

Tax Memo

Harmonization – Information Technology

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 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 on only a very limited basis. Under the HST, the industry will be able to recover the HST paid on these 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. 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 systems modifications. In particular, during the first 8 years of the tax, large businesses (annual taxable sales in excess of \$10 million) have restricted 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 plan for 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, 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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