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HST results in significant changes for funds, pensions and benefit plans

With the incorporation of British Columbia and Ontario into the Harmonized Sales Tax (HST) regime, the number of registered pension plans, investment funds and similar organizations and their members eligible to be considered under the HST rules will increase substantially. (Until July 1, 2010, the tax was confined to Newfoundland & Labrador, Nova Scotia and New Brunswick.) As a result, the federal Department of Finance has introduced a number of new regulations to standardize tax attribution and reporting by financial institutions and investment managers with clients in both HST and non-HST jurisdictions.

While the new reporting and attribution rules are extremely detailed and complex, they are also still under development and subject to change. As a result, they may be revised or clarified in the near future as developments occur.

The following briefly outlines some of these changes:

Selected listed financial institutions (SLFIs)

Under current tax laws, institutions including banks, insurers, segregated funds, investment dealers and registered pension plans are considered *listed financial institutions* (LFIs) for tax reporting purposes. To remove incentives for LFIs or their managers to move to non-HST provinces, organizations that operate in both HST and non-HST provinces will be designated as *selected listed financial institutions* (SLFIs) and will be required to allocate their income under the special attribution method (SAM.)

According to the draft federal regulations, a SLFI can also include **registered pension plans, deferred profit sharing plans, registered retirement income funds, employee benefit plans, health and welfare trusts, in addition to LFIs** operating in two or more HST-participating provinces.

Special attribution method (SAM)

The special attribution method is designed to allocate the applicable tax owing based on the mailing addresses by plan members per tax jurisdiction.

Under the proposed HST rules, SLFIs will be required to determine the value of their investments and then pay tax, minus input tax credits (ITCs), based on the place of residence by province of their plan members and beneficiaries.

Called the provincial attribution percentage (PAP), the formula to be used to calculate the specific HST owing by province is as follows:

$$\frac{\textit{Value held by members resident in HST province}}{\textit{Value held by members resident in Canada}}$$

Example

Using this formula, assume an Alberta-based investment plan (under the legislation, investment plans include pension plans, employee benefit plans, unit trusts, pooled fund trusts, mutual fund trusts and segregated fund trusts) with 30 per cent of its value held by members in Alberta and the remaining 70 per cent held by members in Ontario is charged $100,000 by its investment manager, plus the five per cent Goods and Services Tax (GST), or $5,000, (keeping in mind that Alberta is a non-HST province and only has to collect and charge the five per cent GST.)

Under the proposed HST rules for SLFIs, the plan would have a tax liability in Ontario of $5,600, that is, 70 per cent of the unrecoverable GST multiplied by 8/5 (ie. the eight per cent Ontario provincial value added tax (formerly the provincial sales tax) over the five per cent GST rate.)

The Ontario tax formula would be applied as follows:

$$\frac{\textit{8\% Ontario tax}}{\textit{5\% GST}} \; X \; \textit{\$5,000 Alberta GST}$$

$$= \quad 1.6 \; X \; \$5{,}000 = \$8{,}000 \; X \; 70\% \; \textit{(the percentage of members in Ontario)}$$

$$= \quad \$5{,}600.$$

This formula would be applicable across Canada, with the tax liability being calculated on a per province basis.

Complicating the situation is that both SLFI plan members and annuitants are mobile. As a result, the proportion of tax to be paid in the name of a provincial or territorial jurisdiction could change as members move or transfer to other tax jurisdictions.

Under the federal government's proposed HST rules, the PAP formula will be calculated on September 30 of each year. Using a September 30 calculation date will give SLFIs a six-month period to gather information and calculate tax liabilities using SAM and PAP.

Implications for reporting

The administrative requirements to calculate, assess and distribute the HST liability by province are expected to be challenging for all designated SLFIs. In addition, many of the reporting forms and other administrative support materials have yet to be developed, opening the potential for more confusion later this year.

A detailed outline of the proposed regulations governing SLFIs can be found at the federal Department of Finance website at www.fin.gc.ca. Key-in the term *SLFI* in the on-site search engine and look for the document entitled ***Backgrounder: Financial institution rules for the Harmonized Sales Tax (HST).***