Deloitte.

City of Ottawa
OHST impact analysis

January 15, 2010

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Executive summary

We are pleased to summarize in this report, the results of our Ontario Harmonized Sales Tax (OHST) impact analysis for the City of Ottawa ("the City").

The report is a high-level impact analysis of the OHST on the City's operating costs. It also provides comments regarding impact on revenue, capital, and cash flow and makes a number of recommendations including system changes needed to deal with the OHST.

The report is based on discussions with City personnel and other information provided to us by the City, including detailed transactional data from 2008. Our analysis is based on the 2008 data and intended to provide the City with estimate of the directional impact of the OHST. It relies on our understanding of the facts and assumption contained in Appendix B – Facts and assumptions. If the facts and assumptions are incorrect or are in any way incomplete, please advise us as any new or amended information may alter our analysis, conclusions and recommendations.

The conclusions reached in this report may not apply to similar situations faced by other persons. The results are fact driven and a function of the aggregate mix of transactions and facts unique to the City. It should not be relied upon by other persons as indicative of the OHST impact on their organization. Please refer to the scope limitations and qualifications contained in Appendix A – Scope and qualifications.

Global impact

Effective July 1, 2010, Ontario will harmonize the Ontario Retail Sales Tax (ORST) with the federal Goods and Services Tax (GST). On that date, OHST at a blended rate of 13% [5% federal GST + 8% provincial value added tax (PVAT)] will begin to apply on most goods and services supplied in Ontario.

The OHST significantly broadens the sales tax base in Ontario, reducing the burden on businesses and increasing sales taxes on consumers and ratepayers.

The OHST is designed to be revenue neutral for municipalities by providing municipalities with a rebate of 78% of the PVAT. Based on the facts and assumptions contained in Appendix B – Facts and assumptions, our analysis indicates that, on a global basis, the City will not experience any significant non-recoverable sales tax increases.

Specifically, in 2008 the City incurred approximately $18.6M in unrecoverable ORST. This does not include ORST paid by suppliers and embedded in the cost of goods and services acquired by the City (e.g., ORST embedded in real property construction). Had the OHST applied in 2008, the unrecoverable sales tax would have been approximately $18.9M, excluding implementation costs and any pass-through savings that may be realized by suppliers under the OHST.

The result is an increase in non-recoverable sales tax of approximately $280,000. Therefore, based on 2008 data, the City can expect a net non-recoverable sales tax increase of approximately $140,000 in 2010 and $280,000 in 2011. A further $142,000 in one-time interest cost may be incurred in 2010 as a result of the cash flow implications of the OHST. Please refer to section Global impact on costs and Table 7 - Global estimate of OHST non-recoverable cost as well as Impact on cash flow for more details.

Operating costs

The City can expect cost increases on expenditures not previously subject to ORST (e.g., contract services, electricity, gasoline and diesel fuel, real property contacts, materials used in water treatment, and qualifying firefighting/EMS equipment, etc.).

Conversely, goods and services previously subject to ORST such as most tangible personal property (TPP); labour to install, assemble, adjust, maintain or repair TPP; telecommunication services; non-custom computer software and related services, and commercial parking will see a decrease in the unrecoverable sales tax from 8% to 1.76% after June 30, 2010.

Specific expenditures for which the City will see an increase in non-recoverable sales tax cost is included in the following table.

Table 1 - Anticipated unrecoverable commodity tax increases

Description	2008 Cost	Tax Cost FY2008	Tax Cost FY2010	Tax Cost FY2011+
Consulting – Operating	$ 2,641,489	$0	$ 23,245	$ 46,490
Consulting – Capital	$ 3,766,788	$0	$ 33,148	$ 66,295
Diesel Fuel	$54,831,561	$0	$482,517	$965,035
Heating Fuel	$ 5,186,154	$0	$ 45,638	$ 91,276
Hydro	$25,019,033	$0	$220,167	$440,335

With the exception of Information Technology (IT) consulting, ORST does not typically apply to the above costs. As a result, the City can anticipate a net cost increase of 0.88% in 2010 (1/2 year) and 1.76% on the above costs in 2011 and subsequent years. In the case of diesel fuel, assuming excise taxes remain constant and the purchase price is $1/L, the additional cost per one million litres is $17,600.

The impact on specific City business areas depends on the mix of goods and services purchased by the business area and are outlined in the body of the report in the section entitled Impact on operating expenses. Table 2 – Estimate HST impact on operating costs (below) summarizes the impact on operating cost by program category and funding.

Table 2 – Estimate HST impact on operating costs

		FY 2010		FY 2011+
TAX PAYER SUPPORTED				
City Wide	$	(723,817)	$	(1,447,635)
Police		(103,193)		(206,386)
		(827,010)		(1,654,021)
Transit	$	(504,605)	$	(1,009,211)
TOTAL TAX PAYER SUPPORTED	$	(1,331,615)	$	(2,663,232)
EXTERNAL BOARDS				
BIA Total	$	764	$	1,528
Campsite Authority		(583)		(1,165)
Library		3,029		6,058
Pineview		(9,194)		(18,388)
TOTAL EXTERNAL BOARDS	$	(5,984)	$	(11,968)
RATE PAYER SUPPORTED				
Waste Water		(24,389)		(48,779)
Water		(4,880)		(9,761)
TOTAL RATE PAYER SUPPORTED	$	(29,270)	$	(58,540)
TOTAL INCREASE / (DECREASE) ON OPERATING COSTS	**$**	**(1,366,869)**	**$**	**(2,733,739)**

The net savings on operating costs is the result of a lower effective tax rate, the change in the tax base and the mix of the City's current ORST taxable operating expenditures.

The impact on capital costs are not reflected in the above calculation and may offset these savings (Global impact on costs and Table 7 - Global estimate of OHST non-recoverable cost).

The net savings to City Wide, Police and Transit are the result of a high volume of ORST taxable goods and services exceeding the GST only purchases made in these areas. For example, although the cost of diesel will increase by approximately $1M (see below) it will be offset from tax savings realized on parts, tools and equipment, shop supplies, uniforms and taxable services, etc. acquired by Transit.

Capital costs

The net sales tax cost of capital goods previously subject to ORST (e.g., office equipment, most software, computers, vehicles etc.) may decrease. However, unrecoverable sales tax on intangible, real property and real property construction and repairs may increase by as much as 1.76% or $17,600 per million. This increase in cost may be mitigated if suppliers pass on any savings realized by the supplier under the OHST to the City through reductions in prices.

Using 2008 data, the estimated increase in non-recoverable tax on capital costs is approximately $1.5M in 2010 and $3M in 2011. This calculation assumes no pass-through savings from third party suppliers. Please refer to Impact on capital and Table 9 - Estimate HST impact on capital costs.

Cash flow

Input tax credits (ITCs) and rebates of GST/HST paid or payable are recovered from the Federal government via the City's GST/HST return. Generally, the City is in a credit position as it pays more GST/HST than it collects. Normally, the payment of the ITCs/Rebate is received from the Canada Revenue Agency (CRA) within 30-60 days from the date the GST/HST return has been filed.

Based on the results of the analysis, it appears the OHST will have an initial one-time negative impact of approximate $3.9M on the City's cash flow in July 2010. This amount should be received as a rebate from the CRA within the 30-60 day turnaround time of the City's GST/HST return.

Our calculation of the $3.9M assumes no pass-through of savings by suppliers and does not include implementation or interest costs. The interest cost on the $3.9M is approximately $142,000 annually based on the 2008 blended rate of 3.67%. Please refer to section Impact on cash flow and table Table 10 - OHST cash flow analysis for further details.

Impact on consumers / ratepayers and charities

The harmonization of the ORST with the GST will broaden the tax base and result in increase sales taxes for consumers and ratepayers. The impact of the OHST on any specific person is dependent on that person's particular situation and circumstances.

Consumers / ratepayers

The *Excise Tax Act* (ETA), which imposes the GST/HST, will require the City to charge the 13% HST on GST taxable fees and charges (e.g., ice surface and field rentals, facility/pool rentals, etc) supplied in Ontario. As a result, consumers and ratepayers will see an increase in the amount of sales tax paid (i.e., the additional 8% PVAT) on most HST taxable supplies made by the City.

Ontario has introduced a one-time rebate of up to $1,000, depending on individual or family income, for income tax filers over the age of 18. In addition, a new Ontario sales tax credit will be introduced to help low to middle income individuals and families with a permanent refundable credit of up to $260 for each adult and child. Finally, OHST will not apply on used residential housing. On new homes, relief will be provided in the form of a new housing rebate of 75% of the provincial component to a maximum of $24,000 for part of the provincial component of the HST on the supply of new homes.

Charities and NPOs

Under the OHST, a charity or qualifying NPO (an NPO whose percentage of government funding is at least 40% of its total revenue) will be entitled to a rebate of 82% of the PVAT paid or payable on taxable goods and services acquired for consumption, use or supply in their GST/HST exempt activities.

In certain circumstances, charities and NPO's may recover 100% of the GST/HST paid or payable by way of input tax credit (ITC) when the taxable goods and services are acquired for consumption use or supply in the course of their commercial (GST/HST taxable) activities.

As a result of the 82% PVAT rebate and assuming ITCs are limited; the effective tax rate for a charity or qualifying NPO will decrease from 10.5% on previously ORST taxable goods and services to approximately 3.94% on HST taxable goods and services.

Consequently, charities and qualifying NPOs will likely experience a decrease in unrecoverable sales tax costs if the mix of ORST taxable goods and services purchased by the entity exceeds 18%. Actual savings or costs will depend on the mix of goods and services acquired by the organization and the nature of its activities.

System changes

The OHST will result in a significant change to the tax base and will require a number of system and procedural changes for the City. In fact, compliance with the OHST transitional rules should commence prior to July 1, 2010.

We understand City staff has already begun to make system and procedural changes to address the transitional rule compliance issues. Our recommendations regarding system changes are outlined in the Impact on systems section of this report.

The OHST will impact the City in a number of areas, requiring additional tax to be collected, an increase in tax paid on expenditures as well as tax recovered on purchases, cash flow and system changes. Details of these issues are outlined in the body of our report.

Global impact on costs

Impact of revenues

The following are general comments concerning the impact of the OHST on the City's revenues. A detailed review of revenues was beyond the scope of our analysis and has not been completed.

Most of the City's revenues are not subject to the GST or ORST. For example property taxes, water and sewer levies, building permit fees, etc. are not subject to GST or ORST. After July 1, 2010, these fees will not be subject to GST or OHST.

Generally, the OHST will have the same tax base as the GST. Supplies made by the City which are taxable for GST purposes will also be taxable for OHST purposes. Therefore, if a fee or charge is subject to GST at 5%, it will be subject to HST at 13%.

The City will be required to charge OHST at a rate of 13% (5% federal + 8% Ontario) on goods and services which were, generally, only previously subject to GST (e.g., ice surface and field rentals, facility/pool rentals, etc).

The ETA requires the City to charge and collect the GST/HST on its taxable supplies. It appears that the OHST will have the same disclosure requirements as the GST. It is very likely that invoices will be required to clearly indicate the amount of the OHST charged or that the entire invoice is subject to OHST which is included in the price.

The City will need to consider the impact of the OHST when setting pricing and fees. Price list, signs and catalogues will need to be adjusted to reflect the new OHST rate. This could include a tax included pricing strategy as well as a communication strategy. Changes to tax accounting for debit and credit notes as well as bad debts will need to be adjusted to reflect the OHST.

The broadening of the tax base under the OHST may present challenges in cases where the tax status of goods and services changes from the previous treatment under the ORST. For example, fees for ice surfaces as well as ball diamonds were not taxable for ORST purposes, but such fees will become taxable for OHST purposes. The City will need to develop a strategy for educating taxpayers of the new requirement to charge OHST on previously ORST exempt fees.

The following are examples of revenues that are exempt or not subject to GST/HST.

Table 3 - Examples of GST/HST exempt / non-taxable fees and charges

• Property taxes	• Transit fees
• Building permit fees	• Water and sewer charges
• Marriage licences, birth registrations and burial permits	• Registering documents
• Administering Oaths and declarations	• Interest charges
• Tax certificates	• Dishonoured cheques

Like the GST, OHST will apply to the following fees and charges:

Table 4 - Examples of GST/OHST taxable fees and charges

• Facility rentals	• Pool / gym memberships and rentals[1]
• Parking at a municipal lot or meter	• Tipping fees
• Field and ice surface rentals	• Document search fees
• Photocopies of by-laws, maps	• Sales of land and real estate

Impact of expenditures

The increase or decrease in non-recoverable OHST will depend on:

- the effective sales tax rate;
- the change in the tax base; and
- the mix of the entity's ORST taxable expenditures.

Effective sales tax rate

The effective sales tax rate represents the amount of non-recoverable sales tax paid on GST/HST taxable expenses. Based on our analysis of the data provided, the City's effective sales tax rate in 2008 was 2.19%. This is anticipated to decrease to 1.96% in 2010, (when the OHST has been in place for six months) and fall to 1.76% in 2011 and subsequent years. (The 2008 effective tax rate does not include ORST embedded in goods and services acquired by the City.)

The following table summarizes the overall effective tax rates after harmonization and percentage of ORST taxable expenses for PSBs. This is followed by a calculation of the City's effective tax rate based on the 2008 data.

[1] Special rules apply to exempt from GST/HST certain recreational programs provided primarily to children 14 years of age or younger as well as programs provided primarily to underprivileged individuals or individuals with a disability.

Table 5 - Effective PSBs commodity tax rates after harmonization

Rebates for Public Service Bodies	OHST @ 8% rebate	OHST effective tax rate	GST @ 5% rebate	GST effective tax rate	Effective Tax Rate	% ORST Taxable Expenses
Municipalities	**78%**	**1.76%**	**100%**	**0%**	**1.76%**	**22%**
University and Colleges	78%	1.76%	67%	1.65%	3.41%	22%
School Boards	93%	0.56%	68%	1.6%	2.16%	7%
Hospitals	87%	1.04%	83%	0.85%	1.89%	13%
Charities and qualifying non-profit organizations[2]	**82%**	**1.44%**	**50%**	**2.5%**	**3.94%**	**18%**

Municipalities recover 100% of the GST (or federal portion of the HST) paid or payable on taxable goods and services acquired for their consumption use or supply. Ontario has set the PSB PVAT rebate at 78%. Therefore, unless ITCs are available[3], 22% (100% - 78%) of the PVAT will normally be unrecoverable. This results in non-recoverable sales tax of 22% or an effective tax rate of 1.76% (8% x 22%).

If a municipality's percentage of ORST taxable expenses is in excess of 22% it will experience savings under the OHST. If the municipalities' percentage of ORST taxable expenses is less than 22% it will experience increased unrecoverable tax under the OHST.

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[2] No rebates for "non-qualifying" non-profit organizations (e.g., unions).

[3] The PVAT will be fully recoverable when the expense is incurred in the course of the City's commercial activities (e.g., expenses related to the City's parking operations).

Table 6 – City of Ottawa effective commodity tax rates

	FY2008 (000's)	FY2010 (000's)	FY2011+ (000's)
GST/HST Taxable Goods and Services	$ 851,500	$ 851,500	$ 851,500
GST Paid	42,575	42,575	42,575
GST Recovery (Source: GST Account Data)	(42,575)	(42,575)	(42,575)
Net GST Cost	$ -	$ -	$ -
Anticipated OHST (8% PVAT)	$ -	$ 34,060	$ 68,120
OHST Reabte (78%)	0	26,567	53,134
Net OHST Cost	$ -	$ 7,493	$ 14,986
Total Unrecoverable GST/OHST	$ -	$ 7,493	$ 14,986
ORST Paid (Source: 2008 SAP Data)	18,607	9,303	0
Total Non-recoverable Tax	$ 18,607	$ 16,797	$ 14,986
Effective Commodity Tax Rate	**2.19%**	**1.97%**	**1.76%**

Based on our analysis of the data provided, the City's effective sales tax rate in 2008 was 2.19% ($18,607 / [$851,500 / 5%]). This means that on average 27% (2.19% / 8%) of the City's purchases attracted ORST.

Change in tax base

The OHST is a broader based tax, applying on most goods and services, compared to the ORST which is levied on the majority of goods but only a few services. However, the province has provided greater tax relief to certain persons compared to the limited exemptions under the ORST.

Generally, the City will experience a decrease in unrecoverable commodity tax on goods or services that were previously subject to ORST. This is because the effective tax rate on these expenditures will decrease from 8% to 1.76%[4] effective July 1, 2010.

The City, more likely than not, will experience an increase in unrecoverable tax cost of goods and services that were not subject to ORST. For previously non-taxable ORST expenditures it is expected that the effective tax rate will increase from 0% to 1.76%.

Mix of ORST taxable expenditures

The City can expect to see a decrease in the amount of unrecoverable sales tax incurred on goods and services which were previously subject to ORST such as:

[4] The 2008 effective tax rate does not include ORST embedded in goods and services acquired by the City. For example, service providers and real property contractors incur PST on ORST taxable goods and services acquired to supply the service or real property construction or repair. Under the OHST, such suppliers may see a reduction in their sales tax costs and may pass these savings onto their customers through decreased prices.

- most tangible personal property;
- labour to install, assemble, adjust, maintain or repair TPP;
- telecommunication services;
- non-custom computer software and related services; and
- commercial parking.

The effective tax rate on these expenditures will decreased from 8% to 1.76% effective July 1, 2010.

An increase in unrecoverable tax may be experienced on previously ORST non-taxable/exempt goods and services. The City will more likely than not experience an increase in unrecoverable sales tax cost of goods and services that were not subject to ORST, such as:

- real property;
- intangible property;
- most professional services;
- transportation services;
- electricity;
- gasoline and diesel fuel;
- materials used in water treatment, and
- qualifying firefighting/EMS equipment.

For the above items it is expected that the effective tax rate will increase from 0% to 1.76%. The actual increase in unrecoverable sales tax will depend on the willingness of suppliers to pass-through any savings the supplier realizes as a result of harmonization.

Global estimation of HST non-recoverable cost

The City provided expenditure and tax account data from the year ended December 31, 2008.

Utilizing 2008 data, tax codes as well as the business area and cost centres we calculated the increase in net unrecoverable sales tax of approximately $140,000 in 2010 and $280,000 in 2011. This includes both operating and capital costs and does not reflect any pass-through savings or the direct or indirect allocation of input tax credits. Please refer to Table 7 - Global estimate of OHST non-recoverable cost.

Table 7 - Global estimate of OHST non-recoverable cost

	FY2010	FY2011+
GST under HST	$ 21,287,405	$ 42,574,810
PVAT under HST	34,128,773	68,257,546
Total Potential HST	$ 55,416,178	$ 110,832,356
GST Recovery	(21,287,405)	(42,574,810)
PVAT Recovery	(26,741,545)	(53,483,090)
Total Recoverable HST	(48,028,950)	(96,057,900)
Unrecoverable PST of HST	$ 7,387,228	$ 14,774,456
PST Paid/Self-Assessed in 2008	$ 9,303,370	$ 18,606,741
Less PST Paid on Insurance	(2,055,709)	(4,111,417)
Net PST Paid/Self-Assessed	7,247,662	14,495,323
Increase/(Decrease) Non-recoverable Sales Tax Costs	**$ 139,566**	**$ 279,133**

Table 7 - Global estimate of OHST non-recoverable cost represents all tax code activity posted through the tax accounts, including capital and operating expenses in 2008 data provided to Deloitte. It is a summary of all 2008 GST ITC, GST Rebate and ORST self-assessment activity as well as a computed PVAT based on the tax coding used by the City and other information supplied by City staff. Savings realized on ORST currently being self-assessed on goods produced in-house (e.g., taxable printed matter, signs and signals, etc.) has been reflected in the above calculation. Please refer to Appendix D – Methodology and Appendix B – Facts and assumptions for further details.

Impact on operating expenses

Facts and assumptions

1) Tax paid was estimated using tax codes and GL tax account balances from fiscal 2008;
2) Expenses for fiscal 2008 are assumed to be representative of estimated future expenses;
3) Where the tax paid could not be discerned from the tax code, the GL account description together with input from City staff was used to ascertain the tax status of the expense;
4) Business area and cost centre coding was used to group tax costs into particular program categories;
5) Where the business area or cost centre could not be ascertained from the data, allocations were provided by City staff; and
6) Please refer to Appendix B – Facts and assumptions for a full listing of our Facts and Assumptions.

The impact of the HST on non-recoverable sales tax costs depends in part on the previous ORST treatment of the expenditure. More likely than not, goods and services previously subject to ORST such as most tangible personal property; labour to install, assemble, adjust, maintain or repair TPP; telecommunication services; non-custom computer software and related services, and commercial parking will see a decrease in the unrecoverable sales tax from 8% to 1.76% after June 30, 2010.

Conversely, goods and services such as real property; intangible property; most professional services; transportation services; electricity; gasoline and diesel fuel; materials used in water treatment, and qualifying firefighting/EMS equipment will see an increase in non-recoverable tax of approximately 0.88% in 2008 (1/2 year) and 1.76% in 2011 and thereafter. This assumes suppliers will not pass-through any HST savings realized.

For example, based on 2008 costs the City can anticipate the following increases in unrecoverable tax.

Table 2 - Anticipated unrecoverable commodity tax increases

Description	2008 Cost	Tax Cost FY2008	Tax Cost FY2010	Tax Cost FY2011+
Consulting - Operating	$ 2,641,489	$0	$ 23,245	$ 46,490
Consulting - capital	$ 3,766,788	$0	$ 33,148	$ 66,295
Diesel Fuel	$54,831,561	$0	$482,517	$965,035
Heating Fuel	$ 5,186,154	$0	$ 45,638	$ 91,276
Hydro	$25,019,033	$0	$220,167	$440,335

With the exception of IT consulting, ORST does not typically apply to the above costs. As a result, the City can anticipate a net cost increase of 0.88% in 2008 (1/2 year) and 1.76% on the above costs.

The following table summarizes the impact on operating cost by program category and funding:

Table 8 - Estimate HST impact on operating costs

	FY 2010	FY 2011+
TAX PAYER SUPPORTED		
City Wide	$ (723,817)	$ (1,447,635)
Police	(103,193)	(206,386)
	(827,010)	(1,654,021)
Transit	$ (504,605)	$ (1,009,211)
TOTAL TAX PAYER SUPPORTED	$ (1,331,615)	$ (2,663,232)
EXTERNAL BOARDS		
BIA Total	$ 764	$ 1,528
Campsite Authority	(583)	(1,165)
Library	3,029	6,058
Pineview	(9,194)	(18,388)
TOTAL EXTERNAL BOARDS	$ (5,984)	$ (11,968)
RATE PAYER SUPPORTED		
Waste Water	(24,389)	(48,779)
Water	(4,880)	(9,761)
TOTAL RATE PAYER SUPPORTED	$ (29,270)	$ (58,540)
TOTAL INCREASE / (DECREASE) ON OPERATING COSTS	**$ (1,366,869)**	**$ (2,733,740)**

This is the result of a lower effective tax rate, the change in the tax base and the mix of the City's current ORST taxable operating expenditures. Capital costs are not reflected in the above and may offset these savings (see Table 7 - Global estimate of OHST non-recoverable cost).

EXPLANATION OF VARIANCES

Category	Explanation
City Wide	This credit appears to be created due to the volume of ORST taxable transactions through Information Technology Services, City Clerk and Solicitors Office, Council, Emergency and Protective Services and Public Works. Costs driving the reduction in non-recoverable sales tax appear to be for ORST taxable TPP and taxable services, including: • Parts; • Repairs & maintenance equipment vehicles; • Maintenance materials; • License and maintenance fees; • Vehicle and equipment rentals and leases; • Telecommunications (e.g., telephone, network, data lines, etc); • Road salt; • Software/hardware maintenance; • Construction and building materials; • Printing, copying and photography; • Program and Office supplies; • Uniforms; • Tools; and • Personal safety equipment and supplies.
Police	Similar to the above, the savings are a result of the volume of transactions for ORST taxable TPP and taxable services, including: • Fleet maintenance; • Software/hardware maintenance; • Police and safety supplies; • Telecommunications; • Office supplies; • Police equipment; • Personal safety equipment; • Ammunition and explosives;

	• Program supplies; and • Parking.
Transit	It should also be noted that a significant increase of approximately $1M in non-recoverable tax is being generated by OC Transpo related to diesel fuel. This increase is offset by savings generated by OC Transpo on ORST taxable TPP and taxable services including: • Parts and materials; • Repairs and maintenance vehicles and equipment; • Shop supplies; • Uniforms; • Construction and building materials; • Tools, and equipment; and • Telecommunications.

Conclusions

- Non-recoverable sales tax will increase by approximately 1.76% on previously non-ORST taxable goods and services such as real property, real property maintenance and repair, contract services such as garbage and recycling collections, consulting, hydro, gasoline and diesel fuel. This assumes no pass-through of OHST savings by suppliers.
- The additional cost on diesel fuel is approximately $17,600 per million litres of fuel purchased (assuming $1/litre). Based on 2008 data, this may result in increased diesel costs in 2010 of approximately $480k and approximately $965k in 2011.
- Consulting costs may increase by approximately $56k in 2010, and $113k in 2011; hydro by $220k in 2010, and $440k in 2011, and heating fuel may be up $47k in 2010 and $91k in 2011. All of these estimates are based on 2008 actual costs.
- It is estimated that the City will realize a net savings on operating costs in 2010 of approximately $1.4M and $2.7M in 2011 and subsequent years. This may be offset by the increase in unrecoverable costs on capital costs of 1.76% of contract price of real property construction and service contracts.

Impact on capital

Our analysis did not specifically examine budgeted capital expenditures for 2010 or beyond. Therefore, we are providing the following general comments.

Capital costs incurred by the City include capital goods as well as real property repairs and construction. While the net cost of certain capital goods, including office equipment, most software, computers, vehicles etc. may be reduced by the introduction of HST, real property contracts and service contracts may increase by as much as 1.76% or $17,600 per million.

Service providers and real property contractors incur PST on ORST taxable goods and services acquired to supply the service or real property construction. Under the OHST, such suppliers may see a reduction in their sales tax costs. However, it is not certain that suppliers will pass on all or part of these savings to the City. Further, given time constraints, it is not possible to accurately measure these possible savings and in all likelihood, contract terms and market forces will determine if such savings are passed on. Consequently, we are taking a conservative position and assume that such savings will not be realized. As a result, this calculation assumes no pass-through of savings from third party suppliers.

Our analysis of the 2008 GST and ORST tax account activity indicates an increase in non-recoverable sales tax cost of approximately $1.5M in 2010 and $3M in 2011. Note the capital data includes both capital goods as well as real property and service contracts.

Table 9 - Estimate HST impact on capital costs

	FY2010	FY 2011+
GST under HST	$ 9,954,365	$ 19,908,730
PVAT under HST	15,947,328	31,894,656
Total Potential HST	$ 25,901,693	$ 51,803,386
GST Recovery	(9,954,365)	(19,908,730)
PVAT Recovery	(12,444,670)	(24,889,339)
Total Recoverable HST	(22,399,035)	(44,798,069)
Unrecoverable PVAT	$ 3,502,658	$ 7,005,317
PST Paid/Self-Assessed in 2008	$ 2,002,116	$ 4,004,232
Increase/(Decrease) Non-recoverable Sales Tax Capital	**$ 1,500,542**	**$ 3,001,085**

As demonstrated by our analysis of the 2008 data, the increase in unrecoverable tax on capital expenditures was offset by savings on operating costs. This may also be the case in future years. However, these results depend on the nature and volume of expenditures.

Given the potential increase in tax cost on capital expenditures, it would be important for the City to review its budgeted capital expenditures.

Similarly, the terms of service and real property construction contracts should be reviewed and where possible contractors encouraged to pass along any savings realized as a result of the imposition of the HST.

Impact on consumers / charities

Our analysis did not specifically examine impact on consumers or charities. However, we are providing the following general comments.

The harmonization of the ORST with the GST will broaden the tax base and result in increase sales taxes for consumers and ratepayers. The impact of the OHST on any individual or person is dependent on that person's particular situation and circumstances.

Consumers / ratepayers

The ETA will require the City to disclose and charge HST at 13% on GST taxable fees and charges (e.g., ice surface and field rentals, facility/pool rentals, etc) supplied in Ontario. As a result, consumers and ratepayers will see an increase in the amount of sales tax paid (i.e., the additional 8% PVAT) on most HST taxable supplies made by the City.

To reduce the impact of the increase in sales tax on individuals, Ontario is providing individuals and families with a one-time transitional credit of up to $1,000. The benefits will be available to Ontario income tax filers aged 18 and older and will be calculated using an income test.

Eligible single individuals with an income of $80,000 or less will receive three payments totalling $300. Eligible families with an income of $160,000 or less will receive three payments totalling $1,000. The credit will be paid in three instalments beginning in June 2010, the second in December 2010, and the third in June 2011.

In addition to the transitional credit, a new Ontario sales tax credit will be introduced to help low to middle income individuals and families with a permanent refundable credit of up to $260 for each adult and child. The new sales tax credit will be paid quarterly starting in July 2010. Further, an enhanced refundable property tax credit will be introduced for low and middle income homeowners and tenants.

Finally, OHST will not apply on used residential housing. On new homes, relief will be provided in the form of a new housing rebate for part of the provincial component of the HST on the supply of new homes. The rebate for new primary residences will be 75% of the provincial component to a maximum of $24,000.

Charities and NPO's

It is understood the City provides funding to a number of NPOs and charitable groups. The impact of the OHST on any specific person is dependent on that person's particular situation and circumstances.

A qualifying non-profit organization (qualifying NPO) means an NPO whose percentage of government funding is at least 40% of its total revenue. A qualifying NPO or charity may claim a PSB GST rebate of 50% of the GST paid or payable or a PSB PVAT rebate of 82% of the PVAT paid or payable on taxable goods and services acquired for consumption, use or supply in their GST/HST exempt activities.

In certain circumstances, charities and NPO's may recover 100% of the GST/HST paid or payable by way of ITC when the taxable goods and services are acquired for consumption, use or supply in the course of their commercial (GST/HST taxable) activities.

As a result of the 82% PVAT rebate, the effective tax rate for a charity or qualifying NPO will decrease from 10.5% on previously ORST taxable goods and services to approximately 3.94% on HST taxable goods and services.

Consequently, charities and qualifying NPOs will likely experience a decrease in unrecoverable sales tax costs if the mix of ORST taxable goods and services purchased by the entity exceeds 18%. Again, actual savings or costs will depend on the mix of goods and services acquired by the organization and the nature of its activities.

Impact on cash flow

Assumptions

1) The City will continue to recover ITCs of the GST paid or payable on goods or services acquired for consumption, use or supply in its commercial operations (e.g., parking);
2) The City will continue to claim PSB rebates of 100% of the GST paid or payable on goods or services acquired for consumption, use or supply in its non-commercial activities;
3) The City will be entitled to recover ITCs of the PVAT paid or payable on goods and services acquired for consumption, use or supply in its commercial operations (e.g., parking);
4) The City will be entitled to recover 78% on the PVAT paid or payable on goods or services acquired for consumption, use or supply in its non-commercial activities;
5) The CRA will payout the City's PSB rebates on a timely basis;
6) The interest cost on the one-time incremental cost of paying more tax will not be significant as the City will be collecting and remitting more tax as well as claiming larger rebates of the OHST;
7) Implementation costs such staff training and changes to internal systems and policies, printing costs are all likely to occur but are not reflected in the analysis;
8) The City will not be subject to the ITC restriction on large businesses;
9) The City will not opt for the special quick method of accounting for the GST/HST;
10) Budgeted capital expenditures are not included in the cash flow impact; and
11) The City's fiscal year end is Dec 31.

Please refer to Appendix B – Facts and assumptions for a full listing of our Facts and Assumptions.

The transition from ORST to the OHST will result in a one-time incremental cash flow cost as the City will be paying more tax but will also be collecting and remitting more tax. Based on the 2008 data, which includes both 2008 operating and capital expenditures, the one-time initial cash outlay for OHST on non-ORST taxable goods and services would be approximately $3.9M.

Table 10 - OHST cash flow analysis

OHST Cash Flow Analysis	Annual	Monthly**
OHST Sources of Funds		
Additional OHST Collected on Revenues ($4,585,237 / 5% x 8%)	$7,336,379	$611,365
OHST Use of Funds		
Additional OHST on Purchases Previously Not Subject to ORST *	(53,902,941)	(4,491,912)
Net Cash Flow Impact Before ITC/Rebates**	($46,566,562)	($3,880,547)

Notes:

The above is based on 2008 operating and capital transactions

* Derived from 2008 data and tax codes

** ITC/Rebates of GST/HST paid or payable are recovered from the Federal government via the City's GST/HST return. Generally, the City is in a credit position as it pays more GST/HST than it collects. Normally, the payment of the ITCs/Rebate is received within 60-90 days from the date the GST/HST return has been filed.

This assumes no pass-through of savings by suppliers and does not include implementation costs such as staff training, changes to financial systems and policies, printing and communications costs or interest costs.

Real property contract prices should drop approximately 2%, since ORST will no longer be borne by contractors. However, the provincial portion of HST will apply to the full contract price for an increase of 1.76% on the contract price. This increase will likely result in an overall cost increase on real property construction and service contracts. Again, this increase may be reduced if suppliers pass savings realized by the supplier to the City.

Conclusion

- Based on our analysis it appears the City will have a one-time initial cash outlay of approximate $3.9M. The interest cost on the $3.9 M is approximately $142,000 annually based on the 2008 blended rate of 3.67%. However, this analysis is depends on the accuracy of the data and has not reviewed the OHST impact on budgeted capital expenditures.

Impact on systems

System Changes and other considerations

The City will need to make system and process changes to ensure that it is ready to handle the new tax regime, including but not limited to:

1) adjusting invoicing as well as tax collection and remittance systems to account for the additional 8% provincial portion of the HST on taxable supplies. This would include changes to accommodate the higher HST rate on debit and credit notes as well as bad debts;
2) tracking the HST recoverable as an ITC or rebate and capturing the portion of the HST that is not recoverable;
3) evaluating the GST/HST simplified accounting method and ITC allocation methodologies;
4) updating tax coding on purchases to remove PST self-assessment calculations on transaction no longer subject to PST;
5) creating tax codes to accommodate self-assessment of HST on transactions that straddle the July 1, 2010, implementation date;
6) accommodating Ontario point of sale rebates on books, children's clothing and footwear, children's car seats and booster seat, diapers and feminine hygiene products and prepared food under $4.00;
7) adjusting taxable benefit calculations as well as allowance and reimbursement calculations for the increased OHST rate;
8) reviewing automated payments, procurement card and or corporate credit card transactions;
9) reviewing capital budgets for the impact of the OHST;
10) reviewing real property and service contracts to ensure the appropriate tax coding is used and to the extent possible OHST savings realized by suppliers are passed through to the City; and
11) developing internal controls such as reasonability testing adjusted to reflect the new HST.

A number of other recommendations are contained in Appendix C – Additional recommendations.

Appendix A – Scope and qualifications

In addition to the limitations and disclaimer included in the body of this report, the scope of this report is subject to the qualifications set forth below:

SCOPE/BASIS FOR OUR OPINION

This report is a high-level quantitative analysis of the City's 2008 sales tax costs designed to assist the City in taking the next steps in preparation for OHST. It summarizes the impact of the OHST on the City's operating costs from a global as well as business area perspective. The report also discusses the potential impact on revenue, cash flow and capital expenditures and suggests a number of system changes that will be required to deal with the new tax.

A discussion and high-level impact analysis of this type is not designed to audit existing controls, tax compliance errors or liabilities which might exist in the City's systems or files. We can make no general representation or quantified statements to the actual liability or compliance status regarding indirect tax at the City or the controls required. Our comments are meant to identify potential high-level OHST impact which may be useful. This report is not all-inclusive and should not be relied upon as such.

Our analysis and comments are based on announcements made to date by the Government of Ontario on OHST and the current provisions of the *Excise Tax Act* (Canada) (ETA) and the regulations made there under, the provisions of which are subject to change with retroactive effect. Any such changes could cause the opinions provided herein to become invalid, in whole or in part. Our opinions are valid as of the date of this report and we have no responsibility to report any changes in applicable law or authorities occurring after this date or to update these opinions for any changes in applicable law or authorities occurring after this date.

RELIANCE ON FACTS/REPRESENTATIONS/ASSUMPTIONS

In rendering our opinions, we have relied upon the accuracy and completeness of the facts, assumptions and representations set forth in Appendix B – Facts and assumptions.

The City has represented that such facts, assumptions and representations (referred to collectively as the "facts") are true, correct, and complete. However, we have not independently audited or otherwise verified any of these facts. A misstatement or omission of any fact upon which we have relied could adversely affect the opinions provided in this report. In addition, the opinions provided in this report are based on such facts as provided to us as of the date of this report. Any changes in the legislation, government administrative policies or facts upon which we have relied after the date of this report may necessitate a modification of all or part of the opinions provided in this report. We have no responsibility to update this report for changes in any of the facts occurring after the date of this report.

Qualification re privity

This report shall be solely for the City's informational purposes and may not be relied upon or used by any other person or party for any purpose without the express written consent of Deloitte. This report is not intended for the express or implied benefit of any third party. Unless otherwise agreed to in writing by Deloitte, no third party is entitled to rely in any manner or for any purpose, on the opinions expressed in this report.

We assume no responsibility for tax consequences or any other consequences to any other parties. Instead, any other parties should consult and rely upon the advice of their own counsel, accountant, tax advisor or other advisor.

Miscellaneous – Currency

All amounts referenced herein are in Canadian dollars unless otherwise indicated.

Appendix B – Facts and assumptions

Our analysis is based on the following facts and assumptions. Every effort was made to make the assumptions as reasonable as possible given the information available at the time of our analysis and the time frame given to produce the report. Should any one of the facts or assumptions prove inaccurate or not complete it may impact the outcome of the analysis. These facts and assumptions have been reviewed by and agreed by City staff.

Deloitte has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the data provided by the City. Please refer to Appendix A – Scope and qualifications.

1) This analysis is based on GST and ORST tax account activity grouped by business area/program;

2) Tax paid was estimated using amounts posted to the 2008 commodity tax GL accounts (i.e., GST ITC, GST Rebate and the ORST liability account) as well as reports provided by the City regarding ORST self-assessed and ORST paid on insurance;

3) Tax coding was used to determine the anticipated OHST payable as well as the allowable OHST recoveries. Business area codes and cost centres have been used to allocate the non-recoverable sales tax cost/savings to the appropriate program. Where the data did not contain the business area codes or cost centres, City staff provided the allocation;

4) The 2008 data provided by City staff is accurate, complete and represents all of the data necessary to prepare an estimate of the OHST impact on operating expenses;

5) The 2008 operating expense spending patterns accurately reflect the anticipated operating expense expected in 2010 and 2011;

6) The analysis does not include a review of revenues or (budgeted) capital expenditures and the impact of OHST on these transactions is not reflected in this analysis;

7) The GST rate will be 5% and the municipal GST PSB rebate will remain at 100% of the GST paid or payable;

8) The provincial component of the HST, or the PVAT, will be 8% and the municipal OHST PSB rebate for will be 78% of the PVAT paid or payable;

9) The CRA will payout the City's PSB rebates on a timely basis;

10) The GST and ORST tax coding provided to Deloitte is complete, has been used consistently, and accurately identifies the GST/ORST treatment of the transactions;

11) With the exception of insurance and employee benefit plans, which attract ORST, substantially all of the transactions with a GST implications or ORST implications have been posted to the applicable tax accounts and included in the data provided to Deloitte. Specifically:

   a. The City's 2008 GST account data provided by the City to Deloitte accurately reflects the GST paid, payable or self-assessed by the City in 2008; and

   b. The City's 2008 ORST account data provided by the City to Deloitte accurately reflects the ORST paid, payable or self–assessed by the City in 2008;

12) Other than insurance and benefit plans, any transactions which do not result in postings to the ORST or GST account are not relevant to the analysis;

13) Any variances between the GST returns and the data are journal entries or the monthly adjustment of the City's GST rebate claim. These are timing differences or relate to prior years. There are no adjustments to the GST returns that have would have a material impact on our analysis;

14) The account coding, including document types, business areas, cost centres and GL accounts provided to Deloitte are complete, have been applied consistently and accurately reflect the nature and use of the underlying transactions;

15) For the specific GL expense accounts listed in Table 1 - Anticipated unrecoverable commodity tax increases, we have computed the OHST impact based on our understanding of the ORST treatment of the underlying cost. For example, most consulting (with the exception of IT consulting) is not subject to ORST. Therefore, in calculating the OHST impact we have assumed ORST was not paid on the consulting expenses incurred by the City in 2008;

16) There are no significant postings made by journal entry to the tax accounts;

17) Each program (cost centre group) utilizes its own unique cost centres. Programs do not share the same cost centre;

18) The business area and cost centre coding used by the City as well as all other cost allocations provided by City staff accurately reflect the nature and distribution of the underling expenditures;

19) The OHST place of supply rules, timing of tax payable and tax base will be the same as the GST;

20) The City will not be subject to large supplier ITC restrictions on energy, telecommunication services, road vehicles less than 3,000 kilograms, as well as food beverages and entertainment;

21) Effective July 1, 2010, the City will not be required to pay or self-assess ORST or OHST on goods or services produced or imported for the City's own consumption or use (e.g., goods manufactured for own use such as taxable printed matter, signs and signals, telecommunications, etc.);

22) The tax codes “IS”, “SJ” and “VJ” are used to record PST self-assessed where the supplier has failed to charge PST at source (e.g., imports);

23) The tax codes “IS”, “SJ” and “VJ” do not relate to PST self-assessed on goods produced by the City for its own use (e.g., taxable printed matter, signs and signals, etc.);

24) The ORST self-assessed on the produced costs of printed matter and signs and signals in 2008 is complete and accurate. The City does not produce any other taxable goods for which it is required to self-assess ORST;

25) Signs and signals production costs relate to Public Works and are included in the City Wide business area;

26) OHST payable by the City on imports (e.g., intangibles or services) will not be significant;

27) The point of sale exemptions on books, children’s clothing and footwear, children’s car seats and booster seats, diapers and feminine hygiene products and prepared food under $4.00 would not be significant for the City;

28) The anticipated OHST new housing rebate is not applicable for the City;

29) The estimate of ORST paid on taxable insurance provided by City staff is accurate and reflects the ORST that is likely to be paid in the future;

30) The City will continued to pay ORST on taxable insurance after July 1, 2010;

31) ORST savings realized by third party suppliers will not be passed on to the City. Although the HST may be fully recoverable by most suppliers, it is not certain that suppliers will pass on all or part of these savings to the City. Further, given time constraints, it is not possible to accurately measure these possible savings and in all likelihood, contract terms and market forces will determine if such savings are passed on. Consequently, our approach will take a conservative position and assume that such savings will not be realized;

32) It is anticipated that the self-assessment of OHST on transactions which straddle the implementation date of July 1, 2010, will not be significant and therefore these one-time costs are not reflected in the analysis;

33) The interest cost on the one-time incremental cost of paying more tax will not be significant and has been calculated by the City at approximately $142,000 annually based on the 2008 blended rate of 3.67%;

34) The impact analysis will not reflect the cost of implementation, staffing, training, taxpayer/stakeholder communications or changes to financial systems, internal policies or pricing (e.g., updates to internal controls, tax coding, printing and catalogue costs, website costs, hotline, seminar/meeting costs, newsletters, etc.); and

35) No other significant announcements regarding rate changes, rebates or rebate restrictions will be announced that would significantly impact the HST cost to the City.

Appendix C – Additional recommendations

In addition, the system changes discussed in the body of the report we recommend:

1) The City review its budgeted capital expenditures and adjust the budgets accordingly;
2) The terms of real property construction and service contracts should be reviewed and where possible encourage contractors to pass along any savings realized as a result of the imposition of the HST;
3) The increase in GST/HST to 13% may impact certain GST/HST elections. The City should consider evaluating its current or options to make certain GST/HST elections under the ETA and make or rescind elections as appropriate;
4) The City will need to consider the impact of the HST when setting pricing and fees. Price list, signs and catalogues will need to be adjusted to reflect the new HST rate;
5) The City should prepare for questions from taxpayers regarding the increase in tax charged on HST taxable goods and services (e.g., field and ice surface rentals, facility rentals etc.). This may include an explanation of the City's requirement to charge and disclose the HST as required by the *ETA* which imposes the GST/HST;
6) The CRA is reluctant to allow a GST/HST registrant to retroactively apply ITC allocation methodologies. The City should evaluate its options for GST/HST accounting, including the special quick method and/or develop an ITC allocation methodology before the implementation of the HST;
7) Contracts straddling the July 1, 2010, implementation date should be reviewed to determine how the additional 8% will impact the contract cost and clarify wording where necessary. Consideration should be given to having contracts worded such that any pass-through savings are realized by the City;
8) The City may need to consider self-assessment of the unrecoverable portion of the PSB rebate should it import taxable goods or services into Ontario. Similarly, where tax-paid goods are removed from Ontario, there may be rebates to offset the previously non-recoverable tax as currently exist under the HST rules for New Brunswick, Nova Scotia and Newfoundland;
9) Ontario and Canada have agreed to pay the GST and HST respectively. Care should be exercised when drafting tax clauses with either a provincial or federal department;
10) The City should consider deferring ORST taxable capital or other large ORST taxable expenditures until after July 1, 2010;

11) With the increase in the tax rate from 5% to 13% it will be important for the City to identify material transactions with GST/HST implications. For example, it will be important for the City to consider:

    - transfer payments made or received – are such payments grants or considerations for a supply under the ETA;
    - exchange/barter transactions;
    - legal settlements;
    - para-municipal entities.

12) Any changes to place of supply, drop shipment, zero-rating, restricted ITCs, self-assessment or rebate rules could impact the City. The City should monitor these rules and respond appropriately; and

13) It may be beneficial to identify and file all ORST refunds or rebates as soon as possible after harmonization while staff exists to process refund claims and before the wind down of the ORST.

Appendix D – Methodology

In simplified terms, the increase or decrease in non-recoverable sales tax is the difference between the unrecoverable ORST that would have applied before July 1, 2010, and the non-recoverable HST expected to be incurred after July 1, 2010.

Possible savings that may be realized by suppliers have not been factored in to the analysis due to the difficulty in quantifying such savings and the uncertainty that such savings would be passed on to the City. In all likelihood, contract terms and market forces will determine if such savings are passed on by suppliers to their customers.

Based on discussions with City Staff, 2008 commodity tax account activity are assumed to be representative of estimated future commodity taxes and consequently, the City provided electronic data from its financial platform for 2008. It is assumed that this information is complete and accurate. Please refer to Appendix B – Facts and assumptions.

GST and ORST paid was estimated using amounts posted to the 2008 commodity tax GL accounts (i.e., GST ITC, GST Rebate and the ORST liability account) as well as reports provided by the City regarding ORST self-assessed and ORST paid on insurance.

Tax coding was used to determine the anticipated OHST payable as well as the allowable OHST recoveries. For example, transactions previously subject to GST are assumed to be subject to OHST. If the transaction was tax coded as GST ITC eligible, it is assumed to be OHST ITC eligible. Similarly, if a transaction was coded GST 100% Rebate, it is assumed to be eligible for the OHST 78% rebate.

Business area codes and cost centres have been used to allocate the non-recoverable sales tax cost/savings to the appropriate program. Where the data did not contain the business area codes or cost centres, City staff provided the allocation.

This analysis is based on commodity tax account activity grouped by business area / program. As a result, it is not possible to provide a detailed analysis across all GL expense accounts without further interrogation of the data. Specifically, it would be necessary for the City to provide the GL expense distributions.

The HST impact on Consulting, Diesel Fuel, Heating Fuel and Hydro was determined based on costs provided by the City and from the GL account description and the ORST and HST tax status of the expense. Please refer to Table 1 - Anticipated unrecoverable commodity tax increases.

We have not audited the data nor review the data for tax liabilities. It is assumed to be complete and all account and tax coding accurate. A discussion and high-level impact analysis of this type is not designed to audit existing controls, tax compliance errors or liabilities which might exist in the City's systems or files. The comments made are based on a high-level discussion with City staff and therefore we can make no general representation or quantified statements to the actual liability or compliance status regarding indirect tax at the City or the controls required. Our comments are meant to identify potential high-level OHST impact which may be useful. This report is not all-inclusive and should not be relied upon as such.

Appendix E - Background

Current state

In Ontario, commodity taxes are levied by both the Federal and Provincial governments. Canada imposes the Goods and Services Tax (GST) while Ontario administers the Ontario Retail Sales Tax (ORST). Although both can be viewed as commodity taxes, they differ in tax base and model.

Goods and Service Tax

The GST is a multistage or value added tax. This means that the GST is levied through the supply chain, increasing in value, as the good or services move through to their finial point of consumption.

The GST applies at a rate of 5% on most property (e.g., real property or personal property including tangibles and intangibles, rights, etc.) and services supplied in Canada. Certain goods and services are zero-rated (i.e., taxable at 0%) while others may be exempt from GST. Examples of zero-rated goods include basic groceries as well as prescription drugs. GST exempt goods and services include, among others, financial and health care services as well as most municipal services (e.g., fire, police, garbage and recycling collection, municipal transit and most licences and permit fees).

Examples of GST taxable supplies made by a municipality include:

- most supplies of real property made by a municipality (e.g., facility rentals, municipal parking lots and parking meters provided in the course of a business; licences to use real property such as field and ice surface rentals, municipal golf course fees, etc.);
- telecommunication services, hydro-electricity, and natural gas;
- services provided on an optional fee-for-service basis; and
- most supplies of capital and personal property.

Persons in “commercial activities” (e.g., most businesses) generally charge their customers the GST and recover the GST paid or payable on their expenditures by claiming input tax credits (ITCs). ITCs are offset against GST collected on taxable revenues and any balance payable remitted to Canada. Conversely, a refund is realized if the ITCs exceed the tax charged on taxable revenues.

ITCs are not available to persons engaged in non-commercial activities. For example, persons who make exempt supplies, such as municipalities, universities, schools, hospitals and charities, are not eligible for ITCs on costs incurred in making exempt supplies. However, such persons may be entitled to a rebate of the GST paid or payable on costs incurred to make exempt supplies.

In the case of municipalities, a rebate of 100% of the GST is available to recover GST not otherwise recovered by way of ITC. As a result, municipalities do not bear the cost of the GST.

Ontario Retail Sales Tax

ORST is a single-stage tax imposed on consumers at the point of consumption in Ontario. It applies at the point of consumption. This means businesses which acquire taxable goods (and some services) for their own consumption or use or for the consumption or use of others at their expense pay ORST. The ORST becomes a cost of the business and is passed on through higher prices. As a result, ORST can cascade through the supply chain on certain purchases.

ORST applies at the general rate of 8%, excluding GST. Although the ORST rate is higher, the ORST tax base is not as broad as the GST. ORST applies on most goods and some services as well as certain types of insurance, acquired for consumption or use in Ontario.

Taxable services include, telecommunication services, transient accommodation, maintenance and warranty of goods, commercial parking as well as labour to install, assemble, adjust, repair or repair goods including most computer programs.

Unlike the GST, ORST does not apply on the purchase of real property. Instead ORST is levied on the cost of materials incorporated into real property. This has been estimated to be between 2% to 3% on real property construction costs.

ORST does not apply on the purchase intangibles, certain services or on goods acquired for resale. In addition, exemptions exist to relieve specific types of purchases from ORST. For example, the purchase of electricity, gasoline, and diesel fuel as well as certain publications, etc are exempt from tax.

Persons engaged in commercial activities are not fully relieved from ORST. Rather, a number of targeted exemptions are provided to ease the burden of the ORST for specific types of business. For example, manufacturers may acquire raw materials as well as qualifying production, R&D and processing materials exempt from ORST.

Most municipal services are not subject to ORST. For example, garbage collection, animal control, police services, transit operations, wastewater and water treatment, road maintenance and repair, etc. are not subject to ORST.

Ontario provides ORST exemptions as well as rebates to Municipalities. Examples include, goods acquired for resale, drugs and medicines used in EMS operations acquired under the prescription of a physician, qualifying fire freighting vehicles and equipment, certain library publications and materials used in water treatment.

Municipalities, like other taxpayers, are required to self-assess ORST on taxable good imported or manufactured for their consumption or own use in Ontario.

On balance, most supplies made by a municipality do not attract PST while a municipality will generally incur PST on its taxable purchases.

Harmonization of the ORST and GST

On March 26, 2009, Canada and Ontario entered into a Memorandum of Agreement for Ontario to join a framework agreement for federal collection of a single value added sales tax.

Starting July 1, 2010, the ORST will be converted to a value added tax structure and combined with the federal GST to create a single sales tax at a rate of 13%. The provincial portion of the new Ontario Harmonized Sales Tax (OHST) will be at a rate of 8% and the federal portion at a rate of 5%.

The OHST will generally use the same rules and the broader tax base of the federal GST. For example, OHST will apply on taxable supplies of real property and intangibles as well as most services which are not currently taxed for ORST purposes. In addition, OHST will also apply to electricity, gasoline and diesel fuel which are currently exempt from ORST.

The OHST is expected to have the same place of supply, timing of tax payable, registration, small supplier thresholds, and remittance and return requirements as the GST. The tax will be administered by the Canada Revenue Agency (CRA) and the Canada Border Services Agency (CBSA).

Businesses selling taxable or zero-rated (taxable at 0%) goods and services will be able to claim ITCs on their purchases, as under the GST, with limited exceptions. Businesses selling tax-exempt goods or services will be unable to claim ITCs as under the federal GST rules. For example, most financial [5]as well as municipal services are GST exempt and therefore ITCs may not be claimed in respect of these services.

ORST will continue to apply on taxable insurance premiums as well as private sales of motor vehicles. The sales tax on alcoholic beverages sold through licensed establishments (10%) and through retail stores, (12%) will fall to 8%. To make up for this reduction in tax, the province proposes to make adjustments to current alcohol fees, levies and charges.

A transitional credit up to $1,000 will be available for businesses with less than $2 million in annual revenues from taxable supplies to assist in transition systems to the HST.

Similarly, individuals and families will be provided with a one-time transitional credit of up to $1,000. The benefits will be available to Ontario tax filers aged 18 and older. Eligible single individuals with an income of $80,000 or less will receive three payments totaling $300. Eligible families with an income of $160,000 or less will receive three payments totaling $1,000. The credit will be paid in three installments beginning in June 2010, the second in December 2010, and the third in June 2011.

A new Ontario sales tax credit will be introduced to help low to middle income individuals and families with a permanent refundable credit of up to $260 for each adult and child. The new sales tax credit will be paid quarterly starting in July 2010. In addition, an enhanced refundable property tax credit will be introduced for low and middle income homeowners and tenants.

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[5] Arguably the cost to FIs will increase under the HST. FIs will pay HST on a broader base of goods and services and are unable to recover the GST/HST they paid or payable on supplies acquired to provide their exempt services.

Similar to the GST, HST will not apply on used residential housing. Relief will be provided in the form of a new housing rebate for part of the provincial component for new homes. The rebate for new primary residences will be 75% of the provincial component to a maximum of $24,000.

With the elimination of the ORST, vendor compensation (a maximum of $1,500/yr) will end as part of the transition to the single sales tax. Vendor compensation will continue to apply for ORST returns filed up to and including those filed for the period ending March 31, 2010, under the existing RST system.

For certain goods currently subject to GST and not ORST, a point-of-sale exemption for the provincial component of the HST will be introduced. The point of sale rebates will be restricted to books, children's clothing and footwear, children's car seats and booster seat, diapers and feminine hygiene products and prepared food under $4.00. Point-of-sale-rebates have not been provided for electricity, gasoline or diesel fuel.

Public Sector Body Rebate

Under the OHST, Ontario's public service bodies (e.g., municipalities, hospitals, universities, colleges, school boards, charities and qualifying non-profit organizations) will be entitled to a partial rebate for the provincial component of the tax, not otherwise recovered by way of ITC. The federal portion of the HST will continue to be fully recoverable.

The municipal PSB rate is 78% of the PVAT (provincial portion of the HST). As a result, the effective OHST tax rate for municipalities will be 1.76% (8% x 1 - 0.76%). The effective tax rate represents the amount of non-recoverable tax paid on taxable expenses. For example, a municipality will incur approximately $17,600 of non-recoverable tax for every million dollars of taxable purchases.

Municipalities will have to revert to allocating inputs between taxable and exempt activities in order to identify and recover ITCs on input costs relating to taxable supplies vs. the 78% rebate for the provincial portion of the HST on input costs relating to exempt supplies and/or consider the use of the special quick method of accounting for GST/HST.

Restricted ITCs

Similar to the restricted ITC system in Quebec, large businesses (those with annual taxable sales in excess of $10 million) and financial institutions will be unable to claim ITCs of the provincial portion of the HST in certain areas. These restrictions are temporary. After five years the restrictions are to be phased out over a subsequent three-year period. (This was also the case in Quebec, but Quebec continues to impose the restrictions on ITCs for large business.)

The temporary ITC restrictions for large businesses are:

- Energy (e.g., electricity, natural gas, combustible and steam), except where purchased by farms or used to produce goods for sale;
- telecommunication services other than internet access or toll-free numbers;
- road vehicles weighing less than 3,000 kilograms (and parts and certain services) and fuel to power those vehicles; and
- food, beverages and entertainment.

According to documents released by Ontario Finance, municipalities will not be subject to these ITC restrictions.

Technical and Transitional Rules

Details on the technical and transitional rules continue to be released.

These rules may impact transactions involving the supplies of real property, tangible personal property, personal property and services (e.g., contracts straddling the implementation), imported goods and services, continuous supplies, prepayments, returned goods, memberships and admissions, legal services, transportation of individuals, to name a few.

Of specific interest to the City is the requirement to self-assess the PVAT on transactions that straddle the July 1, 2010, implementation date. Specifically, the City is required to self-assess the provincial component of the HST on consideration that becomes due, or is paid without having become due, after October 14, 2009, and before May 2010, for goods acquired by way of sale to the extent the consideration is for goods that are delivered, and for which ownership is transferred, to the City on or after July 1, 2010, where the goods are not for consumption, use or supply exclusively in the course of the City's commercial activities. Goods delivered before July 1, 2010, would not attract HST.[6]

If the City was using the Special Quick Method of accounting for the GST it appears that it would continue to be required to self-assess the tax. The City would remain eligible for the 78% PSB rebate on the HST self-assessed.

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[6] GST Transitional Rules for Ontario HST

Appendix F – Comparative table

The following table provides a comparison of the effective non-recoverable ORST and HST sales tax rates effective July 1, 2010. Note the impact on 2010 is for ½ year.

Table 11 - Comparison of ORST / HST on sample expenditures for the City

Product / Service	Current ORST	Net-HST Impact
Books with no CDs or DVDs	0%	0%
Books with CDs or DVDs	8%	1.76%
Magazine Subscriptions	0%	1.76%
Parts and services for vehicles weighing < 3000 kilograms	8%	1.76%*
Parts and services for vehicles weighing > 3000 kilograms	8%	1.76%
Energy – electricity, natural gas, steam, diesel fuel and gasoline	0%	1.76*
Repair parts for Firefighting trucks	0%	1.76%
Chemicals for water and sewer treatment	0%	1.76%
Other chemicals, except for water and sewer treatment	8%	1.76%
Prescribed disposable medical supplies	0%	1.76%
Prescribed medicines, hospital beds (LTC Homes only), hearing aids	0%	0%
Basic Groceries, unbottled water supplied by the City	0%	0%
Medical oxygen	0%	0%
Artificial breathing apparatus, cane or crutch for use by a physically disabled, moveable patient lifter, artificial limb	8%	0%
A supply of a toilet, bath or shower seat for use by a disabled individual	8%	0%
Prescribed eyeglasses	0%	0%
All other parts and material supplies (if not for taxable resale)	8%	1.76%
Vehicle Purchases < 3000 kilograms	8%	1.76*

Vehicle Purchases > 3000 kilograms	8%	1.76%
Hybrid vehicles, ORST refund claim max $2,000/ vehicle to March 31, 2012	8%	1.76%*
Fire fighting trucks	0%	1.76%
Office equip., computers (hardware, software, maintenance. Contracts)	8%	1.76%
Land & Building acquisitions	0%	1.76%
Professional, consulting, contractor and advertising services	0%	1.76%
Repair and maintain land, fixture and building	0%	1.76%
Repair on moveable equipment, appliances and machinery	8%	1.76%
Rental of tools and vehicles	8%	1.76%
Rental of land and building	0%	1.76%
Telephone, long distance phone calls, cellular telephones, 911	8%	1.76%*
Toll free numbers	0%	1.76%
Internet Fees	0%	1.76%
Government permit & license fees	0%	0%
Training	0%	1.76%

* These expenditures are normally subject the ITC restrictions for large suppliers (i.e., fully taxable at 8% for OHST purposes). However, the City is not subject to these rules. Consequently, the net effective unrecoverable sales tax rate is 1.76%.

Appendix G - Terminology

The following acronyms and terminology used throughout this report.

Commercial activity – in simplified terms, a business or an adventure or concern in the nature of trade carried on by the person as well as a supply of real property except to the extent such activities involve the making of exempt supplies. If the person is an individual, a personal trust or a partnership, all of the members of which are individuals there must be a reasonable expectation of profit

Commodity Tax – the GST/HST and ORST.

ETA – *Excise Tax Act*. The federal statute which imposed the GST/HST.

GST – The federally imposed Goods and Services Tax. Currently 5%.

HST – Harmonized Sales Tax. The blended federal and provincial value added tax imposed under the ETA. In Ontario, the HST rate is 13% composed on the federal GST of 5% plus the provincial portion of 8%.

ITC – Input Tax Credit. Credits provided to persons engaged in commercial activity of the GST/HST paid or payable on taxable goods or service acquired for consumption, use or supply in the course of their commercial activities.

Large supplier – persons who make in excess of $10 million annual taxable supplies and financial institutions.

OHST – Ontario Harmonized Sales Tax. Rate is 8%.

ORST – Ontario Retail Sales Tax. General rate is 8%.

PSB rebate – Public Service Body Rebate. Municipalities are public service bodies under the ETA and receive a rebate of 100% of the GST paid or payable on goods or services acquired for use otherwise than in commercial (taxable) activities.

PVAT – The provincial portion of the HST. In Ontario PVAT is 8%.

PVAT PSB rebate - Municipalities are public service bodies under the ETA and receive a rebate of 78% of the PVAT paid or payable on goods or services acquired for use otherwise than in commercial (taxable) activities.

Qualifying non-profit organization (qualifying NPO) - an NPO whose percentage of government funding is at least 40% of its total revenue. A qualifying NPO may claim a PSB

GST rebate of 50% of the GST paid or payable and a PSB PVAT rebate of 82% of the PVAT paid or payable.

Supply – the provision of goods or services in any manner including sale, transfer, barter, exchange, licence, rental, lease, gift or disposition.

TPP – tangible personal property. Personal property that can be seen, weighed, measured, felt or touched or that is in any way perceptible to the senses and includes computer programs, natural gas and manufactured gas.

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