

# *Tax* **Bulletin**

The Wilkinson Tax Group

## **The New Harmonized Sales Tax for New Home Builders**

The province of Ontario announced in its March 2009 Budget that it would harmonize the retail sales tax (the Ontario RST) with the federal Goods and Sales Tax (GST). The effective date for implementation of this harmonization is July 1, 2010.

Both the federal and provincial governments passed the enabling legislation on December 15, 2009. While the laws have been enacted, many of the details are just now released which will impact the actual implementation of these rules.

### **Overview**

In simple terms, the harmonization means that the old RST will disappear as of July 1, 2010 and the HST will commence on that same day. For the sale of many goods, there will be no change to the consumer. If the previous sales tax that applied to the sale of goods was 5% GST and 8 % RST, then the total tax of 13% is replaced by an HST of 13%. The major change will apply to the provision of services and the sale of real estate that did not previously attract the RST. The tax on services and real estate will rise from a GST rate of 5% to a rate of 13%.

While there will be an increase in the total tax to consumers of services and real estate newly constructed homes (net of the applicable rebates), the increased revenue to the province will be offset by a reduction in personal and business taxes. The decrease in the personal tax is created by a reduction in the lowest tax bracket rate. The decrease will come to the business community in two measures. Corporations will face a lower tax rate payable in Ontario and the old RST paid on goods will now be replaced by a refundable HST as an input tax credit.

While the government may advertise the harmonization as “revenue neutral”, the implementation of these measures will not affect all of Ontario residents equally. The rules that will implement these provisions will not be simple. In fact, the old adage “the devil is in the details” will be the applicable rule of the day.

### **The Ontario RST**

Effective July 1, 2010, the old RST will no longer apply to transactions in Ontario (with some exceptions such as a special 8% tax on insurance premiums). The cessation of RST on transactions on July 1, 2010 will be met with the imposition of the HST on exactly the same day. The province will provide that the old RST vendor’s compensation will terminate for periods ending after March 31, 2010 and be replaced by a one-time Small Business Transition Credit of up to \$1,000. Larger businesses that have annual sales in excess of \$2,000,000 per annum will not be eligible for the Small Business Transition Credit.

## **The HST**

The HST will be 13% and applied to the supply of goods and services after June 30, 2010. The HST will be levied on any transaction that was previously subject to the 5% GST. Certain items that were exempt from RST such as children's clothing will be eligible for an HST point-of sale rebate for the 8% provincial portion of the HST. The HST will be submitted to the federal government as one tax and the purchaser will be eligible for an input tax credit (ITC) on the full 13% if it was entitled to a full input tax credit before. The provincial portion of the HST (that is the additional 8%) will be accounted for by the federal government and it will pay this tax to the province.

### **Application of the HST to Used Housing**

Under the existing GST regime, there is no tax levied upon the sale of used residential property such as a house, semi-detached house, rental properties and apartment buildings. There is also no tax on real estate that is personal use property when sold by a non-registrant. The sale of property in the course of a business by a registrant will attract the GST. In simple terms, if the GST does not apply to the sale of a real estate now, it will not be subject to the HST in the future.

### **Application of the HST to New Housing**

Any newly built residence (or substantially renovated residential complex) that previously attracted GST will, once the new system commences, be subject to the HST rate of 13%. For purposes of new housing, there will be a notional segregation between the federal GST of 5% and the provincial portion of 8%.

Once the new system is introduced, purchasers of a newly built home will qualify for two rebates:

- A federal rebate on the GST portion of the HST will be calculated in the same fashion as before. The rebate will be 36% of the GST portion on houses up to \$350,000 of value. The rebate will be clawed back until the value of the house exceeds \$450,000 at which time it will disappear.
- A provincial rebate will be provided for the provincial portion of the HST called the Ontario new housing rebate. The rebate will be 75% of the Ontario portion of the HST to a maximum rebate of \$24,000. This ceiling of \$24,000 means that the credit will be maximized when the value of the house reaches \$400,000. The Ontario new housing rebate will not be reduced if the value of the house rises over \$400,000 as in the case of the federal rebate on the GST portion mentioned above.

The Ontario new housing rebate in respect of the provincial part of the HST will be administered by CRA. Builders will be able to pay or credit the Ontario new housing rebate to the purchaser of a new house, just as they currently may pay or credit the existing GST new housing rebate. Both rebates will be obtained on a single application form to be made available by July 1, 2010.

### **New Housing Transitional Rules**

Generally, the HST will apply to a supply to a sale where the earlier of the possession or ownership of the residence is made after June 30, 2010. If either ownership or possession is transferred to the purchaser before July, 2010, the HST will not apply [but the 5% GST will apply].

Where the sale of the new house is subject to the HST, then the two rebates, mentioned above, would be available to the purchaser.

A “grandparented” sale of a new house will not attract HST [but the 5% GST will apply]. A grandparented house sale is one in which there is a written agreement of purchase and sale for a new house that is entered into on or before June 18, 2010 and the earlier of possession or ownership is after June 2010. In this case, even though the ownership or possession is after June 2010, the provincial portion of the HST will not be levied [the 5% federal portion will still apply].

### **Ontario RST transitional new housing rebate**

If a purchaser buys a new house that was partially completed at July 1, 2010 and the sale is not grandparented, he/she face potential double taxation. The builder will incur non-refundable RST on its input of materials up to June 30, 2010 [which the builder will logically add to the sale price of the house] but the price of the house will attract HST on the full value of the house when purchased after June 2010.

To compensate the purchaser for this double taxation, a purchaser of a new house will be entitled to claim an Ontario RST transitional new housing rebate where the construction of the house straddles the July 1, 2010 implementation date and the HST is payable on the purchase. An individual will claim a rebate if the house is at least 10% complete as of July 1, 2010 and the builder certifies the percentage of completion. The rebate will be obtained from the builder or from CRA directly. If the construction commences after July 1, 2010 or if it is completed before that date there is no rebate.

Builders will have to obtain a valid provincial certificate – a letter in good standing – before their first rebate application. They will have to file the application with the CRA. The letter of good standing will be obtained from the Ontario Ministry of Revenue.

The calculation of the Ontario RST transitional new housing rebate is complex. The amount of the rebate is a function of the percentage of completion of the house on July 1, 2010 and the imbedded cost of the RST in the house at that time. The greater the completion of the house, the higher the percentage of RST component. If the house is 90% or more complete on July 1, 2010, then the rebate is 100% of the estimated RST that will be rebated. The estimated RST is the greater of the following times the percentage of completion factor:

- The floor space method – the total square metres times \$45, or
- The fair market value method – 2% of the consideration paid for the house.

If the house is a rental house, multiple unit house, residential condominium unit the builder will claim the Ontario RST transitional new housing rebate. Otherwise, the individual purchaser will claim the rebate.

### **Transitional tax adjustment for new houses**

A special tax will be levied on builders where the sale of the house is grandparented (see above) such that HST is not charged to the purchaser and the construction of the building straddles the implementation date of July 1, 2010. Since the province will not be getting the provincial portion of the HST and the RST will not be collected on the purchase of materials after June 2010, the federal government is collecting a transitional tax adjustment for new homes directly from the builder. In essence, this transitional tax will compensate the province for RST that would have been paid on

purchases after June 2010. This tax is collected by the builder and included by the builder in the net tax calculation on its GST/HST return.

The tax is applied to the sale of new houses that are grandfathered (see above) if the house is less than 90% complete as at July 1, 2010. Where the builder is subject to this transitional tax adjustment and is required to account for the transitional tax adjustment in its net tax calculation, the builder will not be entitled to claim an ITC for the amount of the transitional tax adjustment.

The transitional tax adjustment for new homes is based upon the percentage of completion of the house on July 1, 2020 as certified by the builder. The higher the percentage of completion of the house, the lower the tax rate [presumably because the builder has already incurred a higher amount of RST]. If the house is less than 10% complete the tax is 2% of the total consideration paid for the house. If the percentage of completion is more than 10%, then the tax rate declines until it reaches 0% if the house is equal to or greater than 90% complete.

### **The General Transitional Rules**

The general transitional rules that are discussed below do not apply to the sale of a new house; the rules discussed above will apply to the actual sale of a new house. However, the following general transitional rules will apply to the purchase of goods and services (i.e. material and labour) on the costs incurred by the builder.

As mentioned above, the RST will terminate and the HST will commence after June 30, 2010. The HST will apply to the sale of goods or the provision of services after June 30, 2010. This is an oversimplification because the rules embody several technicalities which are introduced to ensure that taxpayers cannot manipulate transactions to obtain the best tax result.

There are key dates that affect the transitional rules are as follows:

#### *July 1, 2010*

The provision of goods and services after June 30, 2010 will be assessed HST. The traditional GST and the RST will apply to the provision of goods or services before July 1, 2010 under the old rules.

#### *May 1, 2010*

The payment for goods or services after this date and before July 1, 2010 will attract the HST rather than the GST and RST if the goods or services are provided after June 30, 2010. For payments received after April 2010 and are subject to the HST, the vendor of the supply is responsible to collect the HST, not the old GST and the RST.

#### *October 14, 2009*

Any prepayments made by a purchaser that is not a consumer and that is restricted in some way in claiming normal ITC's will have to self-assess the provincial portion of the HST if the payment or invoice is after October 14, 2009 and April 30, 2010 and the service or good is provided after June 30, 2010.

The transitional rules are best analyzed as those pertaining to goods, services, leases and other periodic payment contracts and the sale of new residential housing. The general transitional rules are discussed under the following headings:

*Sale of goods:*

The sale of goods will not attract the HST [but will be subject to the GST and the RST if applicable] if the earlier of the possession or ownership takes place before July 1, 2010. This will be regardless of when the consideration becomes due (i.e. it is invoiced) or is paid without becoming due.

*Provision of services:*

The provision of services will not attract the HST [but will be subject to the GST and the RST if applicable] if all or substantially all (considered to be 90% or more) of the service is provided before July 1, 2010. If less than 90% of the service is provided before July 1, 2010 then the provider will have to allocate the percentage of completion at June 30, 2010 and assess GST on the pre- July 1, 2010 component and assess HST on the post-June 30, 2010. Again, the payment or due date for payment based upon the invoice is not relevant in determining the application of the HST.

*Leasing:*

The treatment of leases is determined by the lease interval, not the date that the lease originated. The lease interval can best be described as the monthly or other periodic payment. The lease interval will attract HST if the lease interval commences after June 30, 2010. If the lease interval commences before July 1, 2010 and it ends before July 31, 2010, it will not attract HST.

## **Builders Disclosure Requirements**

If a written agreement of purchase and sale for a newly constructed house is entered into after June 18, 2009 and before July 1, 2010, the builder will be required to disclose in the written agreement whether the provincial portion for the HST applies to the sale and, if so, whether the stated price in the agreement includes the provincial part of the HST, net of the Ontario new housing rebate and the RST transitional new housing rebate, if applicable.

If the transaction is subject to the HST and the builder does not make a disclosure as outlined above, the stated price in the written agreement would be deemed, under the transitional rules, to include the provincial part the of the HST. In such a case, the purchaser would not be required to pay the provincial part of the HST in addition to the stated price in the agreement.

## **Self-assessment rule for certain purchasers**

Because some “non-consumers” such as exempt suppliers, charities and small business that have elected under the “Quick Method” do not get the full ITC on their inputs, there is a special prepayment rule. If the purchaser pays for, or is invoiced for, goods and services between October 14, 2009 and April 30, 2010, and the goods or services are to be provided after June 30, 2010, then the purchaser must account for and self-assess the provincial portion of the HST. This self-

assessment must be completed for the reporting period that includes July 1, 2010 or if the purchaser is not a registrant, then on a special form to be filed before November 2010.

### **Temporarily Restricted Input Tax Credits**

Large businesses with annual taxable supplies over \$10 million will face restricted input tax credits for certain costs. These enterprises are businesses (not charities and other public sector bodies) that will be restricted in calculating these ITCs for 5 years and after that a reduced restriction phased-in over a 3 year period. The restriction will be on the Ontario portion of the HST (the 8%) on purchases of:

- Energy (except where purchased by farms or used to produce goods for sale)
- Telecommunication services (except internet and toll free numbers)
- Road vehicles weighing less than 3,000 kg, and the related fuel (except diesel), parts and service for these vehicles
- Food, beverages and entertainment expenses.

### **Administration**

All clients will have to make administrative and accounting changes to accommodate the new HST. For example, changes will have to be made to invoicing, rebate calculations, returns and exchanges, the provincial portion of the HST that are restricted to the purchaser etc.

Recently, the federal government has announced that certain entities will have to electronically file their periodic GST/HST returns effective July 1, 2010. Those that will be affected by this rule will be those enterprises that have taxable supplies in excess of \$1.5 million in the previous fiscal period, are subject to the Temporarily Restricted input tax credits mentioned above or are new home builders.

If you wish more information on any of these issues, please contact one of our partners or staff whom may assist you.



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