

Tax Memo

Harmonization – Real Estate Development

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. For the real estate sector, harmonization will lower costs. Currently, many costs (such as building materials) borne by the sector are subject to unrecoverable RST. Under the HST, real estate developers 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, however, the effect of sales tax harmonization will depend on the type of property and status of the purchaser. Sales of non-residential property will be taxable, but purchasers will typically be eligible to claim input tax credits. Consequently, the application of HST on non-residential construction will not be a cost to many buyers. In contrast, purchasers of residential properties will not be able to claim input tax credits.

To mitigate the impact on new homes priced at \$500,000 or less, the Ontario budget announced that for newly constructed primary residences, there will be a partial rebate of the Ontario portion of the tax. For houses up to \$400,000, a 75% rebate of the provincial portion of the tax will apply, resulting in an effective Ontario rate of 2%. This is approximately equivalent to the amount of RST which currently applies on such houses through the taxation of building materials. The rebate will be phased out for houses priced between \$400,000 and \$500,000. For new homes valued at more than \$500,000, it would appear there is no rebate.

What should the real estate 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 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).

Apart from systems issues, Ontario real estate developers should plan for the removal of the RST from costs; subject to any transitional rules, there may be value in managing purchases around the implementation date. Developers should also review agreements entered into with buyers to ensure that they can add on the provincial HST component to their prices. In addition, it is expected that there may be pressure to adjust contracts with purchasers of real property to pass on savings from the removal of the RST.

Details of transitional rules are to be released in the coming months. Experience suggests that transitional rules will apply to transactions straddling the implementation date – such as long-term leases, equipment rentals and fixed-price contracts.

The specific transitional rules will be particularly important to review with respect to the Ontario tax on newly constructed primary residences.

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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