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Instructions for MFOA's HST impact calculation template



MFOA's HST Impact Calculation Template

Introduction

The attached spreadsheet has been designed to assist Ontario municipalities in calculating the estimated impact that the change from the current dual taxation regime GST (Federal Goods and Services Tax) and ORST (Ontario Retail Sales Tax) to HST (Harmonized Sales Tax) administered by the federal government. The fixed 78% rebate on the provincial component of the HST is designed to be fiscally neutral relative to the RST that all municipalities collectively pay. Being neutral on a sector basis does not mean that the move to a harmonized tax would be neutral for each municipality. Some municipalities would experience a net RST savings while others would incur net higher RST costs. The net impact of harmonization on a municipality would depend on the nature, extent and timing of operating and capital expenditures by the municipality.¹

This impact template has a twofold purpose. First, it is offered as a tool to assist municipalities in calculating the impact of harmonization to assist in the preparation of your 2010 budget preparation. Secondly, we hope to acquire information from you to test the reasonableness of the 78% rebate for the RST portion of the HST.

About the Template

Estimating the GST Tax Base: It is assumed that the HST would be paid on all transactions that currently attract a GST payment. Since municipalities receive a 100% rebate on GST paid, we assume that you have a good understanding of the amount of GST paid in 2008. These amounts should be readily available from the GST forms you submit to the federal government for your rebate. Part A of the impact template uses these GST amounts to calculate the base value of goods and services that you purchased. This base of goods and services is assumed to be the same base on which you would pay the HST.

The template grosses up the GST paid to determine the total value of goods and services prior to the payment of GST. This base is used to calculate the HST that would have been payable and breaks this HST component out into two elements:

- The former 5% GST which would continue to be subject to a rebate of 100%, and

¹ Ducharme, Larry; London Transit; Assessment of Impact of Harmonized Sales Tax Municipal Public Transit Services; Summer, 2009

- The former RST of 8% which would be subject to a rebate of 78%.

These numbers would provide an estimate of the total tax amount on an annual basis under tax harmonization.

Estimating Provincial Sales Tax: Discussions with a number of municipalities suggest that this is the most challenging part of the impact analysis. Many municipalities find it difficult to identify all of the provincial sales tax paid, since they have traditionally had no need to track such amounts. Some of our members have engaged in detailed reviews of their accounts payable, including credit card transactions, to identify the types of transactions that would attract the payment of a retail sales tax. Others have accounting software that permits these amounts to be more readily identified. Each municipality would have to evaluate the easiest method of identifying RST transactions that would yield a reasonably accurate estimate of the value of goods purchased upon which RST was paid.

In Part B, you should record the total value of goods purchased that were subject to RST, including the RST paid. The template would calculate the RST paid from this number. The template also estimates the flow through savings expected by eliminating the RST that is embedded in the purchase price of goods and services at each step in the supply chain. If we assume that the federal government would continue the practice of fully rebating the GST portion of the new HST tax, then the difference calculated in Part A and Part B would be the amount that the municipality is affected by the changing taxation system.

Utilizing the most current annualized information (2008, you should enter values in the light blue sections of the spreadsheet. The information can be entered by department or service provision or amassed into one column for the entire municipality. The template includes a number of broad service categories that can be utilized by participating municipalities. It also includes three columns defined as “other.” You can use these columns for service categories not specified in the predetermined columns. If you choose to report results on a consolidated corporate basis, bear in mind that tax impacts would vary by department and service. You might wish to refine your analysis in the future to understand the distribution of impacts throughout your operations.

What You Should Expect to See

The effect of the HST on a particular municipality would generally depend on the balance between several types of expenditures:

- On most goods where you paid RST, you would receive a rebate of 78% less any additional benefit derived through the elimination of previously embedded RST. An example of this might be a municipal vehicle where you paid RST at 8% with no rebate

and now would receive a 78% rebate on the RST portion under an HST. This would result in a net benefit to you.

- On services where you paid GST at the 5% rate, you would pay an HST at 13%. Of this tax payable, you would receive a 100% rebate on the former GST (5%) and a 78% rebate on the former RST (8%). This means there would be a portion of the tax paid on services that is not recoverable. In this case you would have a net tax increase.
- As under the GST, municipalities providing taxable supplies, such as the provision of municipal parking, would be eligible for input tax credits.
- There are also cases where there is currently no RST payable, but there would be an HST payable at 13%. Examples of these cases include:²
 - energy, including diesel/gasoline cost, electricity and natural gas
 - conferences
 - membership fees
 - landscaping and snow removal
 - professional fees – legal, audit, consulting
 - service contracts – contracted public transit services, garbage collection, security, janitorial etc.

In as much as the municipality bore no taxation liability on these items under the current regime, an additional tax levy of 22% of the provincial portion, or about 1.7%, would become payable and add to the cost born by your municipality.

The implementation of the HST in Ontario has a number of special cases. One of the most notable is the requirement to continue paying existing RST (notwithstanding GST does not apply) on the following expenditure items:

- insured employment benefit program premiums; and
- general insurance program premiums as may be applicable (noting auto/public liability premiums are not subject to RST)

While RST continues to apply to the above expenditures, the RST paid is not subject to the 78% rebate that would be part of the new HST.³ Therefore, you should exclude expenditures on these items from the tax impact template.

The following tables provide some examples of the tax treatment for a variety of expenditures under the current tax regime and the HST regime.

Example	GST	RST
Office Furniture	No	Yes
Consulting Contract	Yes	No

² IBID

³ IBID

**Office Furniture Purchase:
Example 1**

Current Tax System		HST Tax System	
Purchase Price	5,000.00	Purchase Price	5,000.00
GST	250.00	HST Federal Portion	250.00
ORST	<u>400.00</u>	HST Provincial Portion	<u>400.00</u>
Total Price	5,650.00	Total Price	5,650.00
GST Rebate	- 250.00	HST Federal Portion Rebate	- 250.00
		HST Provincial Portion Rebate	<u>- 312.00</u>
Net Price	5,400.00		5,088.00
		Net Municipal Effect	(312.00)

**Consulting Contract:
Example 2**

Current Tax System		HST Tax System	
Purchase Price	5,000.00	Purchase Price	5,000.00
GST	250.00	HST Federal Portion	250.00
ORST	<u>00.00</u>	HST Provincial Portion	<u>400.00</u>
Total Price	5,250.00	Total Price	5,650.00
GST Rebate	- 250.00	HST Federal Portion Rebate	- 250.00
		HST Provincial Portion Rebate	<u>- 312.00</u>
Net Price	5,000.00		5,088.00
		Net Municipal Effect	88.00

Negotiating Contract Renewals and / or New Contracts

As a result of the move from the current Ontario Retail Sales and Federal Goods and Services taxation systems to a harmonized taxation system consumers can expect price decreases on certain goods and services as the embedded tax associated with the current ORST system is rebated along the supply chain and ultimately passed through in whole or in part to the consumer. As discussed further in Appendix 1, the provincial government is projecting this savings to the consumer to be in a range from 2% to 8% of current prices.

As illustrated in the examples above, with respect to purchases of office furniture or consulting contracts, the original purchase price of \$5,000 in theory should decrease. Providers of goods, such as office equipment would receive the benefit of alleviating embedded tax as the furniture was manufactured and sold to the wholesaler and purchased by the retailer before final sale to the municipality. Suppliers of consulting services would also pay less for the purchase of supplies required to satisfy the terms of the contract and a portion of those savings could be passed on to the final consumers.

While many inter - municipal contracts including contracts through services boards and the Ontario Provincial Police are tax exempt, some of the costs associated with providing those contracted services would decrease. The purchase of a police vehicle would firstly receive the same taxation benefit as outlined in the Office Furniture purchase noted above as well as a projected price decrease as embedded taxes are negated and savings passed through. Inasmuch the cost of providing some of these contracted services are heavily skewed by the percentage of labour costs the effect on final contract prices may be quite insignificant.

In negotiating new contracts or renegotiating existing contracts it is important that the municipality understand these concepts and discuss price savings that may have resulted in decreased costs to the suppliers of goods and services.

Should any further clarification or information be required please contact Tom Bradbury at:

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Appendix 1: Line by Line Description

Input Lines – Municipal Input Required

Part A – Calculates the HST tax base and estimates the tax liability for the municipality under the newly introduced Harmonized Sales Tax system to come into force in July 2010.

Line 1 - Total ITC Claimed on GST

The Canada Revenue Agency states; **Input tax credit (ITC)** means a credit GST/HST registrants can claim to recover the GST/HST they paid or owe for goods or services they acquired, imported into Canada, or brought into a participating province for use, consumption, or supply in the course of their commercial activities.

Examples of expenses eligible for ITCs include:

- general operating expenses, such as rent and utilities, to the extent that they are used in making taxable supplies;
- new merchandise bought for resale;
- meals and entertainment expenses related to your commercial activities;
- certain allowances and reimbursements you paid to employees and volunteers engaged in your commercial activities;
- capital personal property (such as office furniture, photocopiers, computers, and vehicles) used primarily (more than 50%) in your commercial activities; and
- purchases of, and improvements to, capital real property used primarily in commercial activities.

Example:

Your municipality operates an arena that provides both taxable ice time and exempt supervised skating classes for children under the age of 14. Over the quarterly reporting period, 70% of your hydro usage relates to your exempt supplies and 30% relates to taxable supplies. You can claim 30% of the GST/HST you paid or owe on that quarter's hydro bill as an ITC. You may also be able to claim a municipal rebate for the remaining amount.

See **GST/HST Information for Municipalities** from the Canada Revenue Agency for additional information on the application of GST / HST with respect to municipalities at the following link:

<http://www.cra-arc.gc.ca/E/pub/gp/rc4049/rc4049-09e.pdf>

From GST rebate applications for 2008 the total amounts for ITC claimed and GST Rebate claimed should be readily available. Depending on the sophistication or level of detail available to the individual participant, splitting these amounts among the service categories may be somewhat more onerous. Splitting the amounts among the service categories however, would provide the participating municipalities as well MFOA further insight into the redistribution of attributable tax costs to the service categories.

Line 2 – Total GST Rebate Claimed

Part B – Calculates what the municipality had previously paid in provincial Retail Sales Tax under the current sales tax system

Line 10 - Materials / Services Purchased Subject to RST

The municipality is asked to enter the full value (sales tax included) of all purchases made that were subject to Ontario Retail Sales Tax. For the most part all materials and some services purchased were subject ORST. In an effort to accurately ascertain a credible estimate of purchases subject to RST a reasonable scrutiny of the municipality's records is required. A broader discussion on the application of ORST can be found at the following link;
<http://www.rev.gov.on.ca/english/taxtips/rst/01.html>

Calculated Lines – No Municipal Input Required

Line 3 – Total GST Paid – sums the values entered in lines 1 and 2

Line 4 – Grossed up value of supplies subject to GST – the value in line 4 is divided by 5% thereby yielding the total value of all purchases that were subject to GST

Line 5 – Estimated HST @ 13% - multiplying the total value of purchases subject to GST from line 5 by 13% estimates what would be due in the future on those goods and services after the adoption of the HST system in Ontario

Line 6 – Federal Portion of HST (@ 5/13) – the federal portion of the HST is calculated as 5/13 of the total estimated HST calculated in line 5.

Line 7 – Provincial Portion of HST (@ 8/13) – the provincial portion of the HST is calculated as 8/13 of the total estimated HST calculated in line 5.

Line 8 - Recoverable Provincial Portion of HST (@78%) – that which the municipality would be able to recover from the Provincial portion, 78% of the HST from line 7 is calculated.

Line 9 - Non-recoverable Provincial Portion of HST (@22%) - that which the municipality would not be able to recover from the Provincial portion, 22% of the HST from line 7 is calculated.

Line 11 - Estimated ORST Paid at 8.0% - calculates the estimate of what had been paid in ORST under the current system. The value input in line 10 is divided by 1.08% yielding the original value of the purchases before ORST was applied. The original value of those purchases multiplied by 8% yields an estimate of what the municipality had paid in ORST under the current system.

Line 12 – Net Impact on the Municipality Before Estimated Flow Through Savings – by subtracting line 11, what had been paid under the current system from line 9, the estimated non-recoverable provincial portion of HST, the estimate of the impact on the municipality is calculated in line 12.

Line 13 – HST Rebate % required for Cost Neutrality (before estimated flow through cost savings) – applying the rebate percentage calculated would make the non-recoverable provincial portion of the new HST system, line 9, equate to the estimated ORST paid under the current system, line 11.

Line 14 – Estimated Flow Through Savings at 2% - The current RST applies to many purchases made by businesses in the course of providing goods and services for sale. As a result, the tax can become embedded in the price of the finished goods and services throughout the supply chain. This hidden RST is passed on to consumers. The new harmonized sales tax would use a value-added tax structure, meaning that most businesses would be reimbursed for the sales tax they pay on most of their inputs. Studies show that most of the cost savings to business from removing embedded sales taxes are passed on to consumers through lower prices.⁴ In their presentation at the 2009 AMO conference, the Ontario Ministry of Finance noted that the deletion of the embedded tax throughout the supply chain could decrease the final cost of goods to the consumer by 2% to 8%. The spreadsheet uses the conservative 2% savings estimate for the calculation. Also note Appendix 2, attached, that illustrates the difference between the Retail Sales Tax system currently in place that adds embedded tax at every step in the supply chain and the Value Added Taxation system that would be utilized in the new HST system thereby reducing the final cost of these goods to the consumer.

Line 15– Net Impact on the Municipality After Estimated Flow Through Savings – adds line 12, net impact on the municipality before estimated savings to line 14, estimated flow through

⁴ Ontario Budget 2009, Chapter III, Reforming Ontario's Tax and Pension Systems

savings thereby adjusting the net impact to the municipality by the amount of estimated flow savings.

Line 16 – HST Rebate % required for Cost Neutrality (after estimated flow through cost savings) – applying the rebate percentage calculated would make the non-recoverable provincial portion of the new HST system, line 9, equate to the sum of estimated ORST paid under the current system calculated line 11 plus the estimated flow through savings on line 14.

Further Information can be found at the following federal and provincial websites:

<http://www.cra-arc.gc.ca/E/pub/gp/rc4049/rc4049-09e.pdf>

<http://www.cra-arc.gc.ca/tx/bsnss/tpcs/gst-tps/thr/gvt/xmptspbygv-eng.html>

<http://www.rev.gov.on.ca/english/guides/rst/pdf/810.pdf>