

TAX BULLETIN

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Government Announces New GST/HST Place of Supply Rules

On February 25, 2010 the Department of Finance released, in a Backgrounder entitled *Place of Supply, Self-Assessment and Rebate Rules for the Harmonized Sales Tax (HST)*, substantial changes to the place of supply rules. The original legislation related to these rules was issued in 1997 with the introduction of the HST in the Atlantic Provinces. As described by the Department of Finance in its press release, the rules “need to be modernized” with the announced implementation of the HST on July 1, 2010 in the provinces of Ontario and BC. In early April, Nova Scotia also announced its intention to raise the provincial portion of the HST to 10%.

In very general terms, the place of supply rules, are intended to determine in which province a supply is made. As a result, these rules provide guidance with respect to whether GST registered businesses should collect GST or HST on their Canadian sales and at what rate the GST/HST should be collected. The new rules will have the largest impact on registrants (both resident and non-resident) who make supplies in multiple provincial jurisdictions as the registrant will have to ensure it is collecting tax at the correct rate.

The purpose of this document is not to explain all the changes announced in the twenty-three page Backgrounder, but to highlight which place of supply rules have been changed, which place of supply rules have not been changed, and to provide guidance with respect to the significant changes to the rules that have been announced related to services and intangible personal property. The new place of supply rules will apply to any supply made on or after May 1, 2010, and any supply made after February 25, 2010 and before May 1, 2010, if the consideration for the supply has not become due, and has not been paid, before May 1, 2010.

Place of Supply Rules

The Department of Finance has stated that no changes to the place of supply rules will be made related to the following:

- Supplies of real property,
- Supplies by way of sale of tangible personal property,
- Supplies of tangible personal property, otherwise than by way of sale (e.g., lease),
- Passenger transportation services that are part of a continuous journey (including baggage charges, child supervision and services related to a ticket, voucher or reservation) that are provided by the supplier of the passenger transportation service,
- Freight transportation services,
- Postage and mail delivery services,
- Telecommunication services,
- Repairs, maintenance, cleaning and alterations related to goods,
- Computer related services and internet services - the existing rule will continue to apply, despite the proposed rule for services in relation to tangible personal property (outlined below).

Proposed changes to the place of supply rules will be made to the following:

- Tangible personal property supplied on board conveyance (mode of transportation),
- Services supplied on board conveyances,
- Services provided in respect to tangible personal property not remaining in the same province while the service is being performed
- Customs brokerage services,
- Services of a trustee in respect of a trust governed by an RRSP, RRIF or RESP will be extended to TFSA and RDSP,
- Premium rate telephone service (e.g., 1-900 numbers),
- Air navigation services,
- Railway Rolling Stock (a special transition rule has been proposed).

Due to the specific nature of these supplies we have not provided detailed information, which describes the changes that have been proposed. If you will be making supplies subject to the new rules and require more information, contact your BDO advisor.

Services

Significant changes are proposed related to the place of supply rules for services. The current rules provide that a service is considered to have been made in a particular province if all or substantially all (90% or more) of the Canadian element of the service has been performed in that province. However, if 90% or more of a service is not performed in any one particular province, the supplier has to determine where the “place of negotiation” occurred and provided 90% or more of the service did not occur outside that province the supply was deemed to be made in that province. The legislation went on to a third test if the place of supply still could not be determined.

Under the proposed changes, the reference to place of negotiation has been removed in determining in which province a supply of a service is made. Instead a key factor will be the location of the person who is the recipient of the supply. In this regard, a recipient is generally defined as the person who is liable to pay the consideration for the supply. Note that exceptions to the general rules will apply for personal services, services in relation to real property, tangible personal property, location specific events and services rendered in connection with litigation.

We have provided some general rules to help you understand the proposed changes.

General Rules for Services

Rule #1

Under Rule #1, a supply of a service is deemed to be made in a particular province if in the normal course of business, the supplier obtains an address of the recipient that is:

- (a) a home or business address in Canada of the recipient,
- (b) where the supplier obtains more than one home or business address in Canada of the recipient, the home or business address that is most closely connected with the supply, or
- (c) where the supplier does not obtain a home or business address in Canada of the recipient, another Canadian address that is most closely connected with the supply.

The supply will now be regarded as made in the province in which the particular address is situated.

This is a critical variance from the existing place of supply rules for services as it shifts the determining factor away from where the service was actually performed to the place where the recipient is located.

Example A: An accounting firm in Calgary, Alberta is hired to conduct a financial audit of a company with a business address in Kelowna, BC. In the course of the audit, 60% of the work is performed in Calgary and the remaining 40% is performed at the company's Kelowna address. Because the supplier obtains the recipient's BC business address, the service will be subject to HST at a rate of 12%.

Rule #2

The Backgrounder goes on to state that if Rule #1 does not result in identifying the place of supply of the service, the supply will be deemed to be made in a participating province (i.e. BC, Ontario, New Brunswick, Nova Scotia or Newfoundland and Labrador) if the part of the service that is performed in Canada is performed primarily (more than 50%) in the participating provinces. In this case, the supply will be regarded as made in the participating province in which the greatest proportion of the service is performed (Rule #2). Alternatively, if the part of the service performed in Canada is performed primarily in the non-participating provinces (i.e. Alberta, Saskatchewan, Manitoba, Quebec, Prince Edward Island and the three Territories), the supply will be regarded as being made in a non-participating province and, if taxable, only the GST (5%) will apply.

Example B: A human resources consulting firm with offices in a number of provinces is hired to conduct an executive search in BC and Alberta. The consulting firm does not obtain a Canadian business address or any other address in Canada that is used by the supplier in connection with the supply. 70% of the services performed in Canada are performed in Ontario. The service will be subject to HST at a rate of 13%.

The Tie-Breaker Rule

If Rule #2 applies, but a single participating province cannot be determined (e.g., the service is performed 50% in two participating provinces) the supply will be regarded as made in the participating province with the highest rate of the provincial component of the HST.

Exceptions to General Rules for Services

Personal Services

"Personal services" are generally viewed as a service that is all or substantially all (90% or more) performed in the physical presence of the individual to whom it is rendered (e.g., a haircut or a massage). The rules for personal services will not apply to an advisory, consulting or professional service as these services will generally be subject to the general rules for services, except where another specific rule applies to them.

If the part of a personal service that is performed in Canada is performed primarily in participating provinces, the supply of the service will be regarded as made in the participating province in which the greatest proportion of the service is performed. Alternatively, if the personal service is performed primarily in non-participating provinces it will be regarded as being made in a non-participating province and, if taxable, only GST will apply.

Example C: A service of cutting an individual's hair at a salon in Sudbury, Ontario will be regarded as supplied in Ontario and will be subject to HST at a rate of 13%.

If the greatest proportion of the service is not performed in a particular participating province one can refer to the Tie-Breaker Rule, with adjustments as needed to refer to personal services.

Services in Relation to Real Property

There are separate rules for services related to real property in Canada. A supply of a service related to real property will be regarded as having been made in a participating province if the real property is situated primarily in the participating provinces. In addition, the supply will be regarded as having been made in the participating province in which the greatest proportion of the real property is situated. If this can't be determined, then the *Tie-Breaker Rule* will apply.

If a service related to real property is performed primarily in non-participating provinces, only GST will apply.

Example D: A property management company is hired to provide property management for real property situated in three provinces. 40% of the real property is situated in Ontario, 40% of the real property is situated in BC and 20% of the real

property is situated in Alberta. The real property in Canada is therefore situated primarily in participating provinces and the greatest proportions of the real property are situated in Ontario and BC. Comparing Ontario and BC, the tax rate for Ontario is highest. As a result, the supplier will charge HST at a rate of 13%.

Services Related to Tangible Personal Property

Services related to tangible personal property situated in Canada (at all times) are also subject to special rules. The general rule for services will not apply to supplies of services related to tangible personal property unless it is a service of repairs, maintenance, cleaning and alterations related to goods. If the property remains in a participating province or provinces the entire time the service is performed, the service will be regarded as having been made in a participating province. Otherwise, the supply will be deemed to be made in the participating province in which the greatest proportion of the tangible personal property, which is situated in the participating provinces, is situated.

Alternatively, if the part of the service performed in Canada is performed primarily in the non-participating provinces, the supply will be regarded as being made in a non-participating province and only GST will apply.

If the tangible personal property is situated more than 50% in participating provinces when of the service is performed, but the greatest proportion of the service is not performed in a particular participating province, then the *Tie-Breaker Rule* will apply.

Example E: A national appliance repair company is hired to provide appliance repair services for a flat fee in respect of tangible personal property situated in three provinces. Approximately 40% of the tangible personal property is situated in Ontario, 40% of the tangible personal property is situated in BC and 20% of the tangible personal property is situated in Alberta. The tangible personal property in Canada is therefore situated primarily in participating provinces and the greatest proportions of that tangible personal property are situated in Ontario and BC. Because the tax rate for Ontario is highest, the supplier will charge HST at a rate of 13%.

Services in relation to a location specific event

The general rules for services will not apply to a supply of a service that relates to a location-specific event (e.g., a performance, festival, ceremony, convention, conference, symposium, or other similar event) if the service will be performed primarily at the location of the event in a province. A supply of such a service will be treated as having been made in the province in which the service is primarily performed.

Services rendered in connection with litigation

The general rules for services will not apply to a supply of a service rendered in connection with criminal, civil or administrative litigation in a province (other than a service rendered before the commencement of such litigation). A supply of a service rendered in connection with criminal, civil or administrative litigation in a particular province will be regarded as being made in that particular province.

Example F: An individual from Brandon, Manitoba receives a speeding ticket in Kenora, Ontario. The individual hires a lawyer from Kenora to contest the ticket. The supply of the service will be regarded as having been made in Ontario because it is rendered in connection with litigation in Ontario. Accordingly, the lawyer will charge HST at a rate of 13% (a 5% federal component and an 8% Ontario component).

Intangible Personal Property

The proposed rules for supplies of intangible personal property will continue to be largely dependent on where the intangible personal property can be used. The significant difference between the current rules and the proposed rules, as is the case with services, is the elimination of the place of negotiation as a criterion and the greater emphasis on the location of the recipient of the supply.

General Rules for Intangible Personal Property

Generally, if a supply of intangible personal property is made and the Canadian rights in respect of that property can be used only primarily in participating provinces, the place of supply will be in a participating province and it then becomes a question of which participating province and which HST rate is applicable. If the Canadian rights in respect of the intangible personal property can only

be used in a single participating province, that participating province will be the place of supply.

Example G: An individual purchases a fitness club pass that provides the individual with the right to an unlimited number of uses during a one-month period of club facilities that are only in Newfoundland and Labrador, including access to a fitness seminar, a towel service and a fitness evaluation. The supply of the pass will be regarded as made in Newfoundland and Labrador as it can be used only there and will be subject to HST at a rate of 13%

If a supply of intangible personal property is made and the Canadian rights in respect of that intangible personal property can be used only primarily outside of participating provinces, the supply will be regarded as having been made in a non-participating province and would only be subject to GST.

Example H: A theatre pass that provides admissions to seven plays in Alberta and three plays in BC will be viewed as a supply of intangible personal property with Canadian rights that can be used only primarily in non-participating provinces since the rights that can be used in Alberta are more than 50% of the Canadian rights supplied under the agreement and can be used only in a non-participating province. Therefore, it will only be subject to GST at a rate of 5%.

If the Canadian rights in respect of the intangible personal property can be used in more than one province, the rules are complex and go beyond the scope of this publication. Contact your BDO advisor for more information on these rules.

Specific Exceptions to General Rules for Intangible Personal Property

The general rules for intangible personal property are proposed to apply to all supplies of intangible personal property except where a specific exception applies.

Intangible personal property that relates to real property

A supply of intangible personal property related to real property that is situated primarily in participating provinces will be regarded as to have been made in the participating province in which the greatest proportion of the real property is situated. If a single participating province cannot be determined because the real property is situated

equally in two provinces and the HST rates vary, the *Tie-Breaker Rule* will apply.

Intangible personal property that relates to tangible personal property

A supply of intangible personal property related to tangible personal property in Canada will be regarded as have been made in a participating province if the tangible personal property is ordinarily located primarily in the participating provinces. If you are involved in the making of these supplies and require more information, contact your BDO advisor.

Example I: An individual purchases an option to purchase a famous work of art. The art is ordinarily located in Ontario. The supply of the option will be regarded as made in Ontario and will be subject to HST at a rate of 13%.

A supply of intangible personal property related to tangible personal property situated in Canada will be regarded as having been made in a non-participating province if the tangible personal property is ordinarily located primarily in non-participating provinces. If tangible personal property is ordinarily located equally in participating and non-participating provinces the supply will be deemed to be made in a non-participating province and only GST.

Intangible personal property that relates to services to be performed

For intangible personal property that relates to services to be performed, if the supplier can determine that those services would all be supplied in a single province, then the supply of intangible personal property will generally be regarded as having been made in the same province.

Example J: An individual purchases a train pass that may be used for 10 round-trip train trips from Ottawa, Ontario to Montreal, Quebec. Because the supplier can determine that the place of supply for each supply of a passenger transportation service would be Ontario if supplies of those services were made, the supply of the intangible personal property will be regarded as having been made in Ontario and will be subject to HST at a rate of 13%.

Where a supplier of intangible personal property related to services to be performed cannot determine that the services to which the intangible personal property relates would all be supplied in a

single province, the general rules for intangible personal property would apply to the supply of intangible personal property.

Conclusion

The proposed place of supply rules are dependent on the type of supply that is made and are intended to determine in which province a supply is made. The proposed rules are complex and as a result, it is important for suppliers to determine how these new rules will impact them. Contact your BDO advisor to determine how these new rules will impact you and your business.

The information in this publication is current as of April 30, 2010.

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