

Tax Memo

Harmonization – Manufacturing

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 manufacturing sector. Although manufacturers are permitted to buy materials and production equipment exempt from RST, numerous purchases by manufacturers, from office equipment to delivery vehicles, are subject to RST – a significant cost.

Under the HST, manufacturers will pay more tax on their purchases but, like the GST, they will be able to recover the HST by claiming input tax credits on their GST/HST returns. Therefore, the removal of the non-recoverable RST will lower costs and improve the competitiveness of Ontario manufacturers.

What should manufacturers be doing before the new HST system is introduced?

Many of the systems businesses now use to comply with the GST can be used, with appropriate modifications, to handle the HST. In addition, the transition to the HST 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.

Although the HST in Ontario will substantially mirror the GST, 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) will face restrictions in claiming input tax credits for certain categories of expenditures, such as energy (other than for producing goods for sale), telecommunications, food, beverages and entertainment, and road vehicles weighing under 3,000 kg (including repairs, parts and fuel).

Manufacturers outside Ontario may also have to modify their systems to apply HST, rather than GST, on sales to Ontario customers.

Apart from systems issues, Ontario manufacturers should plan for the removal of the RST from prices and make purchase decisions accordingly. In particular, it may be desirable to postpone certain major purchases until after the implementation of the new tax.

For example, delaying the purchase of new computer hardware and non-custom software (unless used directly in the manufacturing process) until after the RST is removed may result in tax savings.

In some instances, the savings may be less obvious. Although RST does not apply directly on construction projects, RST on the building materials is incorporated into the contractor's price. Therefore, it will be necessary to carefully review the price charged to ensure that the savings from the removal of the RST are passed on.

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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