Commercial Property as Partial Payment to a Registered Entity*

<b>Invoice prepared by: Entity Accepting the Trade-In</b>	
Sale price	\$50,000.00
GST (5% * \$50,000)	\$2,500.00
QST (9.975 * \$50,000)	<u>\$4,987.50</u>
Subtotal	\$57,487.50
Trade-In Value (incl. GST & QST)	<u>(\$22,995.00)</u>
Amount Vendor is required to pay	<u>\$34,492.50</u>
<b>Invoice prepared by: The Vendor Trading-In Property</b>	
Sale price	\$20,000.00
GST collected on unused consumption (5% * \$20,000)	\$1,000.00
QST collected on unused consumption (9.975% * \$20,000)	<u>\$1,995.00</u>
Value of Vendor's Trade-In	<u>\$22,995.00</u>

Note. Table as shown in Revenue Quebec's Special Cases Bulletin, Used Sellers. Retrieved from [www.revenuquebec.ca/en/entreprises/taxes/tpstvhtvq/casparticuliers/biensdoccasion.aspx](http://www.revenuquebec.ca/en/entreprises/taxes/tpstvhtvq/casparticuliers/biensdoccasion.aspx)

In the particular example above, both the vendor proposing the trade-in and the business accepting the trade-in are able to claim an input tax credit and an input tax refund for the taxes paid.<sup>128</sup> This is possible because both parties acquired the property in the course of commercial activities. In order for each party to receive their respective credit or refund each must record and provide proof of the amount of GST and QST collected.<sup>129</sup>

#### 5.4 Jurisdictional Scan Conclusions

The results of the jurisdictional scan returned a patchwork of criteria within Canada. The federal government's GST which applies in all subnational jurisdictions addresses second-hand transactions through the two tax rules titled, the "Small Supplier" Exemption and the "New

<sup>127</sup> Purchases or Trade-Ins of Used Property, Revenue Quebec, last modified February 2015, <http://www.revenuquebec.ca/en/entreprises/taxes/tpstvhtvq/casparticuliers/biensdoccasion.aspx>

<sup>128</sup> Ibid.

<sup>129</sup> Purchases or Trade-Ins of Used Property, Revenue Quebec, last modified February 2015, <http://www.revenuquebec.ca/en/entreprises/taxes/tpstvhtvq/casparticuliers/biensdoccasion.aspx>

Trade-In Approach". Provinces that have signed onto the HST assume these approaches to taxing second-hand transactions. Aside from these two approaches, there is no mention of exempting or taxing second-hand transactions in *The Excise Tax Act* or federally issued tax bulletins. Thus, for the Northern Jurisdictions, as well as Alberta, Ontario, New Brunswick, Prince Edward Island, Nova Scotia and Newfoundland and Labrador, if individuals are not surpassing the threshold of activity, then they are not classified as a business. If an individual is not classified as a business and sells used personal-use property, they are able to engage in these casual transactions without collecting sales tax. In addition, the GST /HST system offers guidelines for when non-registered individuals trade-in their used personal-use property to a registered used-goods dealer. These types of casual transactions are guided by the rules established under the "New Trade-In Approach".

In contrast to the homogenous approach maintained in the GST /HST jurisdictions, provinces with an independent sales tax system present minimal deviation from the federal government's approach. The provinces of BC, Manitoba and Quebec issue public information regarding "Small Sellers" / "Small Suppliers" that closely parallel that of the federal government's "Small Supplier" exemption. The only element of slight variation occurs in B.C.'s and Manitoba's lower threshold for registering an individual generating revenue from second-hand transactions. Manitoba is the only jurisdiction that directly states in tax bulletins that all non-commercial transactions are not subject to RST. Saskatchewan presents the only jurisdiction that does not define a "Small Seller" nor does the province indicate a revenue threshold for transactions to remain under before being classified as a business operation. Saskatchewan is the only jurisdiction which imposes a threshold on the buyer of used property.

Each province with an independent sales tax issue public information regarding acceptable trade-in practices. BC, Saskatchewan, Manitoba and Quebec each maintain policies regarding the trade-in of second-hand items that parallel those of the federal government’s “New Trade-In Approach”.

## **6.0 Discussion of the Jurisdictional Scan & Literature Findings**

Section 5.0 addresses the current state of affairs of casual sales in each subnational jurisdiction in Canada under the HST/GST, PST, RST and QST systems. Moving forward, the research will discuss how the theory described in the literature review agrees and disagrees with the federal and provincial approaches. Through this discussion, the research design intends to provide an understanding of how Canadian jurisdictions are dealing with taxation of the second-hand economy and how current approaches align with the theoretical context of best practice taxation.

### **6.1 Federal Government Policies & the Literature**

The federal government’s HST/GST “Small Supplier” exemption as well as the “New Trade-In Approach” are the two policies which govern casual transactions in the second-hand economy. These policies apply in the provinces of Alberta, New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario and Prince Edward Island as well as Northwest Territories, Nunavut and Yukon territories. Therefore, these approaches to exempt transactions in the second-hand economy from taxation are the most widely used in Canada and have been in practice well before the emergence of internet-based platforms such as Kijiji.<sup>130</sup>

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<sup>130</sup> Revenue Canada, *GST/HST Memoranda Series, 2000* (Ottawa, ON: Revenue Canada), 1

The federal government's "Small Supplier" exemption is supported by the literature as an appropriate means of addressing taxation of the second-hand economy. The 1990 study by Pomp & Oldman introduces the term "casual sales / casual transactions" and the notion of exempting transactions between two non-registered individuals. The authors insist that this exemption is not borne out of normative considerations but rather administrative efficiencies.<sup>131</sup> The federal government's HST/GST "Small Supplier" exemption allows an individual to sell their used personal-use property through non-commercial transactions as long as sales remain below a floating total of \$30,000 over the preceding 12 months and subsequent 12 months. The federal government assumes individual sellers will price their used personal-use property accordingly in the second-hand market and account for the original sale price of item, including the tax they paid during the original transaction. The federal government's approach further agrees with Pomp & Oldman as it gives the responsibility of reimbursement to the individual selling their property.

The federal government operates in a manner that is illustrated by Pomp & Oldman in Table 3 of this report. This aligns with the authors' conclusion from their study which states, "normatively correct results are achieved either by exempting casual sales or by taxing casual sales then reimbursing the original owner of the used item for sales taxes paid on the un-enjoyed consumption".<sup>132</sup> Schenk et. al. discredit the alternative approach of taxation and reimbursement (shown in Table 4) and thus provide further support for the federal

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<sup>131</sup> Pomp & Oldman, *A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins*, 428

<sup>132</sup> Pomp & Oldman, *A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins*, 428

government's "Small Supplier" exemption. It is unreasonable to expect the government to determine the correct value of reimbursement for each casual transaction since items of used personal-use property vary greatly. Casual sales present a range of items and prices and a system of taxation and reimbursement is vulnerable to miscalculating the remaining value of a used item after partial consumption.

The federal government garners support from Pomp & Oldman as well as Schenk et. al. as both studies conclude that a tax on the sale between two non-registered individuals selling used personal-use property is not necessary based on administrative and economic understandings of normative taxation.

The federal government also accounts for the sale and purchase of used property through the "New Trade-In Approach". With respect to the trade-in of used property in a transaction between two registered entities, Schenk et. al. noted a Tax Credit VAT had the redeeming quality of ensuring that used property sold by a registrant is taxable.<sup>133</sup> Under the federal government's "New Trade-In Approach" when a transaction involving used property occurs between two registered entities, the appropriate amount of tax is collected on both the traded-in item as well as the new product.<sup>134</sup> Therefore, Canada's approach fulfils the same desirable objective highlighted by Schenk et. al. This scenario of a transaction among two registrants involving used property is demonstrated in Table 6, as the federal government's "New Trade-In Approach" is identical in operation to the province of Quebec's policy on traded-in property by a registered entity.

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<sup>133</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 184

<sup>134</sup> Certified General Accountants of Ontario, *Toronto: Harmonized Sales Tax in Canada, 2009* (Toronto, ON: Ontario's CGA), 7

The example of a non-registrant trading-in used personal-use property to a registrant (e.g. used-goods dealer) as payment or partial payment, and then that registrant subsequently selling that item as inventory with applicable tax is addressed in the literature as an area of concern. Schenk et. al. suggest that if a registrant sells inventory acquired through this type of transaction and there is non-creditable VAT included in selling price, then there is a possibility of a value added tax being imposed more than once and thus creating a cascading effect of VAT.<sup>135</sup> In order to avoid this cascade effect, Schenk et. al. as well as Ecobici et. al. state that tax should be imposed on the “real value added by the dealer” which is represented by the difference between the VAT-exclusive purchase price and the VAT-exclusive selling price, otherwise referred to as the used-goods dealer’s profit margin.<sup>136</sup> The federal government’s “New Trade-In Approach” agrees with Schenk et. al. and Ecobici et. al. as the policy requires the entity accepting the trade-in to collect tax on the net amount of the sale. In addition, the federal government’s “New Trade-In Approach” expressly excludes the non-registrant from collecting tax on used personal-use property.

## 6.2 BC Policies & the Literature

The province of BC refers to non-registered individuals making casual sales as “Small Sellers” and lays out more stringent criteria required to achieve this qualification than the federal government. An individual selling used personal-use property in BC will have to register and begin collecting PST on their sales once passing the threshold of \$10,000 within a 12-month

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<sup>135</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 185

<sup>136</sup> Nicolaw Ecobici, Lucia Popa-Paliu, & Ionela-Claudia Dina, “Tax and Accounting Implications of the Use of Special Charge Schemes for Second-Hand Goods to the Pawn Shops in Romania” *Annals of the University of Petrosani, Economics* 10 (2010): 137

time period.<sup>137</sup> Therefore, the province is aligned with the findings of Pomp & Oldman as individuals are able to conduct casual transactions without the administrative or economic burdens of taxation. Further, in alignment with Pomp & Oldman, the province of BC holds the small seller responsible for correctly reimbursing themselves for the amount of taxation and consumption they have realized on a particular item of used personal-use property before selling.

The provincial threshold for “Small Sellers” is 66% less than the federal government’s threshold for “Small Suppliers” to register for HST/GST. A more stringent threshold for requiring tax on casual transactions has not been addressed in the literature. For this reason, it is worthwhile to investigate the effectiveness of BC administering a lower threshold than what the federal government uses.

BC also deviates from the federal government’s criteria as it requires all individuals qualifying as “Small Sellers” to maintain records as required by the regulations under the *Provincial Sales Tax Act*. Record keeping has not been addressed by the federal government regarding casual sales under the \$30,000 threshold and according to Schenk et. al. it is an action with negligible results. Schenk et. al. refer to the Australian Tax Office which states, “it would be difficult for the government to verify the authenticity of these receipts because these consumers would not be subject to VAT audits.”<sup>138</sup> For this reason, it is worthwhile to investigate the response of the province requiring non-registered sellers to record their casual sales.

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<sup>137</sup> Provincial Sales Tax Bulletin 003 – Small Sellers, Ministry of Finance, British Columbia, last modified February 2016, [http://www.sbr.gov.bc.ca/documents\\_library/bulletins/pst\\_003.pdf](http://www.sbr.gov.bc.ca/documents_library/bulletins/pst_003.pdf)

<sup>138</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 182

With respect to used property in trade-in transactions, the province specifies that if a non-registrant trades-in used property to a registered entity (e.g. used-goods dealer) as a form of payment or partial payment towards a new item, then tax is to be charged on the difference between the sale price of the new item, less the amount accepted for the trade-in. This is aligned with the findings of Schenk et. al. and Ecobici et. al. which call for taxing the profit margin.<sup>139</sup>

### 6.3 Saskatchewan Policies & the Literature

The province of Saskatchewan differs from the federal government and BC's approach to guiding casual transactions in the second-hand economy as it does not define or qualify a "Small Seller". However, the province does align with the findings of Pomp & Oldman as it exempts taxation of casual transactions with a tax deduction. If non-registered individuals exchange used personal-use property in a non-commercial transaction, then PST is applied to that transaction, less a deduction of \$300. Therefore, with a current PST rate of 5%, individuals can sell used personal-use property without collecting sales tax as long as the value of the item is \$6,000 or less.<sup>140</sup>

This tax deduction differs from all other jurisdictions in Canada and is not mentioned in the literature. Saskatchewan does not define a sales threshold and there is no temporal constraint on non-registered individuals engaging in casual sales. According to the literature it is sensible to define and qualify a "Small Seller" threshold along with a time constraint on sales

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<sup>139</sup> Nicolaw Ecobici, Lucia Popa-Paliu, & Ionela-Claudia Dina, "Tax and Accounting Implications of the Use of Special Charge Schemes for Second-Hand Goods to the Pawn Shops in Romania" *Annals of the University of Petrosani, Economics* 10 (2010): 137

<sup>140</sup> Provincial Sales Tax Bulletin 58 – Information on the Taxation of Used Goods, Ministry of Finance, Saskatchewan, 2

revenue as a means of aligning the province with other jurisdictions and offer enhanced guidance for casual sales of all sizes and frequencies.<sup>141</sup>

The province specifies that if a non-registrant trades-in used property to a registered entity (e.g. used-goods dealer) as a form of payment or partial payment towards a new item, then tax is to be charged on the difference between the sale price of the new item, less the amount accepted for the trade-in. This is aligned with the findings of Schenk et. al. and Ecobici et. al. which advocate for the taxing of the profit margin in an effort to avoid multiple taxation and a cascading VAT.<sup>142</sup>

#### 6.4 Manitoba Policies & the Literature

The findings of Pomp & Oldman are directly addressed by the province of Manitoba. Expressly stated within a tax bulletin is the exemption of all used personal-use property from taxation if items are exchanged through a non-commercial transaction. Manitoba does impose a threshold on the amount of casual sales which equates to \$10,000 or less in a calendar year. However, instead of qualifying sellers below this threshold as “Small Sellers”, the province considers sellers over this threshold as businesses. This presents a different approach than what the federal government and the province of BC have pursued, however it aligns accordingly with the literature and ensures clarity for all non-registrants selling less than \$10,000 in a 12-month period.

The province of Manitoba specifies that when used property is accepted as a trade-in as a means of payment or partial payment the individual offering the trade-in is to be taxed on the

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<sup>141</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 184

<sup>142</sup> Nicolaw Ecobici, Lucia Popa-Paliu, & Ionela-Claudia Dina, “Tax and Accounting Implications of the Use of Special Charge Schemes for Second-Hand Goods to the Pawn Shops in Romania” *Annals of the University of Petrosani, Economics* 10 (2010): 137

difference between the sale price of the new item, less the amount accepted for the trade-in. This is the same policy as the federal government, the province of BC and the province of Saskatchewan. Therefore, Manitoba is aligned with the findings of Schenk et. al. and Ecobici et. al. since traded-in used property is taxed on the profit margin of the registered dealer accepting the trade-in, thus avoiding multiple taxation and a cascading VAT.<sup>143,144</sup>

### 6.5 Quebec Policies & the Literature

Quebec operates policies regarding the second-hand economy that are the most similar to federal government. The province maintains the same qualifications and sales thresholds to define “Small Suppliers” as the federal government maintains. For this reason, the province of Quebec is aligned with the findings of Pomp & Oldman, since casual transactions are permitted to operate without taxation and the responsibility of determining adequate compensation for previous taxes paid and consumption enjoyed is the individual’s responsibility.<sup>145</sup> Unlike the other provinces operating their own sales tax, Quebec implements a threshold for “Small Suppliers” to not exceed \$30,000. The literature does not address the merits of setting a high or low threshold for reporting sales for tax purposes.

The province of Quebec provides extensive explanation for the presence of used property in trade-in transactions. In lockstep with all other jurisdictions, Quebec addresses the findings of Schenk et. al. and Ecobici et. al. as tax is applied on the profit margin of the entity

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<sup>143</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 184

<sup>144</sup> Nicolaw Ecobici, Lucia Popa-Paliu, & Ionela-Claudia Dina, “Tax and Accounting Implications of the Use of Special Charge Schemes for Second-Hand Goods to the Pawn Shops in Romania” *Annals of the University of Petrosani, Economics* 10 (2010): 137

<sup>145</sup> Pomp & Oldman, *A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins*, 429

accepting the trade-in from the non-registered individual.<sup>146,147</sup> Quebec also provides detailed guidance on used property traded-in between two registered entities. This scenario was addressed briefly by Pomp & Oldman and the risk of the state collecting more sales tax than the amount of consumption that occurs is present. For this reason, the province issued a tax bulletin which exemplifies how the double transaction that occurs when used property traded-in by one registered entity is accepted by another registered entity.

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<sup>146</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 184

<sup>147</sup> Nicolaw Ecobici, Lucia Popa-Paliu, & Ionela-Claudia Dina, "Tax and Accounting Implications of the Use of Special Charge Schemes for Second-Hand Goods to the Pawn Shops in Romania" *Annals of the University of Petrosani, Economics* 10 (2010): 137

## 6.6 Discussion Summary

The integration of results discussed throughout Section 6.0 display how various jurisdictions in Canada address the taxation of the second-hand economy in similar ways. The results are summarized in table 7 on the following page. The province of BC and Quebec present two jurisdictions that maintain authority over a provincial sales tax, yet approach exempting small suppliers in a manner that is similar to the GST /HST system. A notable deviation exists where BC imposes a lower threshold of \$10,000 as opposed to the \$30,000 threshold under the GST /HST system. In addition, BC and Quebec also replicate the GST /HST system's "New Trade-In Approach".

The provinces of Saskatchewan and Manitoba do not maintain a category titled "Small Seller" or "Small Supplier" however policies are used that achieve similar results as what is achieved under the GST /HST, BC's PST and Quebec's QST. Further, the provinces of Saskatchewan and Manitoba also address the trade-in of used items in the same manner as all other sales tax jurisdictions in Canada.

The discussion throughout Section 6.0 has integrated the understandings from the literature with the findings from each sales tax jurisdiction's current practices. This section intended on answering the question: how do approaches in Canada regarding the taxation of casual sales in the second-hand economy align with the academic understanding and theoretical findings in the relevant tax literature? Through the discussion process, it is apparent that all jurisdictions in Canada that administer a sales tax are in alignment with the academic understandings of how the respective taxation should operate.

Table 7: Integration of Literature and Jurisdictional Findings

Sales Tax Jurisdiction	Jurisdiction's Approach to Taxing Transactions in the Second-Hand Economy	Necessary Criteria for Taxing Transactions in the Second-Hand Economy (as informed by the literature)	Does the Jurisdiction Align with the Literature?
GST /HST Alberta, The North, Ontario, New Brunswick, Prince Edward Island, Nova Scotia, Newfoundland and Labrador	1) HST/GST "Small Supplier" exemption 2) "New Trade-In Approach"	1) Exempt casual transactions of used personal-use property between two non-registered individuals <ul style="list-style-type: none"> <li>○ "normatively correct results are achieved either by exempting casual sales or by taxing casual sales then reimbursing the original owner of the used item for sales taxes paid on the un-enjoyed consumption".<sup>148</sup></li> <li>○ Administratively burdensome to maintain a system of taxation and reimbursement</li> </ul> 2) When a non-registered individual sells a used item to a registered used-goods dealer, the entity accepting the trade-in is to collect tax on the net amount of the sale <ul style="list-style-type: none"> <li>○ If a registrant sells inventory acquired through this type of transaction and there is non-creditable VAT included in selling price, then there is a possibility of a value added tax being imposed more than once and thus creating a cascading effect of VAT. In order to avoid this cascade effect, Schenk et. al. as well as Ecobici et. al. state that tax should be imposed on the "real value added by the dealer" which is represented by the difference between the VAT-exclusive purchase price and the VAT-exclusive selling price, otherwise referred to as the used-goods dealer's profit margin".<sup>149</sup></li> </ul>	Yes
PST British Columbia	1) BC's "Small Seller" exemption 2) BC's trade-in policy ensures tax is charged on the difference between the sale price of the new item, less the amount accepted for the trade-in.		Yes
PST Saskatchewan	1) No "Small Supplier" or "Small Seller" exemption. But a tax deduction exists to exempt casual transactions below \$6,000 from collecting PST 2) Saskatchewan's trade-in policy ensures tax is charged on the difference between the sale price of the new item, less the amount accepted for the trade-in		Yes
RST Manitoba	1) No "Small Supplier" or "Small Seller" exemption. But individuals selling more than the threshold are qualified as businesses 2) Manitoba's trade-in policy ensures tax is charged on the difference between the sale price of the new item, less the amount accepted for the trade-in		Yes
QST Quebec	1) Quebec maintains a practice that mimics the GST/HST "Small Supplier" exemption 2) Quebec maintains a practice that mimics the GST/HST "New Trade-In Approach"		Yes

<sup>148</sup> Pomp & Oldman, *A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins*, 428

<sup>149</sup> Schenk, Thuronyi, & Cui, *Value Added Tax: A Comparative Approach*, 182

## 6.0 Conclusion

The integration of the literature review with the description of each jurisdiction's policies regarding the second-hand economy returned modest results. It is apparent that all sales tax systems in Canada adequately address transactions in the second-hand economy. There are policies in place in each jurisdiction that are supported by the literature and operate to limit the potential for multiple taxation and cascading taxation when a used product is sold to a second consumer.

The literature highlighted the importance of allowing most casual transactions to occur without taxation. This exemption is not borne out of normative considerations, but rather administrative and economic factors. Casual sales are more appropriately managed by the individuals that conduct them and thus, do not require a system of taxation and reimbursement in order to achieve optimal outcomes. In addition, governments need to be wary of potential multiple taxation and cascading effects of taxation when used personal-use property is sold by non-registrants to registered businesses or used-goods dealers. Registered businesses should follow the special charge schemes highlighted in the literature and apply taxation to the profit margin on that item accepted at trade-in.

The description of current policies across Canada exposes the moderate variations in exemption criteria for transactions in the second-hand economy in each jurisdiction. The policies implemented by the federal government maintain the largest impact as they regulate sales in nine of the 13 subnational jurisdictions. The federal government's GST/HST "Small Supplier" exemption as well as the "New Trade-In Approach" are the most detailed policies in the country for addressing the sale of used personal-use property among non-registrants and registrants. Of the provinces that maintain independent sales taxes, Quebec puts forth the

most similar and detailed policies as the federal government, since the province of Quebec nearly replicates the “Small Supplier” exemption and “New Trade-in Approach”. The provinces of BC and Manitoba present slightly more aggressive thresholds on limiting the amount of non-registered sales. However, these provinces lack the extensive description that the federal government and Quebec government provide for transactions in the second-hand economy. Lastly, the province of Saskatchewan neglects to provide a level of description equal to that of all other jurisdictions in Canada regarding the second-hand economy.

The outset of the literature review introduced the multiple layers of authority in Canada regarding sales taxation. Most provinces and all of the territories have signed over the authority of administering sales tax in their region to the federal government. Through this harmonization, a one-time value-added tax reduces administration costs and simplifies the tax system. Although there is merit behind each of the respective provinces maintaining authority over their regional sales tax, knowledge sharing between the two levels of authority can occur. Provinces can adopt the federal government’s policies regarding the taxation of transactions in the second-hand economy as a means of securing robust and descriptive guidance for market participants.

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## 7.0 Appendices

### 7.1 Peripheral Tax Theory: Value Added Taxation

A value added tax (VAT) is defined in Section 2.0 as a tax on the value a business adds to the materials it buys from other firms as it produces its own product.<sup>150</sup> Carl Shoup illustrates this with a consumer purchasing a loaf of bread. Throughout the value chain from the raw wheat, to the milling process, through the bakery and into the retail store, there are additions of value at each step. A VAT is therefore a tax on the value added at each of these steps. The total value (total cost) to the end consumer is the sum total of all these additions in value.<sup>151</sup> A VAT that is imposed on the marginal increases of value throughout the production process is therefore equivalent to a tax levied on the final sale of the loaf of bread.<sup>152</sup>

Carl Shoup states that a VAT has not been introduced in the past as a means of building a country's tax revenue, but instead has been relied upon to replace other types of sales taxes that have defects.<sup>153</sup> The VAT places neutral strain on the value chain and does not disproportionately favour later stages of the production process, much like the turnover tax does.<sup>154</sup> Carl Shoup finds this economic neutrality to be desirable. Shoup extends this characteristic to bolstering equity, since low-income individuals tend to purchase retail goods lower down on the production chain, such as wholesale retailers. The VAT is also more effective as it can target consumption goods while avoiding capital goods.<sup>155</sup> Further, since the

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<sup>150</sup> Carl Shoup, "The Value Added Tax and Developing Countries," *The World Bank Research Observer* 3, no 2. (1988).

<sup>151</sup> Ibid., 139

<sup>152</sup> Ibid.

<sup>153</sup> Ibid.

<sup>154</sup> Ibid., 141

<sup>155</sup> Carl Shoup, "The Value Added Tax and Developing Countries," p. 141

VAT has a broad tax base, it can raise more revenue while maintaining a lower tax rate than other sales taxes with a narrow tax base (e.g. the manufacturers sales tax).<sup>156</sup>

The method used in computing a consumption based VAT is a refinement on the Subtraction Method. Schenk, Thuryoni & Cui state the subtraction method estimates the value added by computing the difference between a firm's outputs and inputs.<sup>157</sup> The refinement to this method, according to Shoup, is called the Tax Credit Method.<sup>158</sup> Through this refinement, there is a deduction of tax on inputs from tax on sales for each tax period. Shoup explains the calculation of the Tax Credit Method:

“A firm first applies the VAT rate to its sales for the taxable period. It then subtracts from this gross tax the sum of the VAT taxes shown on the invoices of the goods and services it has purchased during that period. Thus, against the gross tax on its sales the firm credits this sum of the VAT taxes that its suppliers have charged to it on the firm's purchase invoices”. (144)<sup>159</sup>  
Through Shoup's explanation of the Tax Credit Method for calculating the VAT, he

identifies a deficiency that presents significant implications for taxation of the second-hand economy. The Tax Credit Method does not accommodate firms that exist outside the VAT system, and in turn leads to over-taxation.<sup>160</sup> For example, if a firm is outside the VAT system because it falls under an exemption for small firms, under the Subtraction Method, the VAT is never imposed on the value added by that firm.<sup>161</sup> However, under the Tax Credit Method, when an exempt firm sells to a taxable firm, the taxable firm finds no VAT stated on its

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<sup>156</sup> Ibid.

<sup>157</sup> Alan Schenk, Victor Thuronyi, & Wei Cui, *Value Added Tax: A Comparative Approach* (New York, NY: Cambridge University Press, 2015), 17

<sup>158</sup> Shoup, “The Value Added Tax and Developing Countries,” p. 143

<sup>159</sup> Ibid., 144

<sup>160</sup> Ibid.

<sup>161</sup> Shoup, *The Value Added Tax and Developing Countries*, 144

purchase invoices and therefore realizes no tax credit.<sup>162</sup> Additionally, when an exempt firm purchases inputs from taxable firms, it receives invoices showing the taxes paid by that supplier. The taxes paid by the supplier are now lost since the exempt firm files no VAT.<sup>163</sup> The taxes paid are never creditable and as a result, the total value added is overtaxed. For this reason, Shoup states that all entities buying and selling items large or small, might want to get into the VAT system.<sup>164</sup> With full participation, all sellers would pay VAT on the value they add and in turn, the tax credits on VATs imposed throughout the production process would flow through to the end consumer.

## 7.2 Peripheral Tax Theory: Retail Sales Taxation

Section 2.0 introduced the RST (also referred to as PST) systems in Canada as being a tax imposed once on the final consumption of goods and services. It is also important to understand the concept that an RST will cascade as each organization along the value chain purchases goods and services on which an RST is charged. A cascading effect of a tax occurs when an item receives tax twice and the value of the second tax is calculated on the value arrived at by adding the value of the first tax to the value of the transaction. For example, a baker is able to purchase the ingredients to bake bread and the necessary packaging to sell the bread. The baker is able to make these purchases and exempt them from tax since these items are sold to consumers. However, the baker is also an end consumer herself when she buys items like furniture, office supplies, shelving, and computers among others. The tax paid on these items becomes hidden in the baker's prices for loaves of bread as she attempts to cover

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<sup>162</sup> Ibid.

<sup>163</sup> Ibid.

<sup>164</sup> Ibid.

her costs with gross revenues in the pursuit of profit. Thus, the baker prices her goods to cover costs (including RST paid) plus a markup. It is on this price that the baker collects the RST from the purchase of their bread. The baker calculates the value of the second tax by adding the value of the first tax into her costs, thus generating a cascading effect of taxation.

In an attempt to minimize the cascading effect, tax theory advocates the allowance of exemptions further up the value chain to manufacturers and producers. Under this approach, producers such as the baker are able to acquire production equipment and consumable items that are exempt from retail sales tax.