

# How will the HST affect your brokerage firm?



By Dino Infanti CA

Effective July 1, 2010, the B.C. Provincial Sales Tax ("PST"), imposed generally at the rate of 7%, is proposed to be harmonized with the federal Goods and Services Tax ("GST") of 5%, creating a federally administered Harmonized Sales Tax ("HST") of 12%. While the administrative details have not been finalized, the additional 7% tax is expected to impact the expenditures incurred to operate your insurance brokerage firm.

The GST is governed by the *Excise Tax Act*. The PST, which is governed by the *Social Services Tax Act*, currently applies to tangible personal property and certain taxable services. Unlike the GST, the PST is not recoverable. B.C.'s intention is to apply the harmonized sales tax to the much broader GST base; however, it will permit input tax credits (to some businesses) to ensure the PST is not a hidden cost.

In the context of an insurance brokerage firm, PST and GST are not collectible on the sale of its products and services. Most of the services provided by insurance brokers are exempt from GST as they are associated with the service of "arranging for the issuance and maintenance of an insurance policy". However, non-financial services such as risk-control programs, financial and estate planning and management services are subject to GST, and will be subject to HST.

To an insurance brokerage firm, the impact may be considerable, in particular as it relates to expenditures incurred for overhead costs such as rent, management fees, consulting fees, accounting fees, royalties, licensing rights, custom software and certain employee expenses. According to Berris Mangan Chartered Accountants' *Insurance Brokerage Profitability Study, 3rd Edition*, published by

Michael Berris, CA, such expenditures generally represent approximately 17% of an average insurance brokerage firm's total expenses. The good news is that salaries, which are the most significant cost in operating an insurance brokerage firm (representing approximately 68% of total expenses), will not be impacted by the HST.

The increased costs will result from the inability of most insurance brokerage firms to recover the HST paid in the form of an input tax credit related to such expenditures. In contrast, the impact of the HST on most non-insurance brokerage companies may not be significant, since such organizations are permitted to recover the HST paid on expenditures.

An average property and casualty insurance brokerage firm incurs approximately 10% of total expenses on rental of its premises, and approximately 7% of total expenses on consulting and business services. Therefore, for an average property and casualty insurance brokerage firm, the HST will increase their costs by approximately \$6,000 per year, or about 1% of its gross income.

Planning points for insurance brokerage firms to consider with the HST:

1. Accelerate the purchase of goods and services for use in your brokerage firm for items that will become subject to HST. For example, if you are considering purchasing real estate to operate your insurance brokerage firm, or the purchase of a custom computer program, you should do so prior to July 1, 2010. You will pay the 5% GST as opposed to the 12% HST.

2. Inter-corporate management fees. Often the owner of an insurance brokerage firm may pay reasonable management fees to a related company. Such fees may currently be subject to 5% GST, and may be subject to 12% HST on July 1, 2010. You may wish to consider restructuring the arrangement to avoid incurring the additional tax. For example, the management company may provide

financial services to the insurance brokerage firm.

3. Reorganize and consolidate your corporate structure. Consider consolidating a holding company and an operating company to eliminate inter-company management and rental fees.

4. Re-evaluate owner compensation. Consider paying salaries to the owner from the insurance brokerage company as opposed to inter-corporate management fees. Any after-tax profits from the insurance brokerage company may then be paid as tax-free (if properly structured) dividends to a holding company.

5. Mix services that are zero-rated and exempt. Most insurance brokerage products and services are exempt and therefore not entitled to input tax credits on purchases. However, some services may be zero-rated, such as risk-control programs, and therefore entitled to input tax credits. You may wish to carefully identify the taxable and non-taxable services to recover some input tax credits.

Often, as with many business decisions, the cost/benefit decision must be analyzed while considering those direct

and indirect factors that are impacted today and in the future.

The HST is a significant change in tax policy that will impact many business owners

and consumers via increased direct costs, such as rent on your premises. The HST impact will be more considerable on an insurance brokerage than on some other businesses because there is generally no ability to claim input tax credits. The benefit portion of the equation is a stronger, healthier economy through the reduction in the administrative burden by administering only one tax, reduced personal and corporate income taxes, and additional redeployment of funds to other government initiatives.

The problem with the cost benefit equation is the costs will be directly felt by British Columbians commencing July 1, 2010, and the benefits will be indirectly realized in the years to come. ♣

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