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DATE: June 1, 2009

REPORT TITLE: **HARMONIZATION OF THE FEDERAL GOODS AND SERVICES TAX AND ONTARIO'S PROVINCIAL SALES TAX**

FROM: Norma Trim, Acting Chief Financial Officer  
and Commissioner of Corporate Services

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## RECOMMENDATION

That the Regional Chair be authorized to prepare a letter to the Premier of Ontario outlining the Region's position regarding the proposed Harmonized Sales Tax and its unfavourable financial impact to the Region of Peel and requesting that the tax impact be cost neutral to all municipalities;

And further that the Regional Chair request that Greater Toronto Area municipalities be represented on the implementation panel which is to assist with the transition to the single sales tax.

## REPORT HIGHLIGHTS

- The 2009 Ontario Budget included a proposal to harmonize the Ontario Provincial Sales Tax (PST) with the Federal Goods and Services Tax (GST) effective July 1, 2010.
- The Harmonized Sales Tax (HST) is 13% comprised of an 8% provincial component and a 5% federal component.
- The provincial component will be subject to a broader range of goods and services with municipalities entitled to a 78% rebate.
- Preliminary analysis indicates that the HST will not be fiscally neutral relative to the PST currently paid and that Peel may be subject to an additional annual tax burden in the \$5 million range which will need to be passed on to both tax and ratepayers.
- The impact of the proposed HST on new homes priced over \$500,000 will disproportionately hit new housing in the Greater Toronto Area (GTA) and may cause buyers to move away from urban centres to obtain less expensive housing.

## DISCUSSION

### 1. Background

#### **Ontario Budget 2009**

The provincial government proposed that effective July 1, 2010, the PST would be harmonized with the GST to create a federally administered single sales tax rate of 13%. The provincial component of the tax would be 8% and the federal component would be 5%. Generally, sales tax harmonization will mean that a broader range of goods and services are

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subject to sales tax. However, it will also mean that tax on business inputs will be reduced or eliminated for many businesses.

### Current GST Tax Structure

The GST is a value-added tax which applies to all commercial activities related to the sale of goods and services. Tax is paid on the supply of goods and services throughout the supply chain, but tax paid by businesses is generally reimbursed through credits. Public services bodies, such as municipalities, claim a rebate to recover the GST. This rebate allows a municipality to recover 100% of the GST paid on their purchases and expenses.

### Current PST Tax Structure

The PST is a consumption tax which means the person who consumes or uses the taxable goods or taxable services pays the tax. The tax rate is 8% and all goods are taxable unless the purchaser is entitled to an exemption. All services are non-taxable unless specifically taxed under the *Retail Sales Act*. The tax base for PST currently applies to a much narrower range of goods and services compared to the GST. There are no rebates to recover the tax and municipalities therefore absorb the PST as an expense, included in the cost of delivering its services.

### HST Impact on Business

The 8% provincial component of the HST will largely mirror the GST. Therefore as with the GST most businesses will be able to claim input tax credits for the provincial component that they pay effectively decreasing the cost of doing business since the recoveries of sales tax on business inputs are currently not permitted. However, those businesses that are not entitled to full rebates will see an increase in the amount of unrecoverable tax they pay since their currently PST exempt goods will now be subject to HST. An example is a business in the financial sector.

### HST Impact on the Public Sector

Municipalities and other public service bodies will be entitled to claim rebates for the provincial portion of the HST similar to the GST rebates currently available to the sector. However, the proposed rebates differ from the GST rebates. For municipalities the rebate is 78%. The following are the rebates for other public service bodies:

Universities and Colleges	78%
School Boards	93%
Hospitals	87%
Charities and Non-Profit Organizations	82%

Rebates of 100% will still be claimed for the 5% federal component of the HST.

The Ministry of Finance claims the net effect of the tax will be fiscally neutral relative to the amount of PST currently paid by these sectors. However, there still exists a tax exposure for individual members of these sectors. The purchase of goods and services currently PST exempt, will be subject to tax under harmonization. An additional tax burden will result if the 78% rebate does not cover the incremental tax payable.

Rent received from the Social Housing clients would not be impacted by the HST.

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### 2. Findings

#### HST Impact on Peel

To estimate the HST impact on Peel, the new single tax rate was applied to the 2008 GST tax base with the appropriate provincial and federal rebates taken to determine net tax payable.

#### Estimate of the HST based on 2008 taxable purchases

	Provincial Component	Federal Component	Harmonized
Taxable Purchases	\$544.2 million	\$544.2 million	\$544.2 million
Taxes Payable			
Provincial (8%)	\$43.5 million		\$43.5 million
Federal (5%)		\$27.2 million	\$27.2 million
Rebate			
Provincial (78%)	(\$33.9) million		(\$33.9) million
Federal (100%)		(\$27.2) million	(\$27.2) million
Net Payable	\$9.6 million	\$0	\$9.6 million

The estimated tax payable under the proposed HST is \$9.6 million.

#### Actual GST and PST paid based on 2008 taxable purchases

	PST	GST	Total
Taxable Purchases	\$58.1 million	\$544.2 million	
Taxes Payable			
Provincial (8%)	\$4.6 million		\$4.6 million
Federal (5%)		\$27.2 million	\$27.2 million
Rebate			
Provincial (N/A)	\$0		
Federal (100%)		(\$27.2) million	(\$27.2) million
Net Payable	\$4.6 million	\$0	\$4.6 million

The actual net tax paid in 2008 was \$4.6 million. The estimate of the HST net payable when compared to the net GST and PST paid indicates that Peel may be subject to an additional tax burden of \$5.0 million (\$9.6 million compared to \$4.6 million).

#### Comparison of provincial taxes payable (HST versus PST)

	HST	PST	Additional Tax Burden
Taxable Purchases	\$544.2 million	\$58.1 million	
Taxes Payable			
Provincial 8%	\$43.5 million	\$4.6 million	\$38.9 million
Rebate			
Provincial (78%)	(\$33.9) million	\$0	(\$33.9) million
Net Payable	\$9.6 million	\$4.6 million	\$5.0 million

The broader tax base for the provincial component of the HST creates an additional \$38.9 million in taxes prior to applying the rebate. The 78% rebate does not cover the additional tax. For this analysis, a rebate of 89% would be required to eliminate the additional \$5.0

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million in tax. This additional estimated \$5 million expense would need to be passed on to tax and ratepayers.

It should be emphasized that limited details regarding the tax harmonization were released in the 2009 Ontario Budget and that further technical information will be available from the federal and provincial governments later in 2009. However, this high level analysis performed using the published HST rate and rebates applicable to municipalities, indicate that the HST will not be fiscally neutral relative to the PST currently paid by the Region.

### **Impact on the Housing Sector**

Currently, the PST applies to building supplies used in the construction of new homes. The single tax would remove this embedded tax that amounts to approximately 2% to 3% on average on the final sale of a new house in Ontario.

To ensure that, on average, new homes under \$400,000 would not be subject to an additional tax burden, a rebate of 75% of the Ontario portion of the tax will be available on purchases of new homes under \$400,000. The rebate will be reduced for new homes priced between \$400,000 and \$500,000 and will not be available for homes that exceed \$500,000. Resale homes will not be subject to the new tax.

New homes worth over \$400,000 will be subject to a significant increase in tax under the HST. While PST currently applies to building materials used in the construction of homes, real property is not subject to PST. Thus a builder building a new home currently must pay unrecoverable PST on many of its supplies which Ontario estimates to be 2% of the final sale price of a home. Under the HST, while the cost to build a home will decrease since builders can claim credits for the sales tax on their inputs, new homes will be subject to an additional 8% tax. Ontario has proposed a rebate of 75% of the Ontario portion of the HST (ie 6%) for new homes sold for under \$400,000. This means that new homes sold for under \$400,000 should be effectively taxed at the same rate under the HST and the PST system.

However, the rebate begins to be phased out at \$400,000 and disappears entirely at \$500,000. HST on a new \$400,000 home will be \$8,000 after the rebate while HST on a \$500,000 home will be \$40,000. This significant increase in taxes on homes valued over \$500,000 will disproportionately affect new housing in the GTA and may cause buyers to move away from urban centres to obtain less expensive housing.

For resale homes buyers and sellers will face additional costs for commissions, lawyer fees, moving costs, home inspection fees and insurance premiums. According to the Ontario Real Estate Board, for a single detached home priced at \$360,000 the HST could add \$2,325.25 in new taxes to closing costs.

In the recent Budget, Ontario also announced that an implementation panel would be established to assist with the transition to the single tax. GTA municipalities should be represented on this implementation panel to provide input.

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**CONCLUSION**

It is recommended that the Regional Chair prepare a letter to the Premier of Ontario outlining the Region's unfavourable financial impact and requesting that the tax changes be cost neutral to all municipalities. As well, it should be requested that GTA municipalities be represented on the implementation panel to assist with the transition to the single sales tax.



Norma Trim  
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**Approved for Submission:**



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c. Legislative Services