

The HST Issue:

Planning for Ontario's Harmonized Sales Tax (HST)

Introduction

This newsletter will provide you with an overview of some of the topics your business needs to consider to prepare for Ontario's HST. There are many technical rules to take into account before the July 1st implementation date as well as some possible cost-saving opportunities.

Overview and Basic HST Rules

The HST will be a federally administered sales tax of 13% that will be modeled after the GST and will include the Ontario Retail Sales Tax (8%).

There will be no separate registration for HST. If a supplier is registered for GST then the supplier is automatically registered for HST. Small suppliers with annual sales of less than \$30,000 will not have to register for HST unless they wish to.

If a good or service is currently zero-rated for GST purposes (i.e. it is taxable for GST purposes at a rate of 0%), it will continue to be zero-rated for HST. Similarly, if the goods or services are exempt from GST, they will be exempt for HST.

For goods and services that are currently subject to the Ontario Retail Sales Tax (PST) businesses will:

- collect and remit HST on the sale of services and goods provided or made in Canada
- be eligible to claim input tax credits (ITC's) for the HST paid on expenditures (subject to some restrictions discussed below)
- possibly benefit from a savings of 8% by claiming back the provincial component of the HST that was not refundable as the PST

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For goods and services that are currently PST exempt, there may be cash flow issues as you will be required to pay 13% HST on your purchases instead of the 5% GST you currently pay. Businesses will not be able to use purchase exemption certificates that were available for Ontario retail sales tax. You will be eligible to claim back the ITC's for the HST paid (subject to some restrictions discussed below) when you file your HST returns.

Ontario will continue to administer the land transfer tax, employer health tax, fuel tax and gasoline tax. The unrecoverable 8% PST will continue to apply to insurance premiums and used vehicles.

The province will require point of sale rebates of the provincial portion of the HST (8%) for these items:

- Children's clothing and footwear
- Car seats and car booster seats
- Diapers and feminine hygiene products
- Books and audio books
- Print newspapers
- Prepared foods and beverages sold for less than \$3

In other words, retailers will only need to collect 5% GST for these products and not the full 13% HST. But they will need to show how the rebate of the provincial component of the HST reduces the tax paid to 5%.

Businesses will be charged HST on almost everything they pay for including:

- Rent
- Temporary placement workers
- Internet access
- Computer software
- Electricity
- Services such as legal, accounting, bookkeeping, janitorial
- Equipment and supplies

- Postage and shipping

Individuals will pay HST on almost everything they purchase including:

- Services such as photography, legal, veterinarian, landscaping
- Internet fees
- Software
- Postage and shipping
- Fitness and golf memberships and fees
- Sports classes
- Gas, oil, electricity
- Restaurant meals
- Haircuts, manicures

Ontario vendor compensation paid to businesses that collect and remit PST will be eliminated as of April 1st, 2010.

To compensate small businesses for the increased compliance costs of administering the HST, the government has proposed the small business transition credit. The credit is a onetime rebate and will be based on a business' or a group of companies' total taxable revenue in the third quarter of 2010.

Small Business Transition Credit	
Taxable Revenue July 1- Sept 30, 2010	Small Business Transition Credit
Less than \$15,000	\$300
\$15,000 – 50,000	2% of taxable revenues
\$50,000 - \$500,000	\$1,000

Individuals will also be eligible for a sales tax transition credit of up to \$300 per individual or \$1,000 per family. These credits will be reduced by 5% for income over \$80,000 per individual or \$160,000 per family.

Input Tax Credit Restrictions

Financial institutions and businesses or groups of companies with annual sales of more than \$10 million (including zero-rated revenues) will not be able to claim the provincial component of their ITC's on the following groups of expenses for the first five years:

- Energy (unless it is used to manufacture goods or to farm)
- Telecommunication (except for internet access and toll-free numbers)
- Road vehicles that weigh less than 3,000 kilograms, their parts and some services
- Fuel for road vehicles
- Food, beverages and entertainment

Eligibility to claim ITC's on these expenses will be phased in over the next 3 years as follows:

- 25% in year 6
- 50% in year 7, and
- 75% in year 8.

Businesses or groups of companies that have sales close to the \$10 million threshold will need to be prepared to repay some of the ITC's claimed

during the year if sales for the year exceed \$10 million. These companies should ensure that they account for the federal and provincial components of these ITC's separately, for example by creating separate accounts in their accounting systems.

Transitional Rules

The Ontario government has released transitional rules related to the implementation of the HST. The rules address transactions that straddle the July 1, 2010 implementation date.

Services

- No HST on services, if 90% of the services are performed prior to July 1, and payment is received by November 1, 2010
- If payments are made after November 1, HST will apply
- No HST on prepayments received prior to May 1, 2010, and
- Purchasers will be responsible for self-assessment of HST on any prepayments made from October 14, 2009 to May 1st, 2010 if the services will be performed after July 1.

There are special rules that you should review



with your advisor if you are engaged in the following services:

- funeral and cemetery services
- passenger transportation
- freight transportation

No HST is required on payments made prior to July 1st for magazine, newspaper and other periodical subscriptions.

Intangibles

HST will apply based on when payment is made. The time of the transfer of the intangible is irrelevant.

There are special rules that you should review with your advisor if you are engaged in sales of the following intangibles:

- memberships
- admissions
- passenger transportation passes



Tangible Personal Property

For tangible personal property the transfer of ownership or the time possession is taken determines if HST is applicable.

Prepayments are not subject to HST if they are made before October 14, 2009.

There are special rules for instalment contracts and leases that you should review with your advisor.

Real Property

Purchasers of new homes bought as primary residences will be eligible for the New Housing Rebate. The rebate will be equal to 75% of the 8% provincial component of the HST, up to a maximum of \$24,000.

Homes purchased for more than \$400,000 will be eligible for the maximum rebate of \$24,000.

Winding Down PST

The PST will cease to apply on most items as of July 1, 2010.

If the HST does not apply to an item that PST applied to, then the PST will continue to apply (e.g. insurance premiums).

PST returns must be filed before October 31, 2010 to be eligible for a refund of PST.

There are special transitional rules for real property contracts and returns and exchanges of goods and services.

The vehicle rules have not been announced yet.

Place of Supply Rules

The place of supply rules will determine which province a supply is made in and which provincial taxes are applicable (e.g. QST, HST).

Supply of goods

The place of supply is the province where the goods are physically delivered or made available.

Supply of real property

The place of supply of real property is the province where the property is situated.

Supply of services

The place of supply for services is usually the province where 90% or more of the service is performed. When less than 90% of the service is supplied in any one province, the province of negotiation (i.e. where the contract is signed),

must be considered. If 10% or more of the services are provided in a province and that province is the province of negotiation then that province is the province of supply. If neither of these conditions apply then the place of supply becomes the province where 50% or more of the service is provided.

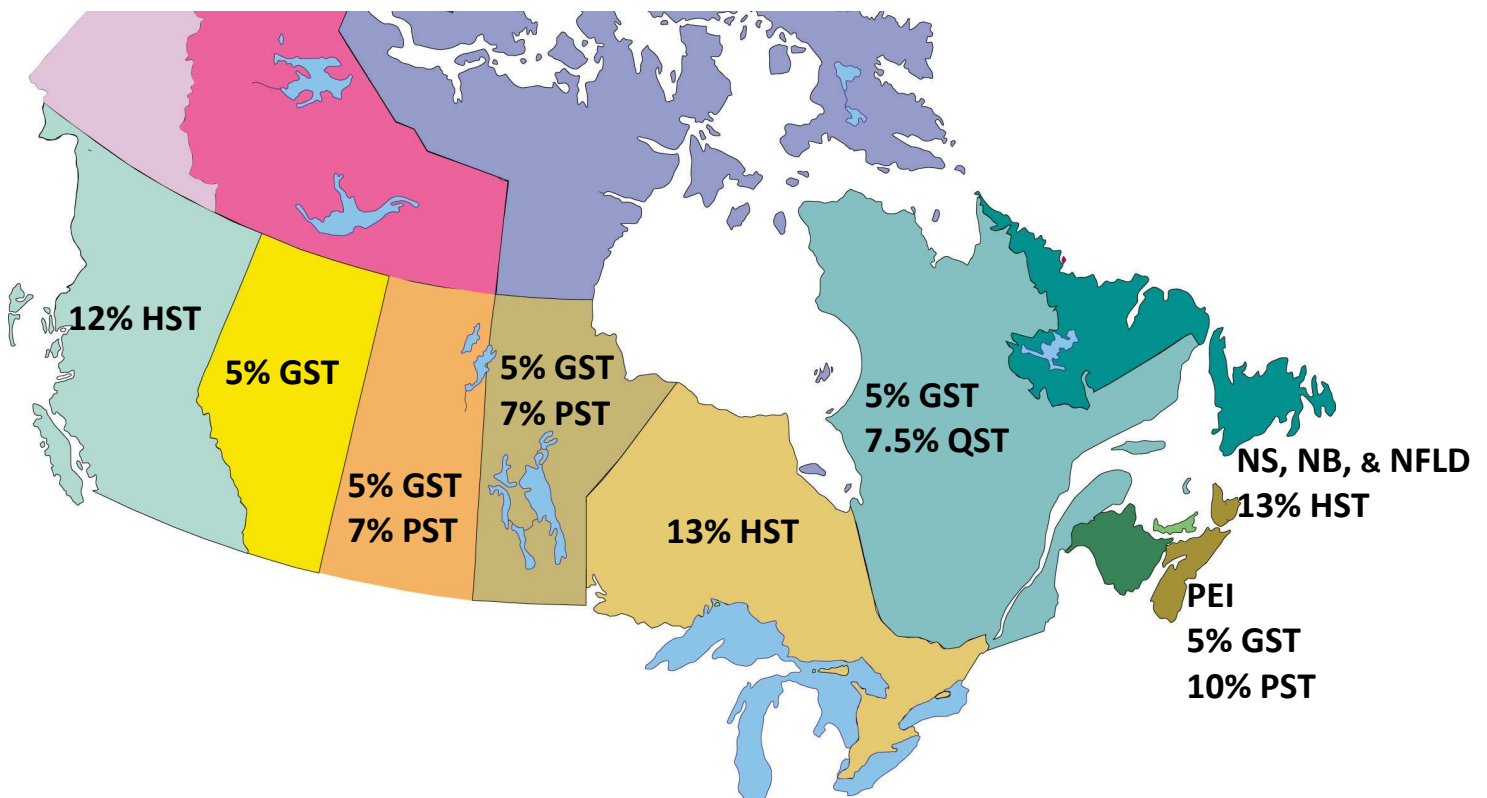
There are several rules specific to certain circumstances (e.g. freight transportation services, memberships, certain repair services, internet service providers, RRSP's) that can be complex and should be discussed with your tax advisor.

Accounting and Systems

There are a number of system and accounting issues that businesses may need to consider including:

- Changing point of sale machines and/or other sales software to calculate one tax of 13%

Provincial PST, GST and HST Rates



- Creating special codes for point of sale rebates to show how the rebate of the provincial component of the HST reduces the tax paid to 5% on certain items (listed above)
- Creating new general ledger accounts to track HST collected and paid after June 30th on regular payments and on prepayments after April 30th if the goods or services will not be provided until July 1st or later
- Creating separate general ledger accounts for claiming ITC's on restricted and non-restricted expenses, e.g. 5% of the ITC is when restrictions related to the transitional rules apply and the 13% ITC is when both the provincial and federal components will be refunded. The proper differentiation of the two types of ITC's may become an area targeted by CRA audits for businesses near the \$10 million threshold for restricted ITC's.
- Reviewing transitional rules to determine if any prepayments are subject to HST
- Implementing procedures to charge HST on amounts not collected before November 1st
- Adjusting automatic accounting entries for HST (e.g. rent, management fees)
- Ensuring systems track the old tax rates and the new HST rates during the transition period
- Adjusting the GST rate charged on employee benefits to reflect the new HST rates
- Paying particular attention to reimbursements of employee expense claims as meals and entertainment may be subject to the restricted ITC rates (for large businesses)
- Updating cash flow projections. Companies that did not pay the 8% PST because of purchase exemption certificates will have to pay the HST and claim the ITC's later. There

may be negative cash flow implications for large volume purchases.

- Considering the competitive disadvantage of charging customers outside Canada HST
- Testing systems for different scenarios to ensure the appropriate rates are being charged
- Avoiding tax inclusive pricing contracts or fixed price contracts if they will extend beyond July 1, and
- Considering the impact of harmonization on real property contracts during the transitional period and after July 1st when bidding for contracts.



Planning opportunities

As with every tax change there are tax planning opportunities. You should discuss the specific planning opportunities that may be available to you with your tax advisor. Some general planning ideas are highlighted below.

Businesses that are eligible to claim ITC's should consider delaying large purchases for items that are PST-taxable until after July 1st, in order to claim the full HST as an ITC. This delay would result in savings of 8%. If the goods are required prior to July 1st, you might consider a short term lease and purchasing the goods after July 1st.

Organizations that provide tax exempt services or goods (i.e. they are not eligible to claim full ITC's), should consider making major acquisitions that are not subject to the PST before July 1st. As these organizations will not be eligible to claim ITC's this would result in savings of up to 8%.

Organizations such as medical or dental clinics may have opportunities to restructure agreements to reduce the impact of HST.

Individuals should also consider making major purchases before July 1st to take advantage of the potential savings.

Please contact one of the members of our taxation services group if you would like to discuss opportunities that may be relevant to you.

Issues Specific to Certain Industries

Some aspects of the HST are relevant to certain industries only.

Health Professionals

Health professionals provide different types of services from an HST/GST perspective.

- Services that are exempt for GST will also be exempt for HST. These include OHIP-insured services and uninsured services that are consultative, diagnostic or health-related. ITC's cannot be claimed for exempt services.

- Zero-rated products include medical aids, eyeglasses, hearing aids, canes, crutches, heart monitoring devices, etc. ITC's can be claimed for all expenditures related to the supply of these products and related services.
- Taxable services include uninsured cosmetic surgery, consulting services and expert witness fees. HST will be charged for these services and ITC's can be claimed for all expenditures related to providing these services.

Manufacturers

Manufacturers are currently paying PST on purchases that are not refundable. Since manufacturers will be eligible to claim ITC's on their purchases their products will cost less to manufacture.

IT and Telecommunications

Customers normally pay 8% PST on the purchase of IT and telecommunication goods and services. Business customers may delay purchases until July 1st if they are eligible to claim ITC's and if they are not subject to the restricted ITC transitional rules.



Public Service Organizations

Rebates for the federal and provincial components of the HST for public service organizations will be as follows:

Rebates for Public Service Organizations						
	BC	ON	NB	NS	NFLD	FED
Municipalities	75%	78%	57.14%	57.14%	0%	100%
Universities & Colleges	0%	78%	0%	67%	0%	67%
School Boards	0%	93%	0%	68%	0%	68%
Hospitals	0%	87%	0%	83%	0%	83%
Charities & Qualified NPO	57%	82%	50%	50%	50%	50%

Financial Institutions

Financial services will generally be exempt from HST. As financial institutions will pay 13% HST on expenses but will not be eligible to claim ITC's, this will result in higher costs for financial institutions.

Automobile Dealers

Ontario's finance minister announced that HST will be collectable on private sales of vehicles. Currently private sales of vehicles are subject to PST only. This will result in a level playing field for car dealers and private sellers of used cars.

Landlords

Landlords of GST-exempt residential rentals will likely see their operating costs increase as many goods and services that are not currently subject to Ontario PST will be taxed at 13%. Landlords cannot claim input tax credits for GST paid on expenses relating to GST-exempt activities.

Expenses such as management fees, maintenance services, lawn care services and electricity are examples of services that are currently taxable at 5% and will become taxable at 13%.

Construction and real estate

Currently, a vendor of a "supply and install contract" for real property is required to pay PST on its inputs. Under the HST system, a vendor should be entitled to claim input tax credits for the HST paid on its inputs, resulting in lower costs. Businesses may wish to consider the effect of the proposed HST when they negotiate and enter into a long-term contract for such services.

Companies that purchase a considerable amount of equipment (i.e. road builders, sewer companies) will benefit from an upfront saving of 8% on equipment purchases. More labour-intensive businesses should not expect significant savings.



Important Dates and Time Periods in 2009 and 2010

October 14, 2009	Prepayments on leases and instalment contracts for tangible personal property are not subject to HST if prior to this date
October 14, 2009 – April 30, 2010	Purchasers' self-assessment period for prepayments for services that will be provided after July 1, 2010
May 1, 2010	Prepayments on goods and services that will be provided after June 30 charged with HST
July 1, 2010	Implementation of HST
July 1, 2010 – September 30, 2010	Quarter used for calculation of small business credit
October 30, 2010	Last day to file a final PST return and obtain a refund
November 1, 2010	HST will apply to payments made this date or later for services that were 90% performed before July 1

Example of Goods & Services Taxable Under HST

Currently Non-Taxable for PST, but Taxable for HST	Currently Exempt for PST, but Taxable for HST
Professional Services <ul style="list-style-type: none"> - Accounting - Legal - Engineering - Consulting - Advertising 	Real Property Contracts <ul style="list-style-type: none"> - Home Renovations - Office Renovations
Internet Access Fees	Office Rent
Energy <ul style="list-style-type: none"> - Gas - Fuel - Electricity 	Goods for Resale and Raw Materials
Membership Fees	Certain Custom Software
Personal Services <ul style="list-style-type: none"> - Hair Cuts - Manicures 	Footwear Under \$30
Cleaning Services	Admissions Under \$4
Taxi and Limousine Fares	
Training Seminars	

This newsletter was prepared by McLarty & Co's taxation services group for the benefit of clients and other interested parties.

Clients are invited to contact the taxation services group or their relationship manager if they have any questions about the HST or another tax or business matter.

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