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Ontario PST Harmonization

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This article discusses the proposed implementation of the Ontario Value-Added Tax and outlines the characteristics of the tax as outlined in the 2009 Ontario Budget.

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Ontario's 2009 budget ended speculation over when and if it would harmonize its PST with the federal GST (see CTH January, 2008). Effective July 1, 2010, a single 13 percent HST replaces the 5 percent GST and the 8 percent Ontario PST. The Ontario component, the Ontario VAT (OVAT), is similar to the harmonized system in three Atlantic Provinces but also reflects some elements in the long-harmonized Quebec sales tax.

The OVAT will be administered by the CRA and filed under a single return. The base for calculating the OVAT will effectively mirror the GST, but point-of-sale rebates exist for books, children's clothing and footwear, children's car seats and car booster seats, diapers, and feminine hygiene products. All those products are currently Ontario-PST-exempt and thus will be subject to only the 5 percent federal component of the OVAT; the vendor's overall ability to claim input tax credits (ITCs) is not reduced. An 8 percent sales tax on the same types of insurance currently taxed under the Ontario PST will continue with no ITC available.

Similar to the QST, large businesses with annual taxable sales in excess of \$10 million and financial institutions cannot claim ITCs for the OVAT exigible on energy (except if purchased by a farm or used to produce goods for sale); telecommunications services (other than internet access fees or charges for toll-free numbers); automobiles and other road vehicles weighing less than 3,000 kilograms, parts, fuel and certain services for such vehicles; and food, beverages, and entertainment expenses. These restrictions apply from July 1, 2010 to June 30, 2015; an ITC is phased in over the subsequent three years. Under the QST, a taxpayer who opts to use a prescribed factor receives a percentage recovery for QST paid in relation to such expenses; it remains to be seen whether a similar alternative will be available for the OVAT.

Various rebates, at different rates from the GST, continue into the OVAT, including MUSH sector and new housing rebates. Curiously absent from the budget documents is a rebate for new residential rental property. Financial institutions face an increased tax burden under the OVAT; no mitigating measures are currently proposed.

With over a year to go before implementation, and after having dealt with some of the same transitional issues when the GST rate was reduced on each of July 1, 2006 and January 1, 2008, some taxpayers will be tempted to defer any action until 2010. However, systems modifications may be required, including some to deal with the abovenoted ITC restrictions. Thought should also be given to managing purchases around the implementation date, subject to transitional rules that may be issued. For example, taxpayers not entitled to claim full ITCs under an OVAT may want to consider advancing the purchases of PST-exempt goods or services; other taxpayers may wish to delay the purchase of big ticket items that are taxed under the current Ontario PST but eligible for full ITCs under the OVAT. Vendors should review their contractual responsibility to pass any savings to their customers when the Ontario PST is eliminated. Purchasers should ensure that the savings from the PST's elimination are passed on by vendors, particularly in the case of real property, IT outsourcing, and telecommunications contracts. The impact on budgeting for capital acquisitions, tax included pricing, and funding formulas should also be reviewed. Long-term leases, equipment rentals and fixed price contracts should be analyzed in the light of the transitional rules, which should be released in the next few months. Although the pros and cons of the OVAT will no doubt continue to be hotly debated, the countdown to harmonization has begun.