

HST brings price add-on

Large companies anticipate operating cost impact

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MANY LANDLORDS in Ontario and British Columbia face additional costs for energy when the harmonized sales tax (HST) takes effect this summer. Electricity and gas are among commodities previously subject solely to the GST and taxed at a rate of 5% that will now be taxed at the harmonized rate of 13% in Ontario or 12% in BC.

Commercial real estate providers earning more than \$10 million annually will be affected because energy is on the list of specified goods and/or services designated for restricted input tax credits (ITCs). Until now, ITCs have been a rebate of simply the GST that corporate taxpayers and self-employed individuals pay on their business costs, and advocates of the HST have championed it as a vehicle for recapturing PST that was previously unrecoverable.

However, the restricted ITCs mean that most large companies will be ineligible for any rebate on the provincial portion of the tax on electricity or gas until July 1, 2015 and won't receive 100% compensation of the tax until July 1, 2018. (There are some exceptions for energy used in manufacturing or scientific research and experimental development.)

The Ontario and BC governments haven't outlined the reasoning behind these restrictions, but state that they are modelled on the Quebec Sales Tax (QST), which has By Barbara Carss Large Companies Anticipate Operating Cost Impact been largely harmonized with the GST since 1992. That might cause some nervousness for large companies since restrictions on input tax refunds as they are known in Quebec were also originally meant to be temporary.

"In the budget of 1997-98, Quebec confirmed that it would maintain the measure indefinitely," notes Jean Gagnon, a Partner who practices tax law with Blake, Cassells & Graydon LLP in Montreal. Today, affected companies prepare for tax increases that will boost the QST on their energy purchases to 8.5% on January 1, 2011 and to 9.5% on January 1, 2012.

VARYING IMPLICATIONS

Restricted ITCs will also be an issue for many large tenants in Ontario and BC, while financial institutions in both provinces will absorb all the new costs of the HST since federal rules imposed when the GST was introduced in 1992 exclude the sector from input tax credits. Tax specialists are advising building owners and managers to think strategically about how they pass extra costs through to tenants.

"The consequences of additional rent depend on who the landlord is and who the tenant is," Craig Robertson, Associate Director of Indirect Tax with Deloitte & Touche LLP, told attendees at a recent seminar organized by the Building Owners and Managers Association (BOMA) of Greater Toronto. "You've really got to consider these add-ons from the perspective of your clients because it can be a significant tick-off factor."

In BC, hydro and gas costs will be exempt from the provincial portion of the HST across the entire residential sector – single-family, condominium and multiresidential rental housing. In Ontario, all consumers will pay the full HST on energy, but the provincial government will dole out \$1,000 to all families with incomes less than \$160,000 or \$300 to all singles with incomes less than \$80,000, which is presumably meant to cover some of the new HST-related costs.

PASS-THROUGH OPTIONS

Hydroelectric utilities are defined in law as the suppliers of electricity and they will be the entities charging the HST to a landlord's bulk meter account for electricity. In scenarios where tenants are separately metered with their own hydroelectric accounts, they would also pay the attributable HST, but that's a negligible proportion of tenants.

"It's a nice concept, but we are not going to be able to get Toronto Hydro or any other utility to rewire buildings to accommodate that. Either it's already happening or it's not going to happen," affirms Mike McGee, President of the energy management consulting firm Energy Profiles Ltd. "It's more the common practice for landlords to sub-meter tenants and we're still exploring what the opportunities are there. For example, is there some way for the subme-

ter company to assume paying the bill so the landlord could avoid paying the HST?"

Many of the rules are still unclear, and tax specialists caution that they're working with government policy documents rather than actual Regulations – which have not yet been released – and the details are complex and numerous. "The rules, for all of us, are mind numbing," Robertson quipped.

Some things are clear, though. Tax experts warn that landlords cannot simply redefine themselves into the utility's regulated role as a direct supplier of electricity or reword leases to charge tenants a distinct fee for electricity that includes the HST.

"Most of the time you don't have the right in the law to be a supplier of electricity. The idea of cleverly going back and rewriting your leases, as a legal recourse, is probably not possible," Glenn Ernst, a tax lawyer with Goodmans LLP, told the BOMA Toronto seminar.

Other adjustments are more feasible. References to the GST should be removed from leases and the definition of taxes should be revised to account for the HST.

Landlords can potentially define the HST on energy as an operating cost and pass it through to tenants in their rents. Such an approach could benefit large companies subject to the same ITC restrictions on energy expenses because they will be eligible for ITCs on all the HST associated with rent.

ENERGY EFFICIENCY CONSIDERATIONS

The ITC restrictions do not apply to the energy that a large company uses for activities associated with scientific research and experimental development (SR&ED), but there is little opportunity for real estate providers to take advantage of this. The formula for calculating allowable tax credits is based on the proportion of a company's workforce involved in SR&ED rather than on innovation related to the actual use of energy. This would seem to benefit laboratories rather than building owners/managers with accredited pilot projects to test energy-efficient technology or alternative energy.

Even so, rising energy costs could convince many building owners/managers that the time is right to invest in energy efficiency. Indeed, higher costs should speed up the payback.