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The Transition to the HST in Ontario

On October 14, 2009, the Ontario Ministry of Finance released Information Notice #3 (the “Ontario Notice”) outlining the general transition rules in support of its implementation of the Harmonized Sales Tax (HST). The HST is scheduled to come into effect on July 1, 2010 subject to legislative approval.

Further details of how the HST will be implemented will be released in the coming months. It is expected that the complete policy and administrative details will be released by the end of March 2010.

The purpose of this bulletin is to briefly address particular issues and questions related to the transitional rules with the intention of illustrating how these rules may impact your business and to provide you with information on what you need to do to prepare your business for the implementation of the HST and the winding down of the current Provincial Sales Tax (PST).

Key Dates

The transitional rules will operate based on four key dates.

- **July 1, 2010** - Implementation of the HST in Ontario.
- **May 1, 2010** – The HST will have to be collected on amounts that are paid or become payable on or after May 1, 2010, for goods or services provided on or after July 1, 2010.
- **October 14, 2009** – This is the date of Ontario’s Notice with respect to certain transitional rules. Certain businesses and public service bodies (non-profits organizations, charities, municipalities, schools, hospitals, etc.) may be required to self-assess the Ontario component of the HST (OHST of 8%) on amounts paid or payable after October 14, 2009 and before May 2010 for goods or services provided on or after July 1, 2010.
- **October 31, 2010** – This is the date on which any outstanding PST becomes payable under the transitional rules to ensure an efficient wind-down of the PST. Practically, the Ontario PST regime will cease to exist on October 31, 2010.

When Does My Business Have to Charge the HST?

Generally, businesses that supply goods or services that are to be delivered or performed on or after July 1, 2010 and are paid or become payable on or after May 1, 2010 will be subject to the HST.

Transitional rules, however, may apply to certain transactions entered into before May 1, 2010, which may result in the OHST being applicable to goods or services that are supplied on or after July 1, 2010.

There are also specific HST transitional rules that may apply to prepaid funeral services, freight and passenger transportation services and magazine subscriptions that straddle July 1, 2010. Businesses that provide these types of services should review the Ontario Notice. The notice is available at the Ontario Ministry of Finance Website: <http://www.rev.gov.on.ca/en/notices/hst/03.html>.

Our business sells goods. When will we have to start collecting the HST?

Registrants will generally need to begin collecting the HST on the sale of goods if possession and ownership of the goods is transferred to the purchaser on or after July 1, 2010, and payment for the goods becomes due or is made after April 30, 2010. Paying for goods in May and June 2010 will not avoid the HST, if delivery occurs on or after July 1, 2010.

Example #1

A customer orders and pays for a patio set on June 15, 2010 and it is delivered in July 2010.

- GST is payable at 5% on June 15, 2010.
- PST is not payable.
- OHST is payable at 8% on July 1, 2010.

Example #2

A customer orders and pays for a patio set on April 30, 2010 and the patio set is delivered in July 2010.

- GST is payable at 5% on April 30, 2010.
- PST is payable at 8% on April 30, 2010.
- OHST is not payable.

My customers are all PST exempt because they buy for “resale”. How will the HST apply?

The exemption for PST on goods acquired for “resale” no longer applies as of July 1, 2010. HST will generally be applicable; however, recovery of the HST may be available depending on the tax status of the customer.

WARNING: Are your billing systems going to be ready on July 1, 2010, to collect the HST from customers that were previously PST exempt?

Our business provides taxable services (GST and PST). How will the HST apply to services we provide after July 1, 2010?

Generally, the HST will apply to the portion of services performed on or after July 1, 2010. However, if 90% or more of the service is performed before July 2010, the HST will not apply.

When services that are performed on or after July 1, 2010 are paid for before May 2010, no HST will apply. However, where the invoices are issued on or after May 1, 2010, the HST will be applicable.

Example #3

Your business provides GST and PST taxable services for the three months ending August 31, 2010. An invoice is issued on August 31, 2010 for the three months. The service is provided evenly over the three months.

- GST is payable at 5% on August 31, 2010 on the entire invoice.
- PST is payable at 8% on August 31, 2010 on one-third of the invoice (June).
- OHST is payable at 8% on August 31, 2010 on two-thirds of the invoice (July and August).

TIP: If businesses provide services that qualify for the “90% or more completion” rule, they should maintain adequate documentation.

TIP: Businesses would be advised to ensure invoices are issued promptly (i.e. before July 1, 2010) for PST exempt services provided to customers who are not entitled to a full input tax credit ("ITC") to avoid customers having to pay unrecoverable OHST.

We are starting a new business that offers admissions to time management workshops starting on July 1, 2010. Participants could be consumers or businesses. We are starting to plan our pricing for our July 2010 fees. How do we account for the HST?

Depending on when you require or receive payment, you may not be required to collect the HST.

Example #4

Your business is registered for the GST and offers on-line registration and payment for workshops that will be offered after June 30, 2010. You accept on-line registration and payments beginning on April 1, 2010.

- GST is payable at 5% on all payments.
- OHST will not have to be collected on any registrations that are paid prior to May 1, 2010.
- OHST is payable on any payments made after April 30, 2010. The OHST is deemed to be payable as of July 1, 2010 and would have to be included in your HST return that covers July 1, 2010.
- Businesses and public service bodies will be required to self-assess the OHST on payments made before May 1, 2010 to the extent they are not entitled to claim a full ITC or rebate of the OHST.

We are a business that obtained GST taxable services from a non-resident. GST was not charged. Do we have an HST issue?

Example #5

Your business hires a consultant from the United States who provides business processing services (GST/PST taxable) from June to August 2010, and he/she is not a GST/PST registrant.

The consultant issues a bill on September 1, 2010 for the three months ending August 31, 2010. The service is provided evenly over the three months. Provided that your business is entitled to claim full ITCs for GST purposes:

- GST/HST - Your business is not required to self-assess the GST or the OHST.
- PST - Your business is required to self-assess the PST on one month of services (June).

We are in the business of leasing computers. How will the HST affect our business?

HST will apply to lease payments where the lease interval begins on or after July 1, 2010. For example, a monthly computer lease for the lease interval July 1, 2010 to July 31, 2010 would have HST applied to the lease payment.

However, where the lease interval begins prior to July 1, 2010 and ends prior to July 31, 2010, the HST will not apply.

As such, leases that straddle the implementation date will need special consideration.

Example #6

A computer is leased from June 15 to July 14, 2010. The lease payment is due on July 14, 2010.

- GST is payable at 5% on July 14, 2010.
- OHST is not payable.
- PST is payable at 8% on July 14, 2010.

WARNING: Will your system be able to account for the tax correctly? Will staff be properly trained to explain the HST rules to customers?

We operate a fitness gym and collect our membership fees in January. How will the HST apply?

For transitional rule purposes, memberships are considered services.

Example #7

On January 1, 2010 a customer signs up for a one year membership and pays the full amount.

- GST is payable at 5% on January 1, 2010.
- OHST is not payable.

If the customer is not a consumer (i.e. the customer is a business or public service body), it generally will be required to self-assess the OHST to the extent the payment relates to the part of the membership that is performed on or after July 1, 2010.

Lifetime Memberships

There are specific guidelines for lifetime memberships in the Ontario Notice that should be referred to where a lifetime membership is supplied after October 14, 2009.

Will I pay the HST on my rent?

The transition rules related to the leasing of commercial real estate mirror those related to the lease of tangible personal property (e.g., computer leases that were discussed in Example #6). Rentals that are currently PST exempt will be subject to the HST as of July 1, 2010.

HST will also generally apply on the sale of real property (other than used residential housing) if both ownership and possession are transferred to the purchaser on or after July 1, 2010.

The province has released additional information specific to the construction industry in respect of new housing. See Ontario Information Notice #2 for details. The notice is available at the Ontario Ministry of Finance website: www.rev.gov.on.ca/en/notices/hst/02.html.

As a business how will the HST impact the expenses I pay for each month?

There are specific rules for continuous supplies such as electricity and natural gas, cable television and cellular phone services. Unless the supplier can determine exactly how much of the property or service is delivered prior to July 1, 2010 (e.g. by way of meter reading), the HST will need to be prorated based on the number of days in the period to which the consideration is attributable.

Example #8

An invoice is issued on July 15, 2010 for the supply of electricity. The supplier has no method of tracking the actual usage that occurred prior to July 1, 2010. The invoice covers 20 days in June and 10 days in July.

- GST is payable at 5% on the entire invoice on July 15, 2010.
- OHST is payable at 8% on one-third of the invoice on July 15, 2010.
- PST is payable on two-thirds of the invoice on July 15, 2010.

The HST will apply to prepayments for services that become due or payable on or after May 1, 2010 where the services are performed on or after July 1, 2010.

I currently claim full ITCs on the GST I pay. Will the HST impact my business?

Large businesses will need to take special care on tracking the OHST on expenses where ITCs are restricted.

Both electricity and telecommunications services are examples of expenses where the claiming of ITCs by large businesses will be restricted during the first eight years of the OHST.

Note that the GST portion of these bills is not subject to ITC restriction. See below for more details on restricted ITCs for large businesses.

How will the HST apply when I import goods or services into Ontario from outside the province?

The HST will generally apply to non-commercial goods that are imported from outside Canada into Ontario by a resident on or after July 1, 2010. For cross-border shoppers this should not present a change. The Canada Border Services currently collects Ontario PST on non-commercial imports and will collect the OHST on or after July 1, 2010.

The OHST may also be applicable to goods imported from other provinces. In instances where the purchaser is not entitled to full ITCs, self-assessment of the OHST is required. There is no requirement to self-assess the GST portion if the vendor did not collect that tax.

For entities that are not entitled to full ITCs and who import commercial goods (e.g., financial institutions and organizations such as charities and non-profits), they will need to track their imports and self-assess the OHST to the extent they import goods on or after July 1, 2010.

In respect of imported services, the general rules related to timing outlined above will apply. If the services are performed on or after July 1, 2010, HST at 13% will be applicable and if full ITCs are not available, self-assessment of the tax is required.

To the extent that purchases made prior to July 1, 2010 give rise to self-assessment, the tax will be deemed to be due as of July 1, 2010 and will need to be included in the reporting period that includes July 1, 2010.

Harmonization Traps

It will be important for many business entities to determine if they are required to self-assess the OHST. The self-assessment liability would generally be triggered when goods or services are acquired by an entity that is not entitled to a full ITC for goods or services that are to be delivered or performed after on or July 1, 2010 but are paid and become payable after October 14, 2009, and before May 1, 2010.

For example, the following entities may have self-assessment issues:

- A financial institution for GST purposes, that includes not only banks and insurance companies, but also includes trusts and other entities that provide GST exempt financial services.
- Certain charities and other public service bodies that use simplified procedures for calculating their GST (i.e. the net tax method for charities). This will also trap small businesses using simplified GST accounting methodologies.
- Large businesses acquiring supplies that result in restricted ITCs (see below).

ITC Restrictions related to the OHST

As noted above, it is important not to lose sight of the fact that large businesses will not be able to recover all the OHST they pay as they currently do with the GST. There will be many instances where businesses will be restricted from claiming the OHST they pay.

ITCs will be restricted during the first 5 years of the new system for financial institutions and businesses with taxable sales in excess of \$10 million annually, and after

that, full ITCs will be phased-in over 3 years. 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.

Issues for Specific Industries

The move to an HST impacts various industry sectors in different ways. The following are some issues that need to be considered by different sectors.

I operate a retail business. How I am going to handle returns and exchanges under the HST?

Returns and exchanges will be an area that may require systems work for retailers. The general guidelines are as follows:

- Where goods are purchased pre-implementation and returned on or after July 1, 2010, the PST will be refunded.
- If a good is returned before November 1, 2010 in exchange for goods with a value in excess of the original purchase price, the OHST applies only to the excess amount.
- If a good is returned for a good of equal or lesser value, no OHST applies.

I am the treasurer for a charity. Will the charity get the same rebate of the HST that it does for GST?

Public services bodies need to keep in mind there are now different rebate rates for the GST and the OHST. Each purchase will need to be reviewed to determine:

- If a portion of the GST on this expense can be recovered.
- If a portion of the OHST on this expense can be recovered.
- If the OHST has to be self-assessed where full recovery is not available.

The following table sets out the OHST rebates for the various public service bodies as announced in the 2009 Ontario budget:

Rebates for Public Service Bodies	Sector Rebate
Municipalities	78%
Universities and Colleges	78%
School Boards	93%
Hospitals	87%
Charities and Qualifying Non-Profit Organizations	82%

As a builder, how will the HST affect me?

As a builder, you will need to determine when to apply the HST. Both the Ontario Ministry of Finance and the Canada Revenue Agency (CRA) have issued bulletins in respect of new housing sales which should be reviewed in detail. Outlined below are some key points to consider.

- Where ownership or possession of a new house transfers prior to July 1, 2010, no OHST will apply - only the GST will apply.
- Grandparented sales: Even when the sale or possession of the house transfers on or after July 1, 2010, provided the written purchase and sale agreement was entered into prior to June 18, 2009 no HST applies. These types of sales are “grandparented” for HST purposes.
- Non-grandparented sales: If the purchase and sale agreement is signed after June 18, 2009 and you transfer ownership and possession after June 2010, the HST will apply.

Are there New Housing Rebates similar to those under the GST for HST?

Where the GST applies to a sale, the new housing rebate rules as they currently operate will apply to the GST portion of the HST.

Where the HST applies, the Ontario new housing rebate may be available in respect of the Ontario portion of the HST paid on the purchase of a newly constructed or substantially renovated house.

Where the house is purchased for use as the primary place of residence of the purchaser (or a relative of the purchaser) and the remaining conditions for claiming a GST new housing rebate are met, the purchaser should be entitled to claim an Ontario new housing rebate. The Ontario new housing rebate would be available regardless of the purchase price for the house – for GST purposes, the rebate is phased-out when the value of the house reaches \$450,000. New homes purchased as primary residences across all price ranges will qualify for a rebate of up to \$24,000 of the 8% provincial component of the HST. The rebate will be equal to 75% of the provincial portion of the HST payable on the purchase of a new home, up to a maximum rebate of \$24,000. For example, the rebate on a new house priced at \$400,000 will be \$24,000 ($\$400,000 \times \text{the } 8\% \text{ provincial component} \times \text{the } 75\% \text{ rebate}$).

The Ontario new housing rebate will be available for the same types of residential properties for which a GST new housing rebate is currently available. Qualifying housing would include newly constructed and substantially renovated homes whether owner occupied or rented. Similar to the GST, the Ontario Ministry of Finance proposes to limit the new housing rebate to homes for use as primary places of residences. As such, recreational properties such as cottages and ski chalets

not used as primary residences would generally not qualify for the new housing rebate.

Are there any adjustments for the PST required?

For a grandparented sale, the builder will not collect the HST but may be required to pay a “transitional tax adjustment” if the housing unit is less than 90% complete as of July 1, 2010. Information Notice Number 2 issued by the Ontario Ministry of Finance outlines the tax adjustment rates which are capped at 2%. For grandparented sales of condominiums, the builder does not collect the HST but will be responsible for the transitional tax adjustment and may be eligible for a PST rebate based on percentage of completion.

Are there any PST rebates available?

In the case of a non-grandparented sale (i.e. HST applies), the purchaser will be entitled to claim a PST rebate based on the degree of completion of the house at July 1, 2010. The rebate will be determined by multiplying the percentage of completion at July 1, 2010 by the “estimated PST content” of the home which will be calculated by either a floor space method or a selling price method. The purchaser may obtain this rebate directly from the builder (i.e. via a reduction in the selling price) or may apply to the CRA directly. A builder would be required to provide a certificate indicating the percentage of completion of the house.

Note that the PST rebate is not available to purchasers of “grandparented” condominiums.

How should the rebate be disclosed to home purchasers?

For a non-grandparented sale, the builder will collect the HST and will be required to disclose whether the HST applies to the sale and whether the stated price includes the provincial portion less the new housing rebate. Where the builder fails to make the disclosure, the price of the house is deemed to include the OHST. In such a case, the purchaser would not be required to pay the Ontario part of the HST in addition to the stated price in the agreement.

Will there be a rebate for PST for contractors?

Ontario intends to rebate the Ontario PST that will be embedded in contractors’ inventory for materials that were “PST paid” but used in residential property construction on or after July 1, 2010. This rebate will be administered by the Ontario Ministry of Finance and rebate applications will be due by December 31, 2010.

Summary

Even though harmonization takes effect July 1, 2010, it is important that businesses start to think about the transition to the HST. As illustrated above, the requirement to charge the HST can start as early as May 1, 2010 and self-assessment may be required on purchases you are making now. Contact your BDO advisor to discuss how harmonization may impact your business.

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