

CORPORATE REPORT

NO: F001 COUNCIL DATE: January 25, 2010

FINANCE COMMITTEE

TO: Mayor & Council DATE: January 15, 2010

FROM: General Manager, Finance & FILE: 1965-01

Technology

SUBJECT: Implications of the Harmonized Sales Tax to the City of Surrey

RECOMMENDATION

The Finance & Technology Departments recommends that the Finance Committee:

1. receive this report as information; and

2. recommend that Council request that the Mayor forward a letter on behalf of Council to the Provincial Minister of Finance requesting that the Province take action to ensure that the implementation of the HST is cost neutral to municipalities relative to the current PST and that a copy of this report be included as background information in the letter and further that the letter and attached report be forwarded to all UBCM member local governments.

INTENT

The purpose of this report is to provide information about the background to and implications of the implementation of the Harmonized Sales Tax (HST) to the City of Surrey.

BACKGROUND

On July 23, 2009 the Province of BC announced its intention to harmonize the current Provincial Sales Tax (PST) with the Federal Goods and Services Tax (GST) to create a single value added tax known as the Harmonized Sales Tax (HST). The HST is currently set to take effect on July 1, 2010 and will be administered by the Federal Government. The current PST will be repealed to correlate with the date of implementation of the HST.

The HST rate for BC will be 12% comprised of a 5% Federal component and a 7% Provincial component. The HST will be applicable to virtually the same purchases as the current GST, which means that transactions that are currently subject to GST will also be subject to HST effective July 1, 2010. The GST is applicable to a much broader base of purchases in comparison to the current PST.

The Province of BC has stated that to protect the public service sector from unfavourable tax implications resulting from the HST, they will be providing rebates on the Provincial portion of HST so that, on average, public sector organizations will not experience an additional financial impact from the implementation of the HST. Specifically, municipalities will be eligible for a

rebate of 75% of the Provincial portion of HST (7%) on all purchases and will continue to receive a 100% rebate of the Federal portion of HST (5%), currently known as the GST, on all purchases. The net effective HST rebate for municipalities will be 85.4% of the HST paid on purchases.

The harmonization of the PST with the GST is focussed on BC's business competitiveness. Under the current system, businesses pay PST on many goods and services for which they cannot claim a credit or rebate. This embedded tax is ultimately passed on to customers in the form of higher prices. Once HST has been implemented, most businesses will be able to claim input tax credits for all the sales tax they pay thus lowering their cost of doing business. It is expected that this savings will be passed on to the customer. The removal of the embedded PST will also encourage investment in the Province by reducing the capital costs associated with establishing a business. A further benefit of sales tax harmonization is that businesses will only have to deal with one governmental organization in remitting sales taxes and substantially one set of administrative rules in relation to administering sales tax. This will result in a relatively more simple tax environment for the operation of a business.

The effect of the introduction of the HST will vary depending upon the industry and the ability of a business to claim input tax credits. For example, the restaurant industry is very labour intensive and consequently is not expected to enjoy any significant relief from input tax credits under the HST while at the same time having to charge their customers an additional 7% for meals. Currently restaurant food is PST exempt but the full HST will be collected on restaurant food after July 1, 2010.

Overall, the Provincial Government is confident that the HST will result in increased productivity for BC businesses and lower investment costs, which will foster economic growth.

DISCUSSION

Although the Province has advised that on average, the public service sector including municipalities, will be in a tax neutral position once the HST has been implemented, it is noted that this is dependent on the spending pattern of any particular municipality.

The City of Surrey, due to its relatively high rate of growth, makes significant annual expenditures for consulting services, real property acquisitions and construction contracts. The implementation of the HST has a greater impact on these types of expenditures. Currently these types of expenditures are PST exempt but will not be HST exempt, depending upon the structure of the agreement. This negative impact will be mitigated to some extent by the municipal HST provincial rebate (being 75% of 7%). The following examples illustrate the effect of the HST in comparison to the PST for different typical City of Surrey transactions:

	PST & GST		HST	
	(no PST rebate, 100% GST rebate)		(net rebate of 85.4%)	
Computer Cost	\$100,000.00		\$100,000.00	
PST	\$7,000.00		-	
GST/HST	\$5,000.00		\$12,000.00	
Total Cost	\$112,000.00		\$112,000.00	
GST/HST Rebate	-\$5,000.00		-\$10,248.00	
Net Cost to City	\$107,000.00		\$101,752.00	
Net Effect	Favorable impact of	\$5.248.00		

CONSULTING SERVICES CONTRACT

PST & GST			HST
	(no PST rebate, 100% GST rebate)		(net rebate of 85.4%)
Service Contract	\$100,000.00		\$100,000.00
PST(exempt)	-		-
GST/HST	\$5,000.00		\$12,000.00
Total Cost	\$105,000.00		\$112,000.00
GST/HST Rebate	-\$5,000.00		-\$10,248.00
Net Cost to City	\$100,000.00		\$101,752.00
Net Effect	Unfavorable impact of	-\$1,752.00	
LAND PURCHASE	PST & GST		HST
	(no PST rebate, 100% GST rebate)		(net rebate of 85.4%)
Parkland	\$5,000,000.00		\$5,000,000.00
PST(exempt)	-		· · · · · · · · · · · · · · · · · · ·
GST/HST	\$250,000.00		\$600,000.00
Total Cost	\$5,250,000.00		\$5,600,000.00
GST/HST Rebate	-\$250,000.00		-\$512,400.00
Net Cost to City	\$5,000,000.00		\$5,087,600.00
Net Effect	Unfavorable impact of	-\$87,600.00	

The City enters into various types of construction contracts and the implications of the introduction of HST will vary with each contract depending upon the proportion of materials, labour and supplies. Below is an example of a typical contract for engineering services.

UNIT PRICED CONTRACT

	PST & GST		HST
(n	o PST rebate, 100% GST rebate)		(net rebate of 85.4%)
Supply and Install 100 Manholes	\$1,467,500.00		\$1,467,500.00
PST(exempt)	-		-
GST/HST	\$73,375.00		\$176,100.00
Total Cost	\$1,540,875.00		\$1,643,600.00
GST/HST Rebate	-\$73,375.00		-\$150,389.40
Net Cost to City	\$1,467,500.00		\$1,493,210.60
Net Effect	Unfavorable impact of	-\$25.710.60	

The actual impact to the City of the HST is somewhat difficult to establish accurately, in part due to the fact that it is not known how business will pass on their input tax savings to their customers. The impact of the HST will vary from year to year depending on the relative magnitude of City expenditures for different goods and services.

For illustrative purposes, had the HST been in place for 2008 in place of the current PST, the City would have had a higher total relative direct tax burden of approximately \$1.3 million, which is equivalent to a 0.7% property tax increase. This amount is comprised of \$0.7 million related to capital expenditures, \$0.5m related to operating expenditures, and \$0.05 million for land acquisitions. It is estimated that the effect of the HST in 2010 with the new sales tax being implemented half way through the fiscal year will be an increased cost burden to the City of \$0.7 million. It is also estimated that it will cost the City approximately \$100,000 to make the required changes to software to capture and track the new HST and to ensure that information is available as the basis to apply for HST rebates. The above totals do not take into account the price reductions in goods that could result from the elimination of the currently hidden PST amount (payable on inputs to the production of the goods) in the price of goods purchased by the City.

Effective July 1, 2010, all municipal services that are currently subject to 5% GST will effectively become subject to 12% HST. Most municipal services that are currently exempt from GST will also be exempt from HST, such as water and sewer charges, garbage collection services, business licences, building permits, recreation programs to youth under 15 and zoning application fees. Over the next several months, all City By-laws will be updated to reflect the introduction of the HST.

In November of 2009, the Province of BC announced that effective January 1, 2010 the PST rate on the purchase price of certain parking rights will increase from 7% to 21%. The City of Surrey is not directly affected by this increase since it currently only offers metered street parking which is exempt from PST. However, GST is currently being charged for City metered parking and effective July 1, 2010 HST will apply to the City's metered parking revenues.

Currently, short-term (less than one month) accommodations in BC are subject to a Provincial Hotel Room Tax (HRT) of 8% in addition to GST (5%). Effective, July 1, 2010 the HRT and GST will be replaced with the 12% HST rate for taxable accommodations. Under current regulations, a municipality or regional district can apply to the Ministry of Finance for an additional 2% HRT. This revenue stream is to be used to promote the tourism industry in the local jurisdiction from which the additional tax is collected and to finance new tourist facilities or programs within that jurisdiction. This additional Hotel Room Tax is collected and administered by the Province. The City of Surrey currently participates in this additional 2% HRT. The Province has indicated that this additional HRT will continue to be in effect until June 30, 2011 to allow the Province an opportunity to engage key stakeholders in developing options to mitigate the loss of this revenue stream. The Surrey Tourism and Convention Association relies on this revenue stream to fund much of its operation. A further report on this matter will be forwarded to Council in due course.

CONCLUSION

The 2010-2014 Five Year Plan that was adopted by Council in December, 2009 reflects the anticipated impact of the implementation of the HST in July, 2010. For the City of Surrey the implementation of the HST will result in a somewhat higher tax burden due primarily to the pattern of the City's expenditures; however, the price of goods purchased by the City is expected to decrease due to the removal of the embedded PST on inputs, which should mitigate to some extent the financial impact of the HST.

Based on the above, it is recommended that the Finance Committee recommend that Council request that the Mayor forward a letter on behalf of Council to the Provincial Minister of Finance requesting that the Province take action to ensure that the implementation of the HST is cost neutral to municipalities relative to the current PST and that a copy of this report be included as background information in the letter and further that a copy of the letter and this report be circulated to UBCM member local governments.

Vivienne Wilke, CGA General Manager, Finance & Technology