MFOA
MUNICIPAL FINANCE OFFICERS' ASSOCIATION OF ONTARIO
HST Newsletter

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HST – REPORTING ISSUES FOR MUNICIPALITIES

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The changeover from Ontario Retail Sales Tax (RST) to the Harmonized Sales Tax (HST) on July 1, 2010, has already raised issues and concerns with respect to your 2010 municipal budgets. Between now and July 1, 2010, you will have to update your accounting environment to be able to handle the changed sales tax environment. Between August 2010 and January 2011, you will have to file HST returns, reporting your collections and claiming allowable ITCs and Public Sector Bodies' rebates, when possible. And in the spring of 2011, this change will have some impact on your 2010 audited financial statements and your municipality's Financial Information Return (FIR) for 2010.

The Worst-Case Scenario

You should operate as though you expect to be contacted by a CRA auditor about your HST filings. This is the worst case scenario. If you are prepared for, and can address such an eventuality, then any other issue or problem relating to HST should be relatively easy.

There are two types of audit. The easier to respond to is the desk or flag audit, where something in an account is flagged by CRA for follow up and the taxpayer is contacted by CRA to send in supporting documentation for the amount claimed or reported. For HST, this might be a request to provide a G/L printout to support one of the numbers on your municipality's HST return.

The other is where an audit team will want to come and work on-site at your offices, and will conduct an audit as thorough as that done for your annual financial statements. As part of the audit, they will require listings of all HST amounts collected, and of all HST amounts being claimed as input tax credits and as Public Service Bodies' rebates, and for supporting documentation as required, as the audit progresses. This may be a time-consuming process for you and your staff. The audit may continue over an extended period of time, until the audit team presents their draft report to you.

In the previous newsletter, we discussed the collection of HST, and how to approach reclaiming as much as possible of the HST that your municipality pays to suppliers. On the HST return, you report your total revenues for the period, the amount of HST collected on eligible sales transactions, and the amounts of ITCs and PSB rebates to which you are entitled.

The major issues will be quite predictable. Are you remitting every penny of HST that you should be remitting? Is the amount 13% of reported revenues? Remember, you will be deemed liable for the HST on a taxable transaction, whether you actually collected it or not. Are you claiming only those ITCs and PSB rebates that you are entitled to?

The HST Audit

The most basic audit test is: does the amount of HST that you reported as collected equal 13% of your reported revenues for the period? If collections don't equal 13% of revenues, have an explanation ready. You should be able to show the value of transactions taxable at 5% and at 0%, or which are tax-exempt. You do much of this now for internal and external financial reporting. Identifying the tax-exempt transactions, which you will do on an invoice or cash register slip anyway, recording the full HST at 13% on taxable transactions, and separately accounting for the POS rebates of the Provincial portion of 8% on applicable transactions will make it easy to identify the impact of those transactions where the Provincial basis for collection is different from the Federal one. Examples are books, and prepared food under $4. This will be discussed further in the next two newsletters.

Expect to be asked for details of all revenue generating transactions, and of all exchanges and trades, if any. This will include providing a sample of your invoices or billing records. Transactions involving parties outside of Canada are of particular interest, whether you are the supplier or the recipient. In the latter case, did you pay or self-assess HST at the appropriate rate? Can you prove that the place of supply or utilization of the good or service is outside of Canada, if you are not self-assessing?

For claiming ITCs and PSB rebates: you will likely be asked for a G/L listing of the individual ITCs, and rebate amounts claimed. This is why it will be advantageous to have separate accounts for the Federal and Provincial components of HST paid out by your municipality. Again, we will return to this issue in the next newsletter. Document in detail the logic your municipality uses to determine what activities are deemed to be commercial ones or claiming Input Tax Credits instead of Public Sector Bodies' rebates.

Remember, there will be no interest in the potential ITCs and PSB rebates that you forgot, or that you decided not to claim because you weren't sure if they would be allowed. The audit would be an opportunity to put them on the table for consideration, as this would certainly be negotiable. However, you would be negotiating from a somewhat weak position, and this might encourage the audit team to look for other things that you "weren't really sure about."

Are Section 211 elections in place for real property used for commercial activities? If so, what happens when there is a change of use? Do you have proof that the properties are still operating for commercial purposes? This is covered in more detail in Notice 132 – Notice of Change in HST/GST Memorandum 19.4.2 Commercial Real Property, Deemed Supplies.

You may also be asked about claims with respect to the Provincial portion of HST paid. Was the expenditure for the provision of a taxable, zero-rated or tax-exempt good or service, or was it for "personal use"? This means that the amount claimed could be 100%/78%/0% of the Provincial portion of HST paid, as the case may be. Is the activity or service being provided deemed to be associated with your municipality, or independent? If tax-exempt and independent, there are no ITCs or rebates allowed. Be prepared to explain how you made these various determinations.

That should give you the context for what we will now discuss under reporting.

Reporting – the HST return

Take out the last GST return that you filed for your municipality. You are now looking at an example of your HST return going forward. It will essentially be the same return. The amount of tax collected on line 105 will likely be 160% more (13/5), and the amount of ITCs claimed on line 108 will be correspondingly larger.

However, you will now be claiming two PSB rebates for your municipal activities, a Federal and a Provincial one. As a result, you will be required to prepare Form GST66, Application for GST/HST Public Service Bodies' Rebate and GST Self-Government Refund. A copy of this form and detailed information for completing it can be found in CRA Publication RC4034, GST/HST Public Service Bodies' Rebate. You will still claim the PSB rebates on line 111 of your HST return, but Form GST 66 will be required to inform CRA as to the breakdown between the Federal and Provincial rebates being claimed. It is likely that Form GST66 will be revised to either (a) include reporting for Ontario and British Columbia, or (b) be issued as "Form GST 66 – Ontario."

Note that you are reporting single, consolidated amounts of HST collected and of input tax credits that do not have any separation or differentiation to address Ontario-specific differences, such as prepared foods under $4.

For normal business transactions, you report three figures:

- HST collected;
- ITCs, and
- municipal rebates claimed

The first could be 13% of revenues reported, although you have a lot of tax-exempt transactions, which you will want to identify and track. The second and third will likely involve complex calculations, unless you have no goods or services that you produce and sell, whether taxable or not. How can you do it?

We will discuss this in the next newsletter on accounting issues, as you will want to set up your accounts so that you can claim back every cent HST that is possible. And this will also prepare you well for dealing with a CRA auditor.

Separate reporting will definitely be helpful if your municipality has revenues that are exempt from the provincial portion of HST, but not from the federal portion, such as books and publications or prepared foods. For invoicing your clients, you will charge HST at 13%, or none on tax-exempt activities. For those sales where there is a point-of-sale rebate of the Provincial portion of HST, account for that as a rebate of the 8%, so that the net collection is the 5% Federal portion. This way, the one account tracks the full HST collected, while the other tracks the POS rebates paid out. The HST collected in the period will be the net balance of the two accounts, but you will have a very clear audit trail of your GST collection activities.

Expect to be invoiced a single 13%, which is the current practice in the Maritimes. For calculating your corresponding ITC claimable, or the two PSB rebates claimable, and for satisfying the CRA auditor, you would be well advised to have the 13% split into the 5% and 8% components. For reporting purposes, it will be helpful to treat HST as two parallel VATs, accounted and reported separately, just as GST and RST currently are. Further, the Provincial component will need to be identified as to whether it is for the provision of taxable goods and services, provision of HST-exempt goods and services, or essentially is for own "personal" use, such as the non-deductible portion of meal expenses..

Remember that the 22% of the Provincial portion of HST that is not rebated on supplies for a municipal activity will be reported as an expense, as this amount is not recoverable or refundable.

There will be relatively little difference from what is required for GST now. Essentially only the rate has changed. The good news is that you will no longer have to collect Ontario RST, and file separate returns with the Ontario Ministry of Revenue, unless your municipality sells insurance coverage and collect premiums. And, after a couple of years, there will be no more Provincial sales tax audits, because we are moving to one-stop "harmonized" service delivery.

Reporting – your municipality's financial statements

This tax change will have some impact on your financial reporting, though more in terms of specific numbers, rather than having new or different line items or reports.

On your Consolidated Statement of Operations, some expense accounts will change, due to increases or decreases in the net sales taxes paid on transactions. For commercial activities, expenses for services will not change, because you will pay 8% additional tax under HST, but get it all back as an ITC. For RST-taxable goods, there will be a reduction of 8/108, or 7.41%, because instead of paying the non-refundable 8% RST, the additional 8% HST is fully claimable as an ITC.

For municipal activities that can take advantage of the PSB rebates, services will cost 1.76% more, because whereas you were reporting only the actual cost of the service with no expense for GST (100% PSB rebate), you will now be reporting the non-rebated Provincial portion of the HST = 22% of 8%, or 1.76%. For RST-taxable goods, there will again be a saving, but of 5.78% of the former net expense (= 108% of supplier pricing), or 78% of the 8% Ontario portion of HST.

As mentioned in the previous newsletter, Other Revenues will be reduced by the sums you were paid for collecting Retail Sales Tax. Your municipality may be eligible for the grants that the Province is offering organizations in 2010 to help defray the costs of implementing this tax change. This tax change will have an impact on the amount you report as Annual Surplus (Deficit) on your Statement of Operations.

On your Consolidated Statement of Financial Position, the year-end amount reported as Sales Taxes Payable or Recoverable, as the case may be, will likely change, because you will be collecting and paying 8% more HST on services, but getting 78% or 100% of the Provincial portion back. If included in your A/R or A/P total reported, the difference will likely appear to be negligible, compared to the other components of those consolidated numbers.

These comments would also apply to your municipality's annual Financial Information Return (FIR) that you file with the Ministry of Municipal Affairs and Housing.

Summary

We have tried to give you a positive approach to HST reporting, and advice on how to try to optimize your liability for HST. We have also looked at specific issues that will arise with respect to HST reporting and to an HST audit by CRA staff.

Our next newsletter will look at the issues you will face in accounting for HST.

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

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