Ontario Harmonized Sales Tax: are you ready for the transition?

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In the recent provincial budget, the Ontario government announced its intention to implement a new harmonized sales tax, effective July 1, 2010. The HST will combine the current federal Goods and Services Tax (5%), with the provincial Retail Sales Tax (8%), to produce a federally administered sales tax of 13%.

The application of the HST will vary according to individual practice type. However, it is anticipated that the greatest financial impact of the HST on physician practices will relate to practice expense components such as lease/rent costs and professional services such as accounting and legal services, which are currently taxed at the 5% GST rate.

The OMA Board has undertaken a number of measures to investigate the potential impact of the HST on members, and to explore potential opportunities to offset or minimize increased expenses that may be incurred by members. This work is ongoing.

Further, the Board hired KPMG Canada to prepare an independent report on the potential issues that members may encounter as a result of the harmonized sales tax. The report appears below.

Physicians practising in Ontario will be affected by Ontario's plan to harmonize its provincial sales tax with the federal Goods and Services Tax (GST), effective July 1, 2010. The following alert addresses the most common issues to be faced by Ontario physicians as a result of harmonization.

Structure of the HST

As announced in the March 26, 2009 budget, Ontario plans to introduce a single, harmonized federally administered sales tax (HST), with a 13% rate, effective July 1, 2010 (the implementation date). The HST will generally employ the same rules and tax base as the GST. There will be no separate requirement to register for the HST. Thus, physicians currently registered for the GST will automatically be registered for the purposes of the HST.

GST – The Basics

As the upcoming HST is to be modeled after the current GST, we have included below some general information regarding the operation of the GST as it is currently structured.

The GST applies at a rate of 5% to most goods and services supplied in Canada. Generally, every person who makes a taxable supply (including a zero-rated supply — defined below) in Canada in the course of a commercial activity is required to register, unless the person qualifies as a small supplier (less than $30,000 annual taxable supplies).

For the purposes of the GST, the term "supply" includes the provision of property or services in any manner, including a sale, transfer, rental, lease, etc.

Businesses that are registered for GST purposes are required to collect and remit GST on taxable supplies made in Canada and are entitled to claim an offsetting input tax credit (ITC) for GST paid on expenditures acquired for use in commercial activities (i.e. in the making of taxable supplies).

A taxable supply is a supply made in the course of a commercial activity and includes any supply other than an exempt supply. The term "taxable supply" includes a zero-rated supply.

Zero-rated supplies (e.g., exported goods/services, medical devices, basic groceries) are taxable supplies to which a 0% rate of GST applies. Suppliers who make zero-rated supplies are generally entitled to recover all of the GST paid on expenditures incurred in order to make such supplies.

GST does not apply to certain supplies deemed to be exempt from tax, such as health-care services and financial services. Unlike zero-rated supplies, suppliers who make exempt supplies are not entitled to recover GST paid on expenditures incurred in order to make exempt supplies.

HST and Health-Care Services

Once the HST comes into effect, physicians who are GST registered will be required to charge and collect tax at a rate of 13% on any taxable supplies (other than zero-rated supplies) of goods and services they sup-

Table 1

Services currently GST exempt. These services will remain exempt from HST after implementation.	Services currently GST taxable at a rate of 5%. These services will attract HST at a rate of 13% after implementation.
• Insured services for which the cost is reimbursable by OHIP. • Uninsured services provided by a physician that qualify as consultative, diagnostic, treatment or other health-care services rendered to an individual.	• Uninsured cosmetic surgery (other than procedures performed for medical/reconstructive purposes). • Uninsured consulting services provided by physicians (e.g., research services provided to pharmaceutical companies). • Expert witness fees for court appearances.

ply in the province of Ontario. Supplies that are currently exempt from GST will remain exempt under HST so there will be no requirement to collect HST on such supplies.

Physicians who are not currently registered for GST purposes (such as GPs that make only exempt supplies) will not be affected by the HST with regards to the services they provide.

As detailed below, all physicians, whether registered or not, will be affected by the fact that HST at a rate of 13% will apply to most of their costs other than labour, whereas the current provincial sales tax only applied to certain costs.

Which services will attract HST?

Currently, the majority of health-care services supplied by physicians are exempt from GST. These services will remain exempt once the HST is introduced. Specifically, all insured services for which the cost is reimbursable by OHIP will remain exempt from HST. In addition, uninsured services provided by physicians that currently qualify for exemption from GST will remain exempt from HST. In this regard, uninsured services provided by a physician are generally exempt from GST where the service supplied is a consultative, diagnostic, treatment or other health-care service rendered to an individual.

Uninsured services such as medical/surgical procedures that are performed for cosmetic purposes and not for medical or reconstructive purposes are currently subject to GST at a rate of 5%. These services will attract HST at a rate of 13% post-implementation where such services are performed in Ontario.

Table 1 (above) provides examples of common services provided by physicians that are currently exempt from GST and will remain exempt, as well as those services currently subject to GST that will attract HST.

In addition to providing services, physicians may also supply their patients with goods, some of which may qualify for zero-rating as medical/assistive devices. As noted above, supplies of zero-rated goods are considered to be taxable supplies, but at a rate of 0%. Some examples of goods that currently qualify for zero-rating as medical and/or assistive devices are as follows:

- Heart monitoring devices
- Hearing aids
- Insulin pumps, syringes
- Orthotic and orthopedic devices
- Medical/surgical prosthesis
- Eyeglasses/contact lenses
- Aerosol chambers, inhalers
- Blood glucose monitors/test strips
- Specially designed footwear
- Canes and crutches

It should be noted that in some cases, there are specific conditions that must be met in order for a medical device to qualify for zero-rating. For a detailed listing of the types of goods that qualify for zero-rating and the conditions that may apply, please refer to the Canada Revenue Agency GST/HST Memoranda Series 4.2, entitled Medical and Assistive Devices (http://www.cra-arc.gc.ca/E/pub/gm/4-2/README.html).

Medical/assistive devices that currently qualify for zero-rating will remain zero-rated upon implementation of the HST.

Input tax credit entitlement

Generally, ITCs can only be claimed by GST registrants who are engaged in commercial activities (i.e. in the making of taxable supplies, including zero-rated supplies). Persons who are engaged exclusively in making exempt supplies are not entitled to register, nor are they entitled to claim ITCs.

Accordingly, physicians who only supply exempt health-care services, including both insured and uninsured services that qualify as consultative, diagnostic, treatment or other health-care services rendered to an individual (such as GPs), are not entitled to register or claim ITCs in respect of the GST paid on purchases of materials, equipment, and/or services acquired to provide their tax-exempt services. This will remain the case after the introduction of the HST.

Physicians who make both GST taxable and GST exempt supplies are entitled to register and claim ITCs for the tax incurred on goods/services acquired that directly relate to the taxable supplies made by the physician. ITCs for expenditures that are used in the making of both taxable and exempt supplies must be apportioned on a reasonable basis.

For example, a physician who performs both exempt reconstructive surgery and taxable cosmetic surgery would be considered to be engaged in making a mixture of both taxable (cosmetic) and exempt (reconstructive) supplies. As such, the physician would be entitled to claim ITCs for those expenditures incurred that directly relate to making taxable supplies of cosmetic procedures, while ITCs for expenditures directly incurred in order to make exempt supplies of reconstructive procedures would not be available. Expenditures incurred that do not directly relate to the making of taxable or exempt supplies would need to be apportioned on a reasonable basis.

Physicians who make exclusively (90% or more) taxable supplies (e.g., physicians who are only engaged in providing taxable cosmetic procedures) are entitled to register and claim full ITCs on purchases of goods/services acquired for use in making those supplies.

Impact of HST on Purchases Made by a Medical Practice

Upon the introduction of the HST, many goods and services purchased by physicians that are currently exempt from Ontario Retail Sales Tax (ORST) will become subject to HST at a rate of 13%. These goods and services are currently subject to GST at a rate of 5%, such that the application of HST will, all other things being equal, result in an incremental 8% cost to the physician.

The impact of this change will mainly be felt by physicians engaged exclusively in making exempt supplies, as they will not be entitled to claim ITCs for the HST payable on such expenditures. Table 2 (above) lists some of the most frequently purchased goods and services currently exempt from ORST that will attract HST post-implementation.

Table 2

Tangible goods currently ORST exempt that will attract 13% HST post-implementation.	Other property/services currently ORST exempt that will attract 13% HST post-implementation.
• Injectable and topical anesthetics containing ephedrine as secondary ingredient. • Certain non-reusable supplies (e.g., needles, tubes, bags and other blood collection supplies). • Orthopedic appliances and repair parts (e.g., splints, slings, braces) that do not otherwise qualify as zero-rated medical devices. • Custom computer programs designed/developed to meet specific requirements of initial purchaser. • Disposable products that are used up or expended during patient treatment, including: - Patient examination gowns - Table paper/covers - Paper towels and tissues - Cotton balls/swabs - Tongue depressors - Disposable face masks - Iodine and alcohol swabs/wipes - Sterile surgical gauze and adhesives - Sutures or other skin closures - Casting materials - Latex/vinyl gloves - Medicated soaps	• Management company fees paid for administrative services. • Certain professional fees and membership dues. • Certain educational courses/seminars. • Commercial real estate rentals, leases, sales. • Other services/intangibles, including: - Janitorial services - Dry cleaning services - Accounting services - Legal services - Advertising services - Staffing services provided by a placement agency - Monitoring and security services - Interior decorating and design services - Magazine subscriptions

Planning Points

Is there any way to reduce the impact of the HST on my practice?

There are certain planning opportunities to consider in order to minimize the initial impact that the introduction of the HST will have on your particular practice. If you are a physician who is engaged exclusively in providing GST-exempt health-care services, you will not be entitled to claim ITCs on the purchases of goods/services for use in your activities. Thus, consideration should be given to the following:

- Accelerate purchases of goods/services currently exempt from ORST that will become subject to HST upon implementation. The table above should be able to assist in this regard. For example, if you are considering the purchase of a custom computer program that would qualify for exemption from ORST, you should purchase that program prior to July 1, 2010. By doing so, you will only incur GST at a rate of 5% on the purchase of the program as opposed to HST at a rate of 13% if the program were to be purchased post-June 30, 2010.
- Review your current contractual and billing arrangements in order to ensure that you are satisfied with the tax status of such, and consider restructuring in order to reduce the amount of unrecoverable HST that will be payable. For example, if you are a physician in a group medical practice that pays a management company for administrative services, those services will attract HST at a rate of 13% post-

implementation. As this HST will not be recoverable to physicians engaged only in exempt activities, consideration should be given to whether the arrangement can be restructured to avoid incurring such unrecoverable tax. For example, if the management company were to act in the capacity of an agent when incurring non-taxable expenditures, such as payroll on behalf of the group of physicians, no HST should apply when physicians reimburse the management company. Note that such planning must be properly documented and executed to achieve the intended result — physicians wishing to consider such planning should consult their professional adviser.

- If you are a physician who is engaged in a mixture of taxable and exempt activities, and as such, will be entitled to claim at least partial ITCs once the HST is introduced, you may want to consider deferring purchases of items that are currently subject to ORST until after the implementation date. For example, if you are considering purchasing taxable computer software that will be used exclusively in taxable activities (e.g., cosmetic surgery), you may want to defer your purchase of this software until after June 30, 2010. By doing so, although you will incur 13% HST on the purchase of the software, you should be entitled to claim a full ITC for the tax paid, as the software was acquired for use exclusively in taxable activities.

Other Considerations

What would the implications be if the federal government were to make health-care services zero-rated as opposed to exempt?

It is understood that the Department of Finance (Finance) has received representations requesting that health-care services provided by physicians be treated as zero-rated services under the GST/HST legislation.

If the GST/HST legislation were amended so as to treat health-care services supplied by physicians as zero-rated supplies as opposed to exempt supplies, the main benefit would be that persons providing such services would become eligible to claim ITCs on all taxable property/services acquired. The reason is that zero-rated supplies are considered to be taxable supplies under the GST/HST legislation, although they are taxed at 0%.

Thus, no tax would need to be collected on health-care services where they were accorded zero-rated status, but any and all purchases of goods/services acquired for use in making such supplies would give rise to full ITC entitlement.

At this time, we are not aware as to whether Finance is currently considering this issue or not. **OMR**

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The information is current to April 30, 2009. The information is of a general nature only and is not intended to be, nor should a user of this information construe it to be, information addressing any particular individual or entity.

The information is based on understanding of the potential implications regarding the proposed Ontario single sales tax (OVAT) as announced in Ontario's 2009 budget delivered on March 26, 2009 and the Memorandum of Agreement Concerning a Canada-Ontario Comprehensive Integrated Tax Co-Ordination Agreement signed on March 10, 2009. As the underlying policy, legislative and administrative details regarding the OVAT have not yet been released, there can be no assurance that these budget announcements will be enacted as proposed or at all.

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