

Auto Dealers

Tax Newsletter 2010

Planning for Ontario's Harmonized Sales Tax (HST)

Introduction

This newsletter is an overview of some of the topics your business should be considering 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%) for most goods and services.

There will be no separate registration for HST. If a supplier is registered for GST then the supplier is automatically registered 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), and
- possibly benefit from a savings of 8% by claiming back the provincial component of the HST that was not refundable as the PST.



Businesses will not be able to use purchase exemption certificates that were available for Ontario's retail sales tax. Instead they will be eligible to claim back the ITC's for the HST paid (subject to some restrictions discussed below) when they file their 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. The rate on privately transferred used vehicles will be 13%

Ontario vendor compensation paid to businesses that collect and remit PST was 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.

Input Tax Credit Restrictions

Businesses or groups of companies with annual sales of more than \$10 million will have to repay or "recapture" the provincial component of their ITC's on specified property and services for the first five years (July 1, 2010 - June 30, 2015).

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

- 25% in year 6 (July 1, 2015-June 30, 2016),
- 50% in year 7 (July 1, 2016-June 30, 2017), and
- 75% in year 8 (July 1, 2017-June 30, 2018).

"Recapture period" means a one year period that begins July 1 and ends June 30th during the Recaptured ITC (RITC) period.

RITC Threshold Amount

A business is considered to be a large business subject to the RITC, if the total taxable supplies of the company and any associated corporations with a permanent establishment in Canada are greater than \$10 million in the last fiscal period ended before that recapture period. The \$10 million, though not confirmed, may include the value of dealer trades which normally dealerships do not consider as sales.

If a business is not a large business at the beginning of a recapture period and, has a fiscal year end during the recapture period and, its RITC threshold amount exceeds \$10 million at that point, the business would generally not be considered a large business until the beginning of the next recapture period.

Specified Property and Services

In general, specified property and services that are subject to RITC would be those that are brought into Ontario for consumption or use in Ontario.

In general, specified property and services would include:

- Specified road vehicles, their parts, services and motor fuel (other than diesel fuel) for use in specified road vehicles,
- Specified energy,
- Specified telecommunication services, and
- Specified food, beverages and entertainment that that are currently subject to an ITC restriction (generally 50%).

ITC restrictions do not apply to inputs solely for re-supply (i.e. inventory).

Specified Road Vehicles

A specified road vehicle would generally mean a motor vehicle that is licensed for use on a public highway and weighs less than 3,000 kg at the time

that the vehicle is first licensed. A vehicle that is licensed exclusively for use elsewhere would generally not be considered a specified road vehicle. A trailer, semi-trailer or detachable axle would not be considered a specified road vehicle.

Parts and Service

The RITC requirement would generally apply to parts and services that are acquired within 12 months of the acquisition of the vehicle. The RITC would generally not apply to routine repair and maintenance of the vehicle.

Use of Specified Road Vehicles before Resupply (Demos and Employee Vehicles)

If a business acquires a vehicle for resale and uses the vehicle on a temporary basis before reselling, the business would be required to recapture a portion of the ITCs that were claimed in respect of that vehicle. For each month the business uses a vehicle as a demo or employee vehicle, the business will be required to recapture 2% of the provincial component of the ITCs.

Fuel for Specified Road Vehicles

The RITC requirement would generally apply to fuel that is used in the engines of the vehicles. Dealers will have to keep track of fuel for

customers' vehicles and fuel for demos separately.

Specified Energy

Specified energy would include electricity, gas, fuel (other than that used in a propulsion engine) and steam that is acquired for use in Ontario.

Transportation costs of the specified energy would also be subject to the RITC.

Specified energy used in the manufacturing of goods for resale would not be subject to the RITC requirements. For the purposes of the RITC, an auto repair shop would not be considered to be manufacturing goods for resale.

Specified Telecommunication Services

Specified telecommunication services would generally include services such as local and long-distance telephone, cable and pay television, satellite tv, facsimile and electronic mail, video, audio and computer link-ups and data transmission acquired by a large business for use in Ontario.

The RITC requirement would also apply to a telecommunication line supplied by way of lease, licence or similar arrangement for use in Ontario.



However, the RITC requirement would not generally apply to:

- Internet access services,
- Web-hosting services,
- Toll-free telephone services, nor
- Telecommunication services acquired by an organizer of a convention for use exclusively at that convention.

There is a proxy calculation when restricted and non-restricted services are bundled into one bill. Contact your accountant for details on how to calculate these.

Specified Meals and Entertainment

Specified meals and entertainment would generally include any meals and entertainment acquired in Ontario, to the extent that the meals and entertainment are subject to the existing (generally 50%) ITC restrictions.

Meals and entertainment acquired for certain events where all employees from a particular location are invited (e.g. a social event) would not be subject to the RITC.

Accounting for RITCs

A large business would complete their HST returns in the following manner:

- Amount of Gross ITCs would be reported in a separate field
- Amount of recaptured ITCs would be reported in a separate field

A large business would have the option of electing to use an estimation/instalment approach for recaptured ITCs. The election would be filed with CRA after the end of the fiscal year and would apply for at least one year. In the estimated approach the business would estimate the total ITCs that would be subject to recapture during the year and would report the appropriate portion of the estimate in its monthly HST returns and would

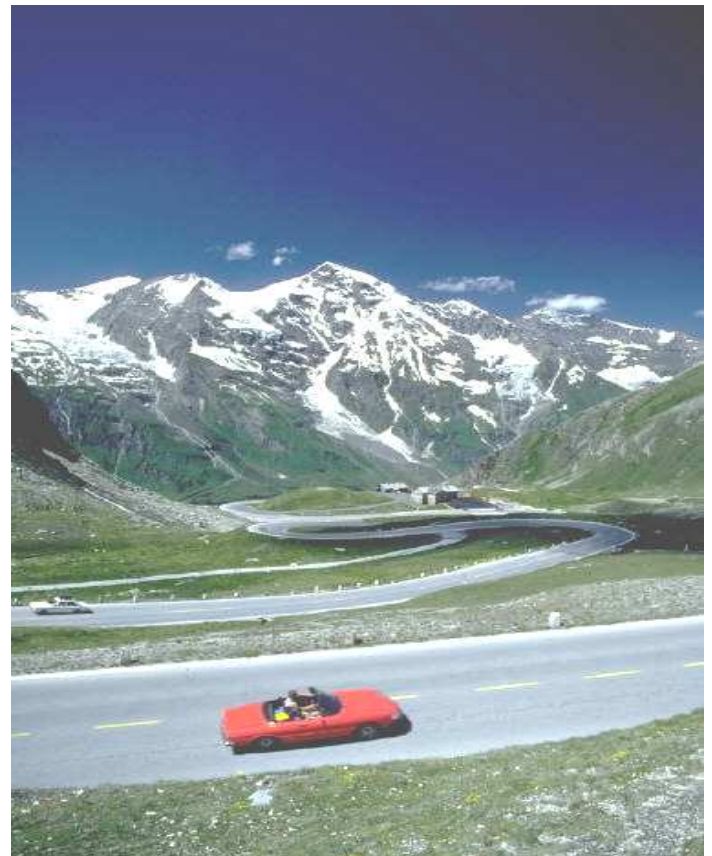
be required to reconcile to the actual RITC at the end of the year.

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

- HST does not apply to services if 90% of the services are performed prior to July 1 and payment is received by November 1, 2010.
- If less than 90% of services are performed pre July 1 then GST applies to services performed pre July 1 and HST to any services performed after.
- If payments are made after November 1, HST will apply.
- HST does not apply to prepayments received prior to May 1, 2010.



Dealerships will have to decide how to handle service and body shop repairs in process at the end of day June 30 since most accounting systems are not set up to charge GST, PST and HST on a single invoice.

Tangible Personal Property

- For tangible personal property, the transfer of ownership and/or the time that the purchaser takes possession determines if HST is applicable.
- Both ownership and delivery of a vehicle have to take place on or after July 1 for HST to apply, otherwise GST applies.
- Prepayments are not subject to HST if they were made before October 14, 2009.
- There are special rules for instalment contracts and leases that you should review with your advisor.

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). It is expected, though not confirmed, that since dealerships will no longer have PST exemption certificates, Ontario-based insurance companies will charge the dealership the 8% PST and dealerships will pass this charge onto the customer. Should a dealership use offshore insurance companies, it is expected that the dealership will have to re-register with the province and continue to charge PST on insurance.
- 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.

Other HST issues relevant to Auto Dealers

Imports

GST/HST on automobile imports will remain at 5%.

Insurance

Insurance premiums will remain GST/HST exempt and will continue to be subject to the 8% Provincial Sales Tax (PST). PST paid is not recoverable as an input tax credit.

Leases

Whether or not HST applies to leases is based on the province in which the vehicle is licensed and will apply to any lease interval subsequent to June 2010. An exception to this rule is that GST (at the rate of 5%) will apply to any leases that started before July 2010 and end before July 31, 2010.

Extended Warranties

HST will apply on or after July 1, 2010.

Trade-Ins

You should not net trade-ins from HST registrants but you should use net amounts for non-registrants (same rules as GST).

Status Indians

HST will apply to all sales unless the purchaser has a Certificate of Indian Status Card and the vehicle is delivered to the reserve by the dealer or the dealer's agent.

Please contact one of the members of our taxation services group if you would like to discuss how HST will impact your business or any opportunities that may be relevant to you.

This newsletter was prepared by McLarty & Co's taxation services group for the benefit of clients in the auto dealer industry 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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