Inequities Created by Recent Changes to the GST/HST Rebate on New Build Rental Housing

The federal government (in what was Bill C-56 and is now law) increased the GST rebate on some new purpose-built rental housing from 36% to 100%. The enhanced rebate is only available to those constructing new rentals in buildings with at least four units. The existing GST rental rebate treated all new rental builds equally. However, this is no longer the case.

For properties now eligible for the 100% rebate, it also removes the previous phase-out thresholds and limits on rebate eligibility. Specifically, the existing GST rental rebate had a phase-out for qualifying residential units valued between $350k and $450k, with no rebate available for units valued at $450k or more.

The government stated that the amendments were intended for the laudable purpose of encouraging the construction of more apartment buildings, student housing and senior residences built specifically for long-term rental accommodation. Ontario announced it would match the GST rebate increase, and the full HST would be eligible.

The design of the new law creates a number of presumably unintended consequences; the government did not intend to disincentivize new rental housing that is affordable or rurally based. The fixes are not complicated. We urge quick action before the new rules have an opportunity to distort the marketplace and entrench inequities.

Issues Created by this Change

1. Favours large builders/landlords/businesses over small ones.

The four units in a single building requirement now favours large builders who tend to put up multi-story multi-unit complexes, over smaller builders who tend to focus on single homes, duplex or triplex units. This also leaves out individuals adding rental units to existing properties by putting accessory dwelling units (ADUs). Such additions are being encouraged by provinces and municipalities through bylaws, zoning and policy changes.

2. Causes market distortion.

The new law also creates market distortions between those building and/or leasing multi-unit structures vs those that do not. The federal government is effectively subsidizing one, but not the other. Smaller builders/landlords are absorbing the additional 64% HST which puts them at a competitive disadvantage with larger builders renting their properties – including in the same neighbourhoods.

This market distortion extends to the provision of badly needed affordable units. Those with the full GST/HST rebate can more easily offer affordable units with the full tax now removed from their costs. This can further advantage those entitled to the full rebate who may now also be eligible to access other affordable housing incentives (federal/provincial/municipal) by not having to include the GST/HST in their rents.

3. Favours urban over rural communities.

This approach also favours urban-based builders/landlords and residents over rural ones. Large multi-unit multi-story builds are not typical in rural settings. Rather, rural communities rely on smaller scale dwelling solutions to chip away at their housing deficit. This will also mean that rural residents will be absorbing this additional non-rebated GST/HST in their rents. The combined effect makes rural communities less attractive rental locations, both for tenants and developers.

4. Provides a financial benefit to large builders/landlords whose size already provides an advantage over smaller ones in the lending market

The policy line magnifies the financial advantages large builders already enjoy on favourable rates for commercial/construction loans. This tilting of the playing field is made worse by federal programs like CMHC's National Housing Co-Investment Fund which effectively provides reduced rate loans for large urban projects.

5. Not aligned with other federal tools and municipal and provincial housing policy changes.

Across Canada provincial and municipal governments are introducing policy changes to encourage the addition of ADUs as infill/intensification tools. Most of these units are intended as rentals. These are excluded from the enhanced rebate.

Duplexes and triplexes are also common build types for urban intensification, an stated goal of provinces and municipalities, and a cost and time effective mechanism to expand rental housing supply. However, these tools of intensification are excluded from the rebate.

Moreover, there is a misalignment with the federal government's CMHC-administered Housing Accelerator Fund, which targets municipalities to, in part, change how they conduct housing related administrative processes, including the treatment of ADUs.

6. Undermines affordability

The current phase out and upper limits for the GST rebate on new build rentals had the consequence of building an affordability test into the GST rebate. Once a unit had a cost of over $450K the rebate was gone. This effectively incentivized lower cost new rental units. Invariably, the lower the unit cost, the lower the rental cost.

By removing the thresholds, the new approach creates an oddity where expensive new rental units (which are prevalent, particularly in the seniors independent living segment) will qualify for the full GST/HST rebate, but smaller units like ADUs, duplexes and triplexes will not. This undermines the ability of smaller scale projects to offer affordable units.

7. Missed opportunity to address the underground economy

Part of Canada's underground economy has been linked to the construction sector. Experience has shown that when sales tax is fully rebated, more buyers seek proper receipts, and more suppliers properly register and account for both sales and income tax. This occurs as the incentive to avoid paying the GST through cash transactions is removed. Further, the net impact could be positive for the government's fiscal framework through increased income tax revenue. Moreover, once construction-related businesses start issuing proper receipts, the instances of registration for provincial worker safety programs increase.

Solutions to Address this Policy Gap

Option 1: Extend the GST/HST new rental rebate to all new built rental units

The simplest solution to the problems identified is to extend the full GST/HST rebate to all new built rentals regardless of how many the builder/landlord is putting in place. This would create no additional administrative costs as those eligible for the new full rebate are already filing for their 36% rebate currently available.

The risks of non-compliance with the rebate rules remains the same given the presence of the current 36% rebate, and administrative protections already in place via the Canada Revenue Agency.

As the cost to the fiscal framework is based on the actual tax paid, which correlates with the number of units built, the impact would be small when compared to the tens of thousands of units large urban developers will be building and no longer bearing GST/HST.

Option 2: Extend the GST/HST new rental rebate to new built rental units where four or more units are built at the same time.

This only closes some policy gaps, leaving behind builders/landlords adding fewer than four units at a time (e.g. one offs of single-family homes, duplexes or triplexes). However, it does remove the overly prescriptive requirement that the four units all be part of the same "single" building. Therefore, building four ADUs, two duplexes (etc.) at one time, would qualify for the full rebate, removing the arbitrary type of building test that is part of the current enhanced rebate.

Option 3: Reintroduce the phase out provisions, returning the previous affordability test for all rebate recipients. Alternatively, provide a rebate "bonus" for affordable units. This could be combined with option 1 or 2.

This approach would bring back an affordability test into the new 100% GST/HST rebate. It would lower the cost to the government by removing higher-cost new rentals from eligibility. It would increase the supply of more affordable rental units by encouraging builders/landlords to keep unit costs down.

If the desire remains to remove all GST/HST from large new rental builds, a formula could be added where lower cost units receive a GST/HST rebate that exceeds the GST/HST paid. This would incentivize the creation of lower cost affordable units (e.g. units from $100k-$200k receive a 10% rebate "bonus", $200k-$300k a 5% bonus).