

The Berris Mangan Review



The Berris Mangan Review provides accounting and tax articles, information, and tips to our clients and friends.

BRITISH COLUMBIA HARMONIZED SALES TAX (HST)

On July 23, 2009, Premier Gordon Campbell and Finance Minister Colin Hansen announced that B.C.'s provincial sales tax (PST) will be converted to a value added tax structure and combined with the federal GST to create the BC harmonized sales tax (HST) at a combined rate of 12% (provincial portion of 7% and federal portion of 5%), effective July 1, 2010.

The HST will generally follow the same rules as the federal GST, with certain provincial exceptions that will be treated as point of sale rebates at the time of purchase.

There are both benefits and disadvantages to the HST. In general, businesses that are entitled to claim input tax credits should have a reduced cost of those expenses to which they were previously subject to PST; theoretically, these savings would be passed on to consumers. On the other hand, the HST will apply to services and tangible assets whereas the PST only applied to tangible assets and services related directly to the asset. Depending on the industry, the HST may be perceived as good or bad for business.

HOW BUSINESSES WILL BE AFFECTED?

Perhaps the most publicized effect of the HST is the increased cost of certain service based industries, such as restaurants and other services oriented businesses. For the service industry, the majority of their inputs relate to labor, therefore, the HST will represent an increase of 7% on their bills without an equivalent reduction in the cost of inputs. To the extent that clients are price sensitive the HST may reduce profitability due to absorbing the cost by reducing fees or through reduced demand and consumption.

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Most businesses will benefit from reduced compliance costs due to the necessity to only follow one set of rules and the filing of one return with the Canada Revenue Agency. However, don't expect to see the benefits immediately as there will be costs to understanding rules relating to the HST, such as point of sale rebates, and modifying software to properly calculate and bill the HST. Further, certain components of the PST will remain or other taxes will be increased where the HST fails to capture certain tax revenue streams that existed prior to the introduction of the HST.

Aside from reduced compliance cost, the benefits and disadvantages are mixed at best.

HST paid by businesses may be claimed back on HST filings and will reduce costs for certain industries. For example:

- Zero-rated (GST is effectively charged a rate of 0%) goods and services sold by certain businesses, such as exporters, will be able to claim the input tax credit for all HST paid; and therefore reducing the company's cost, where previous inputs were subject to the PST.

HST applied on inputs that had not been previously taxed due to exemptions or not being subject to the PST may increase the tax burden. For example:

- For many businesses, exemptions from PST already existed for purchases made for resale, purchases of manufacturing and processing equipment among other purchases, negating the effect of refundable input tax credits;
- Businesses selling tax-exempt goods or services, such as insurance agencies and financial institutions, will not be able to claim input tax credits, therefore, increasing their costs to the extent that previous inputs that were not subject to PST become subject to HST; and

- Large businesses (with annual taxable sales in excess of \$10 million) will temporarily be unable to claim input tax credits on certain items on the provincial portion of the HST.

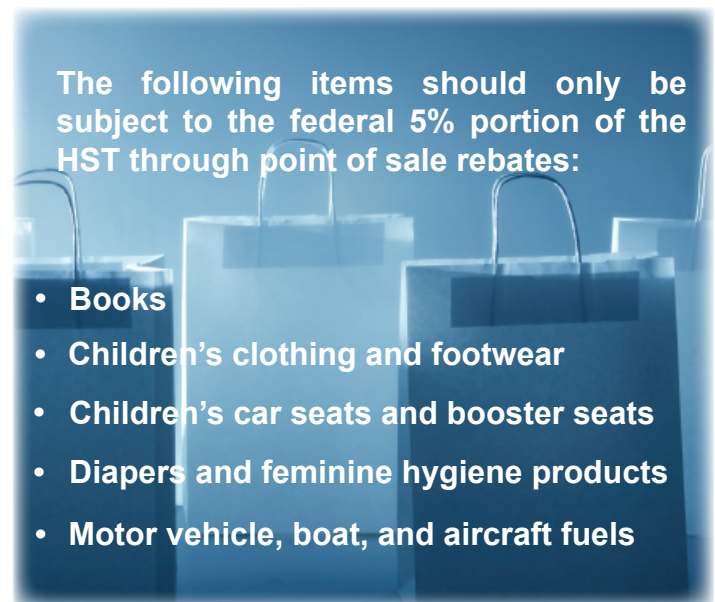
Other types of organizations, such as municipalities, charities and qualifying non-profit organizations, which may be subject to additional costs related to the HST may be able to claim partial rebates for the provincial portion of the HST.

INCREASED COST TO CONSUMERS

Tangible Assets

The PST was generally a 7% tax on tangible goods. To the extent that items previously purchased were subject to both the PST and GST the end cost should be the same.

The PST had exemptions for certain items, which will be continued through point of sale rebates for the provincial portion of the BC HST.



Services

Many services will cost an additional 7% effective July 1, 2010. For the majority of businesses that cannot claim input tax credits and individuals, the increased cost of consumables will be in the form of services.

Many services will cost an additional 7% effective July 1, 2010.

- **Restaurant meals**
- **Commercial rent**
- **Subcontractors and contractors**
- **Non-employee personnel (i.e. management fees, bookkeepers, janitors)**
- **Professional services provide by accountants, consultants, and realtors**
- **Non-medical services such as hair stylist, fitness classes, and memberships dues**

Real Estate

HST will apply to new home sales. However, purchasers of new homes will be able to claim a rebate equal to 5% of the purchase price up to a maximum of \$20,000. The government's intent is that new homes with building costs up to \$400,000 will not be subject to any additional tax burden than under the current regime. It is estimated that there is currently PST embedded in the cost of new homes equivalent to a 2% tax rate.

For new homes sales with a purchase price over \$400,000, there will be additional tax costs. For example, for a new home with a purchase price of \$800,000, there will be additional taxes of \$36,000 under the HST system.

Used or resale homes will not be subject to the HST just as they are not subject to GST.

A new HST credit of \$230 per family member for individuals with income of up to \$20,000 and families with incomes up to \$25,000 will be paid quarterly with the GST and carbon tax credits to help low to middle income individuals and families. The credit will be phased out for incomes above those thresholds. The BC HST

will apply to short-term accommodation replacing the hotel room tax. As a result, the tax on short-term accommodation should be reduced.

By Jamie Nguyen, C.A., Tax Senior jnguyen@berrismangan.com
Aaron Dovell, C.A., Tax Manager adovell@berrismangan.com

Note: The B.C. government recently released transitional rules that will apply for transactions that straddle the July 1, 2010 implementation date for the HST. Further details on these rules will be provided at a later date.

BIG TAX CHANGES FOR U.S. INVESTORS IN CANADA

U.S. investment in Canada has long been a vital component of the Canadian economy. U.S. persons with investments in Canada must plan for the implications of both the Canadian and U.S. tax systems.

During the past year, tax planning for U.S. investment into Canada has been in a state of flux due to recent changes in the Canada-US Income Tax Convention (a treaty between the two countries providing guidance for Canadians and Americans with cross-border tax issues). These changes include new rules that impede the tax benefits of some types of investment structures traditionally used by U.S. investors in Canada.

Among the most popular vehicles used by U.S. investors in Canada are Canadian corporations called Unlimited Liability Companies (ULC's), allowed under the corporate laws of B.C., Alberta and Nova Scotia. While there are some legal differences between ULC's and regular Canadian corporations (for example shareholders of ULC's are less protected from corporate creditors in



some situations), the reasons for popularity with U.S. investors in Canada relate primarily to the differing treatments of ULC's for U.S. and Canadian, income tax purposes.

In general terms, a U.S. person earning income through a regular corporation suffers an element of double taxation based on the accumulation of corporate tax and personal tax (the latter incurred on distribution of corporate after-tax profits). The Canadian income tax system is largely "integrated" meaning that such double taxation generally does not arise.

In many cases a U.S. investor in a ULC that operates a Canadian business, is treated for U.S. tax purposes as having earned business income directly, such that a corporate level of U.S. tax is avoided.

The recent treaty changes effectively result in a disallowance of certain treaty benefits to ULC's, notably that Canadian non-resident withholding tax on dividend distributions from a ULC may apply at a rate of 25%, rather than a treaty-reduced rate of 5%, effective January 1, 2010.

A variety of tax planning strategies are being considered and implemented by U.S. investors, ranging from simple solutions such as retention of the ULC with limited modifications, to more exotic solutions such as the use of a Luxembourg corporation as an owner of the ULC.

Various possible alternatives to the ULC include Canadian entities such as regular Canadian corporations, and partnerships, and U.S. entities such as Limited Liability Companies, and "S" Corporations which operate a Canadian "branch".

These treaty changes have lead to a scramble among U.S. investors in Canada to find investment vehicles that are appropriate alternatives to ULC's. A number of requests have been made recently to the Canada Revenue Agency for its views on the tax treatment of various proposed investment structure strategies, to which CRA has promised responses in the near future.

Amid such change and uncertainty, Canadian businesses with U.S. investors, and those investors, are well advised to carefully analyze how best to structure ongoing ownership of cross-border business and other investments. The treaty changes discussed come into effect on January 1, 2010.

By Brent Axworthy, C.A., Partner baxworthy@berrismangan.com

CLIENT TIPS

What are the benefits and costs of incorporation?

Benefits:

- Limited liability (unless you sign a personal guarantee as a shareholder)
- Protection from creditors
- Increased ability to obtain credit
- Income splitting with family members
- Tax-deferred savings (tax on active income at 13.5% vs. 22%-44% if taken as a salary or earned in a proprietorship/partnership)
- Potential tax-free sale of shares in certain situations

Costs:

Additional time and costs of paperwork and filings including:

- Preparation of annual financial statements and tax return
- Annual legal filings and maintenance of records by a lawyer

If you would like to incorporate we would be pleased to refer you to an excellent corporate lawyer. Alternatively, to self-incorporate follow this link:

<https://www.corporateonline.gov.bc.ca/corporateonline/colin/static/colin/html/index.html>

Corporate Taxes and Remittances

A company may choose any year-end it wishes. The first taxation year cannot be any longer than 53 weeks.

Corporate tax returns must be filed within six months following the year-end of a company. However, any taxes owing must be paid within two or three months of the year-end. Interest will be charged on any balance owing after this date.

If a corporation has taxes owing for a particular year, it will likely have an installment requirement for the following year. Installments are calculated based on 1/12 of the prior years' taxes payable each month of the following taxation year. For example, if a company owed \$12,000 of tax for 2008, it should make installments of \$1,000 per month starting the first month of the following taxation year. If the actual taxes owing for the following year are less than the installments, they will be refunded.

For more information, please contact your Berris Mangan advisor.

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CHARTERED ACCOUNTANTS

T: 604.682.8492 F: 604.683.4782 | www.berrismangan.com