



HST Transitional Rules for Home Builders

Ontario Announcement

June 18, 2009

The Ontario Ministry of Revenue released some details on the application of the new Harmonized Sales Tax (“HST”) to new residential housing. When the HST was first announced in the Ontario Budget on March 26, 2009, no transitional provisions were provided and few details were released on the operation of the new tax, which is to take effect on July 1, 2010. On June 18, 2009, the Ministry released Information Notice No. 2 - Helping Homebuyers and the Housing Industry with an Enhanced New Housing Rebate, a New Rental Housing Rebate and Transitional Rules (the “Notice”). The Ministry is currently working with the federal government to establish other transitional rules to provide for the smooth transition to the new HST. More information on the rules outlined in the Notice and other transitional provisions will be announced in the coming months.

THE ENHANCED NEW HOUSING REBATE

Currently, sales of new residential properties are subject to the Goods and Services Tax (the “GST”) of 5%, but not Ontario Retail Sales Tax (the “RST”). However, RST is currently embedded in the house construction costs. Stephen Dupuis, President and CEO of the Building Industry and Land Development Association (“BILD”) has indicated that, on average, builders currently pay embedded RST of about 2% of the selling price of a new home. Under the new HST, new residential properties will be subject to 13% HST, instead of the current 5% GST and the embedded RST. When the HST was first announced, the new housing rebate was to be 75% of the 8% provincial portion of the HST (in effect, 6%) for primary residences under \$ 400,000, with the rebate amount being phased out for new homes priced between \$ 400,000 and \$ 500,000. Under the original announcement, there would be no rebate for new homes priced more than \$ 500,000.

The Notice proposes an enhancement to the provincial portion of the New Housing Rebate (the “Enhanced Rebate”), which is intended to ensure that the HST will not create an additional tax burden on the first \$400,000 of the purchase price of a new home, as compared to the current system where the RST is embedded in the house construction costs. The Enhanced Rebate will apply to purchasers of eligible new housing in all price ranges and will be calculated as 75% of the 8% provincial portion of the HST on the first \$ 400,000 of the selling price of new homes. This means that all qualifying homes will be eligible for the Enhanced Rebate of 6% (8% x 75%), up to a maximum amount of \$ 24,000 (\$ 400,000 x 8% x 75%). Consequently, the Enhanced Rebate will result in the provincial portion of the HST applying at a rate of 2% (after the Enhanced Rebate) on the first \$ 400,000 of the selling price of new housing and a rate of 8% of the selling price above \$ 400,000.

The Enhanced Rebate will be available for the same type of new homes that currently qualify for the GST New Housing Rebate. Homes that are eligible for the rebate include homes that are used as a primary place of residence such as new homes and condominiums, substantially renovated housing, co-operative housing, owner-built housing, housing on leased land, mobile homes and modular homes. The Ontario portion of the Enhanced Rebate will be administered by the federal government in the same manner as the current GST New Housing Rebate, whereby a purchaser can either assign the rebate to the builder or file a rebate application directly with the Canada Revenue Agency.

It is believed that the storm of criticism that the Ontario government has received for introducing the HST during the current difficult economic times has resulted in the government reviewing some of its original plans on the implementation of the HST. The proposed change to the Enhanced Rebate is one step in the right direction.

THE RENTAL HOUSING REBATE (“RENTAL REBATE”)

The Ontario government is proposing to provide a Rental Rebate for new rental housing, to ensure that the HST will not subject most residential rental properties to more Ontario sales tax than the current RST which is embedded in the house construction costs. The Rental Rebate will operate in much the same manner as the rebate for new homes previously discussed. The new Rental Rebate will be available for all price ranges of rental housing, up to a maximum rebate amount of \$ 24,000 ($\$400,000 \times 8\% \times 75\%$) for residential rental housing costing \$ 400,000 or more.

The new Rental Rebate will be available to both landlords who acquire new rental housing and pay HST on the purchase, and landlords who build their own rental housing and pay the HST under the self supply rules. The new Rental Rebate will be available for new rental housing to be rented out for use as primary places of residence. The same rental housing that qualifies for the current GST New Residential Rental Property Rebate (“GST Rental Rebate”) will be eligible for the Rental Rebate and will include investment properties such as new homes, condominiums, substantially renovated rental housing, co-operative rental housing, additions to traditional apartment buildings, long-term residential care facilities, rental mobile homes, rental modular homes and leased land where the land is used for residential purposes. The rebate for apartment buildings that are not condominiums will be calculated on each rental unit rather than the entire apartment building.

The Ontario portion of the Rental Rebate will be administered by the federal government in the same manner as the current GST Rental Rebate. Landlords will be able to file a rebate application directly with the Canada Revenue Agency or claim the rebate on their HST return.

TRANSITIONAL RULES FOR NEW RESIDENTIAL REAL PROPERTY

For new housing transactions that straddle the implementation of the HST on July 1, 2010, the Canada Revenue Agency will administer transitional rules that will provide for the change from the current RST system to the new HST system. These rules are similar to the transitional rules that applied when the GST was first implemented.

General Application of the HST – New Homes

Subject to the grandparenting provisions, the provincial portion of HST will apply to sales of newly constructed or substantially renovated homes where both ownership and possession are transferred after June 2010. In such cases, the HST will generally be payable on the earlier of the days on which ownership or possession of the new home is transferred to the purchaser. In the case of residential condominium units, where occupancy of the unit is transferred to the purchaser prior to registration (referred to as the “occupancy closing”), the HST will apply and will be payable on the earlier of the day that the ownership of the unit is transferred to the purchaser (referred to as the “final closing”) or 60 days following the date of registration of the condominium unit.

The Ontario portion of HST will not be imposed on sales of newly constructed or substantially renovated homes under purchase and sale agreements where either possession or ownership is transferred before July 2010.

General Application of the HST – New Rental Homes

The following rules will apply to newly constructed or substantially renovated rental homes that include single homes, residential condominiums, and apartment buildings that are not condominiums.

Builders/Landlords

Subject to the grandparenting provisions, the provincial portion of the HST will be payable by builders/landlords under the self supply rules for new rental homes that are first rented out after June 2010. Builders/landlords of apartment buildings that are not condominiums will be required to pay the provincial portion of the HST under the self supply rules when the first unit in the building is rented out after June 2010. The self supply rules for the provincial portion of the HST will not apply to (i) homes that are first rented out before July 2010, or (ii) apartment buildings that are not condominiums where the first unit is rented out prior to July 2010. In either case, the builder/landlord will generally still be required to pay the current federal GST.

Purchasers/Landlords

Subject to the grandparenting provisions, the provincial portion of the HST must be paid by purchasers/landlords to builders of new rental homes where both the ownership and possession of the homes are transferred after June 2010. Purchasers/landlords will not be required to pay the provincial portion of the HST where, under a purchase and sale agreement, ownership or possession of the home is transferred before July 2010. In either case, the builder/landlord will generally still be required to pay the current federal GST.

GRANDPARENTING RULES FOR NEW RESIDENTIAL REAL PROPERTY

The grandparenting rules generally apply to purchase and sale agreements signed on or before June 18, 2009 (the date of the Notice) for newly constructed or substantially renovated homes (including condominiums). Under these grandparenting provisions, these homes will not be subject to the

provincial portion of the HST, even if both ownership and possession of the homes are transferred after June 2010. The grandparenting rules also apply to purchasers/landlords who acquire freehold homes or condominium units for residential rental under a purchase and sale agreement signed on or before June 18, 2009.

Although the sales described above are grandparented and are not subject to the provincial portion of the HST, builders will be able to claim input tax credits to recover the provincial portion of the HST paid on their construction costs after June 30, 2010. However, builders will be required to pay a Transitional Tax Adjustment to account for the RST that would otherwise have been embedded in the new home under the current RST regime.

Transitional Tax Adjustment - Grandparented Homes

Builders of grandparented new homes (single detached homes, semi-detached homes and attached homes) that are partially or fully completed after June 30, 2010 will be required to pay a Transitional Tax Adjustment based on the home's total purchase price and the percentage of completion as at July 1, 2010 as follows:

| % Complete on July 1, 2010 | Transitional Tax Adjustment |
|-----------------------------------|------------------------------------|
| Less than 10% | 2.0% (that is, 100% of 2%) |
| 10% to less than 25% | 1.5% (that is, 75% of 2%) |
| 25% to less than 50% | 1.0% (that is, 50% of 2%) |
| 50% to less than 75% | 0.5% (that is, 25% of 2%) |
| 75% to less than 90% | 0.2% (that is, 10% of 2%) |
| 90% or more | 0% (that is, 0% of 2%) |

Transitional Tax Adjustment - Grandparented Condominiums

Builders of grandparented new residential condominium units will also be required to pay a Transitional Tax Adjustment, but may also be eligible for the RST Transitional Housing Rebate, as discussed below. The Transitional Tax Adjustment will be calculated as a flat 2% of the total selling price of the condominium unit or building, regardless of the percentage complete as at July 1, 2010. As will be discussed, the Transitional Tax Adjustment and the RST Transitional Housing Rebate, taken together, are intended to mirror the embedded RST that would have applied to the condominium unit under the current RST system.

Transitional Rules - Other Situations

Proposed transitional rules will also apply to provide relief for grandparented homes that are subject to the Transitional Tax Adjustment or the provincial portion of the HST and pass through a chain of resellers before being occupied for residential use.

Homes that are newly constructed or substantially renovated by builders for their own personal use, as well as mobile homes and modular homes, will not be subject to the Transitional Tax Adjustment, but instead will be subject to special transitional rules to be announced in the coming months. Such homes may also qualify for the Enhanced Rebate or the Rental Rebate.

RST TRANSITIONAL HOUSING REBATE (“TRANSITIONAL REBATE”)

New housing units that are subject to the provincial portion of the HST after June 30, 2010 and are partially or fully completed before July 1, 2010 will have the current RST embedded in their construction costs. Such housing units may qualify for the Transitional Rebate which is intended to provide relief for the embedded RST.

Purchasers or builders that are able to claim the Transitional Rebate may also be eligible to apply for the Enhanced Rebate or the Rental Rebate, as applicable.

Transitional Rebate – New Homes

The Transitional Rebate may be claimed in respect of (i) non-grandparented new homes which close after June 30, 2010, or (ii) non-grandparented new homes first rented after June 30, 2010.

Transitional Rebate – Condominiums and Apartments

The builder will be entitled to the Transitional Rebate in respect of new condominiums or apartment buildings that are either (i) grandparented and subject to the Transitional Tax Adjustment, or (ii) subject to the provincial portion of the HST.

The operation of the Transitional Tax Adjustment and the Transitional Housing Rebate, taken together, yields the following results:

(i) Grandparented condominium units that are subject to the Transitional Tax Adjustment

As previously discussed, new condominium units will not be subject to the provincial portion of the HST (i.e., such units will be grandparented) where the purchase and sale agreement was signed on or before June 18, 2009, even if both ownership and possession of the unit is transferred after June 2010. In such case, the builder will have paid embedded RST on construction costs incurred prior to July 1, 2010. In addition, such units will be subject to the flat 2% Transitional Tax Adjustment, which is intended to ensure that all construction costs on grandfathered units are subject to the embedded RST that would have applied under the current system. The purpose of the Transitional Rebate is to refund the estimated embedded RST actually paid by the builder, in order to avoid double taxation.

(ii) Condominium units subject to HST

A new condominium unit that is subject to the provincial portion of the HST after June 30, 2010 and which was partially or fully completed before July 1, 2010 will have the current RST embedded in its costs. The Transitional Rebate is intended to provide relief for the embedded RST, so that the unit is not subject to both the embedded RST under the former system and the provincial portion of the HST under the new regime.

Transitional Rebate Calculation

The Transitional Rebate will be calculated by estimating the RST component of the new housing costs based on the percentage of completion on July 1, 2010 using either of the following methods:

- (i) Estimated RST content calculated at a prescribed amount per square metre of floor space in the home ("floor space method"); or
- (ii) Estimated RST content based on the selling price of the home, calculated at 2% of the total price established for GST purposes¹ ("selling price method").

The RST Transitional Housing Rebate calculation will be based on the percentage of completion on July 1, 2010 as follows:

| % Complete on July 1, 2010 | Transitional Rebate |
|-----------------------------------|-------------------------------|
| 90% or more | 100% of estimated RST content |
| 75% to less than 90% | 90% of estimated RST content |
| 50% to less than 75% | 75% of estimated RST content |
| 25% to less than 50% | 50% of estimated RST content |
| 10% to less than 25% | 25% of estimated RST content |
| Less than 10% | 0% of estimated RST content |

The Transitional Rebate can be claimed either by (i) the purchaser filing the required forms with the Canada Revenue Agency, or (ii) the purchaser assigning the Transitional Rebate to the builder who will file the forms with the Canada Revenue Agency. When a purchaser claims this rebate directly from the Canada Revenue Agency, a certification from the builder of the new home's percentage completed at July 1, 2010 must be included with the application. The claim for the RST Transitional Rebate must generally be filed before July 1, 2014. If the rebate calculation is based on the floor space method, the application can be claimed anytime on or after July 1, 2010. If the rebate calculation is based on the selling price method, the claim for the Transitional Rebate cannot be made earlier than the time that the HST (including the provincial portion) or the Transitional Tax Adjustment is payable.

¹ It is our understanding that the selling price for GST purposes excludes the tax and includes the amount of the New Housing Rebate assigned by the purchaser to the builder.

Other Situations

Individuals who build newly constructed or substantially renovated homes for their personal use, as well as mobile homes and modular homes, are not eligible for the Transitional Rebate, but instead will be subject to special transitional rules to be announced in the coming months.

DISCLOSURE REQUIREMENTS BY BUILDERS FOR TRANSITIONAL HOUSING

To avoid confusion to purchasers on the transition to the new HST for the sale of new homes for either personal use or for rental use, the Ministry has proposed certain disclosure requirements that builders must follow for purchase and sale agreements entered into after June 18, 2009 and before July 1, 2010. Builders must disclose in such agreements whether the provincial portion of the HST applies to the sale and whether such selling price is net of the provincial Enhanced Rebate. If this disclosure is not made, the sales price specified in the purchase and sale agreement will be deemed to include the provincial portion of the HST and the purchaser will not be required to pay any additional amount on account of the provincial portion of this tax.

FURTHER CONSIDERATIONS - IMPACT OF HST ON CONTRACTS WITH SUBCONTRACTORS

The HST system is predicated on the assumptions that construction costs currently have embedded RST of 2% and that builders will be able to renegotiate their contracts with subcontractors to remove the embedded RST after July 1, 2010. However, most construction contracts are long-term and it may not be possible for the builder to renegotiate the terms. Furthermore, many construction contracts currently have embedded RST of less than 2%, and therefore many subcontractors will not be in a position to reduce the contract price.

If the builder is able to negotiate a reduction in the subcontractor contracts in respect of the removal of the current embedded RST, consideration should be given to whether this cost reduction should be passed onto purchasers to offset the net cost of the provincial portion of the HST. As previously discussed, the Enhanced Rebate for the first \$400,000 of the purchase price of a new home will bring the Ontario portion of the HST down to 2% for the first \$400,000 of the cost of a new home. Therefore, unless the purchase price (before the provincial portion of the HST) of the new home is decreased by 2% (to reflect the removal of the embedded RST), the HST will not be neutral for the first \$400,000 of the purchase price of a new home. Unfortunately, even if a 2% cost reduction in respect of the current embedded RST can be passed onto purchasers, the HST will increase the purchase price of new homes over \$400,000.

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To discuss the impact of the Budget on you and your business, please contact your advisor at Goldfarb, Shulman, Patel & Co. LLP.

HST TRANSITIONAL RULES FOR SALES OF NEW RESIDENTIAL REAL PROPERTY

The following schedule summarizes the HST transitional rules applicable to new residential real property. This schedule is general in nature and readers should consult with their GSP advisor with respect to their specific situation.

| Agreement Date | Closing Date (Freehold) Occupancy Date (Condominium) | Tax Applicable | Ontario Portion – Enhanced Rebate/ Rental Rebate | Transitional Tax Adjustment | Transitional Rebate |
|----------------------|---|----------------|--|-----------------------------|---|
| Before June 19, 2009 | Before July 2010 | 5% | N/A | N/A | N/A |
| | After June 2010 | 5% | N/A | Yes ¹ | Single Homes – No Condominiums – Yes ² |
| After June 18, 2009 | Before July 2010 | 5% | No | N/A | N/A |
| | After June 2010 | 13% | Yes ³ | No | Yes ⁴ |

¹ For new single homes – 2% x Factor based on % Complete.
For new condominiums = Flat 2%

The Transitional Tax Adjustment is payable by the builder.

² Provided the Transitional Tax Adjustment is payable by builder. The Transitional Rebate must be claimed by the builder.

³ The Enhanced Rebate/Rental Rebate is 75% of the Ontario portion of the HST, to a maximum of \$ 24,000 (\$ 400,000 x 8% x 75%). The Enhanced Rebate/Rental Rebate can be claimed by the purchaser, but typically would be assigned to the builder, as is typically the case with the current GST New Housing Rebate.

⁴ The Transitional Rebate is intended to refund the estimated embedded RST.
For new single homes – claimed by purchaser (or can be assigned to builder).
For new condominiums – claimed by builder.