

PP011 – GST/HST & Surety Bond Premiums

Introduction

The Surety Association of Canada often encounters a widespread misunderstanding about GST/HST and its application to surety bonds. Many question the practice of calculating the surety bond premium on the Contract Price inclusive of the GST/HST since both the contract amount and the bond amount are normally expressed exclusive of GST/HST. The Surety Association of Canada points out that notwithstanding the amounts expressed in the bond itself, the bonding company is required to pay GST/HST on claims and cannot recover these disbursements through input tax credits. It is SAC's position that a surety company is entitled to be compensated for this additional exposure if it so chooses.

Background

The Surety Association of Canada frequently receives calls from contractors, construction purchasers and design professionals inquiring as to how bond premiums are calculated with respect to the GST/HST.

Typically, when computing the premium for performance and payment bonds, a surety company will add the GST/HST to the base price shown in the contract documents in order to apply the contractor's premium rate. The construction community has often expressed concern about this practice and argues that since the contract price and the bond amount are expressed exclusive of GST/HST, a surety should not add the tax to the contract price when calculating the premium.

Unfortunately, the issue is not that straightforward and the rules that apply to contractors and most construction purchasers do not apply to bonding companies. The business of surety is underwritten by appropriately licensed insurance companies, which are not eligible GST/HST registrants. As providers of an exempt service, sureties are required to pay GST/HST on claims and unlike contractors; they cannot recover these payments through input tax credits.

The Surety Association of Canada does not involve itself in the pricing of the product and individual members are responsible for setting their own pricing policy. However, we are pleased to offer the following observations and explanations with respect to the application of GST/HST to surety bonds.

1. Contrary to one popular misconception, despite amendments to the Excise Tax Act over the years, no changes were made to the surety bond's status as a non-commercial activity. Bonds are still "exempt" from GST/HST and premiums do not include the 5% (or higher in harmonized jurisdictions) tax levy.
2. The Excise Tax Act does address claims issues on performance bonds, but only where a surety elects to complete under the "surety completes the contract method" (Option 2 under the standard CCDC 220 – Performance Bond). Under this provision of the Act, the surety may collect GST/HST and receive input tax credits for unpaid monies it receives from the Obligee under the original contract.

However, the surety remains responsible for GST/HST on monies it pays out in excess of the contract price (the surety's loss) and cannot recover GST/HST on the loss amounts. For example, consider the case of a \$ 1 million contract in a non-harmonized jurisdiction where the Principal defaults after having invoiced and received \$500,000, and where the surety arranges for completion of the outstanding work for \$700,000. The surety will collect \$500,000 plus \$25,000 in GST from the owner and may apply that amount to its completion cost. On the \$200,000 loss however the bonding company must pay the \$10,000 GST to its completing contractor and has no way of recovering through the input tax credit (ITC) mechanism.

For performance bond settlements using methods other than Option 2 there has been no change. The surety remains responsible for an Obligee's GST/HST on any amounts in excess of the original contract price.

3. With respect to labour and material payment bonds, there is little doubt that a surety has GST/HST exposure here as settlements represents payment for taxable supplies/services already rendered. Claimants must collect and remit the tax on the amount collected from the surety for the defaulted Principal.

Taking these factors into consideration, we can summarize as follows:

- Under the Excise Tax Act, the scope of the surety's exposure includes GST/HST under both the performance and payment bonds.
- Given that the law imposes GST/HST responsibility on surety companies in the settlement of claims, it is understandable that a bonding company may want to include that risk in the calculation of its premium.

Glossary of Terms

Obligee

An individual or organization in whose favour an obligation is created and to whom a bond is given.

Principal

The individual or organization that bears the primary responsibility for fulfilling the obligation under the written contract referenced in the bond and that has the duty to perform for the Obligee's benefit.

Surety

The party to a surety bond who answers to the Obligee for the Principal's default or failure to perform as required by the underlying contract, permit or law.

This paper is intended to serve as a general guideline to assist members and other readers in responding to the issues discussed. Nothing contained herein should be construed as legal advice and readers are cautioned to consult with legal counsel for such advice.

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