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Ontario to Harmonize their Sales Tax with the GST

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After 18 years, the "other shoe" of the Goods and Services Tax (GST) is ready to drop. In his 2009 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. What does that mean to the IT industry in Ontario, and what are some of the issues and opportunities they need to consider prior to implementation.

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This decision will be applauded by most economists as a step toward improving the productivity and competitiveness of Ontario’s economy. With regard to the IT industry, on the cost side, harmonization with the GST will be beneficial. Currently, many costs borne by the industry are subject to unrecoverable RST, including purchases of hardware and equipment, office furniture and supplies, and vehicles. Although Ontario exempts certain purchases of production materials, machinery and equipment, these exemptions have been available to the IT industry only on a very limited basis. Under the HST, the industry will be able to recover the HST paid on such purchases by claiming input tax credits on their GST/HST returns.

On the sales side, the complexity of the RST rules as they currently apply to the industry has been the subject of much debate and concern. Since the RST rules on software were revamped in 1997, the industry has struggled to understand and apply the rules on a consistent and coherent basis, particularly in light of evolving interpretations from Ontario that were not in sync with industry practice. In particular, properly defining exempt custom software; determining the non-taxable service elements of a software implementation project; applying RST to access charges where software was loaded on a server in Ontario; and trying to support exemption for service charges under certain SaaS models, all represent RST issues that have plagued local industry. Consequently, implementation of the HST will effectively remove these issues and simplify the application of tax. It will also remove the RST-driven incentive for certain suppliers to move their servers outside of Ontario, an unfortunate result of Ontario’s taxing software access charges based on the location of the software, as opposed to that of the user. Importantly, business consumers may see the effective cost of IT services decrease with the advent of a harmonized tax.

What should the IT industry do before the new HST system is introduced?

Although business systems currently used for the GST can also be used to comply with the HST, some modifications may be required. In addition, the transition to the HST in Ontario will give rise to many of the same issues that arose with the GST rate reductions on July 1, 2006 and on January 1, 2008.

The HST in Ontario will substantially mirror the GST, but there are certain differences which will require special systems modifications. In particular, during the first 8 years of the tax, large businesses (annual taxable sales in excess of \$10 million) will face restrictions in claiming input tax credits for certain categories of expenditures, such as energy (other than for producing goods for sale), most telecommunication services, food, beverages and entertainment, and road vehicles weighing under 3,000 kg (including repairs, parts and fuel).

Apart from systems issues, Ontario IT companies should consider carefully the implications of the removal of the RST from costs and may wish to postpone certain major purchases that are currently subject to RST. On the other hand, Ontario IT companies should recognize that their business customers may consider deferring major purchases of RST-taxable software until the HST is implemented.

Experience suggests that transitional rules will apply to transactions straddling the implementation date – such as long-term leases, prepaid service contracts, and fixed-price contracts. For more information, contact: