

HST: Challenging Some Myths



HST Self-Supply on new apartment buildings has been around for a long time. We were first introduced to the world of HST (or GST as it was then known) back in 1990 at a seminar put on by one of the leading accounting companies to help the appraisal profession adjust to the new rules. GST was officially launched in January 1991 and the world of Self-Supply was unleashed. For the first 35 years or so it lay relatively dormant with scarcely a call to our offices from new apartment builders, who are the most affected by the new rules. Rarely were we consulted on Self-Supply valuations. Everyone was seemingly happy in apartment land. But the last 5 years has erupted with calls coming in on a regular basis from clients old and new, anxious to escape the inevitable battle with Canada Revenue Agency's (CRA) auditors and appraisers. (For those looking for a tutorial, see our blog post of August 24th, 2016 on our corporate web site www.turnerdrake.com → Blog → "HST Self-Supply Rules: Is CRA on the Warpath?" And feel the pain).

Undoubtedly the biggest practical problem for apartment builders is the uncertainty it leaves after the building has been completed. HST on new buildings is based on "Fair Market Value", not on the cost of construction. The latter is easily calculated because ITC's (Input Tax Credits) will have been filed with CRA throughout the construction process. The former - "Fair Market Value" - cannot be calculated until the building is completed and it is, like any market value figure, just an opinion. But CRA's opinion increasingly is at odds with the builder's opinion. To make matters worse, CRA's review will come along well after the building has been finished, and therefore well after the mortgage financing has been committed, and occasionally even after the building has been sold. In jurisdictions with regulatory rent controls, rents too will have been committed. In short, the final HST tax bill comes in well after all the dust has (literally) settled. Too bad that it can't be agreed in advance, or based on something more predictable than "Fair Market Value". *So, what can you do to reduce the risk of a dispute with CRA's appraiser? First, accept the reality that back of the envelope calculations will not cut it... even if they are blessed by your accountant. It is unwise to underestimate CRA's Halifax based professional appraisal staff; many are former colleagues, graduates of Turner Drake's training program which includes seven years of mentored training, twenty-four training modules and the University of British Columbia's real estate degree. These guys know their onions! You need a comprehensive valuation report, containing the fiscal, physical and legal attributes of your property, as well as its Fair Market Value at the appropriate appraisal date, prepared by a reputable valuation firm. The Fair Market Value figure must be anchored by a detailed logic path to adequate, comparable and properly analysed sales data. By law the Valuation Report has to comply with the Canadian Uniform Standards (we go the extra mile, our Reports are also compliant*

with the globally accepted Royal Institution of Chartered Surveyors' Red Book).

"Just levelling the playing field..."

The reasoning behind the Self-Supply rules is succinctly laid out in an official CRA publication (GST/HST Memoranda series 19.2.3, paragraph 5) which begins "Purpose of self-supply rules: level playing field". In essence, it is an attempt to put the builder who wants to keep the building on the same footing as an investor who wants to buy it. The selling price will (fingers crossed) include a profit component for the builder and that's what CRA wants a piece of. It's difficult to argue with the principle, but what it overlooks is that HST is just another construction cost to be recovered through the eventual selling price. If HST is charged on the elusive profit component, it simply adds to the cost of the building and hence adds to the selling price. The builder pays tax on the profit and recovers it from the purchaser as part of the selling price. The playing field is level. But if no tax is charged on the elusive profit component, the cost of the building is marginally lower and, assuming a balanced market, the selling price will be marginally lower. The playing field remains level, just slightly smaller. CRA's concern is that the tax on the builder's profit will simply end up in the builder's pocket; but a competitive market will address that. Viewed from that angle, the pain, anguish and sleepless nights endured by the builder waiting to settle the tax bill with CRA is more to do with the size of the playing field than its degree of tilt. All of that pain and anguish could be removed if the tax on profit were a predictable formula, agreed in advance, rather than an elusive opinion coming after the show is over.

HST on Apartment Rents

So, what if the profit or rather the tax thereon, is occasionally underestimated? Eventually it is the end user who pays the HST on goods and services anyway. That's how value-added taxes work. For apartment buildings that means the tenant ultimately bears the cost of the builder's HST, even though residential rental property is, for the most part, officially exempt from HST. Rents must be sufficient to recover all of the costs or else buildings don't get built. So that troublesome tax on the builder's profit ultimately shuffles through to the tenants. Is it a bad thing to give tenants a break these days? And for more on THAT debate, check out "Affordable, Attainable, Available" the lead article in our Fall 2021 Newsletter on our corporate web site www.turnerdrake.com → Newsletter → Newsletter Vol. 2 No. [123](#).