

# Tax Memo

## HST Transitional Rules for Ontario and British Columbia Released

Effective July 1, 2010, Ontario and British Columbia will join Newfoundland and Labrador, Nova Scotia and New Brunswick in implementing the Harmonized Sales Tax (HST). The HST will apply at a rate of 13% in Ontario, and 12% in British Columbia (consisting of a 5% federal part and an 8% or 7% provincial component, respectively). In each province, the HST will replace the existing provincial retail sales tax (PST) system.

On October 14, 2009, the Ontario and B.C. governments released publications outlining the transitional rules governing how HST and each province's PST will apply to transactions occurring around the implementation date for the HST. These rules are broadly intended to provide an orderly transition to the new system.

### Overview

The general transition rules are identical in Ontario and British Columbia and are substantially the same as those used for the 1997 implementation of the HST in the three Atlantic provinces mentioned above. However, in certain areas the transition rules have been streamlined from those used in 1997.

### When does HST apply to sales of goods?

Generally, HST will apply to sales of taxable goods (other than zero-rated goods) in Ontario or British Columbia if the goods are delivered and ownership is transferred after June 30, 2010.

### When does HST apply to services?

In most cases, HST will apply to taxable services provided in Ontario or British Columbia after June 30, 2010. Generally, when the performance of a service straddles the implementation date, HST will be payable on the portion of the consideration that relates to the services performed on or after July 1, 2010. Consequently, a service provider will typically have to pro-rate invoices for supplies of services straddling the implementation date, charging GST and PST (if applicable) for the portion of the service performed before July 2010, and HST for the portion performed on or after July 1, 2010.

However, if 90% or more of a service is performed before July 1, 2010:

- HST will not apply to the service; but
- PST will apply if the services are taxable for PST purposes.

### Leases, licences and similar arrangements for property

Generally, leases or licences of taxable goods, intangible or real property for periods on or after July 1, 2010, are subject to HST. If the lease/licence period straddles the implementation date, the HST will apply only on the portion of the period that falls on or after July 1, 2010.

Nevertheless, where the period begins before July 1, 2010, and ends on or before July 30, 2010:

- HST will not apply to the lease or licence payment; but
- PST will apply if the leases or licences are taxable for PST purposes.

### **Pre-payments before July 1, 2010 for purchases of goods, services, or leases and licences of property**

Three periods are relevant for the HST treatment of prepayments.

First, prepayments made on or before October 14, 2009, for post-June 30, 2010 purchases of goods, services or for leases, licences or similar arrangements are not subject to HST.

Second, HST will generally be collectible on a prepayment that is due or paid without becoming due on or after May 1, 2010, for:

- goods that are delivered and ownership transferred after June 30, 2010;
- services that are performed after June 30, 2010; and
- rent, royalty, or a similar payments for the portion of a lease period occurring after June 30, 2010.

In other words, suppliers must be prepared to collect the HST on pre-payments made on or after May 1, 2010, for these supplies.

Third, organizations and businesses may be required to self-assess the provincial part of the HST on prepayments made after October 14, 2009, and before May 2010, for goods, services, and leases or licences of property supplied on or after July 1, 2010, if these items:

- are not used exclusively in their commercial activities; or
- the supplies are acquired by selected listed financial institutions or certain organizations that use simplified reporting methods under the *Excise Tax Act*.

Self-assessment will also be required by all large organizations and businesses for the provincial portion of the HST on prepayments made after October 14, 2009 and before May 2010, for expenditures in respect of which they are subject to input tax credit (ITC)

restrictions. The restricted ITC categories include energy, most telecommunication services, road vehicles weighing less than 3,000 kg and parts and fuel for these vehicles, and food, beverages and entertainment.

## **Special Transition Rules**

In addition to the above general transition rules, the following sets out a number of special transition rules included in the Ontario and B.C. releases.

### **Memberships and admissions**

The transition rules for services will generally apply to memberships (e.g., in clubs) and admissions (e.g., theatres, etc.) in Ontario and British Columbia. Special rules apply to lifetime memberships. The HST will not apply to admissions that have been sold before October 15, 2009. These admissions will be subject to PST, if applicable.

### **Passenger transportation services**

HST will be payable on prepayments made on or after May 1, 2010, for transportation services that begin on or after July 1, 2010. Generally, the HST will not apply to a passenger transportation service in Ontario or British Columbia that is performed in part on or after July 1, 2010, if the service is part of a continuous journey that begins before July 1, 2010. Special rules apply for transportation passes.

### **Subscriptions**

The HST for Ontario or British Columbia will not apply to any payment made before July 1, 2010, for a subscription to a newspaper, magazine, or other periodical regardless of when delivery occurs. Subscriptions or renewals paid on or after July 1, 2010, will be subject to the HST.

### **Real property**

HST will apply to taxable sales of non-residential real property in Ontario and British Columbia if both ownership and possession are transferred to a buyer after June 30, 2010. The rules for leases of real property are set out above.

On June 19, 2009, Ontario issued detailed transitional rules governing sales of newly constructed residential

real property in Ontario. British Columbia has yet to issue transitional rules for such sales in its province. HST will generally apply to progress payments on contracts to construct, renovate, alter or repair real property to the extent that the progress payment can reasonably be attributed to property delivered or services performed on or after July 1, 2010. For purposes of this rule, a holdback from a progress payment will be considered to be part of the progress payment from which it was held back. This rule will not apply to sales of newly constructed or substantially renovated homes since special transitional rules will apply in Ontario and British Columbia to these properties.

Finally, both Ontario and British Columbia have announced that PST rebates will be available for construction materials owned on June 30, 2010, by real property contractors, which were purchased for use in residential real property contracts that are subject to the HST. Subject to further clarification from Ontario and British Columbia, it appears the rebate may be limited to contracts for the repair or improvement of land and items permanently attached to land, such as buildings and patios. This rebate will be filed by the contractor and will be available for rental housing, condominium and apartment buildings and long-term residential care facilities.

### Other transitional rules

Special transitional rules affect the application of HST in areas such as:

- continuous supplies of goods and services (e.g., electricity) ;
- budget arrangements;
- funeral services;
- sales of exclusive products under the Alternate Collection Method; and
- goods returned on or after July 1, 2010.

## Phase out of PST in Ontario and British Columbia

The announcements by Ontario and British Columbia each contain information on the phase out of each province's PST. The provincial rules are intended to complement the transitional rules for the application of the HST. Briefly, in each province, the existing PST will generally cease to apply to:

- a sale of goods, if the goods are delivered and ownership is transferred to the purchaser on or after July 1, 2010;
- services to the extent they are performed on or after July 1, 2010. (Full PST applies where 90% of the taxable service is performed before July 1, 2010, recognizing that HST does not apply in these instances.)
- supplies by way of lease or licence for periods (or part thereof) on or after July 1, 2010 (other than lease periods beginning before July 1, 2010 and ending before July 31, 2010)
- telecommunications services made available on or after July 1, 2010; and
- admissions for entry into a place of amusement on or after July 1, 2010.

To facilitate the phase-out of the PST, any applicable PST not otherwise payable on or before October 31, 2010, will become payable on that date.

## Managing the transition

These transitional rules could potentially have a significant effect on your organization. Any new contracts that you entertain should suitably address these rules to deal with supplies that may straddle the implementation period. Consideration will also have to be given to existing contracts and arrangements to ensure that any potential price implications are properly incorporated. New procedures and systems modifications may need to be put in place to determine whether PST or HST applies and ensure that billings reflect the correct application of sales tax. Importantly, organizations that are not entitled to claim full input tax credits will have to understand the self-assessment requirements.

PwC has the experience and expertise to help you identify potential issues for your organization and developing strategies to ensure a seamless transition into the HST environment.

Contacts in several locations are listed on the next page.

## For More Help

For further information, please contact the following or your local PwC Indirect Tax representative.

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