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What Businesses and Organizations Need to Know to Prepare for the HST

Overview

On July 1, 2010, Ontario's Retail Sales Tax ("RST") will be replaced by a single, value-added sales tax and combined with the federal Goods and Services Tax ("GST"), resulting in the Harmonized Sales Tax ("HST"). The HST will be applied at a combined tax rate of 13 per cent, made up of an 8 per cent "provincial component" and a 5 per cent "federal component". The 5 per cent rate that comprises the federal component is intended to mirror the current 5 per cent rate of GST, while the 8 per cent provincial component will represent the current rate at which Ontario's provincial RST applies.

Provinces that have already harmonized include Newfoundland & Labrador, New Brunswick and Nova Scotia which have all harmonized at a rate of 13 per cent, although it should be noted that Nova Scotia announced on April 6, 2010 that it will be raising its HST rate to 15 per cent effective July 1, 2010. Like Ontario, B.C. has announced that it will harmonize the sales taxes levied in that province on July 1, 2010, but, unlike Ontario, B.C. will harmonize at a 12 per cent rate, which reflects the 7 per cent rate at which its Social Service Tax is currently levied and the 5 per cent GST.

The HST will be federally administered and will use the same tax base and structure as the federal GST, with few exceptions. This means that it will apply in Ontario to the same base of goods and services that are taxable under the GST framework (i.e., on supplies made, or deemed to be made, in Ontario, or brought into Ontario). Because the HST will apply to the same base of goods and services that the GST currently applies to, some services that were not previously subject to Ontario RST will become taxable as of July 1, 2010 under the HST. Goods and services that are zero-rated or exempt from the GST are expected to retain the same status under the HST.

Key Dates

The key dates that are important to keep in mind on the road to harmonization are as follows:

- **October 14, 2009 to May 1, 2010:** Suppliers have no obligation to collect the HST, but certain purchasers (e.g., financial institutions, certain charities and not-for-profit organizations) may be required to self-assess the HST on property and services to be provided on or after July 1, 2010.
- **May 1, 2010:** Suppliers must begin to collect the HST on goods and services to be provided on or after July 1, 2010.
- **July 1, 2010 (HST implementation date):** On this date, suppliers of goods and services will be required to begin collecting the HST.
- **October 31, 2010:** Any RST outstanding will become payable.
- **November 2010:** As of this date, no RST adjustment will be available at the point of sale in respect of returned items, which means a vendor can no longer refund RST in respect of returned or exchanged items. Any refunds of RST after this date must be applied for with the Ontario Ministry of Revenue.

Timing and Transitional Issues

One of the most significant concerns about the transition to a harmonized sales tax in Ontario is the transition period and the timing concerns have arisen with respect to it. The Ontario government has proposed a set of transitional rules that apply in respect of prepayments made for supplies to be provided on or after the July 1 implementation date to dilute the incentive to pay for such supplies in advance for the purposes of avoiding the extra 8 per cent that will apply, especially with respect to services.

As discussed above, during the period from October 14, 2009 to May 1, 2010, a supplier has no obligation to collect the HST, but certain purchasers – generally those who are not entitled to claim full ITCs on the cost of their inputs – may be required to self-assess the HST on goods and services to be provided on or after July 1, 2010. It is important to be aware that both the HST and Ontario RST may have application during this period. To the extent that both HST and RST are paid on a good or service, the purchaser is entitled to apply for a rebate to the Ontario Ministry of Revenue in respect of the RST paid.

Starting May 1, 2010 during what can be thought of as the "HST pre-implementation period", a vendor will be required to start collecting the HST on goods and services that are to be provided on or after July 1, 2010 if a payment is made or invoiced for the goods or services on or after this date. The transitional rule with respect to intangibles (e.g., the right to reproduce certain portions of a book), however, is different than it is for goods and services. In general, the HST will apply to payments made or invoiced on or after July 1, 2010 for intangible property. Note also that there are certain categories of intangible property to which special rules apply, which include subscriptions for newspapers, magazines and other periodical publications, memberships and admissions.

Note that the transitional rules described above would not apply to provincial governments, such that the HST will only apply to Ontario and B.C. if payment for supplies made to them is made or payable on or after July 1, 2010.

Two important things that will be important to keep in mind with respect to the "HST pre-implementation period" from May 1, 2010 onwards are: (1) billing systems will need to be ready to go May 1, 2010 to the extent that it is expected that goods and services may be paid for from May 1, 2010 onwards, but not delivered, made available or provided until on or after July 1, 2010; and (2) vendors who collect the HST from May 1, 2010 to July 1, 2010 must remember to report it on their tax return that includes July 1, 2010 – do not remit any HST collected from May 1, 2010 to July 1, 2010 early!

Place of Supply

Generally speaking, only supplies made in Canada will be subject to GST/HST and only supplies made in an HST province will be subject to the HST. However, a major issue that often arises is how to determine where a supply has been made, especially where a supply is provided or originates in more than one province. Further complicating matters is the recent release of proposed changes to the place of supply rules by the Department of Finance.

The place of supply rules are important for the purposes of determining whether and at what rate suppliers are required to charge the provincial component of the HST. In general, the proposed rules center around where the recipient of the supply is located, as indicated by the address of the recipient that is most closely connected with the supply. As such, the proposed place of supply rules would generally apply in the following way with respect to the following categories of supplies:

- **Goods:** Place of supply is the province to which the goods are delivered or otherwise made available;
- **Real property:** Place of supply is the province in which the property is located;

- **Services:** The place of supply rules are the most complex with respect to services and detailed rules will apply to specific situations involving services in respect of tangible personal property, services in respect of real property, litigation and ongoing services to which billing periods apply;
- **Intangible property:** Place of supply is the province in which the rights can be used.

This a snapshot of the place of supply rules for illustrative purposes only and a person endeavoring to determine the place of supply of particular property or services must review the place of supply rules in detail in order to make a proper determination.

ITC Restrictions

The Ontario government has proposed temporary restrictions on ITCs that would apply to certain inputs used by large businesses. Large businesses are generally those with annual taxable sales in excess of $10 million and also include financial institutions such as banks, insurance companies, etc. The proposed restrictions would only apply in respect of the 8 per cent provincial portion of the HST and to the following items:

- Telecommunications expenses (excluding internet access and certain toll-free services);
- Meals and entertainment expenses;
- Licensed road vehicles under 3,000 kilograms (and associated parts and certain services); and
- Energy not used to manufacture goods for sale or purchased by farmers.

Full ITCs in respect of the foregoing items would be restricted for the first five years after implementation, after which they would be phased in over a three year period. It is important to remember that, where restricted, ITCs must be reported separately on a GST/HST return.

Special sectors

For special industry sectors such as financial institutions and public service bodies, the HST poses unique problems that can be attributed in large part to the fact that services provided by these industries are generally exempt from the application of GST/HST. While exempt status intuitively sounds like a good thing, it actually has a negative impact on suppliers of financial services, health care services, educational services and other services provided by public service bodies due to the fact that suppliers of exempt services are generally not entitled to claim ITCs in respect of the GST/HST they pay on the cost of their inputs. As such, the HST will cause their costs to go up to the extent that their inputs are currently subject only to the 5 per cent GST – as of July 1, 2010, services for which these entities previously only paid tax at a rate of 5 per cent will go up to 13 per cent. Certain public service bodies will be entitled to a rebate of both the federal and provincial portion of the HST. Whether and how relief to the financial service and public service body sectors will be provided in respect of the extra costs that the HST will impose on them has been perhaps one of the most controversial areas in the harmonization process thus far.

Conclusion

With the May 1, 2010 pre-implementation period rapidly approaching, it is necessary for businesses and organizations to ensure that they have a strategy in place to maximize the advantages and minimize the potential downsides the HST will bring once implemented. If they have not already, it is essential for businesses and organizations to determine the impact that the HST will have on their operations, cash flow, fees, budgeting, current systems and contracts and think about what changes may be necessary to accommodate harmonization. Where unsure, it is important to seek advice from a qualified tax professional as the GST/HST rules are changing frequently as the implementation date approaches. Proposed changes to the rules, as well as the current rules, are complex. The effect that these rules will have on a business or organization must be understood if preparation for harmonization is to be undertaken in the most efficient and effective manner.

What Businesses and Organizations Need to Know to Prepare for the HST

If you have any questions on this topic or would like to know how these rules apply to a particular transaction or would like to discuss any other tax matters, please do not hesitate to contact one of the professionals in our **Commodity Tax Team**.

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