Tax Memo

Harmonization – Electricity Utilities

After 18 years of maintaining a retail sales tax alongside the federal GST, Ontario is making a bold move to modernize sales taxes in the province. In his 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. This system has been in operation in Newfoundland and Labrador, Nova Scotia and New Brunswick since 1997.

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 electricity sector, on the cost side, harmonization with the GST will be beneficial. Currently, power producers, as manufacturers, are eligible to purchase much of their production equipment exempt from RST. However, RST is payable on many other inputs, such as computers, non-custom software, repair equipment and vehicles. Similarly, electricity transmission and distribution companies benefit from certain RST exemptions on purchases, but a substantial portion of costs are subject to RST. With the implementation of the HST, the sector will be able to recover, with certain limitations, the HST paid on these purchases by claiming input tax credits on their GST/HST returns.

On the sales side, electricity is currently exempt from RST and will be taxable under the new Ontario system. Although businesses are generally able to claim input tax credits for the HST paid on their purchases, under the Ontario HST, large businesses (over $10 million of taxable sales per year) and financial institutions will be unable to claim input tax credits for the Ontario portion of the tax paid on electricity purchases (other than energy used for production of goods for sale) during the first 5 years of the tax (i.e., until July 2015). Input tax credits on energy purchases will be phased in during the subsequent 3 years. It is also expected that purchases of electricity for resupply will also be eligible for full input tax credits.

What should the electricity sector 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 as noted above, there are certain differences with regard to the claiming of input tax credits which will require special systems modifications. In particular, in addition to energy expenditures, during the first 8 years of the tax, large businesses will face restrictions in claiming input tax credits for certain categories of expenditures, such as telecommunications services , food, beverages and entertainment, and road vehicles weighing under 3,000 kg (including repairs, parts and fuel).

Apart from systems issues, Ontario electricity producers, transmitters and distributors should plan for the removal of the RST from costs and may wish to postpone certain major purchases which are currently subject to RST.

Experience suggests that transitional rules will apply to transactions straddling the implementation date – such as long-term leases, equipment rentals and fixed-price contracts.

For more information on the implications of Ontario sales tax harmonization on your business and what you should be doing now to prepare for it, contact the following or your local PricewaterhouseCoopers Indirect Tax representative.

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