



British Columbia Harmonized Sales Tax

Glazing Contractors of BC
Window and Door Manufacturers Association of BC
Metal Cladding Association of BC

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BC HST – Agenda

1. Brief review of BCs dual GST/PST regime
2. Problems with the dual sales tax regime
3. Harmonization: 1997 Atlantic Canada experience
4. Implications for BC's construction contractors
5. Implementation issues
6. Other ways to improve profit

BC HST – BCs current regime

Review of BC's Dual Sales Tax Regime

BC HST – BCs current regime

BC's 'dual' sales tax structure

- **5% federal Goods and Services Tax (GST)**
 - Applies to all goods and services unless
 - Exempt or zero-rated
 - GST paid is entirely refundable to commercial enterprises
 - Input tax credit (ITC) claimed for all GST paid on good/services consumed in the course of commercial activities
 - GST is ultimately, borne by the "consumer"
 - Consumer = person who cannot claim an ITC or a some form of rebate.

BC HST – BCs current regime

BCs 'dual' sales tax structure

- **7% Provincial Sales Tax (PST)**
 - "Purchaser" based sales tax
 - Purchaser pays the PST when goods acquired at a "retail sale"
 - For contractors: pay PST on goods/construction materials, unless acquired for resale
 - Applies to "tangible personal property", plus carved-in items
 - Electricity, software, telecommunications
 - Parking, some services
 - Paid by purchasers throughout the economy, not just end consumer
 - Businesses pay PST on inputs, subject to exceptions
 - Qualifying Machinery & Production Equipment (QPME)
 - Raw materials incorporated into manufactured property
 - Certain goods exempt by industry/use: farming, fishing, mining, etc.

BC HST – HST Implementation

HST implementation

- Effective July 1, 2010
 - 5% GST and 7% PST will be combined in a single harmonized sales tax (HST)
 - "Realignment" of the 7% PST with current GST rules
 - HST rate = 12%

- Impact on consumers

	<u>With HST</u>	<u>Change</u>
– Goods taxed at 5% GST + 7% PST	HST at 12%	+0%
– Property taxed at 5% GST	HST at 12%	+7%
– Intangibles taxed at 5% GST only	HST at 12%	+7%
– Services taxed at 5% GST + 7% PST	HST at 12%	+0%
– Services taxed at 5% GST only	HST at 12%	+7%
– GST zero-rated goods/services	HST at 0%	
– GST exempt goods/services	HST-exempt	

BC HST – HST Implementation

Key Dates

- October 14, 2009 – announcement of general transitional rules
- November 18, 2009 – announcement of residential housing transitional rules
- May 1, 2010:
 - General transitional rules apply
 - HST may apply to consideration paid or payable effective this date for goods/services provided/performed on or after July 1, 2010.
- July 1, 2010: implementation of HST
 - HST applies to sales of goods/services delivered/performed on or after July 1, 2010

BC HST – International perspective

Sample of 2009 VAT rates (Reference OECD)

Countries with the highest VAT rates

Sweden, Norway, Poland	25%
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Canada / provinces

AB, YK, NV	5%
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BC	12%
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ON, NB, NS, NF	13%
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Country with the lowest VAT rate

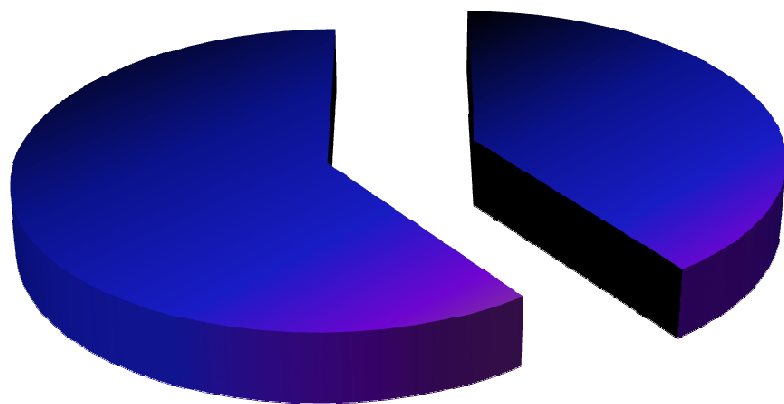
Korea	10%
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Switzerland	7.6%
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Japan	5%
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BC HST – BCs current regime

- BC PST total PST revenues 2008/09: \$4.96 billion



- 40% - PST on business inputs (\$1.98 billion)
- 60% - PST from other sources (\$2.98 billion)

- HST implementation is expected to relieve
 - \$140 million of PST from inputs to the manufacturing sector 2010/2011
 - \$880 million of PST from inputs to the construction sector 2010/2011

BC HST – BCs current regime

Problems with a Dual Regime

BC HST – Key principles of VAT (GST/HST) tax policy

- Neutral between forms of commerce → Business decisions should be motivated by economic, rather than tax considerations
- Efficient → Minimal compliance costs for taxpayers and tax administrations
- Certainty and simplicity → Rules should be clear; incidence of tax should be consistent
- Effective and fair → Collect the right amount of tax; minimal opportunity for evasion; enforcement measures s/b proportionate to the risks involved
- Flexible → Dynamic regime to keep pace with technology and commerce

(Reference: OECD International VAT Guidelines 2006)

BC HST – Problems with a dual GST/PST regime

Problems with dual GST/PST regime

- PST is a consumption tax, but does not apply to all consumables
 - Most services and intangibles are PST-exempt
- Business inputs (consumables) are taxed
 - PST is embedded in cost of production
 - PST applies to imported property, unless an exemption applies or goods are for resale
 - Marked-up in selling price
- Exports should be tax free
 - PST applies if delivery accepted in BC
 - Exported goods have embedded PST in the price, factored into mark-up

BC HST – Problems with a dual GST/PST regime

Problems with dual GST/PST regime

- Complicated
 - PST and GST tax bases differ
 - Corporate reorganization/partnership transactions
 - PST bases differ across PST provinces (e.g.: ON/BC software)
- Virtually no cooperation between BC and Federal tax administrations
- HST eliminates need for PST exemption certificates
 - QPME sale requires FIN 453/M – issued by purchaser
 - No need to determine if equipment being sold is
 - Equipment, QPME, fixture, real property
- Non-recoverable PST increases the cost of capital investment

BC HST – Harmonization - public and industry concerns

HST results in a tax shift

- Broader tax base for consumers - increased tax on retail services
 - Services currently subject to 5% GST become HST taxable at 12%
 - **Restaurants, tourism, accommodation, hospitality**
- Most consumer goods (and some services) are already subject to PST and GST
 - Therefore, no tax increase with HST
 - Non-taxable goods remain that way (food, pharmaceuticals)
 - Point of sale rebates for some items
- **Other sectors with major concerns regarding reduced demand (revenues)**
 - **Residential construction**
 - Increased relieving measures for new home buyers.
 - Complicated transitional rules
 - **Medical practitioners, financial institutions, insurance, education**

BC HST – Lowers the cost of expanding your business

Prov. Country	2009 Rate
BC now	26.4%
BC with HST	15.7%
ON with HST	16.2%
Alberta	16.3%
Quebec	14.8%
US	34.3%
OECD avg	22.0%

Marginal Effective Tax Rates on New Investment (METR)

- Comprehensive measure of the impact of business taxes on new investment.
- "Tax cost of capital investment"
- Captures all taxes that impact net return on capital employed
 - Corporate income tax
 - Capital tax
 - Sales tax
 - Capital cost allowance
 - Excludes: R&D & property taxes

BC HST – Problems with PST HST eliminates PST cost of capital investment

Forklift example

- Assume that the forklift is "qualifying production machinery & equipment" (QPME) for PST purposes.
- \$100,000 forklift purchased for use in two commercial businesses
- Pre-HST, the fully-borne cost of capital is different, depending on use
- With HST, sales tax is no longer a factor in the buying decision

	Before HST		After HST
	Construction	Manufacturer	Any Business
Price of forklift	\$ 100,000	\$ 100,000	\$ 100,000
GST 5% (HST 12%)	5,000	5,000	12,000
PST 7%	7,000	-	-
Less: ITC	(5,000)	(5,000)	(12,000)
Net cost	\$ 107,000	\$ 100,000	\$ 100,000

BC HST – Why harmonize? Benefits

- **Reduced business input costs**
 - Cascading PST eliminated from business inputs: improves margins
 - Lowers cost of expanding your business
 - Capital equipment, machinery, real property, technology (\$880 million)
- **Reduced compliance costs**
 - Single return - reduced compliance costs to businesses (\$150 million)
 - \$30million in administration savings for BC government directed towards other services
 - Single, consistent tax base, one piece of legislation
 - One set of auditors
- **Exports from BC more competitive**
 - International pricing
 - Significant issue for manufacturers facing a high f/x rate

BC HST –

1997 Atlantic Province Harmonization Experience

BC HST – 1997 Atlantic provinces experience

NB, NF, NS harmonized with GST as of Jan.1, 1997

- Observations
 - Data showed that approx. 43% PST sourced from business inputs
 - Consistent with BC and ON (approx. 40%)
- Conclusions re: harmonization
 - 0.8%-0.9% reduction in consumer prices of goods/services
 - Exceptions: shelter +1.4% and clothing +1.5%
 - Annual investment in machinery & equipment rose 12.2% above trend levels
- Similar results in Quebec (QST linked to GST)

(Reference: Michael Smart –"Lessons in Harmony: What experience in the Atlantic Provinces shows about the benefits of harmonized sales tax.")

BC HST –

Implications for BCs Construction Contractors – Specific Issues

BC HST – Commercial vs. Residential Windows

- Effective February 21, 2007:
 - PST exemption only for pre-manufactured windows and skylights listed as being ENERGY STAR® Qualified.
 - PST exemption no longer available for glass and other materials used to manufacture windows and skylights.
 - PST exemption no longer available for window walls in high-rise residential and commercial buildings.
- Effective July 1, 2010, HST will apply to all sales of windows and skylights and will be recoverable by eligible businesses.

BC HST – Commercial real property example Impact of fully recoverable HST

	Situation A	Situation B	
	Before <u>HST</u>	After <u>HST</u>	Revised <u>Selling Price</u>
Land	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000
Materials	5,350,000	5,000,000	5,000,000
Labour	5,000,000	5,000,000	5,000,000
Profit	1,650,000	2,000,000	1,650,000
Selling price	<u>\$ 17,000,000</u>	<u>\$ 17,000,000</u>	<u>\$ 16,650,000</u>

Situation A: Assumes building constructed/sold before July 1, 2010
7% PST cost included in cost of materials
No GST shown (claimed as ITC)

Situation B: Assumes building constructed/sold entirely after July 1, 2010
7% provincial component of HST claimed as ITC

Post-HST: Sell price dropped to \$1,650,000 and realize same margin and purchaser is likely able to claim an ITC for 12% HST paid on selling price

BC HST – Residential construction industry concerns

12% HST

- Applies to new residential housing (non-grandfathered) where ownership and possession transfer on or after July 1, 2010.

Major concern for the industry:

- HST will significantly reduce demand for new residential construction, with serious spin-off effects in the economy.
 - Why? New residential housing will be HST taxable 12%, not 5%, as of July 1, 2010
 - Initial \$20,000 rebate (5% of \$400,000 selling price) not sufficient or realistic given the housing market
 - Federal GST rebate of \$6,300 (max \$350,000 selling price, \$nil at \$450,000) is trivial
- In response, BC augmented the New Housing Rebate and New Housing Transitional Rebate available to purchasers of new residential property on which the 12% HST applies.
 - Must be entitled to claim the rebate (e.g. place of residence of an individual or rented out to an individual as a place of residence.)

BC HST

Brief Review of BC New Housing Rebates / Builder Tax Adjustment

Two BC New Housing Rebates:

- BC New Housing Rebate
 - 5% of selling price to max. of \$26,250 for new residential units
 - No phase out, like 5% GST New Housing Rebate (max. \$350,000, \$nil at \$450,000)
- BC New Housing Transitional Rebate
 - Generally: 2% of selling price (estimated PST embedded in cost of unit) based on the extent of completion as at June 30, 2010.
- BC Builder Transitional Tax Adjustment
 - Generally: 2% of selling price based on extent of completion as at June 30, 2010
 - Approximates the PST claimed as an input tax credit (ITC) on materials consumed on or after July 1, 2010 to completion of unit.

BC HST – Harmonization Recent events

Grandfathered contracts

- GST-taxable homes for written contracts entered into on/before November 18, 2009
 - 5% GST still applies to selling price, even though ownership/possession of property transfers on / after July 1, 2010
 - However, builder adjustment based on %-completion of property at June 30, 2010.

Residential Housing – Transitional Rules

- Transitional tax adjustment (TTA) payable by builders for grandfathered units
 - Why?
 - Only 5% GST collected on grandfathered on units sold after July 1, 2010, but ITC's claimed on materials purchased/incorporated into residential unit as of July 1, 2010
 - Therefore, TTA adjustment = 2% purchase price or FMV at July 1, 2010, based on extent of construction

BC HST Example 1

- Current GST treatment of new residential housing

GST-taxable sale of residential unit on or before Jur			
(Ignore property transfer tax, fees, etc.)			
Selling price	5% GST	GST Rebate	Net Cost to Purchaser
350,000	17,500	(6,300)	361,200
400,000	20,000	(3,150)	416,850
450,000	22,500	-	472,500
525,000	26,250	-	551,250
750,000	37,500	-	787,500
1,000,000	50,000	-	1,050,000

BC HST Example 2

Comparison of non-grandparented new residential property			
GST-taxable vs. HST-taxable sale			
	June 15, 2010	July 15, 2010	
Selling price	525,000	525,000	
5% GST	26,250	-	
12% HST	-	63,000	
Subtotal	551,250	588,000	
GST new housing rebate	-	-	
BC new housing rebate	-	(26,250)	(max)
BC transitional rebate	-	(10,500)	*
Net cost to purchaser	551,250	551,250	
* based on 2% of selling price			

- Assumes unit 100% complete as at May 31, 2010 (not grandfathered)

BC HST Example 3

12% HST-taxable sale of residential unit on or after July 1, 2010							
(Unit completed and available for sale before June 30, 2010)							
(Ignore property transfer tax and fees)							
Selling price	12% HST	GST New Housing Rebate	5% BC New Housing Rebate	2% BC Trans. Rebate	Net Cost to Purchaser	\$- Increase	%
350,000	42,000	(6,300)	(17,500)	(7,000)	361,200	-	0.00%
400,000	48,000	(3,150)	(20,000)	(8,000)	416,850	-	0.00%
450,000	54,000	-	(22,500)	(9,000)	472,500	-	0.00%
525,000	63,000	-	(26,250)	(10,500)	551,250	-	0.00%
750,000	90,000	-	(26,250)	(15,000)	798,750	11,250	1.50%
1,000,000	120,000	-	(26,250)	(20,000)	1,073,750	23,750	2.38%

- Not factored in: price reduction due to passed-on ITCs

BC HST Example 4

Grandparented sale of residential unit sold July 31, 2010			
Various degrees of completion as at June 30, 2010			
% - Complete	100%	50%	0%
Selling price	525,000	525,000	525,000
5% GST	26,250	26,250	26,250
12% HST	-	-	-
Subtotal	551,250	551,250	551,250
GST new housing rebate	-	-	-
BC new housing rebate	-	-	-
BC transitional rebate	-	-	-
Net cost to purchaser	551,250	551,250	551,250
Builder transitional tax	-	2,625	10,500

- Builder transitional tax based on selling price adjustment
- No GST rebate, because \$nil as at \$450,000
- No BC new housing rebate, because no BC component HST paid (grandparented)
- No BC transitional rebate (grandparented)

BC HST Example 5

Grandparented	Yes	Yes	Yes	No	No	No
% Complete Jun 30, 2010	100%	50%	0%	100%	50%	0%
Sold	Aug.31, 2010	Aug.31, 2010	Aug.31, 2010	Aug.31, 2010	Aug.31, 2010	Aug.31, 2010
Selling price	350,000	350,000	350,000	350,000	350,000	350,000
5% GST	17,500	17,500	17,500	-	-	-
12% HST	-	-	-	42,000	42,000	42,000
Subtotal	367,500	367,500	367,500	392,000	392,000	392,000
GST new housing rebate	(6,300)	(6,300)	(6,300)	(6,300)	(6,300)	(6,300)
BC new housing rebate	-	-	-	(17,500)	(17,500)	(17,500)
BC transitional rebate	-	-	-	(7,000)	(5,250)	-
Net cost to purchaser	361,200	361,200	361,200	361,200	362,950	368,200
Builder transitional tax	-	1,750	7,000	-	-	-
Est. ITCs claimed by Builder	-	(1,750)	(7,000)	-	(1,750)	(7,000)
Net tax collected by gov't	11,200	11,200	11,200	11,200	11,200	11,200

BC HST – Harmonization Recent events

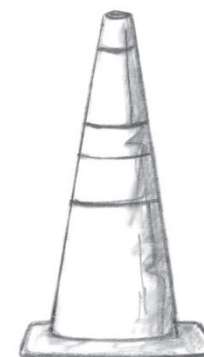
Other rebates, transitional rules and issues

- New housing rebates for
 - Houses on leased land
 - Mobile and floating homes
 - Rebate for owner-built homes
 - Rental housing rebates – purchaser and builder landlords
- Transitional tax adjustments
 - Single unit homes & residential condominiums
 - Transitional housing rebate for embedded PST in homes constructed in part prior to July 2010
- Builder disclosure requirements
- Builder requirement to provide certificate of %-age of completion

BC HST – Restricted BC component ITCs

Restricted ITCs

- Proposed 5 year restriction (followed by 3 year phase in) on 7% BC component of HST
- Businesses with associated group revenues > \$10million
- 7% BC component of HST not claimable as an ITC in relation to:
 - Food, beverages and entertainment, club dues, memberships
 - Energy excluding
 - Energy used by farmers
 - Energy used to produce goods for sale (manufacturers)
 - Telecommunications (other than internet access & toll free numbers)
 - Road vehicles (less than 3,000kg), parts and most services for them
 - Watch for employer provided vehicles (leased or owned)



BC HST – Restricted ITCs

Impact on cost structure

- All manufacturers/ small businesses
 - Energy becomes 7% cheaper due to the refundable BC component of HST
- All other "large" businesses
 - Energy remains same cost pre-HST until 3-year phase in is
- Energy in relation to "goods for sale"?
 - Old PST definition of manufacturing?
 - Commercial real estate landlords

Compliance issues

- Restricted ITC's reportable on BC HST return
 - A/P systems must track restricted amounts separately

BC HST – Real Property Contracts

- Before October 1, 2008:

Type of real property contract:	Who pays the PST:
Lump sum or fixed-price	Contractor pays PST on the materials and equipment
Time and materials	Customer pays PST on the materials and equipment but not on the labour

- As of October 1, 2008
 - Contractor required to pay PST on materials and equipment that are supplied and installed unless customer agrees in writing to pay the PST.

BC HST – Real Property Progress Payments

- HST applies to consideration for property delivered or services performed on or after July 1, 2010.
 - If payment is due or paid without becoming due after October 14, 2009 and before July 1, 2010, HST applies
 - Supplier required to account for BC component of HST in its GST/HST reporting period that includes July 1, 2010.
 - Recipient eligible to claim applicable ITC in its GST/HST reporting period that includes July 1, 2010.

BC HST – Real Property Progress Payments contd.

- Written contract to construct real property > 3 months:
 - Where substantially complete (90% or more) before June 2010, construction deemed to have been substantially completed on June 1, 2010.
 - Consideration on such contract that is not paid or invoiced on or before July 31, 2010 is deemed to become payable on July 31, 2010.
 - Any portion of payment attributable to construction on or after July 1, 2010 is subject to HST.

BC HST – Real Property Holdbacks

- GST/HST payable on holdbacks on earlier of:
 - day holdback paid, and
 - day holdback becomes payable.
- Holdback from progress payment considered to be part of progress payment from which it was held back.
- Holdback subject to same allocation as progress payment, even if holdback is payable or is paid on or after July 1, 2010.

BC HST

Example - Progress Payments & Holdbacks

Assume 3 contract payments of \$500,000, with 10% holdback released on September 15, 2010

	March 15, 2010	May 15, 2010	August 15, 2010		Sept. 15, 2010
	Payment #1	Payment #2	Payment #3		Payment #4
					Holdback
Progress payment	\$ 500,000	\$ 500,000	\$ 500,000		\$ 150,000
10% Holdback	\$ (50,000)	\$ (50,000)	\$ (50,000)		
Net payment	\$ 450,000	\$ 450,000	\$ 450,000		\$ 150,000
Contractor bills GST	22,500	22,500	11,250 (a)		6,250
Contractor bills HST	Nil	Nil	27,000 (b)		3,000
(Monthly filer)					
Remittance Date	Mar.31, 2010	May.31,2010	Aug.31, 2010		Sept.30, 2010
(a) $50\% \times \$450,000 \times 5\% = \$11,250$		(c) $[(2 \times \$50,000) + 50\% \times \$50,000] \times 5\% = \$6,250$			
(b) $50\% \times \$450,000 \times 12\% = \$27,000$		(d) $50\% \times \$50,000 \times 12\% = \$3,000$			

- Assume unit is 50% complete as at June 30, 2010. Therefore, 50% of August progress payment relates to goods/services delivered before June 30th and 50% of goods/services delivered after June 30th.
- Application of GST or HST will generally follow the treatment of the progress payment to which the holdback relates
- Does not apply to sales of newly constructed or substantially renovated homes (other transitional rules apply)
- Special rules for property substantially complete before June 2010

BC HST –

Implementation Issues For Construction Contractors

BC HST – Implementation issues Collection of tax

Transitional Rules

- Suppliers must ensure that they collect the correct amount of tax
 - Transitional rules may be complicated for some businesses
 - Consideration received on or after May 1 is subject to 12% HST if goods/services delivered on or after July 1, 2010.

Systems Issues

- Invoicing and billing systems to be updated for tax rate changes
- Construction contracts updated
- Point of sale rebates (if applicable) must be implemented
 - Existing supply contracts should be reviewed
 - Tax exclusive vs. tax inclusive supply contracts

BC HST – Administration

GST / HST return reporting

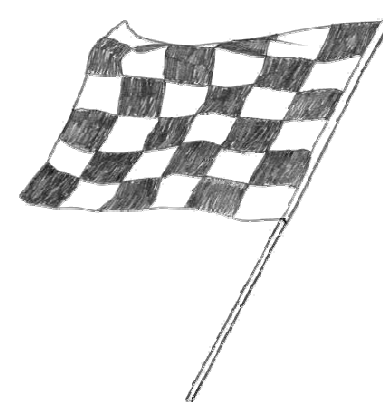
- HST reported on single BC GST/HST return
 - Use existing GST/HST registration number
 - Same reporting period
- CRA to administer
 - Same audit and collection powers
 - Same provisions for filing frequency, penalties & interest, etc.
 - Input tax credit (ITC) documentation requirements
 - Same statute-barring provisions (usually 4 years)
- Continue to file BC PST returns for periods up to and including June 30, 2010.
 - Supplemental PST returns to be filed, if required



BC HST – Implementation issues Other compliance matters

Businesses will have to update their procedures on:

- Returns of goods
- Tax/price adjustments and credit notes
- Volume rebates and coupons
- Deposits and partial payments
- Bad debt adjustments
- Employee reimbursements and allowances
- Taxable benefits (T4)
- Mid- large businesses will need more sophisticated implementation plans
- General ledger accounts
 - Changes implemented for July 1, 2010
 - Cut off issues for non-June 30th year ends
 - Accounting policies for progress payments / holdbacks



BC HST – Improving profitability

Benefits for your business

- Strategize / re-compute product pricing
 - Review absorption costing / job costing systems
 - Re-compute fixed/variable costs and overhead rates
 - Understand how PST-taxable inputs (cheaper after July 1, 2010) impact
 - Cost of sales
 - Gross margin
 - Operating costs
 - Selling price
 - Can you increase your market-share with aggressive pricing funded by PST savings?

BC HST – Other compliance matters

Identify and contact your largest suppliers

- How will harmonization impact (reduce) their prices to you?
- Make sure suppliers are charging you the correct tax

Get it right

- Avoid tax charging disputes that may damage customer relations
- Make sure suppliers are charging tax correctly
- Watch transition rules for goods/services delivered/performed on or after July 1, 2010, paid or prepaid before that date

Invest in staff training to ensure smooth transition to HST

- Accounting, finance, sales, IT

Defer purchases of PST-taxable inputs/consumables, where practical

Start building your implementation plan early

BC HST – Implementation plan

Next steps – can we help?

- GST/HST risk management review
 - Complete review of
 - Tax status of supplies / tax collection & remittance procedures
 - ITC/rebate claiming procedures
 - Input tax credit methodologies
- HST impact assessment
 - Risk management review
 - Implementation planning
 - Systems change management
- PST review
 - Overpaid PST / tax paid in error

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