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## *B.C. Set to Harmonize its Sales Tax with the GST*

On July 23, 2009, the British Columbia (B.C.) government announced its intention to eliminate its existing provincial sales tax (PST) and introduce a harmonized sales tax regime with the federal goods and services tax (GST). This will take effect on July 1, 2010, the same day that Ontario is harmonizing its PST with the GST.

The province is proceeding with this change as a GST-style tax is far more efficient for businesses. The GST is a value-added tax applied to goods and services, which is designed to be paid by the ultimate consumer. Tax paid by businesses during the production or marketing of these goods and services is recovered through the claiming of input tax credits (ITCs), meaning that sales tax is not included in business costs. PST, on the other hand, while still charged to the consumer, is also payable on many business inputs, increasing business costs.

The purpose of this bulletin is to outline how harmonization will impact your business, and what you need to think about to prepare your business for its implementation.

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## Advantages of Harmonization

The biggest winners with the introduction of harmonization will be the B.C. business community. Businesses will realize the following advantages from the introduction of a harmonized sales tax (HST):

### Recovery of PST

Unlike the GST, B.C. businesses pay PST on many business inputs with no ability to recover the tax. This embedded PST becomes part of the costs of the business. Examples of unrecoverable PST include the PST incurred on fixed asset purchases or goods that are used in the business (i.e. not resold to customers). Under a harmonized sales tax system, ITCs will be available to recover the provincial component of the tax, which will result in lower costs – savings which can be passed on to consumers through lower prices.

### Reduction of Paperwork

Instead of dealing with two sales tax systems, businesses will find their compliance burden substantially reduced by a harmonized sales tax system. There will only be one tax collector – and as a result, only one sales tax return to file. Businesses will no longer be subject to sales tax audits by two levels of government. Purchase exemption certificates, which allow for the purchase of certain business inputs to be exempt from PST, will become a thing of the past as the provincial component of an HST will be recovered by claiming an ITC. For entities who are eligible to claim full ITCs, there will also be no need to self assess any sales tax on goods purchased from non-registered vendors that are used in a business in B.C., which is something that PST auditors currently look for on tax audits.

## Implications of Harmonization

B.C. joins Ontario in harmonizing its sales tax with the federal GST on July 1, 2010. They are not, however, the first jurisdictions to harmonize. The Maritime provinces (Nova Scotia, New Brunswick and Newfoundland and Labrador) harmonized their sales tax with the GST when they introduced their HST in 1997. (While the province of Québec has a value-added tax, it is not fully harmonized with the GST.) Like the HST in the Maritimes, the B.C. HST will be administered by the CRA, allowing the province to save millions of dollars in administration costs. B.C.'s HST will be 12%, which is comprised of the 5% GST plus a 7% B.C. tax. The B.C. HST will generally use the same rules and tax base as the GST.

Details of how the HST will be implemented will be released in the coming months.

As part of the implementation of the HST, the government announced the following:

### Refundable B.C. HST Credit

To offset the impact of the HST on those with low incomes, a refundable B.C. HST credit will be paid quarterly with the GST and carbon tax credit.

### Phase-In of Input Tax Credits (ITCs) for Larger Businesses

Although the ability to claim ITCs will be a key component of the new system, the provincial portion of ITCs will be restricted during the first 5 years of the new system for financial institutions and businesses with taxable sales (including zero-rated sales) in excess of \$10 million annually, and after that, full ITCs will be phased in over 3 years. If the fiscal situation permits, the temporary restriction may be phased out sooner. These restrictions will apply to ITCs related to:

- ◆ Energy (except for energy used for farming or the production of goods for sale);
- ◆ Telecommunication services other than internet access or toll-free numbers;
- ◆ Road vehicles weighing less than 3,000 kilograms and related fuel, parts and certain services; and
- ◆ Food, beverages and entertainment.

ITCs will not be restricted for any items purchased for re-sale, such as auto-dealer vehicle inventory or electricity or natural gas purchased for re-distribution by a utility.

The eight year restriction on the ability to claim full ITCs will increase the implementation cost of harmonization for larger businesses and will negatively impact their cash flows. Ontario has introduced similar restrictions in the implementation of their HST.

## Getting Ready for Harmonization

It is not too early to start thinking about how harmonization will impact your business. The following are things that all businesses need to think about as harmonization approaches:

### Conversion of systems

Many businesses will likely find the conversion to the HST a costly and challenging endeavour as systems will need to be changed to accommodate the HST. Invoices, sales receipts, purchase orders and expense reports will likely require modification. Those businesses with complex billing cycles that straddle the transition time

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may find the transition to a harmonized sales tax particularly onerous.

### **Budgeting for HST**

The impact of the introduction of the HST on budgets and cash flow projections will have to be evaluated. The ability to recover previously unrecoverable PST as ITCs will reduce business costs once the HST is implemented. Cash flows will also be impacted due both to the collection and remittance of the HST on a broader range of goods and services sold, and the payment of the HST on business inputs. Larger organizations will have to take into account the restrictions on claiming ITCs on certain expenditures during the first eight years of harmonization. Implementation costs, including any required system changes, will also have to be factored into budgets.

### **Contractual obligations**

Businesses will need to review their contractual obligations to determine the impact of harmonization on these agreements. Harmonization also needs to be considered in negotiating new contracts that extend beyond July 1, 2010. Transitional rules should be carefully reviewed when issued to ensure compliance with the legislation and refund opportunities, if any, are considered.

### **Planning Considerations**

Businesses should review planned expenditures as the conversion date approaches and determine whether these expenditures are subject to PST that can't be recovered. If possible, these expenditures should be incurred after June 2010 so that the provincial component of the tax paid qualifies for an ITC. Consumers, on the other hand, will no doubt be reviewing expenditures that will become subject to the provincial component of the harmonized tax, so that these goods or services are bought before the harmonized tax comes into effect.

In addition, small businesses who file GST returns on a quarterly or annual basis should consider whether they want to file HST returns monthly, if a significant amount of the supplies they sell are zero-rated under the GST. GST does not have to be charged on zero-rated supplies – that said, businesses making zero-rated supplies are still entitled to recover all of the GST paid on business inputs as ITCs. Filing monthly will allow these businesses to recover the HST they pay on a more frequent basis than filing returns on a quarterly or annual basis. Businesses who will have a significant amount of zero-rated supplies will include exporters, grocery stores and farmers. Note that while businesses can change their reporting periods by filing an election, the change will only take effect on the first day of a fiscal year.

### **Interprovincial Issues**

For businesses that operate exclusively in B.C. that are already registered for the GST, the transition to a harmonized sales tax will likely be smooth – and may simply involve a rate change on July 1, 2010. For businesses that operate in both B.C. and other provinces, however, the transition may not be as smooth. They will have to ensure that their systems enable them to determine whether to collect the 5% GST or the 12% HST on shipments of goods or supplies of services (which will depend on where the supply is provided). Many businesses will not have these systems in place, unless they currently make supplies in the Maritime provinces and therefore have been dealing with that HST. Even then, these systems will likely have to be modified.

### **Issues for Specific Industries**

The move to a harmonized sales tax impacts various industry sectors in different ways. Following are some issues that need to be considered by different sectors:

#### **Retail**

Businesses in the retail sector will find that the HST will tax a much broader range of goods and services. These businesses must also ensure that their systems will be equipped to distinguish between items which are fully taxable from those that are subject to the new point-of-sale rebates. As noted in the government's press release of July 23rd, there will be a point-of-sale rebate for the provincial component of certain items including gasoline and diesel fuel for motor vehicles, books, children's clothing and footwear, children's car seats and car booster seats, diapers, and feminine hygiene products, meaning that these products continue to be exempt from the 7% B.C. tax.

#### **Construction and Real Estate Development**

The introduction of the HST has effectively introduced a new tax on new housing. Currently, new housing is only subject to the 5% GST (with a GST rebate available of 36% of the tax paid on the first \$350,000 of the purchase price, which is phased out for homes priced between \$350,000 and \$450,000). Under harmonization, new homes will be subject to the 12% HST.

To ensure that new homes priced up to \$400,000 will bear no more tax than under the current PST system, a partial rebate of the provincial portion of the HST will be provided. The rebate will be equal to 5% of the purchase price up to a maximum rebate of \$20,000. For new homes priced up to \$400,000, this means that the effective B.C. tax rate will be 2%. New homes priced above \$400,000 will receive a flat rebate of \$20,000.

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## Public Service Bodies

There will be rebates for municipalities, charities and eligible non-profit organizations to avoid tax increases for these sectors. Details have not yet been announced.

## Summary

Even though harmonization only takes effect July 1, 2010, it is important that you start to think about the transition to a harmonized sales tax now. Contact your BDO advisor to discuss how harmonization will impact your organization.

*This is a publication of BDO Dunwoody on developments in the area of taxation. This material is general in nature and should not be relied upon to replace the requirement for specific professional advice. The information in this document is current as of July 23, 2009*

*Comments and suggestions should be addressed to National Tax, by FAX (416) 367-3912 or E-mail at [info@bdo.ca](mailto:info@bdo.ca). We invite you to visit our web site at [www.bdo.ca](http://www.bdo.ca) to find out more about our firm and the offices near you. Or call us at 1-800-805-9544.*

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