



ONTARIO NONPROFIT NETWORK BRIEF

NOVEMBER 5, 2009

ANTICIPATED IMPACT OF THE HARMONIZED SALES TAX ON ONTARIO'S NONPROFIT SECTOR

Overview of ONN

The Ontario Nonprofit Network works to serve the more than 43,000 nonprofit and charitable organizations in Ontario to strengthen our ability to provide public benefit to the people of Ontario. Every Ontario community and every person in Ontario is enriched, and supported by our vibrant nonprofit organizations in the fields of arts, social services, sport and recreation, housing, environment, community health as so on. Indeed we have one of the most robust public benefit sectors in the world but it has been too often neglected or overlooked in the development of policies that affect the sector. ONN hopes to change this and ensure Ontario communities continue to be good and creative places to live and raise families.

Towards this end, ONN has convened a cross-sectoral committee to examine the potential impact of the harmonization of the PST/GST on the sector and its public. The sector is very diverse and various sectors and organizations are impacted differently by harmonization depending on the features of their GST status.

The Sector's Four Classes of HST Tax status

Organizations in the nonprofit sector, depending on their circumstances, fall into one of four different classes of sales tax status.

- The largest class or group is charities registered under the Income Tax Act (Canada). They comprise 60% of the sector. Charities generally provide exempt services and (if

not registered for GST / HST purposes) are eligible for GST and PST rebates, and will continue to be eligible for rebates under HST. Those that provide taxable services (and are therefore registered) generally receive a refund of the taxes paid on their inputs.

- Of the remaining 40%, an unknown but small number are “qualifying¹ nonprofits”. A qualifying nonprofit has 40% government funding and are generally treated the same way as charities under HST. They too are eligible for rebates.
- The remaining nonprofits, those without 40% government funding, typically rely on earned revenues and fees but often provide exempt services. As providers of exempt services they cannot register to collect and claim HST yet they are ineligible for rebates. They are classed “non-qualifying nonprofits.” Many local sport and recreation programs, such as community soccer leagues, swim clubs etc., fall into this category as well as social enterprises and innovative public benefit activities that cannot obtain charitable status under Canada’s classification system for charities.
- The fourth class involves a small proportion of nonprofit organizations that provide GST/HST taxable services and are therefore are eligible to register for GST (and therefore HST) using the general method employed by commercial businesses – e.g. many professional performing arts organizations. Registrants filing under the general method typically qualify for a 100% refund of GST (and therefore HST) paid on purchases – that is, the Input Tax Credit (ITC). They will not experience the same potentially negative impact from the transition to HST.

For the purpose of this brief, we will consider the first three of these four classes of sales tax status.

Our Understanding of HST

In this section we have set out the key considerations regarding HST and the nonprofit sector as we understand them, followed by recommendations where we believe there are clear solutions. We then provide more detail on specific issues and areas for discussion.

Our understanding to date:

- The HST is far more pervasive than the PST. Thus, goods (and primarily) services which were not taxable under the PST regime are taxable under the HST.
- Charities and nonprofits are required to register to charge GST if they have annual taxable sales of \$50,000 or more (or they have gross revenue of more than \$250,000).

¹ “Qualifying” in this context is a defined term in the GST / HST legislation which basically requires that the non registered charity, not for profit receive at least 40% of their funding from government grants. Qualifying not for profits qualify for a rebate of a portion of HST paid on purchases.

Charities and nonprofits with taxable sales less than this amount may voluntarily register but in so doing must charge GST on sales. Registrant charities file returns, remitting taxes collected and claiming refunds of taxes paid on inputs.

- Charities and nonprofits which only produce exempt goods and services must remain non-registrants. Charities and “qualifying nonprofits” can file rebate claims. Organizations currently eligible for GST rebates will qualify for HST rebates.
- Charities and “qualifying nonprofits” are eligible for the rebate of GST paid on taxable supplies and as a result they will continue to be eligible for a 50% rebate on 5% of the HST paid (i.e. formerly GST, the federal portion of HST) and an 82% rebate on 8% of the HST paid (i.e. formerly provincial sales tax, the provincial portion of HST). “Non-qualifying nonprofits” are not eligible for the rebates, even if they are providing exempt services such as swim lessons for children or serving disadvantaged groups.
- There are two areas of significant impact for the HST on the sector - on the nonprofit organizations themselves and on the ability of the public to afford their services when the 13% sales tax comes into effect.
- Although the stated intention is that the new tax regime be revenue neutral for the nonprofit sector, there are certain groups of nonprofit organizations and end users of the sector’s services that will be negatively impacted.
- The Province of Ontario has used its authority over the provincial sales tax to favourably support the nonprofit sector. With the move to harmonize with the GST, the province’s capacity to support the sector in this way appears to be lost (or is at least severely restricted). The loss of 100% rebate on PST for nonprofit and charitable capital construction, the loss of the reduction in PST charged on ticket sales of performing arts organizations in venues under 3200 seats, and the loss of other exemptions of charities from provincial sales tax² will have serious impact on the sector.
- For those organizations in the sector who currently receive a 50% rebate on their GST, the HST will impact them in this way: On purchases that are now subject to GST only, the move to HST will increase their costs by 1.44%. On purchases currently subject to PST and GST the move to HST will see those costs reduced by 3.2%. If the current ratio of GST purchases to PST purchases is less than 3:1 the nonprofit or charity will experience the HST as revenue neutral or even advantageous. Based on a small survey, we believe most nonprofit organizations that currently claim the 50% GST rebate will find the HST neutral. However, some who have been exempt from sales tax will be significantly disadvantaged.
- Currently Federal and Provincial payments under funding contracts are based on GST expenses after rebates. Government funders are expected to apply this same approach

² under section 7.(1) Retail Sales Tax Act - Exemptions Regulation 1012, section 1

to HST so service providers will not have any savings to redeploy to cover transition costs and cash flow pressures. HST payments will be much larger than current GST payments and even with quarterly claims the time lag in receiving rebates will place a strain on many organizations.

- The “non-qualifying nonprofits” are even more challenged. They currently pay 5% GST and 8% PST and receive no rebates. Many of these organizations are providing exempt services in their communities and are commonly non-registrants, and therefore do not receive sales tax refunds via Input Tax Credits (ITCs). These organizations will see their costs rise by 8% on items for which they currently pay GST only. This increase will have to be passed on to the end users at a time when enrollment in community programs is already falling from the economic downturn.
- These small grassroots organizations that are “non-qualifying nonprofits” appear to have been overlooked and, as we understand it, they are not eligible for any relief or rebate. Those that offer taxable services could opt to register for the tax, start charging HST to their users, and thereby become eligible for rebates. Registration, and rebate eligibility, could solve the organization’s financial problem – but the tax increase to user fees raises a significant accessibility/affordability issue and would undermine their mission to provide public benefit. HST for “non-qualifying nonprofit” organizations will force them to significantly increase the price and decrease the affordability of their services to their communities.
- Performing arts groups, which are mostly charitable, are also concerned about public access. HST will bring upward pressure on ticket prices. With the move to HST, performing arts groups will lose the PST exemption on ticket sales to performances in venues with fewer than 3200 seats. HST will add 8% to ticket prices. Performing arts organizations are concerned that the public will not be able to absorb such a steep increase in this economic climate.
- Creative communities and healthy lifestyles, both government priorities for its citizens, will not be well served by these end user increases. Community programs are already reporting significant decreases in enrolment in the economic downturn. Moreover, organizations report other sources of income, such as government grants and charitable donations, are also down so these organizations have no ability to absorb HST cost increases.
- Currently, there is a 100% PST rebate on materials used in capital projects for charitable organizations. This will be reduced under the new regime, with only 82% rebates for PST under HST. For large capital projects currently underway, this will increase expenses dramatically. This change has immediate impact on projects underway that have not had an opportunity to factor in the increase to their budgets and fundraising. Moreover, current pricing will be in force and the anticipated price reductions from construction will come too late to help.
- On capital housing projects where the organization must deem market value for the purpose of self-supply, there is currently a 100% GST rebate where a non-profit

housing project is deemed a municipality. In the move to HST the rebate must remain 100% of HST or else the non-profit will face a huge tax liability on the market cost of the building. This will discourage nonprofits from entering the social housing market as it will be yet another obstacle for social housing construction.

- Harmonization will increase the administrative burden on nonprofit organizations. Most who now claim annually will need to claim quarterly in order to avoid an insupportable cash flow squeeze. Since many organizations have a poor understanding of the GST framework they will need considerable orientation to HST. Moreover, small organizations have very little administrative capacity with many being largely run by volunteers. The sector will need specialized training tailored to the different situations of the different subgroups to make the transition as smooth as possible.

RECOMMENDATIONS

1. That Federal and Provincial Government funding contracts use the net HST expense when determining HST for contract reimbursement. In contracts where the impact of HST is not revenue neutral, the government funder should increase the grant to cover the negative impact of HST.
2. That “Non-qualifying nonprofits” which provide exempt public benefit services in their communities be eligible for a HST rebate on the same basis as “qualifying nonprofits” and small charities. With reductions in government funding, a threshold of 40% government funding is no longer a reliable indicator of provision of public benefit. Non-distributing (assets remain in the public domain) and delivery of exempt services should be the criteria for being a “qualifying nonprofit.”
3. The age limit for exempt children’s activities be raised from 14 to 16 years of age.
4. That all charitable and nonprofit organizations including “non-qualifying nonprofits” providing exempt services be eligible for the same grants as for-profit organizations to implement HST.
5. Zero Rate ticket sales from HST for nonprofit and charitable performing arts groups operating in venues under 3200 seats. If this cannot be accommodated, we’d recommend that charitable arts organizations be allowed to keep 100% of the provincial portion of HST collected on ticket sales. Failing this, we would ask that a point-of-sale rebate be implemented. Failing this, we would ask that grants equivalent to the net impact could be made to the affected organizations, to enable them to eliminate price increases directly linked to the implementation of the tax. It would be necessary to work out an agreed-upon mechanism to calculate this.

6. Capital projects of charities should be reimbursed 100% for HST for a period of two years as a phase-in measure.
7. An HST rebate of 100% should be provided for nonprofit housing projects deemed a municipality. For the purpose of self-supply, nonprofit housing providers must pay tax on the market value of the project upon completion. This tax is currently rebated at 100% GST. This practice of 100% rebate must continue for HST or else the tax will be catastrophic on nonprofit housing providers' ability to build social housing.
8. The government should provide the sector with active implementation support. HST implementation training should be sub-sector-specific to assist organizations change their systems over most efficiently. The sector is so diverse and has such limited administrative capacity that specific training tailored to specific needs will be easiest and most cost effective.

Additional Detail and Discussion of Issues

CAPITAL PROJECTS

Currently, there is a 100% PST rebate on materials used in capital projects for nonprofit and charitable organizations. This will be reduced under the new regime, with only 82% rebates for PST under HST. For large capital projects by charitable organizations, this will increase expenses dramatically. For instance, in the case of a building with a value of \$70,000,000, the building owner will be obliged to pay 8% (\$5,600,000) and then may apply for a rebate. For charities, this rebate is 82% (\$4,592,000), leaving the charity with a new tax burden (in this case \$1,008,000). Which is \$1 million more the organization needs to raise that will not be directed to its public benefit purposes.

Nonprofit housing providers deemed a municipality for the purposes of building social housing pay tax on the finished building's market value. Take for example a building of \$70,000,000 as in the example above. Currently the nonprofit provider receives a 100% rebate of the GST owing. If under HST the 100% rebate is not continued the nonprofit provider could be looking at rebates of 50% on GST and 82% of PST. This will leave them with a tax bill of \$2,422,000.

RATIO OF SERVICES TO GOODS

Nonprofit organizations that rely heavily on services, rather than goods, may see increased costs. Many smaller organizations in the social services whose programming is heavily people-dependent, and who cannot afford full-time staffing, rely heavily on the services of consultants and other contracted service-providers. Currently, those expenses attract 5% GST with a 50% rebate and no PST. These expenses will now attract 13% HST which, after rebates, will result in an increase to these costs of 1.44%.

On the other hand, those same organizations will continue to pay 13% sales tax³. As there is currently no rebate on PST, those organizations will, under HST, receive an additional rebate (50% GST and 82% of PST). This will amount to a net saving of 3.9% over current expenditures on items subject to sales tax. The savings in PST will balance or exceed losses on current GST-only purchases if the organization's GST taxed expenses are less than three times the PST eligible expenses. Many, but not all charities and qualifying nonprofits, will experience HST as neutral. Further surveying is required to identify those groups who will experience cost increases.

Table I

	Current GST	Current PST	Current GST + PST	Harmonized Sales Tax
Expenditure	100.00	100.00	100.00	100.00
GST	5.00		5.00	5.00
PST		8.00	8.00	8.00
Rebate GST	2.50		2.50	2.50
Rebate PST				6.56
Total	102.50	108.00	110.50	103.94

ADDITIONAL PRESSURE ON CHARITABLE DISBURSEMENT QUOTA

The new sales tax regime will also have consequences on charities' ability to meet the Charities Directorate's requirements for charitable spending, framed by the disbursement quota rules.

Basically, charities may spend a maximum of 20% of donations received in the previous year on administrative expenses in the current year. For smaller volunteer run, organizations that contract out for bookkeeping, fundraising and administrative support the new sales tax regime will effectively increase the administrative expenses of these organizations. In the extreme case of an organization that contracts out all of their administration the organization now has 1.44% less to spend on administration (including fundraising) than under the current scenario.⁴

CHARITIES ARE NOT "LARGE BUSINESSES"

Large charities that earn a significant portion of their revenues through taxable sales, like arts and cultural organizations, will also be negatively impacted if they are considered to be "large businesses" under the new regime (i.e. \$10 million or more in taxable sales). For eight years, these organizations will be negatively impacted by the reporting requirements – five years in which no input credits may be claimed for certain classes of expenses, followed by three years of reduced input tax credits.

³ A small but unknown number of charities have an exemption from provincial sales tax.

⁴ Adam Aptowitzer, *Tax Harmonization is Not Music to the Ears*, July 9, 2009, available on www.drache.com

IMPLEMENTATION

While not all the rules about implementation are clear yet, what is clear is that there will be considerable confusion and additional costs for organizations to switch their bookkeeping and reporting systems to the new regime. Small and mid-sized nonprofit organizations have limited organizational capacity and often little tax or accounting expertise. In addition, there will be cash flow implications for organizations since the cash outlay between purchase and rebate will be significantly greater than currently. Quarterly filing will be required for many who now file annually.

IMPACTS ON END USERS

Tickets for Cultural Organizations to Rise

There are very specific impacts in particular areas of the nonprofit sector. For instance, the new regime will completely eliminate the current PST exemption on ticket sales for cultural organizations performing in venues of less than 3,200 seats. This exemption has existed for 20 years, made permanent by the government of Ontario only last year, and ending it will be a burden on both charitable cultural organizations and the audiences who buy tickets. This new tax is contrary to some international precedents – for example, within the European Union, a directive was passed to the effect that admission charges for nonprofit cultural organizations (performing arts, galleries, museums, etc.) may not be taxed.

Access to Sports Venues Now More Expensive

The sports and recreation sector may be facing increased costs to access facilities, as they may now be subject to HST, when previously municipal facilities and school boards did not charge tax. We have been unable to determine when HST will be charged on facility rental. It appears to vary between locations among similar organizations. Facility rental is often a major budget item for sports and recreation groups. This increase will impact program affordability for all programs including children's programs.

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