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Get Started! Financial Services May No Longer Be Exempt from the GST/HST

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Someone once joked that the truest form of “capital punishment” is tax. Well, if you’re in the business of helping clients create or manage capital, you suddenly find yourself in a tax world that’s certainly confusing and could be punishing indeed.

The federal government is introducing major changes to the definition of a financial service for GST purposes. And there is growing concern the changes mean that financial services that had been exempt from the GST will now be considered taxable. Specifically, services related to or involving “...agreeing to or arranging for financial services” would no longer be exempt from the tax.

That would turn on its ear almost 20 years of GST guidance over the definition of a financial service. And that’s not the only reason the issue is causing quite a stir. The changes come at a time when Ontario and British Columbia are preparing to adopt on July 1 the Harmonized Sales Tax, which combines provincial sales tax and the GST and will dramatically increase sales taxes in those provinces. And the changes would be retroactive to December 14, 2009.

They were introduced in February in a little missive from the Canada Revenue Agency (CRA) called GST/HST Notice No. 250, and confirmed in the ways and means motion that accompanied in the Federal Budget early last month.

Perhaps to calm nerves, the federal Department of Finance put out a subsequent press release on March 24, indicating that still further changes may be coming. And we could eventually see amending legislation. In the meantime, though, all financial services companies, including exempt market dealers (EMD’s), have important work to do.

For starters, EMDs should take a hard look at the Canada Revenue Agency’s “clarification” on the definition of a financial service, and how it impacts whether GST or HST is to be charged on discretionary or non-discretionary investment management services (and potentially, therefore, on trading related commissions), as well as administrative services and facilitatory services.

We recommend that exempt market dealers in particular review the CRA’s examples in detail to understand if these are the types of services you provide to Canadian residents – services which no longer will be excluded from the definition of financial services and will therefore be subject to the GST/HST. To the extent that an EMD purchases these types of services from a non resident (and this had previously been considered to be a financial service), then the Canadian EMD may be required to self assess and remit to the CRA the equivalent GST/HST on the value of those imported services. Cross border cost sharing and service agreements may require a fresh look to see if there are exposures to the services previously thought of as a financial service.

In Notice 250, CRA provides an example of a private placement under its definition of a facilitatory service. The example describes a classic underwriting situation where the dealer is engaged to find a buyer, assist with the valuation, oversee due diligence, negotiate pricing, arrange financing and close the deal. Traditionally, many dealers would have considered this a financial service and thus exempt from GST/HST. But based on the CRA’s example, the GST/HST will need to be charged and remitted. The CRA’s new interpretation also suggests that investment management fees for discretionary and non discretionary accounts could be subject to GST including commissions paid on investment products.

There is a lot to think about here, both on the revenue side and the cost side of an EMD's business.

If you have always been charging GST/HST on your services then there should be no large impact: you and your clients are used to paying the tax bill, even if that tax bill is going up July 1st in B.C. and Ontario. But if you have not been charging GST/HST, then you will need to look at each of the services you provide and the services you purchase. In some cases, an EMD may be better off charging GST as now all GST paid would be recoverable. If an EMD has a mix of taxable services and exempt financial services, then it will have to carefully review their situation. If an EMD was previously providing only exempt financial services, there may be a radical change to its business which will require changes to billing systems and processes over the remittance of GST/HST.

And you have to think of your customers as well as your own business. For corporate customers who are GST taxable, GST/HST is recoverable. However, retail customers and exempt entities such as mutual funds, hedge funds and investment fund limited partnerships cannot recover GST/HST paid and thus this is an absolute increase in cost for them.

There is bound to be a period of turmoil until there is absolute clarity on what is a taxable financial service versus an exempt financial service. But the stakes are too high to risk simply waiting for things to sort themselves out. Those wise enough to take the time now to have a detailed look at what they do - and who they do it for - will avoid or at least limit the punishment.

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