



CHBA PRE-BUDGET SUBMISSION – AUGUST 2011

SUMMARY

The CHBA has three specific and inter-related recommendations to make to the federal government:

- Changes to the GST treatment of new housing and renovations.
- Vigorously tackle the underground 'cash' economy.
- Encourage investment in new purpose-built rental housing.

CHANGES TO THE GST TREATMENT OF NEW HOUSING AND RENOVATIONS

Housing affordability benefited from the reduction in the general rate of the Goods and Services Tax (GST) from 7% to 5%. As a result of this reduction, plus the continuation of the GST New Housing Rebate, the actual rate of GST on new homes eligible for the full rebate was reduced from 4.48% to 3.2%. This restored the level of federal sales taxes collected on new homes closer to the level which applied prior to the introduction of the GST in 1991. The reduction in the general rate of GST was a major step in supporting housing affordability.

However, two key changes are required with respect to the GST treatment of new housing and renovations:

- Adoption of a single-threshold/full rebate for new housing; and,
- A home renovation tax rebate.

Background on Thresholds for the New Housing Rebate

The GST New Housing Rebate reduces the actual rate of GST payable on eligible new homes from 5% to 3.2%.

Purchasers of new homes priced below \$350,000 receive the full rebate – i.e. the actual rate of GST on their new homes is 3.2%. Purchasers of homes priced between \$350,000 and \$450,000 receive a progressively reduced rebate – and the actual rate of GST rises accordingly. Homes priced at \$450,000 or more receive no rebate – i.e. the actual rate of GST for these homes is 5%.

For new homes priced between \$350,000 and \$450,000, the GST payable is as follows:

House Price	\$350,000	\$400,000	\$450,000
5% GST	\$17,500	\$20,000	\$22,500
GST New Housing Rebate	\$6,300	\$3,150	\$0
Actual GST Payable	\$11,200	\$16,850	\$22,500
Actual GST as % of House Price	3.2%	4.21%	5.0%

When these thresholds were introduced, the federal government estimated that roughly 95% of new home buyers would be eligible for the rebate – it was intended that the rebate would apply to all homebuyers except the “very wealthy”.

However, with rising house prices, many new home buyers (a majority in many urban centres) do not qualify for the full rebate because the rebate thresholds have been frozen at the same level since 1991. In short, new home buyers are paying more GST than would be the case had the rebate thresholds been adjusted to reflect rising house prices. This has had a negative impact on housing affordability.

Federal Commitment

When the GST was introduced in 1991, the federal government made a commitment to adjust the thresholds to reflect changes in housing prices, and thus to protect housing affordability over time. As stated in the *Goods and Services Tax Technical Paper*, August 1989 (page 19):

“The government will review these thresholds at least every two years and adjust them as necessary to ensure that they adequately reflect changes in economic conditions and housing markets.”

During the 1990s, immediately after the introduction of the GST, housing prices were relatively stable in most parts of Canada, so there was little need to adjust the thresholds to reflect changes in housing prices. As a result, the thresholds were not adjusted. Since the mid-1990s, new house prices have increased by almost 60% nationally; however, the thresholds have remained frozen at the levels established in 1991 – *twenty years ago*.

Meeting the Federal Government Commitment to Adjust the GST Rebate Thresholds

For many years, the CHBA recommended that the federal government adjust the GST New Housing Rebate thresholds in line with its commitment at the time that the GST was introduced. If the rebate thresholds had been adjusted to reflect the increase in new house prices to 2010, they would increase from their current \$350,000-\$450,000 to \$550,000-\$705,000.

Since the thresholds have now been frozen for two decades, the CHBA is recommending a new approach. The CHBA recommends that the federal government adopt the rebate model for new housing that has been adopted by the provincial governments of Ontario and British Columbia under sales tax harmonization. This model is designed to protect housing affordability through a single price threshold. Below the threshold, housing is taxed at a lower rate. The amount of the rebate at the price threshold is available to all housing priced above the threshold. Adoption of a similar rebate model for the GST would achieve substantially the same result as the indexation of the current thresholds for the new housing rebate.

Based on the rebate model for new housing under the harmonized sales tax in Ontario and British Columbia, and a rebate threshold of \$400,000, the federal government would have received roughly \$380 million less in GST revenues in 2011.

The purpose of the federal government’s commitment to adjust the GST rebate thresholds was to protect housing affordability over time. With almost all new houses in many major centres now ineligible for the GST rebate, action by the federal government to fulfill this commitment is urgent.

Home Renovation Tax Rebate

A Home Renovation Tax Rebate is necessary to restore fairness in the tax system for renovation work. Across Canada, homeowners who undertake renovations pay an unfair level of sales tax under the GST and, in those provinces where it is in place, under the Harmonized Sales Tax (HST). This unfair level of taxation adds significantly to the cost faced by Canadians when they invest in maintaining or enhancing their homes.

Prior to the introduction of the GST, the 9% Federal Sales Tax (FST) applied only to the materials portion of home renovation expenditures. Also, the FST was applied to the price of products at the factory gate rather than on the full retail price. Since materials account for only a portion of the full cost of a renovation (labour and profits were not taxed under the FST), it is estimated that the FST represented only approximately 2.5% of the delivered cost of a contracted home renovation. The current GST taxes the same project at 5% – twice the previous amount. In provinces where the HST is in place, the tax burden is very much greater.

To restore fairness to how home renovations are taxed by the federal government, and to provide an incentive for homeowners to hire legitimate tax-paying contractors rather than underground ‘cash’ operators, the federal government should introduce a permanent Home Renovation Tax Rebate equal to 2.5% of the total cost of a home renovation.

As illustrated by the temporary Home Renovation Tax Credit (HRTC), a permanent Home Renovation Tax Rebate will have another important benefit – *combatting the underground economy*. By requiring homeowners to have receipts to back up their HRTC claims, the federal government dealt a major setback to underground ‘cash’ operators. Consumers intending to take advantage of the HRTC required documentation when they hired a renovator – this placed cash operators at a significant disadvantage. Requiring receipts for renovation work under the HRTC resulted in increased government revenues as legitimate tax-paying contractors gained business that would otherwise have been lost to tax-evaders.

TACKLING THE UNDERGROUND ‘CASH’ ECONOMY

The large and growing underground ‘cash’ economy in construction undermines housing quality and harms legitimate tax-paying contractors. In addition, governments at all levels are losing billions of dollars annually as a result of the activities of underground ‘cash’ operators – especially in the residential renovation sector. For example, the Ontario Construction Secretariat estimates that average annual government revenue losses from underground activity in construction average \$1.4-\$2.4 billion in Ontario alone.

Ensuring that those who should be paying taxes are doing so is important for Canada’s economic recovery and for reducing government deficits.

The main Canada Revenue Agency (CRA) response to the growth of underground practices in construction has been the Contract Payment Reporting System (CPRS). An evaluation of the CPRS by the Agency itself concluded that it is “not effective in that segment of the underground economy where transactions are purposefully hidden by both the contractor and sub-contractor to circumvent tax laws and other legal obligations (commonly known as the ‘cash’ economy).” Underground operators, by definition, operate in cash only, outside the legitimate economy. The CPRS simply makes such cash-only operators even more careful about the ways in which they conduct their activities.

Clearly, current initiatives are not effective in addressing the underground cash economy in construction. A new approach is urgently needed.

Initiatives aimed at reducing underground activity in other countries should be examined for application in Canada.

In addition, as part of the federal government’s strategy to address the underground economy:

All firms and individuals in the construction industry should be required to register for a Business Number, even if they wish to take advantage of the GST exemption for companies which operate below the \$30,000 annual sales threshold. Such a requirement would make it more difficult for underground operators to hide their activities from the CRA.

As noted, the proposed permanent Home Renovation Tax Rebate would complement these efforts, and bring a much larger proportion of renovation projects ‘above ground’.

ENCOURAGE INVESTMENT IN NEW PURPOSE-BUILT RENTAL HOUSING

The national rental apartment vacancy rate is within the 2-3% range indicative of a ‘balanced’ rental market. Few major centres have *very* tight rental markets and most major centres have vacancy rates within or above the ‘balanced’ range.

However, the predominance of oversupplied and/or balanced rental markets in most parts of Canada is only temporary. New rental construction is well below the level of projected demographic requirements. In future years, the combination of high demand for rental housing and low volumes of rental construction will lead to tightening rental markets – unless there is a substantial increase in the volume of new rental construction. Such an increase in rental construction activity will require a significant improvement in the economics of investment in new purpose-built rental housing developments.

Changes in the federal income tax treatment of purpose-built rental housing during the 1970s and 1980s significantly reduced the attractiveness of rental investment. Similarly, the introduction of the GST in 1991 added to the federal sales taxes on purpose-built rental housing projects – and further discouraged new rental investment. As a result, the volume of new purpose-built rental housing in Canada is substantially lower than the levels attained prior to the changes in income taxes and the GST.

There was a modest improvement in the effect of the GST on rental housing when the GST new housing rebate was extended to include private purpose-built rental housing (in 2000), and when the general rate of GST was reduced from 7% to 5%. However, much more fundamental changes are needed in the federal tax regime for rental housing to encourage investment in new purpose-built rental housing.

The CHBA calls for reforms to the federal tax treatment of purpose-built rental housing, including consideration of:

- **Deferring capital gains and recaptured depreciation deductions upon the disposition of rental properties if the proceeds are used to invest in new purpose-built rental properties.**
- **Extending eligibility for deductions of rental losses created by capital cost allowance against income from other sources.**
- **Relaxing restrictions on the deductibility of soft costs.**
- **Allowing small businesses with purpose-built rental properties to be eligible for the favourable tax rate which applies to other types of small businesses.**
- **Zero-rating purpose-built rental housing for the purposes of the GST/HST – because residential rents are GST/HST exempt, the GST/HST paid by businesses investing in purpose-built rental housing should be refunded, as is effectively the case with other similar types of businesses which pay GST/HST on inputs but cannot charge GST/HST on their products or services.**

The CHBA does not support proposals for grants or tax preferences for low-cost rental housing production or renovation, favouring instead direct financial support to low-income households to meet their needs.

ABOUT CHBA

The Canadian Home Builders' Association is the voice of Canada's residential construction industry.

CHBA's membership includes new home builders, renovators, developers, suppliers, trades, manufacturers, lenders and other professionals. The CHBA has over 50 Local Home Builders' Associations and 8 Provincial Associations. The CHBA's Standing Committees and Councils oversee the work of the Association in areas as diverse as technical and economic research, education and training, renovation, the environment, urban issues, warranty and marketing. Through the voluntary efforts of its members, the CHBA serves both consumers and producers of housing by supporting quality, affordability and choice in housing for all Canadians.