



CHBA Technical Brief: Correcting GST Anomalies to Stimulate Additional Purpose-Built Rental Housing

The Challenge:

CHBA estimates that, based on a gap between demographic demand and current construction trends, Canada could be short 300,000 family-oriented housing units over the next decade. Supply shortages are already driving up home prices and rents in our largest urban centres. Over the past two decades, significantly less new purpose-built rental has been built. More recently, a partial recovery has taken place, but production is still below demographic requirements, and depends heavily on very low interest rates. Federal GST/HST policies have been a key factor behind the decline of new rental investment. Here are some key details.

GST/HST Policy Anomalies

Residential rental development is treated very differently from other commercial rental properties.

GST/HST is intended to be a tax on final consumption, borne by consumers, not businesses. Most businesses charge GST/HST on their products and services and remit these funds to the government, after deducting the GST/HST they pay on their inputs. Commercial rental developers, e.g. office building and shopping centre owners, pay GST/HST on development and operating costs of the buildings. They then deduct "input tax credits" from the GST/HST they collect on the rents paid by tenants prior to remitting the net GST/HST to the government. Commercial tenants also deduct the GST/HST paid to their landlords from GST/HST they collect on their sales – the principle is that businesses collect the GST/HST, but do not bear these taxes, which are passed on to the ultimate consumers.

GST/HST is *not charged on residential rents* – a policy based mainly on the fact that lower-income households comprise a large proportion of tenants, and charging GST on their rents would substantially increase their shelter costs. In a similar vein, a decision was also made *not to charge GST on groceries*, because they are a basic necessity.

Like all businesses, residential rental landlords still must pay GST/HST on the goods and services they purchase in developing and operating their properties. However, since no GST/HST collected on residential rents, residential rental landlords are 'stranded' in relation to their input credits, as they have no stream of GST/HST receipts from which these credits can be deducted. The effect of the current GST/HST treatment of rental housing is higher development and operating costs than would be the case if they were treated like most other businesses in Canada.

“Self-Supply” Rules for new purpose-built rental housing developments have perverse effects.

The declared purpose of the “self-supply” rules is to put builders of new developments on an equal footing with investors who buy a new (or substantially renovated) residential complex. The intent is to charge GST on the value that is added to the residential complex “by GST-exempt inputs such as the value of the employed labour, financing costs and profit.” However, in reality, the current application of the self-supply rules in calculating GST on new rental developments *create uncertainty and other disincentives to construct purpose-built rental housing.*

Currently the Canada Revenue Agency seeks to charge GST on the “fair market value” of the building as rented up, or sometimes on the value as if the building were sold as individual condominium units. Such valuations include the premium paid for condominiums which would be earned through a marketing campaign, or at least the value gained through the specialized business of renting up a new rental building. Both additions to the value go well beyond the value of the building itself created by the “employed labour, financing costs and profit” put into the construction of the building.

The current approach is creates an advantage for a person who contracts to buy a new building because most agreements to buy new buildings do not include the value of the rental income stream, nor the imputed value of being able to sell the building as condominiums. The value which the self-supply policy seeks to tax would be more accurately captured by a building value determined on the basis of “cost plus profit”.

Recommendations:

- Revise the federal tax regime to exempt new “purpose-built” rental developments from GST/HST, also called “zero-rating” these developments.
- Change GST rules regarding the "self-supply" of multi-unit residential buildings to more appropriately be based on “cost plus profit”.
- *Cost Implications:* Federal revenues foregone as a result of the proposed changes above are likely to be modest, especially when the added revenues associated with a greater volume of purpose-built construction activity are taken into account.