

Tax Memo

Ontario Sales Tax Harmonization

After 18 years of maintaining a retail sales tax alongside the federal GST, Ontario is making a bold move to modernize sales taxes in the province. In his budget, Finance Minister Dwight Duncan announced that Ontario will be “harmonizing” its sales tax system with the GST, effective July 1, 2010. Instead of a 5% federal GST and 8% Ontario Retail Sales Tax (RST), there will be a single 13% Harmonized Sales Tax (HST) in Ontario. This system has been in operation in Newfoundland and Labrador, Nova Scotia and New Brunswick since 1997.

The Ontario HST will be administered by the Canada Revenue Agency. To facilitate administration, the tax base and basic operational rules for the Ontario portion of the combined tax will be the substantially the same as for the GST. Registrants will file a single return. As for the GST, businesses with taxable sales under \$30,000 per year (\$50,000 in the case of a public service body) will not be required to register.

Nevertheless, the Ontario portion of the HST will differ from the federal portion in a number of key areas. These are described below.

Temporary Restriction in Claiming Input Tax Credits for Large Businesses

Similar to the input tax refund system in the Quebec Sales Tax, large businesses in Ontario (with annual taxable sales in excess of \$10 million) and financial institutions will be unable to claim input tax credits (ITCs) for the following purchases:

- energy (except when purchased by farms or used to produce goods for sale);
- telecommunications services (other than internet access fees or charges for toll-free numbers);
- automobiles and other road vehicles weighing less than 3,000 kilograms; parts and certain services for vehicles and fuel for such vehicles; and
- food, beverages, and entertainment expenses.

It is proposed that the above restrictions would apply in full for the first five years of the tax (i.e., from July 2010 through to June 30, 2015). During the subsequent three years, full ITCs would be phased in.

Point of Sale Relief for Selected Items

Although the tax base for the Ontario portion of the tax will broadly mirror the GST, Ontario is providing point-of-sale rebates for its portion of the tax for the following selected items:

- books;
- children's clothing and footwear;
- children's car seats and car booster seats;
- diapers; and
- feminine hygiene products.

Consequently, for the above products, the sales tax will apply at the 5% rate only. The point-of-sale rebate will not reduce the ability of vendors to claim full ITCs.

New Housing Rebate

For newly constructed primary residences, there will be a partial rebate for the Ontario portion of the tax for new houses priced up to \$500,000. For houses up to \$400,000, a 75% rebate of the provincial portion of the tax will apply, resulting in an effective Ontario rate of 2% (in addition to the federal rate). This is approximately equivalent to the amount of RST which currently applies on such houses through the taxation of building materials. The rebate will be proportionally reduced for houses priced between \$400,000 and \$500,000. For homes valued above \$500,000, there would appear to be no rebate.

Rebates for Public Service Bodies – Charities, Non-Profit Organizations and the MUSH Sector

In a similar fashion to the federal GST, Ontario will provide rebates to charities, qualifying non-profit organizations, municipalities, universities, colleges, school boards, and hospitals. The intention of the rebates is to be fiscally neutral relative to the amount of RST currently paid by these entities. The rebate rates for the Ontario portion of the tax will be as follows:

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|---------------------------------|-----|
| • Municipalities | 78% |
| • Universities and Colleges | 78% |
| • School Boards | 93% |
| • Hospitals | 87% |
| • Charities and Qualifying NPOs | 82% |

Insurance Premiums

Financial services will be exempt under the Ontario HST. The HST base is significantly broader than that for the RST, and so harmonization substantially increases the tax burden for the financial sector. The budget proposals do not contemplate any mitigation of this incremental cost. Given the magnitude of the tax increase in this sector, this aspect deserves serious consideration.

Notwithstanding that financial services will be exempt under the new sales tax, the budget proposes to continue to impose an 8% sales tax on the same types of insurance currently taxed under the RST.

Private Transfers of Motor Vehicles

Under the GST, no tax applies on private transfers of used motor vehicles. However, like the current RST, the Ontario portion of the new tax will apply to such transfers.

Alcohol Sales

The current RST applies at a rate of 10% on sales of alcoholic beverages in licensed establishments, and 12% for sales in retail stores. Under the new tax, the rate will fall to 8%. However, the government proposes to make adjustments to fees, levies and other charges on alcoholic beverages to maintain the existing revenue yield.

Tourism Sector

The current RST rate on hotel accommodation in Ontario is 5%. The provincial portion of the new tax will increase to 8%. In recognition of the potential effect of the increased tax rate on tourism, the budget proposes to allocate some \$40 million annually to destination marketing in Ontario tourism regions.

Transitional Issues

Small Business Transition Credit

In recognition that businesses will incur costs to change their point-of-sale and accounting systems to collect the new tax, Ontario will provide a one-time transition credit to small businesses. The amount of the credit will depend on the small business' level of taxable sales in the first fiscal quarter commencing after June 30, 2010. Small businesses with taxable sales under \$15,000 in the quarter will receive a credit of \$300. Businesses with sales in the quarter over \$15,000 but not more than \$50,000 will be receive a credit equal to 2% of taxable

revenue in the quarter. Lastly, businesses with taxable revenue in the quarter over \$50,000 but not more than \$500,000 will be eligible for a credit of \$1000.

Additional Information – Technical Design/Transition

The budget documents indicated that additional information on technical design issues and transitional rules will be released in the coming months to help taxpayers and businesses prepare for the implementation of the new sales tax system.

Implications for Selected Industries/ Sectors

For information on the implications of Ontario sales tax harmonization for the following selected industries/ sectors, please refer to the following industry-focused sales tax harmonization tax memos at pwc.com/ca/tax under “of further interest”:

- Manufacturing
- Mining
- Forestry
- Real Estate
- Retail Trade
- Financial Services
- Electricity Utilities
- Telecommunications
- Information Technology (IT)
- MUSH Sector
- Charities/Non-Profit Organizations

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