

# Tax Memo

## Harmonization – Telecommunications

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 telecommunications 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 switches, routers, IT products, repair equipment and vehicles. Although Ontario exempts certain purchases of production machinery and equipment, these exemptions have never been extended to telecommunications providers. Under the new system, 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, most telecommunications services are currently subject to RST. Consequently, implementation of the HST will amount to one tax replacing another on the charge to customers. 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 telecommunications services (other than fees for internet access and toll-free numbers) during the first 5 years of the tax (i.e., until July 2015). Input tax credits on telecommunications services will be phased in during the subsequent 3 years.

### **What should the telecommunications 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. It is expected this will be a particularly important issue for the telecommunications sector given the complexity of the billing systems to track and invoice customers for the telecommunications services they use.

The HST in Ontario will substantially mirror the GST, but as noted above, there are certain differences which will require systems modifications. In particular, in addition to telecommunications services, during the first 8 years of the tax, large businesses will have restricted input tax credits for certain categories of expenditures, such as energy, food, beverages and entertainment, and road vehicles weighing under 3,000 kg (including repairs, parts and fuel).

Apart from systems issues, Ontario telecommunications companies 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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