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LawyerDoneDeal Corp.
60A Wellesley Street West
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Attention: Maurizio Romanin, President

Dear Mr. Romanin:

Re: GST on “extras” on new home purchases

I understand that your company prepares software that is used by lawyers and builders for completing real estate transactions.

You have asked me to explain how the Goods and Services Tax (GST) on new housing should apply to “extras”, such as upgrades, appliances and changes, charged by a builder to a new home purchaser. The specific question is how to account for the reduction in the GST rate from 7% to 6% effective July 2006, and the upcoming reduction to 5% effective January 2008.

As you know, I am considered a leading authority on the GST, and have specialized in consulting and writing about the GST since its introduction in 1991. I am the author of numerous GST publications published by Thomson Carswell, including *Canada GST Service*; *Canada GST Cases*; *The Practitioner’s Goods and Services Tax Annotated*; *GST Memoranda, Bulletins & Policies*; *GST Times*; *GST Case Notes*; and *Basic Tax and GST Guide for Lawyers*.

The rate transition problem

I understand that some builders are charging the GST at one rate on the new home and at another rate on “extras”.

For example, if a new home Agreement of Purchase and Sale was signed before May 3, 2006, the GST must be charged at the new home at 7%, but effective July 2006, the general GST rate has gone down to 6%. Some builders are charging 7% on the home and 6% on the extras. The calculations become much more complex when factoring in the effect of the new housing rebate on each of these rates.

These questions will be exacerbated when the proposed amendments to the *Excise Tax Act* (as proposed in the federal Economic Statement of October 30, 2007) are enacted, as there will be a further cutoff date for Agreements of Purchase and Sale. The GST will remain at 6% if the Agreement of Purchase and Sale was signed from May 3, 2006 through October 30, 2007, while there will be a reduction in the general GST rate to 5% effective January 1, 2008.

My analysis of this issue appears below.

Is there a single supply?

On any discussion of “extras” on the sale of a new home, there is a question that *must* be answered before anything else:

**** Is this particular “extra” part of the “single supply” of the “residential complex” that is being purchased? ****

Until this question is answered, there can be no useful discussion of the GST treatment.

The concept of “single supply” has been developed by the Courts, in cases such as *O.A. Brown Ltd. v. Canada*, [1995] GSTC 40 (TCC), and *Hidden Valley Golf Resort Assn. v. Canada*, [2000] GSTC 42 (FCA). If a supply is made up of two or more components, but they are inextricably interwoven with each other, then the Courts may consider that **they are all one single supply**. The GST status of the major component of that supply then determines the GST treatment of the entire “single supply”. This concept has been applied to many different fact situations throughout the GST case law in over 25 reported cases.

The Canada Revenue Agency’s interpretation on single supplies is found in GST/HST Policy P-077R2, “Single and multiple supplies” (April 27, 2004), available at www.cra.gc.ca. The CRA states:

There is a single supply where one or more elements constitute the supply and any remaining elements serve only to enhance the supply.

The CRA provides a number of questions that can be asked to help determine whether there is a single supply, along with four examples (none of which relates to new housing).

There is no automatic answer to the question of whether “extras” are part of the “single supply” of a new home, although in most cases they are. CRA administrative policy is found in GST New Memoranda Series chapter 19.3.1, “Rebate For Builder-Built Unit (Land Purchased)” (July 1998), paragraph 10:

10. In addition to amounts paid or payable in respect of the purchase of the unit (e.g., the housing rebate when the purchaser and builder agree to include it as part of the consideration for the unit), total consideration includes payment to the builder for:

- (a) *Goods and services* — goods and services that form part of the unit, such as built-in appliances, landscaping, a finished basement, wall-to-wall carpeting, in-ground pool or an attached garage;
- (b) *Appurtenances* — appurtenances to the home, such as a detached garage, permanently affixed shed or above-ground swimming pool;
- (c) *Other supplies* — other supplies (for example, free-standing appliances) if they:
 - (i) form part of an all-inclusive single consideration made at the time of signing the agreement of purchase and sale for the unit and for which there is no separate identification in the agreement for the consideration paid or payable for the supplies,
 - (ii) are of the type normally supplied by the builder for similar residences, that is, they were not custom ordered (as opposed to simple colour changes or normal upgrades), are offered generally by others in the construction industry, and relate to the use and enjoyment of the unit by the purchaser, and
 - (iii) the purchaser did not have a choice of taking a cash discount or other supply instead of the supply in question;
- (d) *Equitable interest* — the supply by the builder of an interest in the unit prior to the sale of the actual unit; and
- (e) *If residential condominium unit* — an interest in the common areas of a residential condominium unit and, as well, the consideration for the purchase of a parking space in the condominium complex, provided that the ownership or possession of the parking space was transferred at the same time that ownership or possession of the condominium unit was transferred.

GST effects

Once it is determined that, in a particular case, an “extra” is or is not part of the “single supply” of the new home, then the GST treatment is quite simple:

1. If the “extra” is **part of the single supply of the home**, then for GST purposes it constitutes a **change in the price being paid** for the home.

If the home is being sold at 7% because the deal was signed before May 3, 2006, then the adjustment to the price is at 7%. The resulting increase in price will either reduce or increase the New Housing Rebate, depending on whether the total consideration for the home is above or below \$350,000

(and of course will have no impact on the rebate if the home was already over \$450,000 before the increase). For purposes of all calculations, there has simply been a change in the total price paid for the home.

Similarly, if the home is being sold at 6% because the deal was signed from May 3, 2006 through October 30, 2007, then the adjustment to the price is at 6%. Again, the resulting increase in price may increase or reduce the New Housing Rebate.

2. If the “extra” is **not part of the single supply of the home**, then it is a **separate contract** for a supply, taxed at **6 %** (or **5 %** if the GST is neither paid nor payable until 2008).

Since this is a separate supply, the amount paid is not part of the “total consideration” for the home, and is **not included in the New Housing Rebate calculation**.

Clearly, therefore, the real question to be dealt with on any “extra” is whether it is part of the “single supply” of the home. Once that question is answered, the GST treatment becomes obvious.

Confirmation from CRA

I have spoken with Daryl Hooley of GST/HST Rulings and Interpretations at CRA Headquarters in Ottawa. He specializes in GST issues involving real property. He agrees with my interpretation, that the first question is whether there is a single supply, and that if there is, then the “extra” simply changes the total consideration for the new home.

The CRA has released a Question and Answer document on the upcoming rate reduction to 5%, dated November 13, 2007 (“Notice226” on the CRA’s web site). Questions 13-15 state:

Q.13. After entering into a written agreement of purchase and sale in September 2007 for a new residential complex, the purchaser requests in November 2007 that additional upgrades be made to the complex. Do the new rates of tax apply to the additional amount payable for the upgrades?

A. Upgrades to a residential complex will generally result in modifications to the existing agreement, such that the upgrades form part of the agreement of purchase and sale for the complex. In this case, the tax rate applicable to the purchase of the complex will prevail. Since a written agreement of purchase and sale was entered into after May 2, 2006 and on or before October 30, 2007, 6% GST or 14% HST will apply to the total amount payable for the complex, including the amount payable for the upgrades.

If both ownership and possession of the complex are transferred on or after January 1, 2008, a GST/HST 2008 transitional rebate will be available to the purchaser to account for the rate reduction based on the total amount payable for the complex, including the amount payable for the upgrades. If either ownership or possession is transferred before January 1, 2008, the purchaser will not be entitled to claim a transitional rebate.

- Q.14. A written agreement of purchase and sale entered into in September 2007 for a new residential complex provides for standard kitchen cabinets. The purchaser negotiates with the builder for an upgrade to deluxe cabinets in November 2007. Do the new rates of tax apply to the additional amount payable for the upgrade?*

The additional amount the builder charges for the upgrade is an additional amount payable for the residential complex. The purchaser is not considered to have entered into a new agreement as a result of the upgrade and there is no impact on the application of the transitional rules. Since the agreement was entered into after May 2, 2006 and on or before October 30, 2007, 6% GST or 14% HST will apply on the total amount payable for the residential complex, including the amount payable for the upgrade.

If both ownership and possession of the complex are transferred on or after January 1, 2008, the purchaser may claim a GST/HST 2008 transitional rebate. When determining the amount of the transitional rebate, the total amount paid for the complex includes the additional amount paid for the upgrade. A transitional rebate is not available if either ownership or possession is transferred before January 1, 2008.

- Q.15. After entering into a written agreement of purchase and sale for a residential complex in September 2007, the purchaser requests that the builder upgrade the flooring on the main level to hardwood. The amount payable for the upgrade is not included in the written agreement of purchase and sale, nor is an addendum to that agreement made in respect of the upgrade. The builder issues a separate invoice for the upgrade on February 12, 2008, and the purchaser pays the amount directly to the builder on the following day. Both ownership and possession of the residential complex will be transferred in April 2008. Do the new rates of tax apply to the additional amount payable for the upgrade?*

The additional amount the builder charges for the upgrade is an additional amount payable for the residential complex. Although the purchase and sale agreement is not actually modified, the upgrade nonetheless forms part of the single supply of the residential complex made by the builder, as the builder is not making a separate supply of hardwood flooring. Since the written agreement of purchase and sale was entered into after May 2, 2006, and on or before October 30, 2007, 6% GST or 14% HST will apply on the total amount payable for the residential complex, including the amount payable for the upgrade.

Where both ownership and possession are transferred on or after January 1, 2008, the purchaser may claim a GST/HST 2008 transitional rebate. When determining the amount of the transitional rebate, the total amount paid for the complex includes the additional amount paid for the upgrade. A transitional rebate is not available if either ownership or possession is transferred before January 1, 2008.

Daryl Hooley also noted to me that CRA Headquarters interpretation letter 80518 (July 23, 2006) deals with the same issue in the context of manufactured homes, and provides some guidance as to when there is a “single supply”. This letter is available on Carswell’s GST VIEWS database. Although it discusses modular homes, Daryl Hooley stated to me that the principles in it will apply to regular new home sales as well. The following is an excerpt:

In circumstances where additional items (e.g., such as finishing services required to complete the modular home) are not included in the original agreement for the sale of a modular home but are provided at the time of delivery of the modular home or shortly thereafter, the additional items may still form part of a single supply of a modular home provided that:

- (a) the additional items constitute part of the residential complex, i.e., they form part of the modular home or they are an appurtenance to the modular home that is reasonably necessary for the use and enjoyment of the modular home as a place of residence for individuals;
- (b) the additional items are ordered prior to the time that title to the residential complex is transferred to the purchaser;
- (c) the additional items are provided at or around the same time as the other elements included in the supply of the residential complex; and
- (d) it is reasonable in all the circumstances to conclude that the parties intended for the additional elements to be part of the original agreement and not a separate supply.

Practical problems in calculating the GST on extras

You have noted that there is a practical problem in determining how much GST applies to any particular extra. In particular, if the extra is part of the “single supply” so that the total consideration for the new home changes, the cost of the extra will affect the rebate for the home as a whole.

For example, on a deal for a \$340,000 home signed between May 3, 2006 and October 30, 2007, the builder is charging a net 3.84% (6%, minus 36% of 6% for the new housing rebate). An addition for “extras” that takes the pre-GST cost up to \$350,000 will *increase* the rebate available, but any increase beyond \$350,000 will *reduce* the rebate.

Unfortunately, there is no way around this problem other than to recalculate the GST on the new home as a whole. A builder cannot necessarily predict that the GST on a \$10,000 extra will be 6%, 3.84% or some other rate (in fact, in the \$350,000 to \$450,000 bracket, the effective rate will exceed 6%). The total consideration for the home must be recalculated, and the increase in the total (net of rebate) GST will tell you how much GST is being charged for the extra.

Note in particular that, where the total consideration is less than \$350,000, the developer should *not* be charging the full 6% GST on the extra, if the new housing rebate is being claimed.

Transitional rebate for purchasers

Finally, I should stress that the reason the GST has been left at 7% for deals signed by May 2, 2006, and 6% for deals signed after that date and by October 30, 2007, is *not* to keep the GST higher. It is to ensure that the savings resulting from the reduction in GST go to the purchaser, not the builder (since new homes are priced GST-included).

A purchaser who pays the old rate of 7% (or, after 2007, 6%) for a new home is entitled to a “**transitional rebate**” of 1% of the cost of the home (or 2% if the deal was signed by May 2, 2006 and the closing is in 2008 or later). This transitional rebate is then reduced to reflect the impact of the new housing rebate. The rebate is found in sections 256.3 through 256.6, and proposed sections 256.7 through 256.77, of the *Excise Tax Act*.

Builders should make sure to advise purchasers of the availability of this rebate, which the purchaser claims directly from the CRA using Form GST193. It makes the home cheaper to the purchaser, so giving this advice will benefit the builder. The builder and the builder’s lawyer should stress to the purchaser and the purchaser’s lawyer that the purchaser needs to claim the rebate directly from the CRA.

Information about the transitional rebate from 7% to 6% is available on the CRA web site at www.cra.gc.ca: see in particular Info Sheet GI-015, “GST/HST Rate Reduction and Purchasers of New Housing” (July 2007).

Information on the transitional rebate from 6% (or 7%) to 5% is available on the Department of Finance web site, at www.fin.gc.ca, in the October 30, 2007 Economic Statement, “Tax Measures: Supplementary Information”. See also questions 18-27 in “Notice226”, on the CRA web site, the same Q&A from which I reproduced questions 13-15 above (which also mention the transitional rebate).

Conclusion

In summary:

- (a) Determine whether the “extra” is part of the single supply of the new home.

- (b) If it is, the "extra" increases the price of the home. Recalculate the GST (and rebate) on the total price.
- (c) If it is not, the "extra" is a separate sale, at the current GST rate, and the new housing rebate does not apply to it.
- (d) Make sure to advise purchasers to claim their transitional 1% or 2% rebate.

I trust that this information is helpful. Please let me know if I can be of further assistance.

Yours truly,

A handwritten signature in black ink, appearing to read "David Sherman", with a horizontal line extending to the right.

David Sherman