Implementation of Ontario's Harmonized Sales Tax

August 24, 2009

On August 24, 2009, Tax Executives Institute submitted the following comments to the Ontario Ministry of Revenue on implementation issues relating to the adoption of a harmonized sales tax in the Province of Ontario. The comments, which took the form of a letter to Steve Orsini, Assistant Deputy Minister in the Minstry's Office of the Budget and Taxation, were prepared under the auspices of TEI's Canadian Commodity Tax Committee and the Toronto Chapter's Ontario Tax Committee, whose chairs are Diana M. Spagnuolo of Imperial Oil Limited and Carol Nixon of Lanxess Inc., respectively. Materially participating in the preparation of the comments were Vincent Alicandri of Hydro One Networks, Inc; Carol Felepchuk of TD Bank Financial Group; Daniel Karvonen and Martina Krummen of FNC Lavalin Inc.; Phil W. Riley of ArcelorMittal Dofasco Inc.; Richard Taylor of Rogers Communications Inc.; Natalie St-Pierre of Bell Canada; and Michael J. Willis of LaFarge Canada Inc. Mary L. Fahey, TEI's General Counsel, served as legal staff liaison on this project. ***Note:*** *On September 16, TEI submitted comments to members of the Ontario Legislative Assembly, expressing support for the enactment of a Harmonized Sales Tax in the Province.*

On March 10, 2009, the Government of Canada and Province of Ontario signed a Memorandum of Agreement (MOA) to use their best efforts to negotiate a new Canada-Ontario Comprehensive Integrated Tax Co-ordination Agreement, whereby Canada Revenue Agency and Canada Border Services Agency would administer an Ontario value-add-ed tax (OVAT). The parties agreed to work toward implementation of the harmonized sales tax regime effective July 1, 2010, when Ontario's current retail sales tax (RST) will be combined with the federal goods and services tax (GST) to create a single sales tax rate of 13 percent (i.e., 8-percent provincial tax and 5-percent federal tax).

TEI commends the Province for moving to simplify tax administration by harmonizing its RST with the GST. This letter responds to your request for TEI's comments on transitional and other issues that may arise as Ontario implements the new taxing regime. We have focused on the issues you believed to be the most pressing and will address other issues in a separate letter later this year. We urge the Province to release draft language promptly to permit time for public comment and for companies to implement the new regime.

Background

Tax Executives Institute is the preeminent association of business tax executives. The Institute's 7,000 professionals manage the tax affairs of 3,200 of the leading companies in Canada, the United States, Asia, and Europe and must contend daily with the planning and compliance aspects of Canada's business tax laws. Canadians make up 10 percent of TEI's membership, with our Canadian members belonging to chapters in Calgary, Montreal, Toronto, and Vancouver, which together constitute one of our nine geographic regions. Our non-Canadian members (including those in Europe and Asia) work for companies with substantial activities in Canada. In sum, TEI's membership includes representatives from most major industries including manufacturing, distributing, wholesaling, and retailing; real estate; transportation; financial services; telecommunications; and natural resources (including timber and integrated oil companies). TEI concerns itself with issues of tax policy and administration and is dedicated to working with government agencies to reduce the costs and burdens of tax compliance and administration to our common benefit.

Temporary ITC Restrictions

The MOA provides that, during the implementation of the OVAT, large businesses will be temporarily restricted from claiming input tax credits (ITCs) on certain expenses, such as telecommunication services (other than Internet access or toll-free numbers), certain road vehicles, fuel, and energy, which includes electricity, natural gas, com-bustibles and steam. Further detail about the proposed restriction was provided in chapter 3 of the Ontario Budget, 2009:

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Similar to the restricted input tax credit (ITC) system in Québec, large businesses (those with annual taxable sales in excess of $10 million) and financial institutions would be unable to claim input tax credits in certain areas.

After five years, full ITCs on taxable supplies will be phased in over a three-year period.

The Institute recommends that the Province follow the model of the Maritime Provinces, which did not place temporary restrictions on large corporations for claiming ITCs. The ITC restrictions are especially disappointing in respect of financial institutions that have limited recoveries of tax. In addition, financial services should be treated as zero-rated (rather than exempt) supplies under the federal and provincial systems, just as they are treated under the Québec sales tax regime. By failing to provide unrestricted ITCs for all supplies to businesses and by failing to zero rate financial services, the harmonization is incomplete and economically inefficient.

a. The Québec Experience. TEI was asked to comment on the Québec sales tax (QST) restrictions on input tax refunds (ITRs) as they apply to large businesses. Like the proposed OVAT, the QST legislation contains ITR restrictions. These restrictions are imposed under section 206.1 of the Québec Sales Tax Act and include telecommunication services, road vehicles, and fuel, as well as certain supplies of electricity, gas combustibles, and steam.

The ITR restrictions imposed by section 206.1 have been repealed for small and medium businesses, but remain in effect for large businesses. Large businesses are defined as registrants whose value of the
taxable and non-taxable supplies made in Canada by the registrant, by a person with whom the registrant is associated, or by a person whose business the registrant has continued, exceeds $10,000,000 during the
last fiscal period. In this respect, the value of the supplies made in Canada must include the value of all the exports, including those deemed to be made outside Canada, but the amount of the GST, as well as the value attributable either to the sale of immovables that are capital property or to the goodwill of a business sold for which no GST is payable, must be excluded.

The efforts and controls required by large businesses to apply these restrictions are significant. Even after large investments of time and resources, compliance remains challenging. Because of the lack of clarity, companies and auditors have applied these restrictions inconsistently, spawning numerous disputes on audit.

b. Telecommunication Services

1. Application of the QST. Québec's ITR restrictions apply only with respect to supplies of telephone service and other services of transmitting and receiving telecommunications (e.g., the right to send or receive messages over a private or dedicated line service). They do not apply to supplies of telecommunication equipment (*e.g.*, the lease or sale of telephones, switches, serv ers, dark fibre, etc.).

The ITR restrictions were introduced under paragraphs 4 and 5 of section 206.1 of the Québec Sales Tax Act, which provided that the restrictions applied to (i) telephone service (e.g., local voice service) that was taxable as moveable property under the Québec Retail Sales Tax Act; and (ii) a telecommunication service or any telecommunication in respect of which the tax prescribed by the Telecommunications Tax Act would apply, but for the repeal of said tax. The Telecommunications Tax Act taxed the service of sending and receiving telecommunications, other than telephone service, but did not tax equipment or other property. In practice, the Québec Retail Sales Tax applied on the flat monthly rate for local telephone service, and the Telecommunications Tax applied on long distance and other usage-based charges for the service of sending and receiving telecommunications. When the ITR restrictions were introduced, Québec could have restricted the right to claim ITRs on supplies of "telecommunication services," as defined under the Québec Sales Tax Act. Instead, it restricted only ITR recovery on telecommunications and telecommunication services taxable under the Telecommunications Tax Act, and telephone service.

The QST restriction does not apply to Internet access, F 1-800 or 888 telephone service, and other related telecommunication services. In addition, the restriction does not apply to the supply of a telecommunication service to a large business carrying on the business of supplying telecommunication services, where the telecommunication service is to be used directly and solely for the purpose of making a taxable supply of another telecommunication service by that large business. Telecommunication providers can purchase supplies of telecommunication services necessary to provide telecommunication services to customers, pay their suppliers QST, and recover the QST7F.

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In practice, a large telecommunication service provider often experiences restricted ITRs with respect to QST paid on purchases of telephone and data transmission services from other registrants, for use by its own employees in communicating with each other, customers, or other external persons. The telecommunication service provider will recover the QST paid to suppliers on supplies of all other telecommunication services, equipment, and property.

2. Application to the OVAT. To streamline compliance and limit disputes between taxpayers and the government, the legislation implementing the OVAT ITC restrictions on telecommunication services should be precise and unambiguous. The ITC restrictions should achieve a result identical to Québec's to ensure:

- A cost-effective transition to the new rules for large businesses that have already set up systems and processes to manage and account for restricted QST ITRs on telecommunication services;
- The intent of the MOA is met; and
- Fairness and competitiveness between Ontario and Québec businesses.

The legislation should restrict large businesses from recovering only the OVAT charged to them by other registrants on supplies of telephone and other services of transmitting and receiving telecommunications (*e.g.*, the right to send or receive messages over a private or dedicated line service), other than Internet access or toll-free telecommunication services, except where the large business is in the business of supplying telecommunication services and acquiring the telecommunication service to use primarily and directly for the purpose of making a taxable supply of a telecommunication service.

Care should be taken to ensure that the ITC restrictions do not apply to supplies of telephones or other telecommunication equipment. In particular, paragraph (b) of the definition of telecommunication service and the definition of telecommunication facility under section 123 of the Excise Tax Act (ETA) should not be included in its entirety to avoid restricting the recovery of OVAT on leases and other supplies of telephones and telecommunication equipment, similar to the existing QST ITR restrictions.

There are several methods for accomplishing the above. Two possible methods are set forth below.

i. Method 1. The first method uses a definition of "restricted telecommunication services" in paragraph (a) of section 123 of the Excise Tax Act (ETA) — to include services that are telecommunication services — and the supply of a telecommunication channel under ETA subsections 136.4(1) and (2) — to cover supplies of private line service and rights to have telecommunications trans-mitted/received over a telecommunication provider's network.

Under this method, "restricted telecommunication services" would be defined as

(A) the service of emitting, transmitting or receiving signs, signals, writing, images or sounds or any intelligence of any nature by wire, cable, radio, optical or other electromagnetic system, or by any similar technical system; or

(B) the supply of access to a circuit, line, frequency, channel, or partial channel operated by a person supplying telecommunication services, for sending or receiving telecommunications;

but does not include —

(C) Internet access, or

(D) toll-free telecommunication services.

Restriction. In determining an input tax credit of a registrant who qualifies as a large business, no amount shall be included in respect of the provincial component of the tax payable by said registrant in respect of the supply in Ontario of restricted telecommunication services except where,

(1) the restricted telecommunication service is supplied to a registrant who carries on the business of supplying telecommunication services; and

(2) the restricted telecommunication service is to be used primarily and directly for the purpose of making a taxable supply of telecommunication services.

ii. Method 2. The second proposed method uses a slightly different definition for "restricted telecommunication service" that is a modified version of the definition of telecommunication services and telecommunication facilities, but is otherwise identical to the first proposed method.

Under this method, "restricted telecommunication service" would be defined as

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(A) the service of emitting, transmitting or receiving signs, signals, writing, images or sounds or intelligence of any nature by wire, cable, radio, optical, or other electromagnetic system, or by any similar technical system; or

(B) making available for such emission, transmission or reception restricted telecommunication facilities operated by a person supplying services referred to in paragraph (A);

but would not include —

(C) Internet access; or

(D) toll-free telecommunication services.

"Restricted telecommunication facility" would be defined as — any network or system of wires, cables, radio, optical, electromagnetic, or similar transmission media, that is used or is capable of being used for the transmission of telecommunications; . . . .

Restriction. In determining an input tax credit of a registrant who qualifies as a large business, no amount shall be included in respect of the provincial component of the tax payable by said registrant in respect of the supply in Ontario of restricted telecommunication services except where,

(1) the restricted telecommunication service is supplied to a registrant who carries on the business of
supplying telecommunication services; and

(2) the restricted telecommunication service is to be used primarily and directly for the purpose of making
a taxable supply of telecommunication services.

c. Energy

1. Application of the QST. The ITR restrictions relating to electricity, gas, combustibles, or steam are imposed under paragraph 3 of section 206.1 of the Québec Sales Tax Act. ITRs are allowed, however, when these supplies are acquired for use in production activities as defined under section 17 of the old Québec Retail Sales Tax Act. As a result, the determination of what constituted production activities under the old Québec Retail Sales Tax Act became quite important because it would determine whether ITRs were available in relation to the energy consumed in a specific activity. Revenu Québec has published more than 20 Interpretation Bulletins to assist taxpayers with the determination of who qualified as a manufacturer and what constituted manufacture and production activities.

Even with the detailed information available, taxpayers had difficulty determining the ITC eligibility with respect to energy consumption. To maximize and document the ITR recovery on energy consumption, many manufacturers retained firms specializing in power studies to analyse the energy consumption of a given production plant and issue a report detailing the portion of the energy consumed in qualifying production activities. Generally, government auditors would accept such studies. Where these studies were performed internally, however, auditors reviewed the studies in depth and generally challenged the eligible portion of the electricity consumption. Typically, the ITR claim would be reduced.

From a technical perspective, the power studies accepted by Revenu Québec must be inclusive, rather than exclusive. For example, a business may not consider the entire hydro usage and simply exclude the energy consumed by non-production activities. Rather, the consumption of each qualifying piece of equipment or activity must be measured. This renders the process much more complex and costly for the taxpayer. In addition, this complex process raised many questions with respect to activities such as climate control in industries such as pulp and paper, food processing, and drug manufacture, as well as quality control and research and development activities.

2. Application to the OVAT. To streamline compliance and limit disputes between taxpayers and the government, the legislation implementing the OVAT ITC restrictions on energy should be precise and unambiguous. Although Ontario has published two relevant guides (Retail Sales Tax Guide 400 — Manufacturers and Retails Sales Tax Guide 401 — Manufacturing Contractors), additional guidance is needed.

For example, "energy" subject to ITC restriction must be clearly defined. In Ontario, gas and electricity for end-use consumption are sold in different ways:

- The commodity may be sold by one supplier, while ancillary services such as storage, transmission and distribution, and billing services are sold by a second supplier;
- Both the commodity and the ancillary services may be sold by the same supplier;
- The commodity may be sold, but no actual supply of energy takes place (a maximum demand charge basis contract); and
- Ancillary services may be sold, but no supply of the commodity takes place (*e.g.*, gas storage).

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The quantity of the commodity is measured and the value can be readily determined. Because of the varied nature and application of the ancillary services — many of which are not related to a quantity of the energy being supplied — an "all-inclusive" unit price of energy would be much more difficult to determine and subject to disagreement on audit.

TEI recommends that the definition of "energy" subject to ITC restriction be limited to the price for commodity, *i.e.*, ancillary charges for services such as transmission and distribution would not be subject to the ITC restriction.

With respect to supplies acquired for use in production activities (where ITRs are permitted), the rules must clearly define what constitutes "manufacturing." Also, in light of British Columbia's announcement that it will harmonize its provincial sales tax with the GST and introduce ITC restrictions, the same definition should apply for all provinces with a harmonized sales tax (HST). It will also be important to clarify whether the manufacturing activities will be limited to activities that generate tangible personal property for sale or whether it will include the provision of services, real property, and other supplies such as software transmitted electronically.

Clear guidelines on how to establish or calculate the portion of energy used in production activities must be issued to ensure fairness, encourage compliance, and limit audit disputes. For example, will the eligible energy consumption be determined by manufacturing line, plant, division, or by the corporation as a whole? Will the electricity used in the course of research and development activities qualify regardless whether these activities are carried out in the production plant or at a different location? These issues need to be addressed as the Province moves forward with implementing the OVAT.

The Ontario Ministry of Finance has historically facilitated tax administration by allowing the use of determined factors. TEI urges Ontario to again consider the introduction of simplified rules, such as a "substantially all" test and the use of determined factors. For example, in situations where the production activities are located in a single plant, and where all or substantially all (90 percent or more) of the energy is used in production activities, the Province should consider allowing an ITC for the entire energy consumption. Such a system would encourage ease of administration, be efficient and cost effective, and limit disputes between taxpayers and the government.

For facilities that include a production plant as well as administrative offices, Ontario should consider practical approaches such as the use of determined factors. Such factors could be based on the number of employees or the square footage relating to production activities. In addition, if a taxpayer prefers to engage a third party to conduct a power survey, this option should also be available, although it should not be the preferred or only method accepted by the Province.

Finally, from an administrative perspective, Ontario should consider permitting taxpayers the option of claiming full ITCs for the tax paid on energy during the year with an annual adjustment (self-assess-ment) for the non-eligible portion. This is in line with what is currently permissible under the existing GST for the tax paid on meal and entertainment expenses.

d. Continuous Supply Commodities.

The implementation of the HST in participating provinces in 1997 provided that the provincial component of the HST (tax payable under subsection 165(2) of the ETA) would not apply to any portion of the continuous supply that was delivered/ performed before the implementation date, provided that consideration for the supply that straddled the HST start-up date became due or was paid within four months following the implementation date.

A similar provision applied to supplies of property or services under a budget arrangement (Equal Billing Plan). Supply for any billing period was deemed to be made evenly over the days that were included in the billing period for the purposes of determining the amount of supply that was made before implementation date.

TEI recommends that the same provisions of the ETA that applied to the implementation of the HST in 1997 be applied to the implementation of the OVAT and to the restriction from deduction of ITCs on energy (where applicable).

e. Fuel and Road Vehicles

1. Application of the QST. Under the QST legislation, road vehicles weighing less than the 3,000 kilograms are subject to ITR restrictions. Fuel used to power such vehicles is also restricted. Under the QST system, many interpretative questions needed to be resolved. For example, the definition of fuel includes both gasoline and diesel fuel, and while Revenu Québec restricts the ITRs on gasoline, it allows ITRs on diesel fuel.

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In addition, many issues arose upon audit regarding the fuel and energy (which includes combustibles) restrictions. For example, consider the situation of diesel fuel used by large stationary mining exploration drilling equipment. The fuel is clearly used in an off-road vehicle by a non-propulsive engine and should give rise to ITRs. Whether the equipment was used in production activities is also debatable. Revenu Québec auditors attempted to deny the ITRs. Although ultimately resolved in the taxpayer's favor, the issue took a long time to resolve because of the lack of guidance.

2. Application to the OVAT. The OVAT legislation will provide for similar restrictions with respect to fuel, combustibles, and road vehicles. To provide clarity and avoid audit disputes, TEI recommends that guidance be provided with respect to:

- The definition of road vehicles subject to the restrictions. Will off-road vehicles be included? In order for the restrictions to apply, must the vehicle be self-propelled?
- What parts and services relating to road vehicles will be subject to the ITC restriction?; and
- The definition of restricted fuel, as well as combustibles.

Place of Supply Rules for Services and Intangibles

a. In General.

Implementation of the OVAT raises significant issues relating to the current place of supply rules for services and intangibles that could negatively affect the competitiveness of suppliers located in Ontario. TEI suggests that the following principles be used in revamping these rules.

If the supply for services or intangibles is considered to be made in Canada under the current federal ETA, then the location (*i.e.*, address) of the contracting party for the customer should be used to determine the tax to charge. If the contracting party for the customer is located in one of the harmonized provinces, then the HST would apply.

The government may consider exceptions to the rule to pull the supply into a province if it is in respect of tangible personal property or real property that is located in that province, or if it is made to an individual who is in a province at the time the supply is performed and had contact with the supplier (similar to sections 7 and 10.1 of Part V of Schedule VI of the ETA). These exceptions, however, should be as limited as possible to keep the rules simple and easy to administer.

In some respects, similar rules now exist in the exceptions to the place of supply rules within the regulations (*e.g.*, for com-puter-related services, Internet, and trustee services for registered retirement savings plans (RRSP), registered retirement income funds (RRIF), and registered education savings plans (RESPs)).

b. Exceptions to the Place of Supply Rules for Services.

If the place of supply rules for services cannot be revamped, the regulations adjusting the place of supply rules for services must be expanded. The current place of supply rules for participating provinces are found in ETA section 144.1 and are more fully described in Schedule IX. Currently, the test is based on the place of performance of the service, with consideration given to the place of negotiation of the contract. Exceptions to this general rule can be found in the regulations (entitled Place of Supply GST/HST Regulations).

Examples of current exceptions for services relate to memberships supplied to individuals (which are taxed based on the mailing address); trustees' services in respect of a RRSP, RRIF, or RESP (which are taxed at the subscriber's address); and internet-access or computer-related services (which are taxed at the recipient's address if tracked, or the mailing address of the customer if the recipi-ent's location is not tracked).

Ontario should carefully consider the rules relating to Ontario-based service providers supplying services to either exempt or individual consumers located outside the Province because the place of supply rules may put them at a competitive disadvantage to suppliers located outside of the participating provinces. This may cause customers to look to service providers located outside of Ontario or could even cause Ontario service providers to consider relocating all or a portion of their activities to other provinces.

Financial planning and investment management services are examples that should be added to the regulations with the place of taxation based on the normal address of the customer. Call centre services outside of those provided in respect of computer services (which are already covered by the regulations) would also be a good candidate for inclusion in the regulations with tax applying based on the location of the recipient, if tracked, or the mailing address of the customer. Finally, trustee and custodial services should be added to the exceptions, including fees for RRSPs and RRIFs, as well as the new tax-free savings accounts (TFSAs).

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Transitional Rules

a. SLFIs.

Because the OVAT will generally have the same tax base as the GST, financial services will be exempt from the revised tax — which is likely to result in higher costs because the institutions will pay the OVAT on more expenses but generally will not be able to claim ITCs to recover the tax. There are special rules for determining amounts that a selected listed financial institution (SLFI) must include in a special attribution method (SAM) that serves as a proxy for the appropriate amount of the provincial component of the HST (*i.e.*, the 8-percent component) that should be borne by the SLFI on property and services it consumes in its exempt activities.

When Nova Scotia, New Brunswick, and Newfoundland implemented the HST in 1997, the transitional rules in respect of self-assessment for SLFIs using the SAM formula caused some concern. These rules required a self-assessment of tax on supplies paid after October 23, 1996, and before February 1, 1997, where the supply was performed or provided after the April 1 implementation date. This self-assessment seems contrary to the purpose behind the use of SAM.

It is difficult to track and audit supplies of this nature. To simplify the process, while still ensuring an appropriate share of the full year's tax is taken into account, TEI recommends not requiring self-assessment, but rather letting taxpayers pick up a pro-rata share of the full year's GST payable on which to calculate the related provincial component of the HST. For example, with an implementation date of July 1, and a fiscal year end of October 31, the SLFI formula would require that 4/12 of the full year's GST be used to calculate the related provincial component of the HST. This would ensure that a share of purchases made throughout the year is included in the calculation without requiring any additional self-assessment. It would also negate any seasonality of expenses.

b. Supply and Install Construction Contracts.

The transition from an RST regime to the OVAT for supply and install construction contracts has its own unique issues. Under the RST regime, the contractor is deemed to be the consumer of tangible personal property used in the real property construction. The transition to the OVAT regime will change the imposition of tax on supply and install contracts. TEI would be pleased to consult with the Province concerning transitional measures relating to contracts straddling the July 1, 2010, effective date.

The Province must also review and clarify the RST self-assessment timing rules for goods manufactured for, or goods purchased from, suppliers for incorporation directly into supply and install contracts. During the transition, tangible personal property could be delivered to a job site and installed by the contractor on or before June 30, 2010, but the formal acceptance by the owner may occur on or after July 1, 2010, and thus be subject to the OVAT. A procedure should be developed for claiming a refund of RST on tax-paid goods (direct inventory) stockpiled on and off job sites as of July 1, 2010, when the goods are to be incorporated directly into supply and install jobs. There should also be a procedure to claim a refund of RST on tax-paid construction "indirect" materials and consumables stockpiled on and off job sites as of July 1, 2010.

In the construction industry, work can be rejected well after installation and the owners may seek either a replacement or financial redress. The transition rules should include provisions to allow the recovery of RST paid on materials and supplies installed prior to July 1, 2010, but replaced after June 30, 2010, or in cases where the contractor has provided financial redress. Guidance is also needed on whether to invoice the OVAT for holdbacks receivable and payable as of July 1, 2010, but released after harmonization.

Under the RST regime, there are specific rules for manufacturing contractors who perform supply and install contracts. Clarification of the rules on the temporary OVAT ITC restrictions applied on energy costs used in the manufacture of goods to be used on supply and install contracts must take into account that these costs are currently non-taxable under the RST regime. TEI recommends that Ontario's definition of manufacturing exempt from the ITC restrictions "manufacturing contractors and manufacturing for its own use," so that the construction sector does not face higher material expenditures with a new tax on energy costs. In general, to minimize the possibility of double taxation on the final customer, TEI recommends that a mechanism be in place to rebate all RST that is included in the amount of a real property contractor's unbilled work-in-progress as of June 30, 2010, that would be subject to OVAT when it is billed.

c. Long-Term Residential Care Facilities.

The 2009 Ontario Budget announced several new rebates to help homebuyers and the housing industry with an enhanced new housing rebate (up to $24,000) and a new rental housing rebate (also up to $24,000). Single Sales Tax Information Notice 2 (SST 2) (June 18, 2009) is the most recent document released by the Ministry on the new rebates and transitional rules. The notice states that long-term residential care facilities are eligible for the rental housing rebate; SST 2 does not, however, specifically include the facilities in its discussion of the transitional rules.

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Landlords may apply for the rebate by filing a rebate application with the Canada Revenue Agency, which will administer the rebate along with the GST rebate for qualified housing. Apparently, as with the GST, the maximum rebate amount of $24,000 will be the same for each long-term residential unit.

SST 2 describes the transitional rules that will apply to new housing transactions straddling the OVAT implementation date of July 1, 2010. In discussing these transitional rules, SST 2 refers only to new homes and new rental homes, but does not specifically address the transitional rules vis à vis long-term residential care facilities.

Grandparenting rules apply to sales of newly constructed or substantially renovated homes and condominiums. If a written agreement of purchase and sale were entered into on or before the June 18, 2009, announcement date, the sale will not be subject to the provincial portion of the OVAT where both ownership and possession of the home are transferred after June 2010. SST 2 specifically states that the grandparenting rules do not apply to traditional apartment buildings; hence they will likely not apply to long-term residential care facilities. There is no explanation why apartment buildings are excluded from these rules. This issue needs to be clarified.

Where the construction is completed in full or in part prior to July 2010, RST will be embedded in the cost of the home. Where new homes are subject to the provincial portion of the OVAT after June 2010, an RST transitional housing rebate will be available to provide relief.

For newly constructed apartment buildings and condominiums, the RST transitional housing rebate is available to the builder, not the purchaser. It is unclear how this rebate applies to long-term residential care facilities. Ontario should confirm that the RST transitional rebate is available and that the builder will be required to provide evidence to the purchaser that the rebate is passed along to the facility as a reduction in cost.

Generally, the rebate will be calculated as a proportion of the estimated RST embedded in the construction based on the percentage of completion of the home. Two methods will be available for calculating the estimated embedded RST: estimated RST content on a "floor space method" or a "selling price method" calculated at 2 percent of the selling price.

Eligibility for the RST transitional housing rebate will not affect the purchaser's or builder's ability to claim the new housing or rental housing rebate. Ontario should confirm that long-term residential care facilities will also continue to qualify for the new rental housing rebate.

Where a written purchase agreement is entered into after June 18, 2009, and before July 1, 2010, the builder will be required to disclose whether the provincial portion of the OVAT applies to the sale and if the price includes the OVAT net of the new housing rebate. If the transaction is subject to OVAT and the builder does not make a disclosure, the stated price is deemed to include the provincial portion of the tax. Such disclosure would also be advisable for long-term residential care facilities. Whether the new rental housing rebate must be submitted by the purchaser or whether it can be assigned to the builder to net off the price in the case of long-term residential care facilities should also be clarified.

In sum, Ontario should clarify —

- The maximum new rental housing rebate will be $24,000 for each long-term residential care unit;
- The transitional rules will apply to long-term residential care facilities in the same manner as for apartment buildings;
- Whether long-term residential care facilities are eligible for the grandparenting rules;
- The RST transitional rebate is available to long-term residential care facilities and builders will be required to provide evidence that the rebate is passed along to the purchaser;
- Both the RST transitional housing rebate and the new rental housing rebate are available to long-term residential care facilities;
- Builder disclosure regarding the tax application will be required where long-term care facilities are constructed; and
- The new rental housing rebates can be assigned to the builder to net off the price in the case of long-term residential care facilities.

Conclusion

Tax Executives Institute appreciates the opportunity to comment on this matter. TEI would be pleased to meet with you or members of your Ministry to discuss the issues more fully. If you should have any questions about TEI's letter, please contact TEI's Vice President for Canadian Affairs, Sherrie Ann Pollock, at 416.955.7373 (sher-rieann.pollock@rbcdexia-is.com). Alternatively, questions may be posed to Diana M. Spagnuolo, Chair of TEI's Canadian Commodity Tax Committee, at 403.237.2948 (diana.m.spagnuolo@esso.ca).