



## **Harmonized sales tax not in Canadian investors' best interests**

By Peter Intraligi

Invesco Trimark believes that Canadian investors should be exempt from paying the Ontario Provincial Sales Tax (PST). The proposal to harmonize the PST with the Federal Goods and Services Tax (GST) will effectively increase the management fee on a mutual fund investment by 8% (PST) effective July 2010.

We believe the proposal to harmonize the PST with the GST is detrimental for investors in mutual funds and longer term, for the people of Ontario.

We believe there are two key reasons why investors should be exempt from paying the proposed Harmonized Sales Tax (HST), which I will address in turn.

### **Higher fees result in lower returns**

The tax levied on management fees is a large component of the management expense ratio (MER). With the proposed HST, a typical retail mutual fund will see an increase in its MER of approximately 0.18%.

If, for example, the MER of a fund is 2.15% and the portfolio manager is able to generate 7% return on investment before accounting for fees, then the return to an investor is 4.85%. An 8% increase in the MER will decrease the net return on his or her investment proportionately.

So what does that mean in real dollar terms? Let's look at an example. If you invest \$50,000 in mutual funds, the HST will reduce the funds' return by approximately \$145 each year. The taxes levied are almost triple of what is currently charged on the same investment. Since the tax is applied to the market value of an investment, the annual amount may increase over time. In other words, if an investment increases by 7% per year over five years, the associated taxes would amount to \$845. This increase runs counter to the efforts that Invesco Trimark has made over the years to contain and reduce fees and associated costs borne by investors.

Collectively, Canadian mutual fund investors – not just Ontarians – will pay approximately \$1.6 billion in harmonized sales taxes to the province of Ontario each year – an increase of about \$1 billion. This is being done at a time when interest rates are at historic lows, dividends are being cut and the market is down over 30% from its peak.

### **Unintended consequences on Ontario's economy**

While some aspects of the Government's proposal for a combined HST are positive, there are factors that may offset the benefits. Over the long term the HST has the potential to negatively impact Ontario's economy. Here's how: Investment management companies that continue to operate their business in Ontario will be required to charge their clients an additional tax that would otherwise not be required if the business were located in another province. This creates an incentive for mutual fund managers to move their operations to provinces where management fees are not subject to HST.

Today, the vast majority of Canadian fund managers are located in Ontario, thereby generating billions of dollars in tax revenue. Over time, if investors are not exempt from paying the HST on their investments, mutual fund companies may have to consider moving their business to other provinces in Canada in order to keep their products price competitive. If those companies leave the province, they would not be subject to Ontario provincial income taxes and this could result in a significant reduction in tax revenue income for the Province of Ontario.

Lastly, it should be noted that taxes such as GST and PST (and HST) are generally applied in the jurisdiction where a service is rendered. If a mutual fund and the manager are considered Ontario residents for tax purposes, then it does not really matter where the investor in a fund is located. It is the fund that is receiving the service from the manager. As an example, many Canadian mutual funds have a small proportion of investors who reside outside Canada, but they do not receive any sort of rebate for the GST paid by the fund on management fees or other services.

At Invesco Trimark, we have long believed that mutual fund management fees should not be subject to GST. We urge the Government (both Federal and Provincial) to exempt mutual fund management fees from the HST. Additional taxes are simply not in the best interests of investors. Although it is an unintended consequence, imposition of the HST could prove to be detrimental to both investors across the country and to the people of Ontario.

Peter Intraligi is President and Chief Operating Officer at Invesco Trimark Ltd.

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