

Tax Memo

Harmonization – Financial Services

After 18 years of maintaining a retail sales tax alongside the federal GST, Ontario is making a bold move to modernize sales taxes in the province. In his budget, Finance Minister Dwight Duncan announced that Ontario will be “harmonizing” its sales tax system with the GST, effective July 1, 2010. Instead of a 5% federal GST and 8% Ontario Retail Sales Tax (RST), there will be a single 13% Harmonized Sales Tax (HST) in Ontario. This system has been in operation in Newfoundland and Labrador, Nova Scotia and New Brunswick since 1997.

This decision will be applauded by most economists as a step toward improving the productivity and competitiveness of Ontario’s economy. With regard to the financial services sector, however, because financial services are exempt under the GST/HST, financial institutions cannot claim input tax credits on most of their purchases. The HST base is significantly broader than that for the RST, and so harmonization substantially increases the tax burden for the financial sector. The budget proposals do not contemplate any mitigation of this incremental cost. Given the magnitude of the tax increase in this sector, this aspect deserves serious consideration.

Notwithstanding that financial services will be exempt under the new sales tax, the budget proposes to continue to impose an 8% sales tax on the same types of insurance currently taxed under the RST.

What should the financial services sector do before the new HST system is introduced?

The financial services sector may wish to highlight, for the Ontario and federal governments, policy options that would offset the adverse cost implications of the HST on the sector. In addition, financial institutions should review their upcoming purchases, and accelerate major acquisitions that are not subject to RST, such as custom software, to reduce the cost of sales tax harmonization.

Although business systems currently used for the GST can also be used to comply with the HST, some modifications may be required. In addition, the transition to the HST in Ontario will give rise to many of the same issues that arose with the GST rate reductions on July 1, 2006 and on January 1, 2008.

The HST in Ontario will substantially mirror the GST, but there are certain differences which will require systems modifications. In particular, during the first 8 years of the tax, financial institutions and large businesses (annual taxable sales in excess of \$10 million) will have restricted input tax credits for certain categories of expenditures, such as energy, telecommunications, food, beverages and entertainment, and road vehicles weighing under 3,000 kg (including repairs, parts and fuel). Therefore, if a financial institution is otherwise eligible to claim input tax credits for inputs used in

commercial activities, it will nevertheless be restricted from claiming input tax credits for the above categories during the transition period.

Apart from systems issues, experience suggests that transitional rules (yet to be announced) will apply to transactions straddling the implementation date – such as long-term leases, equipment rentals and fixed-price contracts. Implementation of the HST in Ontario is also expected to give rise to “place of supply” issues for financial institutions in Ontario and elsewhere in Canada, and to affect the filing of returns by Selected Listed Financial Institutions.

For more information on the implications of Ontario sales tax harmonization on your business and what you should be doing now to prepare for it, contact the following or your local PricewaterhouseCoopers Indirect Tax representative.

Toronto	
Mike Firth ¹	
416 869 8718	michael.p.firth@ca.pwc.com
Brian Wurts	
416 869 2345	brian.d.wurts@ca.pwc.com
Ottawa	
Joanne Heffernan	
613 755 4344	joanne.heffernan@ca.pwc.com
Lloyd McMaster	
613 755 4337	lloyd.w.mcmaster@ca.pwc.com
Windsor/Waterloo/ London	
Zen Nimeck	
519 985 8917	zen.nimeck@ca.pwc.com

1. Member of PricewaterhouseCoopers' Canadian National Tax Services (CNTS). CNTS comprises a multi-disciplinary group of tax accountants, lawyers and other specialists from a variety of professional backgrounds in taxation, including government, with the mandate to enhance the overall value and scope of tax services PricewaterhouseCoopers provides to its clients.

Tax News Network (TNN) provides subscribers with Canadian and international information, insight and analysis to support well informed tax and business decisions. Try it today at www.ca.taxnews.com.

PRICEWATERHOUSECOOPERS 

PricewaterhouseCoopers LLP has been recognized by World Finance as Canada's "Best Transfer Pricing Team" for 2009.



© 2009 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.

This publication is intended to inform readers of developments as of the date of publication, and is neither a definitive analysis of the law nor a substitute for professional advice. Readers should discuss with professional advisers how the information may apply to their specific situations.

This publication may be displayed or printed only if for personal non-commercial use and unchanged (with all copyright and other proprietary notices retained). Unauthorized reproduction is expressly prohibited.