
HARMONIZATION AND HOUSING

*A Guide for Provincial Associations
in Addressing Key Issues in the Harmonization
of Provincial Sales Taxes with the GST*

Canadian Home Builders' Association

January 2008

INTRODUCTION

Four provinces (Newfoundland, Nova Scotia, New Brunswick, and Quebec) have combined their provincial sales taxes (PSTs) with the GST – the result is the Harmonized Sales Tax (HST). The rate for the HSTs in the harmonized Atlantic provinces is 13% (5% GST and 8% PST). In Quebec, the combined rate is 12.5%.

Harmonization of the PSTs in the remaining provinces (PEI, Ontario, Manitoba, Saskatchewan and B.C.) is very much on the agenda of the federal government. As stated in the federal government's Autumn 2007 Economic Statement:

“Harmonizing with the GST is the single most important action that these provinces could take to improve their provincial and Canada's overall tax competitiveness. The Government is willing to work with the five provinces that still have [PSTs] to help facilitate the transition to provincial value-added taxes harmonized with the GST. Moving forward with provinces to complete the sales tax harmonization initiative would give Canada a strong tax advantage in all provinces in attracting new investment.”¹

With respect to its effect on housing, the experience with harmonization to date is not encouraging – the housing sector bears much greater provincial sales taxes in the harmonized provinces than was the case prior to harmonization. In New Brunswick, despite providing rebates for part of the provincial share of the HST for new housing initially, the provincial government subsequently abolished the rebate. In Nova Scotia, the rebate for new housing for part of the provincial share of the HST has been substantially reduced, and is restricted to first-time buyers of new homes. In Newfoundland and Labrador, a rebate of the provincial share of the HST applies only to homes in Labrador. Therefore, in the three harmonized Atlantic provinces, the effective rate of PST in the harmonized GST is 8% of the price of most new homes – the same rate as on other goods and services. In Quebec, there is a rebate for new homes priced at less than \$200,000 which reduces the provincial share of the HST to 5%; for new homes priced above \$225,000, the full Quebec Sales Tax of 7.5% applies.

Manitoba has not harmonized its PST with the GST; however, it has spread the base for the PST to include some services to construction – bringing the tax base closer to that of the GST. Previously, the PST applied only to the materials used in construction; however, it now applies to the full value of mechanical and electrical contracts (not just the materials in these contracts), as well as legal fees and a share of architectural and engineering fees – both previously exempt from the PST. This is evidence of the attraction (to provincial governments) of the broader base of the GST and the potential of the larger base to enhance provincial tax revenues – in this case, at the expense of housing affordability.

This paper has been prepared by the CHBA as a primer for use by provincial associations in formulating their positions on harmonization in their provinces. It is an update of a paper previously prepared by the CHBA.

¹ Department of Finance, *Strong Leadership. A Better Canada*, Economic Statement, October 30, 2007, page 79.

There are several reasons why provincial governments could find it advantageous to harmonize their sales taxes with the GST:

- Elimination of the duplication of operating two separate retail tax systems offers potential cost savings;
- Local businesses should enjoy lower costs with a harmonized PST through the use of input tax credits on their sales tax payments; and,
- Harmonization could be a means of surreptitiously increasing provincial tax revenues through the expansion of the sales tax base.

For the home building industry, experience in the provinces which have already harmonized their sales taxes with the GST suggests that harmonization will be extremely detrimental to housing affordability, unless affordability is taken into account in the design of the new tax.

The National Agenda Regarding Taxation of Housing

The GST is a major concern for the housing industry and housing consumers, but it is not the only tax-related issue confronting the housing sector. Over the past several years, the housing industry has experienced an ever-increasing array of levies, fees, charges and taxes from municipalities and provincial governments. In addition, federal tax changes in the late 1980s increased costs for the housing industry and, as discussed below, the GST added a further tax burden on housing. The combined effect has been to raise significantly the costs borne by the housing industry – costs which ultimately are passed on to the home buyer in the form of higher prices. For some time, the CHBA has been calling for a comprehensive review of the tax environment as it affects housing affordability. The seemingly inexorable rise in the burden of taxation on the industry has a direct effect on the ability of Canadians to purchase a home.

It is imperative that the various levies, fees, charges and taxes from all levels of government be reassessed and rationalized. Consultations on the harmonization of provincial sales taxes with the GST would present an ideal opportunity to focus government attention on the issue of the total tax burden borne by the housing sector – and its effect on housing affordability.

Approaching Provincial Governments Regarding Harmonization

In discussions with provincial governments on harmonization, the CHBA recommends that provincial associations adopt a constructive approach to the process. Associations may wish to consider adopting criteria for harmonization similar to the following criteria which were used by the CHBA during its consultations with the federal government prior to the introduction of the GST:

- It must not negatively affect housing affordability;
- It must be clearly understandable;
- It must not interfere artificially with consumer choice and expenditure decisions with respect to housing;
- It must not disrupt housing markets – which would unsettle the economy;
- It must not discriminate against different income groups;

- It must be kept simple both in application and in administration, so as not to cause any undue financial burden on government, the home building industry or housing consumers; and,
- It must apply equitably across all regions of the country.

In addition, provincial associations may wish to take the opportunity to emphasize strongly the CHBA's call for a comprehensive review of the cumulative effects of the full range of levies, fees, charges and taxes which are borne by housing consumers. At a minimum, other provincial government transaction-related taxes, such as land transfer taxes, could be included in the consultations with provincial governments.

Contents of This Paper

The remainder of this paper is divided into the following three sections:

1. **The GST and housing** – a description of how the GST was introduced, how it operates with respect to housing and the effects of the GST on housing;
2. **Harmonization and housing** – a review of the reasons why harmonization is attractive and potential problems in relation to the housing sector, including the situation in provinces which have already harmonized their sales taxes with the GST; and,
3. **A process for dealing with harmonization** – identification of the main issues which should be addressed by provincial associations in their discussions with provincial governments with respect to harmonization, and recommended positions for each issue.

In addition, there is an Appendix which contains details of how to derive estimates of the amounts of provincial sales taxes currently paid on housing, and estimates of the amounts of provincial sales taxes currently payable on new houses in selected centres across Canada.

THE GST AND HOUSING

Since the concept of harmonization means the combination of provincial retail sales taxes with the GST, it is instructive to examine the GST and its effect on the housing sector. Many of the problems associated with the GST have the potential to be problems in harmonized provincial sales taxes.

Replacement of the FST with the GST

The GST was introduced on January 1, 1991 as a replacement for the Federal Sales Tax. The major differences between the GST and the FST it replaced are:

- **Larger tax base** – unlike the FST which applied only to goods, the GST applies to services as well. As such, many types of activities (including new housing and renovation work) which previously were not subject to the FST are now taxed.
- **Different timing of collection** – the FST was paid by manufacturers and added into the price of their goods prior to sale; the GST is added onto the price of goods and services at the time of sale.
- **Input tax credits** – businesses can deduct GST paid on inputs used in the operation of their business from the GST collected on the sale of their output.
- **Lower tax rate** – the GST is a uniform 5% (initially 7%) of the cost for all goods and services sold in Canada with a few limited exceptions (e.g., groceries, medical services). New ownership housing is another exception; the effective rate of tax is reduced through the New Home Buyer Rebate which is discussed in more detail below. Prior to the introduction of the GST, the FST was 13.5% on most products and 9% on building materials.

The replacement of the FST with the GST had significant implications for housing. It lowered the tax payable on materials used as inputs for construction, but the ultimate product became subject to a tax which was not levied previously. Since the amount of FST which was included in new housing was well below 7% of the final house price, the New Home Buyer Rebate was introduced in an effort to mitigate the effect of the higher tax on housing affordability. In 2000, new rental projects, which previously had been subject to the full 7% GST, also became eligible for the rebate. In addition, ‘substantial renovations’ are also eligible for the rebate, but the definition is so restrictive that very few renovation jobs are eligible for a rebate.

In 2006, the federal government reduced the rate of GST to 6%. In the Autumn of 2007, the federal government announced a further reduction in the rate to 5%. With the New Home Buyer Rebate, the effective rate of GST on new housing priced below \$350,000 is now 3.2% [5% minus (36% of 5%)]. The New Home Buyer Rebate is reduced for new homes priced above \$350,000 and there is no rebate for new homes priced above \$450,000 – they are subject to the full 5% GST.

Operation of the GST

The GST is payable on a large proportion of the inputs used by businesses. The major exception is internal payroll which is not subject to GST. Therefore, in building and selling a new house, for example, a builder pays 5% GST on all of the lumber, drywall and other materials used in construction, as well as on the work undertaken by subcontractors or professionals used in the process of building the house and operating the business. GST is not payable on the labour employed directly by the builder as part of his/her operations. Upon sale of the house, the builder charges 5% GST (less the rebate, if applicable), and remits to the federal government the difference between the GST received from the purchaser and the GST which the builder has paid on the inputs used to build the house and operate the business.

The treatment of various parts of the housing industry under the GST is not consistent:

- Sales of new ownership homes are subject to 5% GST on the full sales price of the home, including extras (less a rebate of 36% of the GST) for new homes priced less than \$350,000.² Effectively, for homes priced less than \$350,000, the GST payable is 3.2% of the price [36% of 5% = 3.2%]. The rebate applies to principal residences only.
 - for homes priced between \$350,000 and \$450,000, the amount of the rebate declines progressively to nil for homes priced at \$450,000 and over.
- Sales of residential complexes by persons who are not the builders of these complexes are exempt from GST. These types of sales would include most sales of existing homes and existing residential rental properties.
- New privately-owned rental housing is subject to 5% GST on the full sales price (if sold to another owner), or the fair market value (if retained in the developer's portfolio – under the so-called 'self-supply rule'), less a rebate of 36% of the GST for rental housing projects where the units are valued at less than \$350,000 – effectively the rate of GST for new rental housing valued at less than \$350,000 per unit is 3.2% (the same as for ownership housing). For rental projects with units valued at more than \$350,000, there is the same phase-out of the rebate as applies to ownership housing.
- Residential rents are exempt from the GST.
 - as a result, unlike other investors in real property (e.g. retail and office buildings), investors in residential rental properties cannot utilize the GST paid on the construction of their new building as a deduction against GST collected from tenants.
 - similarly, no credit is received for GST paid by landlords and investors in the operation of the residential rental property.
- New non-profit or government-sponsored housing for the needy, students or the disabled generally receives a rebate of roughly half of the GST payable.
- Renovations to housing are generally subject to 5% GST on the full cost of the renovation (including labour, materials and profit).
 - sales of substantially renovated houses are subject to 5% GST on the full value of the house; if sold to qualifying homeowners, these houses are eligible for the same rebate treatment as new housing. However, the definitions of 'substantial renovations' are so restrictive that very few renovation jobs are eligible for the rebate.
 - for non-substantial renovations performed by a builder on a home which is subsequently sold, GST is payable on the materials and sub-contractor inputs, but not on profit, internal payroll or the original property.

² The GST New Home Buyer Rebate is not automatic: the purchaser and dwelling must qualify. Also, the rebate is legally payable to the purchaser but can be assigned to the builder by the purchaser.

- Sales of new homes, which are not used as a primary place of residence, are subject to 5% GST with no rebate.

The GST was introduced to replace the FST on January 1, 1991. For dwellings which were either under construction or completed and held in inventory at that time, rebates to recover FST paid on building materials purchased in 1990 became available when the dwelling was sold in 1991. The rebate was a purchaser rebate which could be assigned to the builder. A formula was used to estimate the amount of FST which had been paid for materials included in the dwelling under construction at that time.

Effect of the GST on Housing

The GST has had a significant effect on the housing sector. It has raised the cost of housing, discouraged investment in new private rental housing, and helped to fuel the underground economy. Some of the major effects of the GST on the housing sector are outlined below:

- **Increased costs** - even with the rebate, the cost of new housing increased due to the GST. At the time the GST was introduced, the CHBA estimated that the total federal sales taxes on new housing constituted 2-3% of the price of a new home across Canada – the range reflected differences in the value of land which varies significantly across the country. As a result, the GST sought a rebate of 4.5% to bring GST revenues to the same level [7% minus 4.5% = 2.5%]. These estimates were presented to the Department of Finance in an effort to obtain an increase in the size of the rebate. The increased cost of new housing due to the GST was reflected in higher new housing prices. Also, while resale houses are exempt from the GST, there is little question that similar price rises occurred for resale houses as well.

The recent reduction in the GST to 5%, plus the rebate, results in an effective rate of GST on new housing of 3.2% for new homes priced less than \$350,000 – largely achieving the goal of CHBA in achieving neutrality with the pre-GST levels of federal sales taxes on new housing.

By its nature, the GST as a tax instrument has the effect of exacerbating the overall tax burden on new homes arising from all of the charges and taxes of all levels of government. In short, when another tax or charge is raised (or introduced), the application of the GST causes an additional tax-on-tax (or pyramiding) impact beyond the amount of the other charge or tax.

- **Increased costs for rental housing** – initially, there was no rebate of GST for new rental housing projects. The extension of the rebate to include new rental housing projects in 2000, plus the reduction in the base rate of GST to 5%, has reduced the effective rate of GST on rental housing to close to the levels of federal sales taxes which applied prior to the introduction of the GST. However, there are no input tax credits on on-going purchases for existing landlords in the operation of a rental project. As a result, the economic rents required to make new rental construction viable have increased due to the GST. This discourages new rental construction and ultimately leads to higher rents. This

is, of course, negative both for developers/investors in rental property, and for tenants who face less choice and higher rents because of the GST.

- **Increased costs for renovations and heightened underground activity** - the GST added significantly to the cost of renovations since previously only materials were subject to the FST – whereas the GST applies to the full value of the renovation (including labour and profits). Very few renovations qualify for rebates as ‘substantial renovations’. As a result there has been a dramatic increase in the volume of underground renovation activity. Estimates prepared by the Ontario Construction Secretariat indicate that underground operators account for two-thirds of all residential repair jobs and over half of larger residential renovation jobs in Ontario.³

These negative effects on the housing sector resulted from the introduction of the GST. It is imperative for provincial associations to ensure that harmonization of provincial retail sales taxes with the GST does not further exacerbate these problems for the housing sector – as has occurred in the harmonized Atlantic provinces.

HARMONIZATION AND HOUSING

Why Harmonization is Attractive

Harmonization of provincial retail sales taxes with the GST is an attractive concept **in theory**. It means, ideally, the combination of the two taxes into one joint federal/provincial tax. This tax would be levied on the same goods and services at one tax rate which combines both the federal and provincial taxes. This has three significant potential advantages from the viewpoint of provincial governments:

- **Potential cost savings** resulting from the elimination of the duplication of effort required to run two separate sales tax systems. To the extent that provinces simply adopt the tax base used by the GST and add their tax onto the existing GST (as occurred in the Atlantic provinces which harmonized their provincial sales taxes with the GST), there would be a large potential cost saving for provinces. They can eliminate some of their bureaucracy and simply receive a cheque for their share of tax revenue in future.
- **Lower costs for businesses.** With the existing PST, businesses (including builders) cannot apply for input tax credits as they can with the GST. This results in higher costs for businesses in provinces with a PST compared with provinces which harmonize their sales taxes with the GST. With a harmonized tax system, businesses would be able to deduct all sales taxes paid on inputs from the tax collected on their sales. Therefore, the cost of the PST would be removed from businesses’ cost base. These lower costs would make business in the province more competitive.

³ Ontario Construction Secretariat, *Estimates of Revenue Losses as a Result of Underground Practices in the Ontario Construction Industry*, 2001.

- **A revenue-grab by provinces.** The tax base for provincial sales taxes is narrower than that used by the GST. Therefore, there is a vast potential for generating additional sales tax revenues for provinces through harmonization even if they lower their tax rates. This was the case in the Atlantic provinces since rebates (where they occur) are very limited.

Associations should attempt to ensure that the proposed system in their province is true harmonization – one system and one set of forms covering all aspects of the operations of a business, though some specific exceptions may be in the industry’s interests (as discussed later in this paper).

Potential Disadvantages of Harmonization for the Housing Sector

Both builders and consumers of housing could be significant losers from harmonization, unless there are major adjustments made to the harmonized tax rates which apply to housing.

The main problem is that the amount of PST now collected from the housing industry is generally well below the amount which would likely flow from a combined tax system, even if it was designed to be revenue neutral with respect to total revenues from sales taxes – as was promised with the GST. Strict application of a new harmonized tax rate to the housing sector (including new ownership housing, rental housing and renovation) would have the same types of negative effects as those which resulted from the GST (outlined previously). However, the combined effect of the two taxes would make the consequences much more severe.

To avoid an increase in the cost of new housing and renovation work from harmonization of provincial retail sales taxes with the GST will require substantial rebates of the tax payable on housing. This will have to apply not only to new ownership housing but also to rental housing and renovations.⁴ An illustration of how to estimate the amount of the rebate which would be necessary is presented in the Appendix.

Other potential housing industry concerns in harmonization include:

- The transition rules between the current system and the new harmonized system must be fair to builders, and recognize the taxes which have already been paid on inputs to construction.
- As with any bureaucratic system, there is a potential extra burden of paperwork for builders if the rules of harmonization are too complicated. If designed properly, however, this should not be as much of a problem with the harmonization of the PST as it

⁴ The experience with harmonization in Atlantic Canada is not encouraging in terms of the effect of the process on housing. In New Brunswick, despite providing rebates for new housing initially, the provincial government subsequently abolished the rebate. In Nova Scotia, the rebate has been substantially reduced, and is restricted to first-time buyers of new homes. In Newfoundland and Labrador, the rebate applies only to new homes built in Labrador.

was with the implementation of the GST. Most of the procedures should be the same as with the GST (or with slight adjustments) – and only one body would collect the taxes.

These concerns are discussed in the next section of this paper which presents a guide for provincial associations in dealing with harmonization.

A PROCESS FOR DEALING WITH HARMONIZATION

This section of the paper outlines a process by which a provincial association can formulate its position on harmonization. The intent is to identify the major concerns which builders in most provinces will have with harmonization and to outline ways of addressing them. Of particular importance to provincial associations, a methodology is presented to estimate the effects of harmonization on housing prices.

The First Stage – General Principles

Once a province has announced that it is intending to harmonize its PST with the GST, it is important to establish the general principles under which harmonization will occur. An early meeting with provincial officials must seek answers to the following questions. They represent the major concerns with harmonization from the housing industry's perspective:

- Will the price of new housing be affected?
- Will the costs of rental housing and renovation be affected?
- Will the new system add to the paperwork for builders?
- Will builders' cash flows be affected?
- Will the transition rules fairly reflect the taxes already paid by builders for homes which are under construction?

Another important issue to present to provincial officials is whether harmonization might occur within the context of a review of the overall burden of provincial and municipal levies, fees, charges and taxes on the housing sector – in particular, development charges and land transfer taxes. The discussions should provide an excellent opportunity to demonstrate the cumulative total of charges (confirmed in research from CMHC's 2002 report *Levies, Fees, Charges and Taxes on New Housing, 2002*⁵), and their effect on ownership affordability.

Once answers to these questions are obtained in principle, provincial associations can formulate their general positions on harmonization. In developing these positions, it is important to recognize the significant benefits which harmonization could potentially bring to the provincial economy (and to the housing industry) through lowering the cost of doing business and lowering provincial government administration costs. In general, provincial associations should be able to support the principle of harmonization; however, the answers to the questions on the treatment of the housing

⁵ This report is currently being updated by CMHC.

industry are of critical importance. Also, the issue of whether harmonization will be used as a vehicle to increase overall tax revenues will be a major concern.

With the general principles established, provincial associations should be able to work with provincial officials to ensure that the principles are upheld in the actual implementation of harmonization. Means by which provincial associations can assess whether these principles are being met are provided in the remainder of this paper. Each of the questions are addressed in turn.

Will the Price of New Housing be Affected?

Since most inputs to housing are not currently subject to PST, inclusion of new housing at the rate established for other goods and services will increase the effective cost of housing and be detrimental for housing affordability, unless specific provision is made. This provision could take the form of a rebate (as in the case of the GST) or, less likely, a lower tax rate for housing or no tax at all. A rebate is the most likely route and is the only option discussed here.

A crucial part of the formulation of a provincial association's position on harmonization is how large the rebate for new housing should be, if the tax is not to result in a higher cost to the consumer. The process by which this can be calculated for a typical house is discussed briefly below and illustrated in detail in the Appendix.

The process consists generally of the following steps:

- Estimate the price of a typical new house;
- Estimate the cost of materials used in the house (as well as any services which are subject to the PST);
- Identify any non-taxable materials;
- Calculate the estimated PST included in the house;
- Estimate the price of the house without the sales tax and the GST;
- Calculate the current effective rate of PST on the total price of the house; and,
- Compare this with the proposed PST sales tax rate to ascertain the rebate which would be required if harmonization is to have a neutral effect on the price of the house.

If a rebate is proposed which is less than that determined in the calculation, the price of housing can be expected to rise following harmonization, with consequential negative effects on housing affordability and the volume of new housing built.

A separate issue is the price limit for the rebate. With the GST, the rebate is 36% of the GST payable [36% of 5% = 1.8%] for dwellings priced less than \$350,000; the rebate declines progressively for houses priced between \$350,000 and \$450,000; for housing priced at \$450,000 and over, no rebate is provided so the full 5% GST applies. This is discriminatory and should be avoided with the harmonized PST – if the principle that prices will not be affected has been agreed to by the provincial government, then price limits should not apply.

It should be a relatively simple matter to establish a schedule of rebates for a provincial tax on top of the GST. For example, assuming that the harmonized provincial rate is 8%, and that the rebate

required to have a neutral effect on house prices is 4.5%, the following combined GST and provincial schedule for dwellings at various price levels would apply:

- Up to \$350,000 Rebate: 6.3% (PST rebate of 4.5% plus GST rebate of 1.8%)
- \$350,000-\$449,999 Rebate: 4.5% (PST rebate) plus the GST rebate
- Over \$450,000 Rebate: 4.5% (PST rebate), no GST rebate

If price limits for rebates are established by a provincial government, **efforts should be made to ensure that the government will adjust the limits annually to reflect inflation, and will press the federal government to do the same.** Despite making a commitment to adjust the threshold levels for the rebate on a regular basis, the federal government has not made any adjustments to the threshold levels since the GST was introduced in 1991.

It should be kept in mind that between 1991 and 2007, Statistics Canada's New House Price Index increased by roughly 50%. If the GST rebate thresholds had been indexed, they would have risen from \$350,000-\$450,000 to roughly \$525,000-\$675,000 – i.e. all new homes priced less than \$525,000 would be eligible to receive the full GST New Housing Rebate and it would be phased out for homes in the \$525,000-\$675,000 price range. The indexation of the GST rebate thresholds should be pursued with provincial governments in the process of introducing a harmonized sales tax.

Will the Costs of Rental Housing and Renovation be Affected?

The GST does not treat rental housing and renovation fairly. Investments in commercial rental properties (e.g. retail and office buildings) effectively do not bear the GST – they can deduct GST paid against GST payable on rents. Use of GST tax credits is not possible with rental housing since residential rents are not subject to the GST. CHBA's position is that rental housing should be zero-rated (i.e. effectively exempted from GST – as is the case with groceries). Unfortunately, this is unlikely to be considered as part of the harmonization process. Nevertheless, associations should make the unfairness of the current GST approach clear to provincial governments, and every effort should be made to cushion the impact of the harmonized PST on rental housing. At a minimum, rebates similar to those for ownership housing should be available for new rental housing projects, as is the case with the GST.

In terms of renovations, the imposition of the full 5% GST on renovation work has been a major factor in the increase in 'cash-deal' renovations. Similar treatment under a harmonized sales tax would further compound the problem for the renovation sector. A strong case can be made for rebates for renovations.

The amounts by which the cost of rental housing and renovations will increase if they are taxed at the full rate, and the amount of rebate that would be required to offset this, can be calculated using the same methodology as that used for ownership housing illustrated in the Appendix. The initial information on typical project costs and the share of total costs accounted for by materials can be obtained from rental developers and renovators.

Higher costs for rental housing will be reflected in increases in the rents necessary to make rental construction economically viable. A rental housing developer would be able to prepare estimates of the amount by which rents would have to increase to reflect the higher provincial tax on new rental construction.

In addition, in the operation of a rental building, no input tax credits are provided for GST paid on repairs, maintenance, improvements or other activities undertaken in the normal course of operating the building – these increased costs would have been reflected in higher rents. Unless there is specific recognition that the harmonized tax will further increase costs, harmonization will lead to additional increases in rents. The negative effect on tenants, especially low-income tenants (through rent increases and/or lower volumes of construction and maintenance), are strong arguments in favour of the provision of substantial rebates for new rental housing.

For renovations, higher costs due to the HST would discourage homeowners from hiring professional contractors, and/or substituting their own labour or labour from the underground economy. In making the case for rebates for renovations similar to those offered for new ownership housing, several points can be made:

- Less renovation work has implications for the quality of the housing stock;
- The substitution of do-it-yourself and underground labour instead of contractors has implications for government tax revenues;
- The quality of renovations undertaken will likely decline since, unlike professional renovators, underground labour typically does not provide written contracts and generally does not maintain the quality standards of professional renovators; and,
- Employment in the construction sector will be reduced even further if there is less overall renovation work and more do-it-yourself work.

Balanced against these arguments for rebates of harmonized PST for renovations is the argument (also being made by CHBA) in favour of adoption of the same rules (and forms) as those used for the GST. This raises an issue: given the detrimental effect which the GST has already had on renovation, a strong argument can be made for an exception from the uniform conformance with GST procedures and rules in the cases of renovations. The effect of this, however, will be to add some complexity to the administration of the new tax system.

Will the New System Add to the Paperwork for Builders?

A problem with the GST is the extra burden placed on builders through increased paperwork for keeping track of GST paid on inputs, collecting GST from purchasers and claiming/remitting the balance to the federal government. Most builders are relatively small businesses. They are not set up to deal with large volumes of extra paperwork.

Now that builders have established the systems necessary to deal with the GST, however, harmonization of the PST with the GST should not add significantly (if at all) to the paperwork – as long as **special** arrangements with respect to the operation of the harmonized system are minimized. In assessing the proposed harmonized procedures, associations should seek to ensure that special arrangements are kept to a minimum – or extra paperwork could be required.

Will the Transition Rules Fairly Reflect the Taxes Already Paid by Builders for Homes Which are Under Construction?

Initially, the transition rules which applied to the GST were considered generally fair by the CHBA. However, the practicalities of the administration of those rules by Revenue Canada (now the Canada Revenue Agency), as well as the impact of the recession, created difficulties. Provincial associations should be aware of this when assessing the impact of a harmonized PST.

- A rebate should be provided to builders to recover the estimated sales tax paid on the materials used in new houses under construction at the time when the harmonized tax is introduced. No such rebate was available under the GST. FST rebates were available only to the purchaser, when the house was sold. The size of the rebate depended on when the house was ultimately completed and the estimated amount of the old sales tax which had been paid.
- The method for estimating the amount of provincial tax paid on a new dwelling illustrated in the Appendix will also be useful in estimating the taxes already paid on homes during the transition period.

For calculating the FST rebate when the (initial 7%) GST was introduced in 1991, builders were able to use either 4.25% of the purchase price, or \$50 per square metre of prescribed floor space.

APPENDIX

CALCULATING THE CURRENT SALES TAXES ON NEW HOUSING AND THE EFFECT OF HARMONIZATION ON NEW HOUSE PRICES AND AFFORDABILITY

This Appendix provides a methodology for estimating the amount of provincial retail sales taxes which are currently included in the prices of typical new dwellings, as well as the increase in prices (and decline in affordability levels) which could occur as a result of harmonization. The methodology is intended for the use of provincial associations in preparing background information for discussions with provincial government officials on harmonization of PST with the GST.

The Appendix is divided into three sections. The first two sections use an illustrative national example to explain the following:

- Estimating current PST included in new houses (Exhibit 1 Top); and
- Effect of harmonization on new house prices (Exhibit 1 Bottom).

The final section presents rough illustrative estimates (Exhibit 2) of the amount of PST in typical new houses across Canada from the CMHC study *Levies, Fees, Charges and Taxes on New Housing, 2002*.

Estimating Current Provincial Sales Tax Included in New Houses (Exhibit 1)

- **Estimate the price of a typical new house:** a good starting point for this task is the median new house price which is available from the house price estimates prepared monthly by CMHC for major centres in Canada. Since a provincial typical price is required for the preparation of estimates by provincial associations, the CMHC data for major centres would need to be weighted according to starts per centre, along with an estimate of prices in areas not covered by the CMHC data.

For the sample calculation shown in Exhibit 1, a typical price for Canada of \$150,000 is used – this is assumed to be the price including GST less the rebate.

- **Estimate the cost of the materials that are used in the house:** from some local builders, obtain estimates of the breakdown of the cost of the typical new house which separates materials from other (non-taxable) inputs into the house. Estimates from several builders of the percentage share of the final selling price of houses represented by materials should allow provincial associations to prepare an estimate for the typical house. In preparing their estimates, builders will need to consult with their trades – some trades include materials as part of their contract price and the materials share of these contracts will need to be determined if the estimates are to be accurate.

For the sample calculation here, a share of 25% was chosen (\$37,500 on a \$150,000 house). This is materials NOT including PST (i.e. the PST has been removed from the estimated materials cost).

Note: for those provinces in which the PST is calculated using the price **plus the GST**, the materials cost should include the GST payable on these materials since the GST now forms part of the tax base in these provinces. For those provinces which do not include the GST in their tax base, the materials cost estimates should not include the GST.

- **Identify any non-taxable materials:** some materials (such as insulation and energy-saving devices) may be exempt from the PST. To the extent that these types of materials are included in the typical new house, they should be excluded from these calculations. Builders will be aware of what proportion of materials used in new houses are taxable.

For the illustrative example shown in Exhibit 1, a rough estimate of \$1,500 of non-taxable materials is used to represent the situation in a province which exempts insulation from PST.

- **Calculate provincial taxes included in the typical house:** applying the current PST rate to the estimate of taxable materials included in the typical house yields an estimate of the amount of provincial tax which is currently included in the house.

For the \$150,000 house, the estimated taxable materials are \$36,000 (not including PST). At the assumed typical PST rate of 8%, this would yield an estimated total of \$2,880 of PST in the typical house.

- **Add in an estimate of taxes payable on other items:** to the extent that PST is payable for materials used in other parts of builders' operations (e.g., from buying materials for the office to equipment and materials used in servicing land), ideally, these should be estimated and included in the estimated tax for a typical home as well. An estimate of \$300 has been included in the illustrative calculations shown in Exhibit 1. Thus, the total estimated PST on the typical house is \$3,180.

Estimating the Effect of Harmonization on New House Prices (Exhibit 1 – Bottom)

- **Estimate the price of the house less sales tax:** the price of the house with the PST removed is \$146,820 [\$150,000 less \$3,180]. This price still includes the GST (less the rebate).
- **Estimate the GST (less rebate):** the GST rebate is 36% of the 5% GST, which works out to 1.8%; so the GST less the rebate is 3.2%. The GST (less the 1.8% rebate) is applied to the cost of the house (which includes the PST). The original price of the house (including GST) in this example is \$150,000, so the GST can be calculated using the formula $3.2/103.2 \times \$150,000 = \$4,651$.

- **Estimate the price of the house less both sales tax and GST:** the price of the house excluding both GST and the PST is an estimated \$142,169 [$\$150,000$ less $\$3,180$ (PST) and $\$4,651$ (GST) = $\$142,169$].
- **Estimate the current effective PST rate on new housing:** the estimated current effective PST rate on new housing is the estimated current provincial sales tax receipts on the typical new house ($\$3,180$) compared to the price of the house less all taxes ($\$142,169$) – 2.24%. This has been rounded to 2.2% for this analysis. This is the tax rate which, if applied to the new base on which the harmonized tax will apply, would be neutral in terms of its effect on provincial revenues.

If, for example, the new harmonized provincial tax rate is set at 8%, **a rebate of 5.8% of the house price** would be necessary to have no effect on provincial revenues in this illustrative example (8% minus 2.2% = 5.8%).

- **Difference between maintaining same provincial revenues and effect on house prices:** if the current effective sales tax rate (as calculated above) is added to the GST rate of 3.2% (rather than being applied on top of it as is currently done for taxable goods in some provinces), the price of housing should, in fact, fall marginally.

In the illustrative example, 5.4% (3.2% + 2.2%) applied to the base price of $\$142,169$ would yield total taxes of $\$7,677$ and a total price, including taxes of $\$149,846$ – less than the original $\$150,000$ house price. The difference is mainly in the GST payable since the 3.25% GST now applies to a lower price (excluding the PST). The remaining difference is due to rounding of the effective PST to 2.2% for this example.

The reason that less GST is payable on the house under the harmonized system is that there is no more pyramiding of GST on top of the PST, as occurs at present.

Keeping the effective PST rate the same (i.e. in this example, provide a rebate of 5.8%) would be the most beneficial approach from the perspective of housing affordability.

- **Estimate the effect of higher provincial taxes on house prices:** to the extent that the rebate for new houses is significantly below the difference between the current effective tax payable on a new house and the new harmonized PST rate, house prices for buyers will increase.

In the example presented in Exhibit 1, a new PST rate of 8% is assumed. If no rebate of the provincial share of the new HST is provided, the total taxes payable on the house would be 11.2% [8% plus the 3.2% GST after allowing for the GST rebate]. This would yield total federal and provincial sales taxes of $\$15,923$. Adding this to the $\$142,169$ price (excluding sales taxes), would result in a price plus taxes of $\$158,092$; $\$8,092$ above the current $\$150,000$ price (including all taxes).

Therefore, with harmonization, and without an additional rebate, there would be an increase in the house price including taxes ($\$8,092$) or 5.4% of the original price of the typical house (including GST).

In submissions to the provincial government, it would be worth noting that the 11.2% effective HST for new housing is what actually applies in the three harmonized Atlantic Provinces – hence the reason for the concern with respect to harmonization.

EXHIBIT 1

ILLUSTRATIVE EXAMPLE OF EFFECT OF HARMONIZATION ON NEW HOUSE PRICES

Provincial Sales Taxes Included in New House Prices

| | |
|--|-----------|
| Typical new house price including GST | \$150,000 |
| Estimated materials share | 25.0% |
| Estimated cost of materials | \$37,500 |
| Non-taxable materials | \$1,500 |
| Taxable materials | \$36,000 |
| Provincial sales tax rate | 8.0% |
| Provincial sales tax payable on materials used in the house | \$2,880 |
| Provincial sales tax payable on other items | \$300 |
| Total provincial sales taxes | \$3,180 |

Effective Rate of PST

| | |
|---|-----------|
| Price of typical new house (including GST) after removal of provincial sales tax | \$146,820 |
| GST (less rebate) | \$4,651 |
| Price of typical new house excluding both GST and provincial sales tax | \$142,169 |
| Effective provincial sales tax rate | 2.2% |

If No PST Rebate

| | |
|--|-----------|
| Assumed new provincial sales tax rate | 8.0% |
| Total tax including GST less rebate (3.2%) | 11.2% |
| Total taxes payable | \$15,923 |
| Price of house including taxes | \$158,092 |

Estimates of PST in Housing (Exhibit 2)

Exhibit 2 presents estimates of the amount of PST in new house prices in 30 centres across Canada in 2002 (including the harmonized provinces) from the report *Levies, Fees, Charges and Taxes on New Housing, 2002*, prepared for CMHC. The estimates are out of date (2002); however, the report is currently being updated by CMHC. Associations may use these estimates (or the updated estimates) as a check on their estimates of the amount of PST in new houses in their provinces.

EXHIBIT 2

EXCERPT FROM STUDY ON LEVIES, FEES, CHARGES
AND TAXES ON NEW HOUSING, 2002

| Estimated Provincial Sales Taxes | | | |
|--|----------------|---------------------------------|-----------------------------|
| Typical Modest Single-Detached Houses, 2002 | | | |
| Municipality | Price | Provincial Sales Tax | Percent of Price |
| <i>Harmonized Provinces</i> | | | |
| St. John's | 130,000 | 10,400 | 8.0% |
| Halifax | 140,000 | 11,200 | 8.0% |
| Moncton | 120,000 | 9,600 | 8.0% |
| Montreal | 145,000 | 7,272 | 5.0% |
| Laval | 155,000 | 7,773 | 5.0% |
| Longueuil | 140,000 | 7,021 | 5.0% |
| Gatineau | 135,000 | 6,770 | 5.0% |
| Quebec City | 110,000 | 5,517 | 5.0% |
| <i>Non-Harmonized Provinces</i> | | | |
| Charlottetown | 125,000 | 5,404 | 4.3% |
| Toronto | 285,000 | 5,867 | 2.1% |
| Mississauga | 260,000 | 5,256 | 2.0% |
| Vaughan | 275,000 | 5,519 | 2.0% |
| London | 160,000 | 4,454 | 2.8% |
| Ottawa | 230,000 | 5,565 | 2.4% |
| Sudbury | 150,000 | 4,234 | 2.8% |
| Windsor | 150,000 | 4,117 | 2.7% |
| Winnipeg | 145,000 | 4,251 | 2.9% |
| Regina | 135,000 | 2,922 | 2.2% |
| Saskatoon | 145,000 | 2,965 | 2.0% |
| Calgary | 175,000 | - | 0.0% |
| Edmonton | 165,000 | - | 0.0% |
| Grande Prairie | 130,000 | - | 0.0% |
| Burnaby | 395,000 | 5,425 | 1.4% |
| Surrey | 315,000 | 5,930 | 1.9% |
| Kelowna | 210,000 | 4,452 | 2.1% |
| Prince George | 160,000 | 4,072 | 2.5% |
| Saanich | 255,000 | 4,827 | 1.9% |
| Whitehorse | 150,000 | - | 0.0% |
| Yellowknife | 165,000 | - | 0.0% |
| Average | 188,833 | 4,853 | 2.6% |

Source: Levies, Fees, Charges and Taxes on New Housing, 2002,
prepared by Greg Lampert for CMHC, 2003.