

An article by G. Stockton



Labour Services and Ontario Retail Sales Tax

Although Ontario Retail Sales Tax was legislated in 1961, it was not until 1979 that certain services, in contrast to goods (tangible personal property), became taxable under the Act. At that time, telecommunications and transient accommodations were defined as taxable followed by labour services in 1982. By 1993 certain kinds of insurance and parking services were included. The rules respecting taxable software services were clarified in 1997. The inclusion of taxable services reflects the change from a manufacturing and goods based economy to a service based economy. Simply put, services have become a major source of sales tax under the Act and there is every reason to believe that this trend will continue.

In this article, we will present some of the basic rules applicable to taxable services but will focus on the **taxation of labour services**. The rules regarding other types of taxable services can get very detailed and therefore would require a much more space than available here. Furthermore, it is always prudent to refer to sales tax guides, rulings and interpretations, a sales tax consultant, in conjunction with the Retail Sales Tax Act issued by the Ministry, when attempting to understand these rules in a particular situation.

Bear in mind that many of the general rules governing the taxation of goods or tangible personal property (TPP), are equally applicable to taxable services. For example, a service must be provided or consumed in Ontario before taxation can occur. What may differ is interpreting when consumption or use takes place in Ontario for TPP and services respectively. More will be said about this later.

Starting with a (slightly abbreviated) definition of a taxable service under **Section 1(1) of the Retail Sales Tax Act** we can observe that many services are still excluded from the definition. Under the Act, a taxable service means:

- a) Telecommunication services of all kinds, including without restricting the generality of the forgoing, telephone and telegraph services, community antenna television and cable television transmissions by microwave relay stations or by satellite, and pay television, but not including public broadcasting services that are broadcast through the air...
- b) Transient accommodations

- c) **Labour** provided to install, assemble, dismantle, adjust, repair or maintain tangible personal property
- d) Any contract for the service, maintenance or warranty of tangible personal property
- e) The provision of the right to park a motor vehicle...in a commercial parking space

Notice under (a) telecommunications, that Internet services are not mentioned. Going forward this type of telecommunication service may become a major source of sales tax revenue when the legislators can agree on the specific rules. Under (d) a “contract for the service...” is only taxable if it is a contract related to TPP (goods). Under (e) the “right to park” is only taxable if the right means a commercial parking space.

Fundamentally, the provider of a **taxable service and a non-taxable** service do not differ. All service providers must pay retail sales tax on the goods and equipment they use in their business that enables them to provide the service. This, of course, excludes goods that are re-sold. For example an auto repair shop would pay tax on the equipment to repair your car but not on parts used in the repair service. In contrast a manufacturer, that by definition is not a service provider, can take advantage of much broader exempting provisions than a service provider.

As we mentioned, we will turn to a more detailed discussion of **taxable labour** as defined under (c) of Section 1(1) of the Act. In conjunction with Section 1(1), **Section 7(1)2** of the Act explains broadly when **labour is exempt**. Looking closely at the definition under S.1, we can observe that the labour has to do something to TPP, namely install, repair, modify and adjust it, in order to attract sales tax. So as a result, labour such as most professional services or labour to install or repair real property would be exempt. For example, the repairer of the roof of your building or the contractor who paves your driveway would/should not charge tax on their work because your building and driveway are not examples of tangible personal property.

Sales Tax Guide 601, available from the Retail Sales Tax Branch, outlines a number of taxable and non-taxable labour services, all of which are consistent with the definitions under S. 1(1)(c) and S. 7(1)2 of the Act. For the purposes here, we will summarize the main non-taxable categories found in Guide 601. By doing this we can have better understanding of what comprises a taxable service, in contrast. Each of the categories of labour summarized below does not alter, modify or repair TPP. This is why they are examples of non-taxable services. The list includes:

Testing and Cleaning
 Personal Care
 Real property labour
 Consulting Services

A caution should be made with respect to the provision of **consulting services**. What the service provider may call consulting, the Sales Tax Act and auditor might deem to be a

taxable service. Many software service providers have charged for consulting services on a tax-exempt basis when in fact they are providing taxable labour because they actually are altering or modifying software that is TPP. Consulting should be virtually equivalent to giving **advice** or the consultant should be working on software that is deemed not to be TPP under another provision of the Act in order for the consulting to be tax exempt.

The general rule has been stated. Labour must do something to TPP to attract tax. Now we can discuss the **exceptions to the general rule.** If the TPP that is being modified, repaired, etc., is deemed exempt under the Act, then the labour is exempt. Manufacturing equipment or equipment used in hospital care, for example, are exempt TPP under other provisions of the Act. And because they are exempt, any related labour is exempt. So, for example, a repairer of your manufacturing equipment should not be charging tax on their labour. There are many other examples but the exception remains the same. **If the TPP is exempt, then the related labour to repair, modify or adjust it is also exempt.**

As noted earlier, we said that if the labour service is not performed in Ontario then it is not subject to Ontario Sales Tax. We should also state that if the repair is done outside of Ontario and the repaired part or equipment is returned to Ontario, then the labour could be subject to Ontario Tax. So labour services purchased from other jurisdictions and either performed in Ontario or performed on goods returned to Ontario could be subject to Ontario sales tax. For example, if you contracted with a repairer from another province to do work in Ontario, this labour may be taxable even if the repairer did not charge you Ontario Sales Tax. **The liability for tax rests with the purchaser.** Conversely, sales tax does not apply to the repair of goods in Ontario that are subsequently removed from Ontario.

If your business provides or receives both taxable and non-taxable services at the same time, the charges should be segregated clearly on the invoice. Detailed records must be kept to support and justify the portion of non-taxable services. Otherwise, the entire charge may be subject to tax. Also note, as explained under Section 7(1)2, labour that is provided by a person for his/her own use is exempt. This refers to your employee's labour.

Finally, if your company is providing a taxable service in Ontario, then you will be **required to register** as a vendor and to charge, collect and remit tax like any vendor of taxable goods.

In the future one might anticipate changes to the definition of taxable labour under the Act so that services such as consulting, legal and other professional services will broaden the sales tax base in Ontario.

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