HST – ACCOUNTING ISSUES FOR MUNICIPALITIES

By Bruce E. Ratford, CMA, CMM III

The previous HST newsletter looked at reporting issues, and particularly at how to prepare your municipality to report your HST amounts to the Canada Revenue Agency (CRA). Because of the potential for an HST audit, we also discussed how to deal with that possibility.

To provide the reporting and the back-up data that you will need, your accounting environment must be configured to provide it. In this newsletter, we will look at the accounting issues arising from this change in tax regimes.

Sales and receivables

Depending on the good or service, you may currently charge 0% or 5% GST and 0% 5%, 8%, 10% or 12% RST. Harmonization will reduce that to 0%, 5%, 13%, and 8%. The unique 8% is insurance, where RST will continue to be charged – as RST, but is zero-rated for HST, because it is a financial service.

You may wish to set up a second "Value Added Tax" rate of 8% on sales in your tax tables, which then allows you to account for any possible HST rate on a transaction by charging one or both taxes, as the case may be. The two tax components would flow through to your invoices, as well as into your G/L accounts. You would charge your clients the consolidated HST rate, but this would allow you to track the differences in tax treatment, such as for books or prepared food under $4. Remember – it is easy to aggregate information, but a nightmare to have to disaggregate data.

Alternatively, you could treat every transaction as either taxable at 13%, or at 0% (zero-rated or tax-exempt, as the case may be). This would require a single account for collections. You would then set up a second account for recording the Provincial point-of-sale rebates given on specified sales, such as books and prepared foods under $4. For accounting purposes, this is analogous to offering an 8% discount on the sale price, given after calculating the HST payable. This would aggregate your POS rebates in a single account, and would probably make follow up and audits simpler. Remember, the amount of HST collected to be reported on line 105 of your return would be the sum of the 13% collected on every taxable transaction, less the total of your POS rebates given.

For invoicing sales to your clients, it is the same procedure as for the current GST, only the rate now becomes 0%, 5% or generally 13%, as the case may be. There will be no RST charged or recorded, except for insurance premiums.

Remember to always include your GST/HST registration number on every invoice. Your client is not obligated to pay the HST you are collecting if you do not provide a registration number. Nevertheless, you will be deemed by CRA to have collected the HST anyway, even if the client does not pay. Your current GST registration number will be your HST registration number.

Payables

Here you definitely want the two-tax approach, of 5% and 8%, so that the two amounts paid can be processed separately. The Federal portion of HST will be accounted for exactly the same as you do for GST now. The 5% paid will be GST receivable as an Input Tax Credit or a Public Sector Bodies' rebate, and will not be an expense in whole or in part against the program. For the Provincial portion of HST, set up a second VAT tax for tax paid on acquisitions in your tax rate table at a rate of 8%.

a) Commercial activities

For any commercial activities that are either taxable or zero-rated, this 8% will be claimable as an ITC, so will be recorded as HST (Provincial) Receivable, in its own account, just as the Federal portion of HST paid will be recorded in a HST (Federal) Receivable account. Thus you will be able to readily identify transactions where the Federal and Provincial tax treatments diverge. While this will create more line entries, it will make tracking easier.

b) Tax-exempt activities

Tax-exempt activities, like financial services, do not currently charge GST on their sales, and cannot claim any Input Tax Credit for GST paid. The same will be true with respect to HST. It will not be charged on sales, and no ITCs can be claimed. If you have any activities of this nature, such as any insurance programs that you run, include the HST paid on a supply as part of the total cost to the program of the supply.

As discussed in the HST basics webinar, municipal activities are tax-exempt, so that normally, this approach would be mandatory, and while no HST will be charged on services rendered, your municipality would not be able to claim any HST paid back as either an ITC or as a PSG rebate.

c) Municipal activities

The federal legislation includes the concept of association for municipalities, so that if an activity is deemed to be associated with a municipality, then the tax treatment for the activity will be the same as for the municipality. This means that there would be a 100% rebate of the federal portion of HST (or 5%), and a 78% rebate of the provincial portion of the HST (78% of 8%, or 6.24%)

The newsletter "Collecting and Claiming HST" listed municipal activities or services that are tax-exempt, but because they are by definition associated with the municipality providing the service, they become eligible for the Public Sector Bodies' rebates that the municipality itself can claim.

In this case, the HST paid has three components – Federal GST of 5% that is fully refundable as a PSG rebate, 78% PSG rebate of the Provincial 8%, and the remaining 22% of the Provincial 8% tax that will have to be expensed. Allocate and account for it that way. Use a "VAT" account for the federal 5%, another with the rate of 6.24% (100% claimable) for the Provincial rebate, and a "sales" tax rate of 1.76% for expensing the balance. This way, you capture the two PSB rebates and have an audit trail for them, and have expensed the portion that you cannot get a refund for.

d) Dual purpose items

Sometimes a supply will be used for two types of activities, with perhaps different tax treatments. For example, perhaps your municipality purchases a bus that provides transit services in town from Monday to Friday, and is contracted out for charter services on the week-end. Five days it is used by a tax-exempt activity associated with your municipality, whereas it provides taxable commercial services on the weekends. Allocate out the supplier's amount billed accordingly. Here the usage would be 71.4% for own use, and 28.6% for providing taxable services, based on time allocated to each.

When you buy the bus, allocate out the purchase price accordingly, and claim a 100% ITC for 28.6% of the HST paid for the commercial activity share of the bus (equals 3.72% of the purchase price paid), 71.4% of 5% or 3.57% of the purchase price paid as the Federal PSB rebate allowable for the municipal usage of the bus, 71.4% of 78% of 8% or 4.46% of the purchase price paid as the Provincial PSB rebate allowable for the municipal usage, and expense the remaining HST paid as a charge against the municipal activity. This would equal 1.25% of the purchase price paid, or 71.4% of 22% of 8%.

On-going expenses relating to the bus would be allocated out in a similar manner, if they relate to both functions for which the bus is used. As you can see, splitting out the HST into its two component portions will facilitate maximizing the amount that you can claim as an ITC or as a PSB rebate, as well as provide a detailed audit trail.

This type of allocation is mandatory for GST, and will be for HST.

e) Special tax treatments

Certain items, such as new residential real property, have special and/or capped rebates. For housing, this is 75% of the Provincial portion of HST, up to a ceiling of $24,000. For accounting purposes, split the purchase price into two components: (1) 75% of the purchase price, up to $300K – process as a supply for a zero-rated service, as discussed earlier, and (2) the remaining 25%, up to $100K, plus all charges over $400K – process as a "tax-exempt" supply, where there is no ITC or PSB rebate claimable. This will allow you to capture the rebate allowed, plus claim the municipal rebate on the portion of HST not subject to rebate, which will be 78% of the amount in point (2) for the Provincial PSB rebate..

These situations can be handled within the same basic framework, but may require some creative finessing to appropriately capture the PSB rebates you will need to claim.

And that basically covers the major accounting issues related to the implementation of HST. A number of special issues and situations, like the capped rebate for residential real property, are addressed in some of the Info Sheets published by Canada Revenue Agency.

Summary

This newsletter has looked at specific issues that will arise with respect to accounting for HST.

Our next newsletter will look at the issues you will face in budgeting for HST.

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For more information and resources regarding Harmonized Sales Tax, please go to MFOA's HST webpages, or contact:

Dan Cowin
Executive Director
MFOA
dan@mfoa.on.ca
416-362-9001 x 223