MFOA
MUNICIPAL FINANCE OFFICERS' ASSOCIATION OF ONTARIO
HST Newsletter

HST Newsletter 6 May 18, 2010

HST – BUDGETING ISSUES FOR MUNICIPALITIES

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In the previous newsletters, we looked at issues that your municipality may have to address relating to reporting and accounting for the new Harmonized Sales Tax regime in Ontario. Last but not least, we will now take a look at budgeting issues, recognizing that your municipality will probably already have an approved 2010 budget.

The changeover from Ontario Retail Sales Tax (RST) to the HST occurs on July 1, 2010, so that you may have already tried to update your budget to accommodate the changes for the last half of the year. Or perhaps your municipality is taking a wait-and-see attitude, since the change is coming in half-way through the year.

Major issues

There are two major issues or concerns relating to budgeting arising from the switch from the Retail Sales Tax (RST) to HST:

(1) What will be the net impact of the change to HST on the net amount of sales taxes that your municipality will pay and have to absorb as an expense? Will this be a case of "win some, lose some"?

(2) What will be the impact of the change to HST on supplier pricing, due to the introduction of Input Tax Credits (ITCs) at all stages of the supply chain. We discussed this in the first newsletter. Prices of goods produced in Ontario should theoretically decrease, due to the removal of embedded RST in every stage associated with the product or service.

The official word is that the Public Sector Bodies' rebate for municipalities should make the tax change "fiscally neutral" for the municipal sector as a whole. That may well be overall, but at the program and line item level, they will definitely all be either winners or losers, and almost certainly at the department and even at the municipality level. How can you try to deal with this?

Remember: this starts halfway through the fiscal year for your current budget cycle that is probably now going through the approval process. The bad news is that you have probably not taken this into consideration in preparing your 2010 budget - have you?

The good news is that the 2010 impact will be only 50% of what it will be for a full year. You also have the opportunity to mitigate that impact somewhat by timing your purchases to reduce the impact. Practice strategic procurement. Defer items where you now pay RST until after June 30, 2010. For those items that will now be taxed under HST, but which were not under RST, try to acquire them before July 1st.

Let's look at this for 2010, and for 2011 and future years.

2010

This is not easily done, and is probably a non-issue at this point in time, as your 2010 budget(s) may have already been approved.

One option is to assume that HST will be fiscally neutral, and to budget as though there will be no change. You may well have taken that approach, lacking reasonable evidence to the contrary. For operations, the worst case scenario is that you will end up 1.76% over budget on accounts that were not subject to RST, but you will be 5.78% under spent on those accounts that were subject to RST, because you will now be getting the 78% rebate of the provincial share of HST.

Whether the result is a wash or not, the difference will likely be minimal, especially if you are able to take advantage of timing this summer. For example, if (a) salaries are 80% of your budget, (b) all expenses are not currently subject to RST, but will be subject to 13% HST, and (c) all expenses will be evenly spread throughout the year, the net impact would be 0.176% of the total budget for the year, a negligible hit of $1.76 per thousand dollars! The worst case scenario is that your 2010 expenditures may be 0.88% over budget, if they occur evenly throughout the year, more if later in the year, less if earlier, and they are 100% for contracted services not currently subject to RST.

With capital projects, timing is less of an option, but the contingency allocation should generally provide enough margin to accommodate the potential cost of the additional tax. At worst, the difference will be $17,600 per million dollars.

At the same time, contractors may start to pass on the savings they incur due to no longer having to absorb the cost of RST on their purchases that are not RST-exempt. But don't count on this. Due to timing and inventories in the supply chain, it took up to18 months for such savings to be passed through when HST was introduced in the Maritime Provinces in 1997. Much will depend on how competitive the market place is for any given good or service.

2011

By the time you are finalizing your 2011 budget(s), HST will have been implemented, and you will have a few months of experience in terms of impacts on your municipality. Already, you may have been able to negotiate revised pricing, or see some price changes, depending on how competitive a particular market is, and how fast goods move through the supply chain.

For your operating accounts, the potential impact can be reasonably determined on a line-by-line basis. Don't expect professional service providers to pass along any RST savings, as the amounts will be small, and this will likely be treated by them as an alternative to a small rate increase.

For capital, treat each capital expenditure or project individually, to try to determine whether the 2011 cost will increase or decrease. While this change will add $17,600 to a $1 million acquisition, because of the Provincial portion of HST being added to the invoice, this will be offset by how much RST you might have paid to the contractor, or by how much RST was imbedded in the contractor's costs, and how much of that RST saving will be passed through to your municipality. The final test is how significant are these amounts?

Tax-exempt activities will likely pay more, as the HST – Federal and Provincial will be charged on services and fuels under HST. Taxable and municipal activities would potentially save, due to being able to claim all or 78% of the Provincial portion of HST paid out. The real bottom line for your municipality will depend on the amount of capital construction relative to operating expenditures, and the volume of services being utilized

However, the ultimate test is your own situation, with your own mix of business activities and your own unique baskets of transactions. Some municipalities are forecasting increased costs of several million dollars, whereas for many, the financial impact of the tax change may be minimal or none.

Unfortunately, you won't really know for sure until HST has been up and running for at least a year – and the damage has already been done.

To summarize, the following table shows the budgeting, accounting and reporting of the standard HST transaction for the three different types of activity: taxable or commercial; tax-exempt; and municipal activities. This is from the perspective of the entity buying the goods and services, as this is far more complex than is the case where an entity such as your municipality is the provider or supplier.

	Commercial activity	Tax-exempt activity	Municipal activity
Budgeting	Contract price	Contract price + 13% HST	Contract price + 1.76%
Accounting - expensed	Contract price	Contract price + 13% HST	Contract price + 1.76%
Accounting - receivable	5% HST(F) + 8% HST(P)	n/a	5% HST(F) + 6.24% HST(P)
Reporting – financial statements	Contract price	Contract price + 13% HST	Contract price + 1.76%
Reporting – HST tax return	5% HST(F) + 8% HST(P)	n/a	5% HST(F) + 6.24% HST(P)

Please note that most or all of your municipality's activities would likely be deemed to be associated, so that the municipal activities approach will likely be the predominant one used. Accounting is shown in terms of what will be expenses, and what is receivable as an ITC/rebate respectively. Reporting is shown in terms of your municipal financial statements and for your municipality's HST returns respectively.

Summary

This newsletter has looked at issues relating to budgeting for HST, just as we covered accounting and reporting in previous ones. This concludes our look at budgeting, accounting and reporting.

Our next newsletter will look at the implementation and change over issues you will face in getting ready for HST.

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

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NOTE: This Newsletter is published to assist you in preparing for the changeover to HST in Ontario as of July 1, 2010, based on information believed to be current up to a week before posting on the web. While every endeavour has been made to be as complete and accurate as possible, MFOA and the author accept no responsibility for any differences of opinion that the Canada Revenue Agency and the Ontario Ministry of Revenue may adopt with respect to the ideas and concepts presented, nor for any outcomes of those differences. The ultimate authority in these matters is the respective Federal and Provincial legislation.