

# Manufacturing Contractors

## About this Guide

The information in this *Guide* explains how Retail Sales Tax (RST) applies to goods manufactured and installed by contractors. Please note that this *Guide* replaces the previous version dated January 1997.

## Definitions

**Manufacturer** For the purposes of RST, a manufacturer is a person who manufactures, fabricates, produces or assembles goods:

- for sale to others and the fair value of goods sold exceeds \$5,000 in the fiscal year, or
- for own use and the cost to produce the goods exceeds \$50,000 in the fiscal year. (see **RST Guide 400 - Manufacturers**).

**Manufacturing** Manufacturing includes work done in a plant or in a factory away from a construction site, or in a mobile unit or workshop on or near the construction site. It includes most work done at these locations that changes raw materials into manufactured goods for use in real property contracts.

The assembly of machinery or the fabrication of other materials by a contractor, at a location on the job site where they become real property or attached to real property, is not a manufacturing operation. In these circumstances RST applies to all materials and machinery incorporated into the project as well as to the equipment used to perform the contract.

A contractor would not be considered a manufacturer in the case where the contractor produces a by-product in the course of completing a construction contract and the contractor further utilizes the by-product within the construction contract.

### Example:

A contractor is hired to perform the drilling and blasting of rock in a road bed resulting in the production of shot rock that is subsequently incorporated into real property (i.e., a road). These are not manufacturing operations when performed by the contractor hired to build the road.

However, if a contractor is hired for the purposes of creating shot rock, or for recycling old asphalt, these are considered manufacturing operations.

## Temporary Workshop Facilities

A contractor may also provide temporary workshop facilities at the job site, where machinery or other materials are fabricated into components before being transported to the location on the job site where they are to become real property or attached to real property. This is considered a manufacturing operation.

**Temporary Workshop Facilities (con't)** Temporary workshop facilities can be mobile or stationary facilities where items are manufactured, including workshops and equipment that are moved from one job site to the next. An example would be a truck with production equipment used to manufacture eavestroughing.

**Manufacturing Contractor** A manufacturing contractor is a real property contractor who manufactures or produces taxable goods and installs them as fixtures to real property, provided the cost to produce the goods in a fiscal year exceeds \$50,000.

If the cost to produce the goods exceeds \$50,000, the manufacturing contractor must calculate Retail Sales Tax (RST) on the manufactured cost (direct materials, direct labour, and manufacturing overhead) of these goods. The RST calculated must be remitted on **Line 3** (Tax on Purchases for Own Consumption) of the periodic return. Manufacturing contractors may recover the RST calculated and remitted as part of the price of the contract charged to their customer. However, RST must not be billed or shown on the contract.

If the cost to produce the goods is \$50,000 or less (per fiscal year), the contractor does not qualify as a manufacturing contractor, and must pay 8 per cent RST on the purchase of all raw materials and equipment.

Qualifying manufacturing contractors are entitled to the exemptions available to manufacturers on the purchase of materials and manufacturing equipment. They may purchase materials and equipment exempt from RST by providing their suppliers with a valid Purchase Exemption Certificate (PEC). The exemption applies to equipment which must be used primarily and directly (more than 50 per cent of the time) in manufacturing. Equipment that remains taxable includes office equipment, supplies and installation equipment.

Examples of the type of goods produced and installed by manufacturing contractors include:

- aluminum ductwork
- blinds
- doors and windows
- kitchen or bathroom cabinets and vanities
- ornamental and wrought-iron railings
- prefabricated building and roof trusses
- ready-mix concrete and asphalt mix
- roof decking
- septic tanks
- sheet metal products
- siding and eavestroughs
- wall partitions

**Real Property** Real property means land and any items permanently attached to land (see **RST Guide 206 - Real Property and Fixtures**). The following are examples of items that are considered real property when installed:

- buildings
- communication towers
- driveways
- fences
- in-ground swimming pools
- patios
- roads
- sidewalks
- utility poles

**Real Property Contractor** A real property contractor is a person who builds, repairs, or improves real property for others. Real property contractors include general and trade contractors, such as carpenters, electricians, painters, plumbers, and also installers of fixtures, such as central air-conditioning units, cabinets and vanities, heating equipment, and water tanks (see **Small Business Pointer SBP 902 - Real Property Contractors**).

**Tangible Personal Property**

Tangible personal property (TPP) is anything that can be seen, weighed, measured, felt, or touched; that is, anything perceptible to the senses. It also includes computer programs, natural gas, and manufactured gas. Retail Sales Tax (RST) applies to all purchases/sales of TPP, unless there is a specific exemption.

**Fixtures**

Fixtures are items of TPP that have been permanently attached to real property in such a way that they are considered part of real property. Permanently attached means bolted, nailed, screwed, embedded in concrete or permanently affixed in some way.

The following are examples of items that are fixtures when attached to real property:

- car wash equipment
- central air-conditioning units
- counters and cabinets
- fireplace inserts
- furnaces
- gasoline pumps
- theatre seats
- water heaters

Free standing equipment is not considered a fixture although it may be connected to a building by wiring or plumbing. Examples include window type air-conditioning units, clothes washers and dryers, refrigerators, and stoves. Free standing equipment or items which are built into a structure or building become fixtures, such as dishwashers and kitchen counters.

In limited situations, free standing equipment or items which are not attached to realty may be considered fixtures. The size, weight and circumstances will determine their status. For example, an above ground swimming pool may be a fixture, even though it may not be attached to the land.

## Calculation and Remittance of RST

To calculate the tax liability on the goods produced and installed as real property, multiply the manufactured cost by 8 per cent. The RST is due at the time the goods are produced, not when they are installed. If progress billings are issued for a project, RST should be calculated at the time each progress billing is issued. The tax owing must be reported on Line 3 (Tax on Purchases for Own Consumption) of the RST return. Failure to file a return or remit all RST payable will result in the application of a penalty equal to 5 per cent of the tax payable with no maximum (see **RST Guide 205 - Penalties**).

**Note:**

Some manufacturing contractors incorrectly charge RST on a “tax extra” basis on real property contracts. “Tax extra” means RST is being charged on the total contract price. Although the RST has been collected in error, contractors must remit all RST collected to the Ministry.

For real property contracts, the contractors are responsible for the payment of RST. For this reason, contractors can still be assessed for the applicable RST on items produced and/or purchased for use in real property contracts even though RST has been collected from their customers. Customers who pay RST in error may claim a refund from the Ministry (see **RST Guide 700 - Refunds, Rebates and Adjustments**).

## Manufactured Cost

### General

Manufactured cost is calculated according to generally accepted accounting principles and is considered to be the fair value of TPP manufactured, processed or produced.

Manufactured cost includes direct materials, direct labour, manufacturing overhead. It does not include installation costs, profits, any costs not associated with manufacturing (e.g., office equipment and supplies), or any federal Goods and Services Tax paid on materials or services.

### Direct Materials

The cost of direct materials used is the cost of those materials that can be identified with a particular job or process. It includes the costs necessary to acquire and prepare the materials for use such as shipping costs to transport the goods to the manufacturing location, federal duty and excise taxes, storage, and insurance costs of materials inventory.

Direct materials also include processing materials and consumables that are used directly in producing or fabricating goods. Consumables are items that are used up in the manufacturing of a product but do not become part of the finished product. Materials are generally considered to be consumables when purchased in quantitative measures such as litres, kilograms, bags or rolls. For example, in the case of a cabinet manufacturer, the wood, hinges, and stain are direct materials while sandpaper, masking tape, and paint brushes are consumables.

Any Retail Sales Tax paid to a supplier for direct materials, is to be separated and deducted from the tax calculated on manufactured cost.

### Direct Labour

The cost of direct labour relates to wages and salaries paid to workers whose time can be readily identified with specific production jobs in the manufacturing process. The pay of a machine operator, for example, would constitute direct labour while the salary of a sweeper is indirect labour.

In sole proprietorships, where the owner takes drawings in lieu of wages, and is directly involved in manufacturing, a reasonable amount must be allocated to manufacturing labour based on current shop rates. Similarly, if the owner of a corporation pays himself a bonus instead of wages for his direct involvement in manufacturing, then a reasonable amount must be allocated to manufacturing labour based on the shop rate.

Direct labour does not include labour to install fixtures to real property or repair TPP.

### Manufacturing Overhead

Manufacturing overhead is made up of all manufacturing costs that have not been classified as direct materials or direct labour.

Examples include:

- indirect material costs such as operating supplies, non-durable tools, repair and maintenance supplies, janitorial supplies
- indirect labour such as manufacturing supervision, inspection, material handling, janitorial work, and repairs and maintenance
- employee benefits and payroll costs for direct and indirect labour (e.g., vacation pay, pension plan contributions, employment insurance, workplace safety and insurance premium, etc.)
- rental of manufacturing equipment and space
- property and business taxes connected with manufacturing operations

### Manufacturing Overhead (continued)

- insurance on manufacturing buildings and equipment
- depreciation and amortization expenses on buildings, machinery, equipment and leasehold improvements related to manufacturing operations
- energy costs used in manufacturing operations
- freight on incoming shipments not identified with direct or indirect material
- transportation costs of hauling manufactured items between company plants
- royalties and licensing fees related to production processes or use of equipment
- engineering and drafting costs related to own use product design.

Where an expense item such as rent relates to both manufacturing and general overhead costs, a reasonable estimate will be necessary to allocate cost between the manufacturing and non-manufacturing areas (e.g., the percentage of floor space used).

## Manufactured Cost Estimates

### Using Previous Years Actual Cost

Manufacturing contractors may use the previous fiscal year's actual costs to estimate direct labour and manufacturing overhead for the current fiscal year. The Retail Sales Tax (RST) paid for the current fiscal year must be recalculated at year-end when actual cost figures are available to determine the actual RST owing for the year.

If RST is underpaid, the underpayment must be reported on the next periodic return. An overpayment may be deducted through an internal adjustment to the RST owing in the contractor's records. The actual manufactured cost calculated may then be used to estimate RST for the next fiscal period.

#### Note:

Manufacturing contractors using estimates to calculate RST owing must be consistent and use the same method when filing their returns.

### Using Approved Formulas

It may be difficult for a manufacturing contractor to determine the fair value of goods that have been produced for own use. In these instances, it is the policy of the Ministry of Revenue to allow a taxpayer the option of applying an approved formula for calculating the tax payable by using available records. Whichever method is chosen, it must be used consistently.

If the approved formula is used consistently throughout the year, then the contractor is not required to adjust his manufactured cost to actual at the year-end. Any other use of these formulas or of other formulas devised to calculate RST on own use must first be approved by the Ministry. The use of these formulas is subject to audit.

### Asphalt Mix

Producers of asphalt mix may use one of the following formulas to calculate the RST payable:

#### Formula 1:

Where asphalt mix is produced using new materials or liquid asphalt purchased by the producer along with other materials supplied by the customer, the producer should account for RST on a value of:

\$30.00 X number of tonnes of mix supplied and installed

**Asphalt Mix**  
*(continued)*

**Formula 2:**

Where asphalt mix is produced using new liquid asphalt supplied by the customer and at least 25 per cent of the total mixture is either recycled materials or reclaimed materials supplied by the customer, the producer should account for Retail Sales Tax (RST) on a value of:

\$19.00 X number of tonnes of mix supplied and installed

**Machinery and Equipment**

Manufacturers of taxable machinery and equipment produced for own use may estimate their manufacturing overhead as 150 per cent of their cost of direct labour. The RST payable would be calculated as follows (dollar amounts are for illustration purposes only):

Direct Material	\$100.00
Direct Labour	70.00
Overhead using formula of 150 per cent of Direct Labour (\$70.00 x 150 per cent )	<u>105.00</u>
Manufactured cost	<u>\$ 275.00</u>
RST payable (\$275.00 x 8 per cent )	<u>\$ 22.00</u>

**Monuments**

Monument dealers may determine the RST payable as follows:

55 per cent X the installed selling price X 8 per cent RST  
(see **RST Guide 403 - Monument Dealers**)

**Sheet Metal Products**

Sheet metal products are components and fixtures preassembled or manufactured from galvanized metal, aluminum, painted galvanized metal, copper, stainless steel, and roof deck. A sheet metal contractor is a contractor who manufactures these products for use in real property contracts. The RST payable is calculated by multiplying the cost of the materials used (excluding GST) by the applicable factor:

Type of Metal	Factor
Galvanized Metal - unfinished	15 per cent
Galvanized Metal - painted	13 per cent
Copper	11 per cent
Stainless Steel	11 per cent
Aluminum	13 per cent
Roof deck	9 per cent




**Example:**

Total cost of aluminum is \$250.00. The RST owing is calculated as \$250.00 x 13 per cent = \$32.50. The RST calculated using the factor is approximately the same as adding 8 per cent RST to the actual manufactured cost.

## Special Circumstances

<b>Federal Government</b>	Where a manufacturing contractor enters into a contract with the federal government for goods manufactured to be used in the supply and installation of equipment, the nature of the equipment will determine whether the contract should be tendered on an RST-included basis or an RST-excluded basis, as discussed in the paragraphs below.
<b>RST-included Contracts</b>	Contracts for equipment manufactured and installed by the contractor that directly services the building (e.g., elevators, escalators, central heating and air conditioning, etc.) must be tendered on an RST-included basis. The contractors must pay or account for Retail Sales Tax (RST) on materials used to complete these contracts. The contractors are the consumers of the materials used to fulfil these contracts. The RST paid on the materials is a cost element of the contracts.
<b>RST-excluded Contracts</b>	<p>Contracts for equipment manufactured and installed that becomes a fixture and does not directly service the building (e.g., material handling equipment, production machinery, communication equipment, training equipment, etc.) must be tendered on an RST-excluded basis. Manufacturing contractors engaged in contracts of this nature are permitted to make RST exempt purchases on materials used to complete these contracts by providing a valid PEC to their suppliers. RST must not be charged on federal government contracts of this nature.</p> <p>Manufacturing contractor's billings must identify separately the charges applicable to each of the above two types of contracts.</p>
<b>Responsibility to Determine Tax Status</b>	Manufacturing contractors are responsible for determining whether the installed equipment is subject to RST. A manufacturing contractor may contact the local Ontario Ministry of Revenue Tax Office to determine if the customer or the installed equipment qualifies for RST exemption before tendering contracts. To purchase goods from suppliers without paying RST, manufacturing contractors must provide their suppliers with a valid PEC.
<b>Goods Exported</b>	If a customer is located outside Ontario, the manufacturing contractor is not required to remit RST on the manufactured cost of the goods, where they are shipped directly to a point outside Ontario.
<b>Supply Only Sales</b>	If a manufacturing contractor sells manufactured goods to another contractor or a property owner, without installation, RST must be collected on the selling price. In this case, RST is not accounted for on the manufactured cost since the goods are not consumed by the manufacturer. The RST collected on these sales must be reported on <b>Line 2</b> (Tax Collected on Sales) of the RST return. Compensation may be claimed on the amount of RST collected on supply only sales.
<b>Taxable Purchases</b>	Manufacturing contractors who buy finished goods for use in real property contracts without further manufacturing required, must pay RST to their suppliers on the fair value of the goods, unless the goods are purchased for use by a customer who is entitled to acquire them exempt from RST (see <b>RST Guide 400 - Manufacturers, RST Guide 808 - Status Indians, Indian Bands and Band Councils, and RST Guide 807 - Farmers</b> ).

## More Information

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## Disclaimer and References

The information contained in this publication is provided only as a guideline and is not intended to replace the legislation.

### Legislative References:

- *Retail Sales Tax Act*, subsections 1(1), 15.1(1), (2), 2(9); paragraphs 7(1)40, 7(1)41, 7(1)68
- Regulation 1012 under the *Retail Sales Tax Act*, sections 1, 14, 23
- Regulation 1013 under the *Retail Sales Tax Act*, section 1

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