

Taxation Bulletin

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Will The HST Apply? The Proposed HST Place of Supply Rules

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Overview

On July 1, 2010, Ontario and British Columbia will replace their respective provincial Retail Sales Taxes (“RST”) with the federal value-added Harmonized Sales Tax (“HST”). The federal component of this new HST will be 5%. The provincial components of the HST will be 8% in Ontario (for a combined rate of 13%) and 7% in British Columbia (for a combined rate of 12%).

On February 25, 2010, the Department of Finance announced amendments to the existing HST place of supply (“POS”) rules under Part IX of the *Excise Tax Act* (Canada) (the “Act”). These existing POS rules have been in existence since Newfoundland, New Brunswick and Nova Scotia harmonized their provincial sales taxes with the federal GST in 1997, but they were generally limited to circumstances where business was being done in one of these harmonized provinces. The amendments to these POS rules, in conjunction with the harmonization of Ontario and BC, will drastically change the sales tax landscape not only for those businesses located in one of the harmonized provinces, but also for all Canadian businesses that make supplies of goods or services to persons or

businesses located in the harmonized provinces.

In addition to the proposed POS rules, the Department of Finance also announced proposed expansions and amendments to existing rules that require businesses to self-assess the provincial component of HST in certain circumstances, as well as those existing rules relating to rebates of the provincial component of HST where input tax credits are not available. These rules will be of critical importance in combination with the proposed amendments to the POS rules particularly as they relate to supplies of services and intangible property.

On February 26, 2010, the Canada Revenue Agency released its GST/HST Technical Information Bulletin (B-103) providing its views on how these proposed POS rules will apply. These two documents provide a massive amount of new information regarding these proposed rules and their application. A full summary of these proposed rules is well outside the scope of this Bulletin; rather it aims to provide a general overview and to highlight some of the more important rules that will impact businesses when the HST is adopted on July 1, 2010 in Ontario and British Columbia.

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What are the Place of Supply Rules?

Pursuant to section 165(2) of the Act, businesses must collect and remit the 5% federal component and the requisite provincial component on a “taxable supply made in a participating province”. Participating provinces are those that have implemented the HST. If a supply is made in Canada for GST purposes, then the POS rules are used to determine whether a particular supply takes place within a participating province, and accordingly whether it is subject to the provincial component of the HST.

The POS rules differ depending on the type of property or service supplied, and so the first step in any POS analysis is determining whether the supplier is making a supply of: services, tangible personal property, intangible personal property or real property.

There are then a series of general and specific rules that must be examined to determine whether they apply to a given supply such that it is characterized as having been made in one of the harmonized provinces. The general rules will tend to apply in most circumstances, but if one of the specific rules applies to the facts at hand (e.g. services rendered in connection with litigation), then the general rules will not be applicable. Accordingly, once it has been determined the type of property or service being supplied, it must then be determined if one of the specific POS rules applies, and if not, then the general rules will be applied.

Application of the Proposed POS Rules

The proposed changes to the POS rules are scheduled to apply to:

- all supplies made on or after May 1, 2010; and

- any supply made after February 25, 2010 and before May 1, 2010 if the consideration has not been paid or become due before May 1, 2010.

The self-assessment and rebate rules will apply on a slightly different schedule, applying generally to supplies that take place on or after July 1, 2010 or to any other supply where some or all of the consideration is due or paid on or after July 1, 2010.

Supplies of Services - The General Rules

Very significant changes have been made to the general POS rules for supplies of services, most notably that there will be a greater emphasis placed on the location of the recipient of the supply, rather than the place where the service was performed. The proposed general rules are as follows:

Rule 1: If a supply of a service is made and, in the normal course of business, the supplier obtains a particular address of the recipient in Canada of the recipient, the supply will be regarded as made in the province in which the address is situated. This rule also applies where the supplier obtains more than one address of the recipient or where the supplier fails to obtain an address of the recipient (but would ordinarily have done so); in these circumstances, the Canadian address that is most closely connected with the supply will be used to determine the province of supply.

Rule 2: If, in the normal course of business, an address in Canada of the recipient is not obtained by the supplier of a service, the supply will be regarded as having been made in a participating province if the service is performed primarily in the participating provinces. In such instances, the supply will be regarded as made in the participating province in which the greatest proportion of the service is performed.

Rule 3: If Rule 2 applies, but a single participating province cannot be determined as being the

participating province in which the greatest proportion of the service is performed because the service is performed equally in two or more participating provinces, the supply will be regarded as made in the participating province with the higher rate of the provincial component of HST.

Rule 4: If Rule 3 applies, but a single participating province still cannot be determined to be the place of supply because the rate of the provincial component of the HST in two or more of the participating provinces is the same, the supplier will be required to charge that particular rate.

Supplies of Services – The Specific Rules

In addition to the general rules, there are specific rules for a number of specific types of services that will overrule the general POS rules for services. Some of these specific POS rules for services have been changed from the existing POS rules, and some will remain the same.

Changes are proposed to the existing POS rules for the following specific types of services:

- personal services
- services in relation to real property
- services in relation to tangible personal property
- services in relation to a location-specific event
- services rendered in connection with litigation
- services supplied on board conveyances
- customs brokerage services in respect of non-commercial goods
- premium rate telephone services
- air navigation services.

No changes are proposed to the existing POS rules for the following specific types of services:

- passenger transportation services, baggage charges and child supervision
- services related to a ticket, voucher or reservation
- freight transportation services
- postage and mail delivery services
- telecommunication services
- customs brokerage services in respect of commercial goods
- repairs, maintenance, cleaning, alterations and other services relating to goods
- service of a trustee in respect of a trust governed by an RRSP, RRIF or RESP
- computer-related services and internet access .

Supplies of Intangible Personal Property – The General Rules

Very significant changes have been made to the general POS rules for supplies of intangible personal property (“IPP”); although the rules continue to be largely dependant on where the IPP can be used, the proposed rules place greater emphasis on the location of the recipient of the supply.

The first thing to be determined is where the IPP can be used. In circumstances where the IPP being supplied is restricted such that it can be used only primarily (more than 50%) in the participating provinces (e.g. a bus pass for the Toronto transit system), a certain set of rules apply. In circumstances where the IPP can either be used only primarily outside of the participating provinces (e.g. a bus pass for the Winnipeg transit system) or where

the IPP is not restricted such that it can only primarily be used inside or outside the participating provinces (e.g. movie passes that can be used in theatres locating in both Ontario and Manitoba), then different sets of rules apply (discussed below).

IPP that can be used only primarily in participating provinces

Generally, if a supply of IPP is made and the Canadian rights in respect of that property can be used only in a single participating province, that participating province will be the place of supply.

If the Canadian rights in respect of the IPP can be used in more than one participating province, the following rules will apply:

Rule 1: If under the agreement for the supply, the greatest proportion of use of the Canadian rights that are restricted to participating provinces would have to occur in a particular participating province if all such rights were used, the supply of the IPP will be regarded as having been made in that particular participating province.

Rule 2: If (a) Rule 1 does not apply to a particular supply of IPP, (b) the value of the consideration for the supply is \$300 or less, and (c) the supply is either made in the physical presence of an individual who is, or who acts on behalf of, the recipient at a permanent establishment of the supplier through which the supply is made in a participating province where the IPP can be used, or made through a vending machine situated in a participating province where the IPP can be used, the supply will be regarded as having been made in that province.

Rule 3: If neither Rule 1 nor Rule 2 apply to a particular supply of IPP and if, in the normal course of business, the supplier obtains a particular address of the recipient that is a home or business address in Canada of the recipient, and the particular address is in a participating province in which the Canadian

rights in respect of the IPP can be used, the supply is made in that participating province.

Rule 4: If none of the above rules apply to a particular supply of IPP, the supply will be regarded as made in the participating province for which the provincial component of the HST is the highest at the time the supply is made.

Rule 5: If a single participating province cannot be determined as the place of supply under Rule 4 because the rate of the provincial component of the HST in two or more of the participating provinces is the same, the supplier will charge HST by applying that particular rate.

IPP that can be used only primarily outside participating provinces

Generally, if a supply of IPP is made and the Canadian rights in respect of that IPP can be used only primarily outside participating provinces, the supply will be regarded as having been made in a non-participating province, and accordingly only GST (5%) would apply.

IPP that can be used otherwise than only primarily in participating provinces and otherwise than only primarily in non-participating provinces

In these circumstances, Rules 2-4 for IPP that can be used only primarily in participating provinces (discussed above) will generally be applied. These rules would also apply when the Canadian rights can be used only equally in participating and non-participating provinces.

Supplies of Intangible Personal Property – The Specific Rules

In addition to the general IPP POS rules, there are a number of special rules, each of which has

undergone significant changes from the existing POS rules, that apply to:

- IPP that relates to real property
- IPP that relates to tangible personal property
- IPP that relates to services to be performed.

Supplies of Tangible Personal Property

No significant changes have been proposed to the existing POS rules for supplies of tangible personal property (“TPP”), apart from those supplies that take place on board a conveyance.

According to the existing POS rules, where TPP is supplied by way of sale (rather than by lease, license or similar method), the supply is generally made within a given province if the supplier delivers or makes the property available to the recipient in that province.

For supplies of TPP made by way of rental, lease or license, when TPP is rented (continuously used or possessed by the recipient for 3 months or less) the supply is made in the province where the property is delivered or made available. In the case of TPP that is leased or licensed (continuously used or possessed for *more than 3 months*), the place of supply is the province where the property is “ordinarily located” when the supply is made. There are also special rules for unique situations such as for specified motor vehicles and for supplies of railway rolling stock, including a special new transitional rule for supplies of railway rolling stock.

Supplies of Real Property

No changes are proposed to the current POS rules for supplies of real property. The existing POS rules for supplies of real property is determined based on where the real property is located. If the real property is located in a participating province, the

place of supply is that province. If part of the property is located in a participating province and part of it outside (in a non-participating province or outside Canada), the sale is deemed to be a separate supply for each portion of the land, with the requisite tax rates of each jurisdiction applicable to the portion located within them.

Self-Assessment of the Provincial Component of the HST

A critical component of the POS rules will be the self-assessment rules announced. These rules will require self-assessment and remittance of the provincial component of the HST in circumstances where the POS rules indicate that a supply has been made in a non-participating province, but where that supply is consumed, used or supplied in a participating province.

The proposed rules expand the existing HST self-assessment rules with respect to:

- TPP that is brought into a particular participating province from another participating province for which the provincial component of the HST is lower;
- IPP or a service that is acquired in a province for consumption, use or supply “significantly” in participating provinces for which the provincial component of the HST is higher than the provincial component of the HST for the province of acquisition; and
- IPP or a service that is acquired outside Canada for consumption, use or supply “significantly” in participating provinces.

The expanded rules also provide formulas for calculating the amounts of tax for self-assessment purposes for these types of property and services. Generally, the existing exemptions from the

requirement to self-assess would continue under the proposed rules.

Rebates of the Provincial Component of the HST

Special expanded HST rebate mechanisms were also announced that will apply to assist businesses and people that are not entitled to input tax credits in circumstances where property or services are acquired in participating provinces, but will be used, consumed or supplied outside these provinces.

The proposed rules expand the rebate provisions with respect to:

- supplies of IPP or services that are acquired for consumption, use or supply “significantly” in provinces for which the provincial component of the HST is lower than the provincial component of the HST for the province in which the property or service was acquired;
- importations of non-commercial goods by a resident of a participating province at a place

outside the participating province but that are for consumption or use exclusively in another province for which the provincial component of the HST is lower than the provincial component of the HST that was paid; and

- TPP removed from a participating province to a non-participating province or to another participating province for which the provincial component of the HST is lower.

Generally, the requirements and restrictions under the current rebate rules will continue to apply under the expanded rules.

Where can I find additional information?

For more information on the proposed place of supply rules and other HST related questions, please contact:

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