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MUNICIPAL FINANCE OFFICERS' ASSOCIATION OF ONTARIO
HST Newsletter

HST Newsletter 7 May 18, 2010

HST – IMPLEMENTATION AND CHANGE-OVER ISSUES

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The three previous newsletters discussed issues relating to budgeting, accounting and reporting. We concentrated on what you can try to do, particularly to generate satisfactory tax and financial reporting. In this newsletter, we will talk a little about how you might make this happen.

This discussion will have to be at a very high level and general in nature, because of the great variety of accounting systems and environments in use in the municipalities of Ontario, and because yours and every other municipality's accounting environment is unique, with a unique set of concerns and constraints. The goal here is to provide food for thought, rather than definitive solutions for specific types of situations.

Whatever you use, the change to the Harmonized Sales Tax (HST) next July will have systems implications, because your current accounting environment will not be set up to automatically handle HST transactions for an Ontario municipality, especially the Public Sector Bodies' (PSB) rebate. This newsletter will discuss the fine tuning of accounting software that any municipality will have to implement between now and May 31, 2010. That is to give you at least one month for testing or parallel runs to confirm that your reconfigured environment will give you what you need, and to have a little time for any final tweaking.

What will you have to do?

For accounting and reporting for sales taxation, every accounting system uses the following four elements:

- tax rates
- tax codes
- tax accounts
- tax reporting

The first three points are essentially tables in your system that will need to be updated to be able to properly account for the Harmonized Sales Tax starting next July 1st, for both revenues and for payments. Tax reporting is assistance in preparing sales tax returns.

Tax rate is self-explanatory. Federal HST is 5%. Provincial HST is 8%. Ontario retail sales tax for insurance premiums and for used vehicles is 8%, and so on.

Tax code is a combination of tax rates that apply to a specific transaction. One tax code will be HST-standard, comprised of HST – Federal at 5% and HST – Provincial at 8%, to give the standard HST charge of 13%. Another will be HST – standard re PSB rebate. As suggested in the previous newsletter, this will have three components - HST – Federal at 5% and HST – Provincial rebate at 6.24%, and HST – non-rebated at 1.76%, to give the total standard HST charge of 13%, this last component being expensed, of course.

Tax accounts are special accounts for accumulating sales tax amounts. You will require at least one HST account for Federal HST collected on services and products invoiced by your municipality. You will similarly require at least one HST account for provincial HST collected on services and products invoiced by your municipality. And you will need two corresponding sets of tax accounts for processing the HST paid out to your suppliers, one for accumulating the Input Tax Credits (ITCs) for commercial operations, and one for accumulating the PSB rebates (Federal and Provincial) claimable on the purchase of supplies for municipal activities that are not commercial ones.

Whatever you are running your accounting under, the requirements for accounting for the HST will be the same. And the issues that you will need to address will be the same. Terminology and the actual mechanics of effecting the reconfiguration required may vary somewhat, but these accounting systems all have to perform the identical operations, in the same or a similar way, because they are all largely table driven.

This applies equally whether you have a multi-million dollar SAP implementation, a modest Great Plains implementation, or happen to use QuickBooks, a shrink-wrapped accounting software package designed for small businesses. QuickBooks is about as basic accounting software as one can buy, yet the implementation process for the Ontario version of HST is the same as it is for PeopleSoft.

Current configuration

First, let us look at how accounting software processes sales tax for the current GST and RST tax regimes. Then we will look at how to handle the HST, and specifically the Provincial portion of it. Last but not least, we will look at what will be required for HST reporting to Canada Revenue Agency (CRA), particularly for the amounts paid to suppliers.

We mentioned that there are three building blocks for sales tax reporting. Tax rates are the most basic one. The minimum sales tax rates that you will require are probably:

- 0% = GST exempt/GST zero-rated
- 5% = GST standard rate
- 0% = PST – Ontario - exempt
- 5% = PST – Ontario – hotel accommodation
- 8% = PST – Ontario – standard rate
- 10% = PST – Ontario – admissions, alcohol
- 12% = PST – Ontario – bottled alcoholic drinks
- Other Provincial rates?

In actual fact, you likely have dealings with suppliers in other provinces, so that you will need to include the other sales tax rates for British Columbia, Saskatchewan, Manitoba and Prince Edward Island, Quebec’s Provincial GST, and HST in New Brunswick, Nova Scotia and Newfoundland and Labrador. There are no territorial sales taxes in Yukon, Northwest Territory and Nunavut.

Note that any sales to parties outside of Canada would be GST and RST exempt, so are accommodated. Purchases coming from outside Canada would be subject to GST and RST at the applicable rates shown, so are again covered, This is usually paid by the customs broker at the point of entry into Canada

Supplies delivered from other provinces may or may not have RST assessed. If not, there is an obligation to self-assess Ontario RST, and remit it, such as for the bus from Winnipeg. If local RST is charged, in theory a refund should be requested, and the Ontario RST self-assessed and paid. In reality, there is an informal agreement on reciprocity, so that if RST is paid to another jurisdiction, that is sufficient. Either way, you have the necessary tax rates.

Tax accounts are the next building block. The list is fairly short, though you may have others for various reasons and purposes. One municipality currently uses 24 sales tax accounts.

- GST collected
- Input Tax Credits
- Federal PSB rebates claimed
- GST self-assessed
- PST collected
- PST commission revenues.

The first four cover basic GST, since the Federal PSB rebate is 100% of GST paid, as is the Input Tax Credit. RST is only collected, and this would include self-assessed amounts, since you are collecting the requisite RST from your own municipality. And you will record the commissions paid for collecting RST as "other revenue".

You may also have accounts for penalties and interest paid, for RST and for GST.

Tax codes are the third building block. Note that tax rates are linked to tax accounts for sales and for purchases. A tax code brings these together for a specific transaction, so that the sales taxes can be calculated properly, and then the relevant components of the taxes can be posted against the appropriate accounts.

These are the most common tax codes that you might use in Ontario, and cover the various permutations and combinations of GST and RST:

Tax Code	**GST rate**	**PST rate**	**Total tax**
EXE	**0%**	**0%**	**0%**
GST	**5%**	**0%**	**5%**
PST	**0%**	**8%**	**8%**
STD	**5%**	**8%**	**13%**
HOT	**5%**	**5%**	**10%**
BAR	**5%**	**10%**	**15%**
LCB	**5%**	**12%**	**17%**

The tax codes should be self-explanatory from the two tax rates shown for each.

The two tax rates are shown, and the tax code will calculate total sales tax on the transaction at the combined rate shown. The tax code will then split the tax amount into the appropriate two portions, with the tax rate telling the tax code which G/L accounts each portion is to be posted against. This will be done automatically once your Accounts Payable staff person posts the invoice in your system. It is the same in SAP and in QuickBooks, and in all the software packages in between!

Configuration for HST

Now let's look at what happens as of July 1, 2010. HST will now be charged at a rate of 13%. The Federal portion is 5%, and the Provincial portion will be 8%

The tax rate table becomes:

- 0% = HST (Federal) – exempt and zero-rated
- 5% = HST (Federal) - standard rate
- 0% = HST (Ontario) – zero-rated and tax exempt
- 8% = HST (Ontario) – taxable
- 6.24% = HST (Ontario) – PSB rebate for municipal activities
- 1.76% = HST (Ontario) – non-rebated portion for municipal activities
- 8% = RST (Ontario) – insurance, used cars
- Other Provincial rates?

Federal HST has two rates as shown, as does the Provincial portion of HST. Note that you will still need the 8% RST rate, to account for insurance premiums, and for the acquisition of used vehicles from private parties, if your municipality engages in that practice. You will also need a notional HST tax rate of 1.76%, in order to properly expense the 22% of the provincial portion of HST that is not covered by the municipal rebate.

Other provincial rates are a question mark. As before, you will probably need them, due to having transactions that take place in other Canadian provinces, such as if and when your staff travel out of province.

Tax accounts will be a little more involved, due to the requirement to capture the Provincial portion of HST paid on purchases:

- HST (Federal) - collected
- HST (Ontario) collected
- Input Tax Credits claimed – Federal
- PSB rebates claimed – Federal
- Input Tax Credits claimed - Ontario
- PSB rebates claimed - Ontario
- HST (Federal) - self-assessed
- HST (Ontario) - self-assessed
- RST (Ontario) - collected (perhaps)

You will certainly need the first eight, and may be more, depending on the complexity of your activities, and the level of detail that you will want to capture for your municipality. The last one – RST collected, will be required if you are collecting insurance premiums from clients of your municipality.

Tax codes may require a little more creativity, to properly handle some of the more obscure types of transaction that you may encounter. These are the most useful tax codes in the world of tomorrow. Though the most obvious ones, there may well be others that you may need, depending on certain types of specialized transactions that your municipality may be involved in.

Tax Code	HST (F)	HST (P)	"GST/PST" expense	Total tax
EXE	0%	0%	0%	0%
GST	5%	0%	0%	5%
STD	5%	8%	0%	13%
MUN	5%	6.24%	1.76%	13%
RST	0%	0%	8%	8%
HOU	1.8%	6%	3.2% + 2%	13%
MEM	2.5%	3.12%	7.38%	13%
MEC	2.5%	4%	6.5%	13%

- EXE is a zero-rated or tax-exempt supply
- GST has only Federal HST charged on the supply, such as a book
- STD is the standard HST tax rate of 13%
- MUN is the code for claiming the PSG rebates on both portions of the HST
- RST is the sales tax charged on insurance premiums (HST = 0%)
- HOU is the tax treatment for a new residential housing unit up to a sale price of $350,000
- MEM is the reporting of HST paid on meals and entertainment for a municipal activity
- MEC is the reporting of HST paid on meals and entertainment for a commercial or zero-rated activity.

Insurance is the one anomaly here, in that the tax change will not impact on this service in any way. It is currently GST-exempt because it is a financial service, so therefore will be HST exempt. No HST will be charged, ergo no HST can be credited or rebated. The insurer will collect the same amount as a premium, and the net cost to the policy holder will remain exactly the same amount, including sales tax. However, the 8% RST charged on insurance premiums is being retained, as one of the couple of ways in which the current retail sales tax will continue to live.

Reporting issues

Self-assessment

Sometimes HST will not be charged by a supplier, such as if you purchased on-line from a supplier in the USA. This could also be for one portion of the HST, especially the Provincial portion, say if buying from a supplier in another province

Treat the transaction as though fully taxed, reporting the amount of self-assessment on line 405 of your HST return.

New housing rebates

The new housing rebates can be accounted for in a variety of ways. The vendor will normally provide the rebate in the Statement of Adjustments for the sale. Up to $350K per unit, you can use a Tax Code, as indicated earlier. Over $350K, use the standard tax code, and post the HST rebates received as credits against the payable.

Since the rebates will normally be given by the vendor, the two portions of HST paid could be posted directly to the corresponding ITC/rebate receivable accounts as a dollar amount, rather than as an amount calculated through a tax code. This is one situation where some creative implementation and accounting process may be called for.

Non-deductible meal and entertainment expense

ITCs and rebates are allowed for 50% of the total cost, including taxes.

Set up a MEx Tax Code as indicated earlier, or split the transaction into two halves. One half of the total expense claims the ITCs/rebates, if allowed, while the other half is accounted as 100% expense. If the 50% eligibility rule will apply to your meals and entertainment costs, pick one of the two suggested approaches. Either one should pass muster with a CRA auditor, if scrutinized.

When the expense is fully allowable, such as catering for all staff of a unit, then treat it as a standard expense for claiming HST ITCs or rebates.

Other special cases?

Not very likely, but if and when they arise, deal with them with a creative and workable approach. Some may indeed be programmable as a special tax code. Others may be easier dealt with by adding lines to the payables voucher to address the peculiarities of the situation by recording the taxes as line item in the voucher itself.

Remember, it is always correct, if tedious, to record sales taxes and sales tax ITCs and PSB rebates as line items on a payables voucher, though it is preferable to have the accounting system process these items through its tax handling processes.

HST Reporting

Filing an HST return that minimizes your municipality's net financial obligation for HST will be the goal of your accounting for HST. As stated before, the requirements are deceptively simple"

- Total revenues for period (line 101)
- HST collected (line 103)
- ITCs and rebates being claimed (line 106)
- HST paid on acquisition of tangible real property (line 205)
- HST self-assessed (line 405)
- Other lines on the HST return

Note that there is separate reporting of Federal and Provincial HST PSB rebates claimed on Form GST66. Ideally, you will be able to obtain all of these numbers from appropriate general ledger accounts.

Most software packages have sales tax reporting built in, or offer the potential to create useful reports to assist in the preparation of HST reports. However, is the reporting reliable? Do a parallel run to test it. For example, the Provincial sales tax reporting in QuickBooks is well known in the accounting community to be unreliable, and that it is better to use G/L account totals to generate RST tax return figures.

In fact, this is always my preferred approach, as then I know where the numbers on my tax return come from. Most important, if the return is audited, I can produce complete backup for the numbers submitted. And my return will always agree with my general ledger.

Do make sure that the revenues that you report in your financial reporting for a business activity agree with the revenues total that you report on line 101 of your HST returns. That is one of the first things that a CRA auditor will check.

One last thing. Configure your system so that whatever happens and whatever you report will be easily auditable, - by your auditor, and by CRA's auditors. The simpler and more transparent your accounting, the easier, faster and less painful any audit will be. CRA auditors will have less to be investigate and to fathom out, while your own auditor may not be able to charge you as much in fees.

Summary

This newsletter has covered a number of issues concerning implementing the new HST tax regime in an accounting system. The intent has been to give you a sense of the issues involved, and the needs that will have to be addressed rather than a hands-on guide, as the specific details for each software environment will be different.

Good luck with your own implementation.

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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.