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Ontario PST and Software

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This article discusses the application of Ontario Retail Sales Tax to software and software-related services, comments on the increasing complexity of the rules, and highlights areas where the interpretation of the Ministry is at odds with that of the industry as a whole.

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Ontario PST and Software

In April 2006 the Ontario released revamped PST guide “Computer Programs and Related Services” (No. 650) triggering industry concern that the rules’ complexity had increased yet again. Two areas of special concern are IT service exemptions and custom software definitions. (See Canadian Tax Highlights, July 2006.) A year of audit experience under the new guide appears to indicate that industry concerns were well-founded. In the past the ministry has worked with taxpayers, acknowledging and accommodating the unique characteristics of a particular industry and product to arrive at a reasonable solution for PST application. It may be time to do so again.

IT service exemptions

The Guide’s new conditions for exemption eligibility focus less on the service’s nature and more on whether it is provided in conjunction with taxable services. For example, the legislation expressly exempts project planning, defined to include “the analysis of specifications, determination and verification of hardware and software prerequisites, scheduling, the preparation of reports, reviewing documentation and discussions of any kind”. The Guide suggests that such services are taxable if they must be performed to supply a taxable service, and if planning services are provided throughout the project, only those provided at the initial stages can be exempt. The Guide is not clear, but it seems to say that the project planning phases that are typical of a contract for the configuration and installation of taxable software are no longer be exempt, or are exempt only at the project’s outset. Such conclusions seems to run counter to the legislation and the ministry’s previous interpretations and also ignore the fact that planning for a larger implementation project may be ongoing, as initial plans are finetuned to conform to evolving customer requirements or unanticipated setbacks.

The turn of events creates uncertainty about the fate of other exempt services. The codification of areas of exemption was presumably intended to introduce some certainty and simplicity in an otherwise complex tax regime. Many IT service providers had painstakingly developed tax matrices based on the legislated areas of exemption and taxability; they are now left wondering whether they may be liable for taxes that the new interpretation indicates should have been collected. Their customers, already overburdened with high taxes on their IT spending, may not have paid or self-assessed enough tax according to the ministry.

Custom software

Whether software is truly custom is also developing into a troublesome audit issue. A custom computer program is designed and developed solely to meet the specific requirements of one person and is intended for its exclusive use. The ministry says that software is custom only if all rights to it are transferred to the purchaser; otherwise the software is taxable computer program. In practice, software can be created for one user and incorporate the latest innovations, but may still include some subroutines and strands of code to which the programmer either cannot or will not cede control. Reusable elements may include a code for standard security routines that do not reflect or compromise the true and unique nature of the program, but for convenience is used time and again. A programmer should be allowed to reuse such a code without jeopardizing the custom nature of the software: the fact that marble is commonly used in building construction does not compromise the uniqueness of the Taj Mahal.

For more information, please contact the author.