

Important GST Details, *Effective July 1, 2006*



Highlights

- GST Rate Reduced to 6% on July 1, 2006
- Four General Rules for Real Property Contracts
- Explaining the Transitional Rebate to Your Clients
- The New Housing Rebate
- Figuring the Transitional Rebate and the New Housing Rebate
- Renegotiated Contracts
- Assignments of Purchase Contracts
- Commissions

Overview

On May 2, 2006, the Minister of Finance announced a 1% reduction of the Goods and Services Tax (GST)/Harmonized Sales Tax (HST) rate effective for tax paid or payable as of July 1, 2006.

This fact sheet focuses on the GST issues frequently encountered by professionals involving transfers of GST-taxable new and substantially renovated residential property.

The GST rate reduction does not affect the GST-exempt status of used residential property.

The information contained herein is not intended to replace the law

found in the *Excise Tax Act* – Part IX Goods and Services Tax. Contact your BDO advisor for specific GST advice on any real property transactions.

For simplicity, the term “house” will be used throughout this document in reference to a residential property and, generally speaking, includes a single family home, a semidetached house, a duplex, a townhouse, a residential condominium unit, a manufactured or modular home, and a floating home. A “new house” refers to newly constructed residential property or substantially renovated residential property.

The GST rate reduction does not affect the GST-exempt status of used residential property.

General Rule: Timing of the New 6% Rate

As a general rule, 7% GST continues to apply to all supplies of GST-taxable goods and services (other than zero-rated goods and services), where the consideration is paid or payable on or before June 30.

The 6% GST applies to consideration paid or payable for supplies of GST-taxable goods and services (other than zero-rated goods

and services) on or after July 1, 2006, in the following circumstances.

- If the consideration is payable on or after July 1, 2006, without having been paid before that date, the 6% rate applies.
- If the consideration is paid on or after July 1, 2006, without having become payable before that date, the 6% rate applies.
- If the consideration is paid or payable before July 1, 2006, the 7% rate applies.

Four General Rules Relating to Purchases of New Residential Property and Substantially Renovated Residential Property

Newly constructed and substantially renovated housing is GST-taxable. Except in very limited circumstances, the builder must charge and collect GST from the purchaser.

There are four general rules to remember when dealing with GST on new residential property.

1. **Pre-May 3, 2006, contract/ Pre-July 1, 2006, possession and ownership:** where a written agreement to purchase a new house was signed before May 3, 2006, and either *possession or ownership* transfers to the purchaser before July 1, 2006, the **7% GST rate applies**.

2. **Pre-May 3, 2006, contract/ Post-June 30, 2006, possession and ownership:** where a written agreement to purchase a new house was signed before May 3, 2006 and *possession and ownership* transfer after June 30, 2006, the purchaser will pay **6% GST, after claiming the Transitional Rebate.**
3. **Post-May 2, 2006, contract/ Pre-July 1, 2006, possession and ownership:** where a written agreement to purchase a new house was signed after May 2, 2006, and either *possession or ownership* transfers before July 1, 2006, the **7% GST rate applies.**
4. **Post-May 2, 2006, contract/ Post-June 30, 2006, possession and ownership:** where a written agreement to purchase a new house was signed after May 2, 2006, and *possession and ownership* transfer after June 30, 2006, the **6% GST rate applies.**

Explaining the Transitional Rebate to Your Clients

Simply put, the Transitional Rebate reduces the purchaser's GST on new or substantially renovated housing to 6% (ignoring the New Housing Rebate), even though the contract to purchase was signed before May 3, 2006, when GST rate was still 7%.

This rebate applies only to contracts entered into before May 3, 2006, and only when *possession and ownership* transfer on or after July 1. The purchaser still pays 7% GST under the contract, but separately claims the Transitional Rebate, which will be 1% of the purchase price, assuming the purchaser is not entitled to the New Housing Rebate.

Example: 1% Transitional Rebate for a New House Priced at more than \$450,000

A purchaser signs a contract to purchase a new \$450,000 house on March 1, 2006. Possession and ownership of the house will not pass until July 15, 2006, once construction is complete. The contract was signed at a time when the GST

rate in effect was 7%, but because possession and ownership passed on July 15, the purchaser's GST will be reduced to 6% after claiming the Transitional Rebate.

If, however, *possession or ownership* transfers to the purchaser before July 1, the Transitional Rebate cannot be claimed, leaving the purchaser to pay the full 7% GST stipulated in the original purchase contract.

Where eligible, the New Housing Rebate refunds a portion of the GST paid by the purchaser on the new housing.

Purchasers have 2 years to claim the Transitional Rebate and may claim this rebate even if not entitled to the New Housing Rebate.

The builder cannot pay or credit the Transitional Rebate to the purchaser. This rebate does not apply to commercial real property.

Any purchaser can claim the Transitional Rebate so long as:

- (a) the property is new or substantially renovated housing;
- (b) the purchaser does not claim an input tax credit for any GST paid on the purchase of the property;
- (c) the contract was entered into before May 3, 2006; and
- (d) *possession and ownership* transfer on or after July 1, 2006.

The New Housing Rebate: from \$8750 down to \$7560 (max)

The GST New Housing Rebate reduces, to some extent, the GST burden on the purchaser of a new residential property, where the house is priced less than \$450,000. Before July 1, the maximum New Housing Rebate is \$8750. On or after July 1, 2006, the maximum New Housing Rebate is \$7560.

For new houses priced \$350,000 or less and *possession and ownership*

passes to the purchaser on or after July 1, 2006, the rebate is the least of:

- (a) 36% of GST paid, or
- (b) \$7560. ($\$350,000 \times 6\% \times 36\% = \7560)

The New Housing Rebate is still phased out for new houses priced \$350,000 to \$450,000 and is \$Nil for new houses priced more than \$450,000.

The 6% GST rate change has similarly reduced the New Rental Housing Rebate, the Cooperative Housing Rebate, and the Rebate for Owner-Built Housing Rebate.

The Transitional Rebate and the New Housing Rebate

Where eligible, the New Housing Rebate refunds a portion of the GST paid by the purchaser on the new housing. In some cases, the purchaser may assign the New Housing Rebate directly to the builder. In any case, after receiving the New Housing Rebate, the purchaser's net GST burden is less than 7% on the property and an adjustment to the Transitional Rebate is made.

This is why, when the purchaser receives a New Housing Rebate, the Transitional Rebate is not exactly 1% of the purchase price of the new housing.

For contracts entered into before May 3, 2006, for the purchase of a new house priced \$450,000 or more, the New Housing Rebate will always be \$zero and the Transitional Rebate will always be 1% of the purchase price.

In the case where a contract to purchase a new house priced less than \$450,000 is entered into before May 3, 2006, the purchaser's New Housing Rebate must be taken into account when calculating the Transitional Rebate.

Example: Transitional Rebate and the New Housing Rebate

Assume the purchaser buys a new home priced at \$200,000 plus GST and is entitled to the New Housing Rebate. The Transitional Rebate works out to \$1280, rather than \$2000.

Here's why.

First, the new housing rebate on a \$200,000 house is \$5040—that is, 36% of the 7% GST paid on \$200,000¹.

Second, the Transitional Rebate is adjusted because the purchaser is only out of pocket \$8960² of GST on the full \$200,000 purchase price of the new house. In actual fact, the Transitional Rebate works out to be \$1280³, not the \$2000 that the purchaser may be expecting.

Renegotiated Contracts

The reason for the renegotiated contract must be something other than to artificially access a 1% GST rate reduction.

If a pre-May 3, 2006, contract is renegotiated after May 2 for the sole purpose of extending the *possession and ownership* date to a day that falls on or after July 1, the CRA will consider the renegotiated contract to be a new contract and may invoke an “anti-avoidance” rule to collect the GST benefit from your client.

If, however, a pre-May 3, 2006, contract is renegotiated after May 2 to include an upgrade to a premium appliance package, the contract is not considered to be a new contract and the purchaser will still be entitled to claim the Transitional Rebate if *possession and ownership* transfer on or after July 1, 2006.

Example: Renegotiated Contract to Include Upgrades

A purchaser enters into contract on March 1, 2006, to buy a new \$500,000 house that will be completed by the builder on August 15, 2006. On May 15, however, the purchaser negotiates a \$40,000 appliance upgrade. As long as *possession and ownership* transfer on or after July 1, 2006, the purchaser will pay 7% GST on the original \$500,000 contract price plus 7% GST on the \$40,000 appliance upgrade.

Because, however, the contract is still considered to be a pre-May 3, 2005, contract (notwithstanding the renegotiated upgrades) and

possession and ownership transfer on or after July 1, 2006, the purchaser will be entitled to a Transitional Rebate. This rebate will be \$5400, computed on the total amount (\$540,000) paid for the new house. Overall, the GST burden is 6%⁴.

This is exactly the same 6% GST result as if the contract was signed on or after May 3, 2006, for the purchase of the new \$540,000 house (including upgrades) with *possession and ownership* transferring on or after July 1, 2006.

The reason for the renegotiated contract must be something other than to artificially access a 1% GST rate reduction.

Assignments of Purchase Contracts

The assignment of a contract to purchase new housing to a second purchaser is considered, by the CRA, to be a new agreement because the person who is liable to pay the consideration for the supply, changed as a result of the assignment.

As such, where a purchase agreement is assigned on or after May 3, 2006, and *possession and ownership* under the new agreement transfer on or after July 1, 2006, the 6% GST rate will apply.

In this case, the Transitional Rebate cannot be claimed by the second purchaser, because the new agreement was entered into on or after May 3, 2006.

Commissions

Typically, real estate agents and brokers do not issue invoices; rather, the client (vendor) is required to pay the commission in accordance with the agent/broker service agreement. Usually, the commission is payable when possession of the real property transfers to the purchaser.

As such, under the agent/broker service agreement, if the commission

is paid or payable on or after July 1, 2006, the 6% GST rate will apply. If the commission is paid or payable before July 1, 2006, the 7% GST rate will apply.

Usually, the rate of GST chargeable on the real estate commission will follow the GST rate that applies to the specific real property transaction. This is because the commission is earned at the time the deal closes, which usually coincides with the transfer of *possession or ownership* of the property.

If the 7% GST rate applies to the sale of any real property, the 7% GST rate will apply to the sales commission.

Possession or ownership transfers before July 1, 2006

If the 6% GST rate applies to the sale of any real property, the 6% GST will apply to the commission.

Possession and ownership transfer on or after July 1, 2006

The agent/broker service agreement is separate from the purchase and sale agreement. Therefore, the timing of the commission payment (and the GST thereon) will remain independent of the 7% GST rate that would apply if a purchaser took early possession of a new house, under a contract that originally called for the possession and ownership to transfer to the purchaser on or after July 1, 2006.

Other References

The CRA Website has a great series of real property and other general GST questions and answers that may be of interest, all of which deal with the July 1, 2006, GST rate reduction. <http://www.cra-arc.gc.ca/tax/business/topics/gst/menu-e.html> ▲

- 1 Calculated as:
 $\$200,000 \times 7\% \times 36\% = \underline{\$5040}$
- 2 Calculated as:
 $\$200,000 \times 7\% = \$14,000$ less $\$5040 = \underline{\$8960}$
- 3 Calculated as:
 $\$200,000 \times [1\% - (\$5040 / \$200,000) / 7]$
 $\$200,000 \times [.01 - .0036]$
 $\$200,000 \times .0064 = \underline{\$1280}$
- 4 Calculated as:
 $[\$540,000 \times 7\% = \$37,800 - (\$540,000 \times 1\%)]$
 $= \$32,400 / \$540,000 = 6\%$ GST burden.