

Canada
Tax

Contacts

**National Indirect
Tax Leader**
Robert Demers
514-393-5156

Quebec and Atlantic
Robert Demers
514-393-5156

Ontario
Rory Pike
416-874-3330

Mike Matthews
613-751-5310

Toronto
Danny Cisterna
416-601-6362

Doug Myrden
416-601-6197

Prairies
Dean Grubb
780-421-3640

Alberta
Jason Riche
403-267-1702

British Columbia
Janice Roper
604-640-3353

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Increased CRA audits of dental and orthodontic practices

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There has been significant number of GST/HST audits of dental and orthodontic practices in recent months. These enforcement activities undertaken by the Canada Revenue Agency (CRA) have highlighted the inconsistent application of the existing administrative agreement between the federal government and the Canadian Dental Association (CDA).

The administrative agreement

With the introduction of the GST in 1991, it became apparent that the process of determining which supplies were specifically designed for orthodontic appliances (zero-rated supplies for GST) was difficult and led to various contradictory interpretations between CRA and Canadian dentists and orthodontists. In 1998, an administrative agreement was signed between representatives of the CDA, the Canadian Association of Orthodontists (CAO) and the Director of Public Sector Bodies and Governments, GST Rulings and Interpretations Branch, Revenue Canada (as it was then known). The Orthodontic Supplies Agreement (OSA) between the CDA, CAO and CRA intended for all parts for orthodontic appliances to be subject to the GST. Orthodontists and dentists acquiring these parts would be able to recover the tax as a **full 100%** input tax credit (ITC). All other office expenses (such as rent, utilities, office supplies and other dental supplies) are eligible for a **partial ITC**. A separate line item in the financial statements should differentiate the expenses of orthodontic supplies. For administrative purposes, the CRA accepts that dentists who claim ITCs on a periodic basis can use an estimate of 35% of the total cost to the patient of the orthodontic treatment to represent the 'consideration' for the supply of the zero-rated orthodontic appliance. This administrative approach was formulated on the basis that this estimated amount is the maximum charge that can be made for an orthodontic appliance. However, when actual figures are available (such as at year end), there is a requirement to ensure that the claim for ITCs corresponds to actual percentage of taxable/zero-rated supplies rather than estimated figures.

The billing process

Generally, the billing process for dentists and orthodontists operate in one of the following ways:

- 1) An initial payment is required, followed by periodic payments spread over the anticipated duration of the treatment (the most common type);

- 2) The fee is broken down into the charge for the orthodontic services and the charge for the orthodontic appliance; or
- 3) A lump-sum price is indicated for the orthodontic treatment.

Under the OSA, CRA accepted the initial payment portion of the orthodontic treatment plus any appliance fees as the “appliance fee”. The appliance fee cannot be greater than 35% of the total orthodontic fees for calculating the ITC unless the practitioner can justify the larger appliance fee.

What is CRA's policy?

In several of the recent audits of orthodontist practices where the CRA has denied all ITC claims. The CRA has taken the position that the invoices must separately identify the consideration for the supply of the orthodontic appliance from the consideration for the supply of the dental service. This apparent change to their policy with respect to the requirement to separately identify the orthodontic appliance was not part of the OSA and does not appear to be supported by recent case law. As a result of the position being taken, we are seeing dentists/orthodontists who are adhering to the OSA being denied their ITCs claims.

In 2001, the CRA published an interpretation letter confirming the original position taken in 1991. The CRA confirmed that although a dentist/orthodontist can bill the entire orthodontic treatment (dental service and orthodontic appliance) for a single consideration, the orthodontist is still making two different supplies: an exempt supply of dental service and a zero-rated supply of orthodontic appliances. As a result, the CRA confirmed that orthodontists can use the 35% ratio to represent the “consideration” paid for the supply of orthodontic appliance.

In 2004, the CRA published another interpretation letter but with a completely different position. According to this letter, an orthodontist is considered to have made multiple supplies but only where the consideration paid for the orthodontic appliance is identified separately from the consideration for the exempt dental service. However, the CRA confirmed in that same letter that orthodontists can continue to use the 35% ratio to represent the “consideration” paid for the supply of the orthodontic appliance. It is confusing why the CRA agreed with the use of 35% to determine the portion of the “consideration” paid for the supply of the orthodontic appliance if the CRA did not agree with the fact that an orthodontist may have multiple supplies when billing them for one single consideration.

In addition, Revenu Québec, which administers the GST in Québec, notes in its *Interpretation Bulletin* TVQ. 176-4/R2 “Supplies of orthodontic appliances, artificial teeth and health care services” (June 29, 2007) that where the phrase “initial payment” appears on an invoice, the invoice amount will be deemed to be the value of the orthodontic appliance supplied, up to 35% of the total orthodontic fee billed to a client. As such, although the dentist/orthodontist may not identify that separate supplies are provided, as long as “initial payment” is on an invoice, the 35% ratio can be used. It is interesting to note that Revenu Quebec is not disallowing ITCs for dentists/orthodontists.

It is clear the conflicting interpretations are leading to confusion in the industry. It is also important to note that these public statements may not be legally binding in a court of law.

What can you do?

To reduce the risk of having ITCs denied by a CRA auditor, Deloitte strongly suggests that dentists/orthodontists modify their billing processes from this point forward. Orthodontists should separately identify the consideration for the zero-rated supply of the orthodontic appliance from the consideration for the exempt supply of the orthodontic service.

Based on our discussions with senior officials at the CRA, we understand they are currently reviewing all of their administrative policies regarding dentists/orthodontists. It appears that the CRA may be contemplating a new position which may deny all ITCs claimed by dentists/orthodontists. Specifically, CRA is considering adopting a policy position based on the understanding that dentists/orthodontists are providing a single supply of an exempt health care service. This new position would be applicable to all type of billings made by orthodontists. Therefore, even where the consideration for the zero-rated supply of orthodontic appliances would be identified separately from the consideration for the exempt supply of the orthodontic service, the supply would be deemed to be a single supply of exempt orthodontic services. We were also informed that if CRA were to enforce a new more restrictive approach that this would be done on a prospective basis. Until such time a new policy is communicated to the industry, we will be forced to deal with GST/HST audits on a case-by-case basis.

If you would like to discuss these or any other indirect tax matters, please contact your local Deloitte indirect tax contact or any of the Deloitte practitioners listed in this newsletter.

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2 Queen Street East, Suite 1200
Toronto, ON M5C 3G7 Canada

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