

# Ontario PR threat surprises fund industry

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A reported threat by the Ontario government to launch a negative PR campaign on mutual fund fees has surprised mutual fund industry advocates, who have been publicly campaigning to get some sort of exemption from the provinces' harmonized sales tax (HST) proposal.

Whether it has merit or not, a publicly funded PR campaign against mutual funds is not something the mutual fund industry, or the advisors who sell mutual funds, would want to see.

What is already established is the fact that the HST proposal in its current form will increase the cost of most Canadian domiciled mutual funds by roughly 8% if implemented. A cost that will more than likely have to be passed on to all Canadian investors, since most mutual fund firms have a base of operations in Ontario.

Industry organizations such as The Investment Funds Institute of Canada (IFIC), along with a number of individual fund company executives, have called for the Ontario and British Columbia governments to consider an exemption for mutual funds, considering the important role they play in retirement for Canada and the fact that other financial products will not be subject to the HST.

According to a *Globe and Mail* story published on Thursday, the provincial finance department wants the mutual fund industry to cease its public campaigning. It has even inferred it will launch a counter-campaign against mutual fund fees if the industry persists.

Joanne De Laurentiis, president and CEO of IFIC, told Advisor.ca that the reported threat is surprising, for two reasons. First, the industry has nothing to hide with regard to how mutual fund fees are disclosed; management expense ratios (MERs) and the underlying management fee of mutual funds are transparent. Second, she says that the industry's discussions with the Ontario government have actually been very productive.

"We have been having a very constructive dialogue with the minister's office and staff in the finance department. The dialogue has been open and constructive, and there has been a clear understanding to the concerns of the industry," De Laurentiis says.

That primary concern is that investment funds are being singled out in the proposal versus other investment products such as GICs, stocks or bonds. According to IFIC, sales tax applies to all goods, services and labour — the management fee — used to supply mutual funds. Sales tax applies only to some services used to supply GICs, securities and other non-fund products — it does not apply to salaries, which represents about 75% to 80% of a financial company's expense.

De Laurentiis says that without making some changes, the sales tax laws will unfairly penalize investment funds based purely on their structure. Mutual funds are arguably the most widely used investment vehicles by retail Canadian investors, representing 70% of RRSP assets.

"With harmonization, the tax on the MER goes from 5% to 13%, which is pretty high. The issue we have with this really

goes to the way the GST was implemented in 1991," De Laurentiis says. "The industry was very small in 1991, so there wasn't a recognition of the policy implication treating investment funds differently from a tax perspective than other financial products."

Investment funds have to be held in trust apart from the firm that distributes them. As a result, the firm has to pay the fund a management fee. That management fee is considered a taxable service subject to GST, so the fund firm has to pay GST on the fees it pays to the fund.

To give some context in how huge the proportional increase in taxes the fund firm has to pay, consider that the most fund firms have fixed operating costs apart from the fund, which is 20 basis points or less.

For example, on a fund with an MER of 2.20%, the HST would add about 18 basis points of tax expenditures. Sales tax in total, including GST and the HST, would be about 30 basis points — almost double the operating expenses of most mutual funds.

"Think of the total fee breakdown in three points: there is a management fee, there is distribution, and there are administrative fees, and on all three of those there is GST on all three of those aspects of the fee," says Peter Intraligi, president of Toronto-based Invesco Trimark. "If you take the investment management component and then you add administrative costs, the combination of those two times (1.05) gives you the [final cost of the fund]. With the HST, it's going to be multiplying that number by 1.13."

In a submission he sent to the Ontario government, Intraligi says if a fund that has an MER of 2.15% that returned a conservative 7% over five years, the investor would pay an additional \$845 in taxes under the HST proposal. This increase negates much of the work his firm has done to reduce investment costs for investors.

"This is not about the mutual fund industry; it's about a new tax on investment savings. Whether it's an ETF, a mutual fund or a seg fund, all of those are going to be subject to the HST, and all of their costs will go up," Intraligi tells Advisor.ca. "As an investor, I invest my money for one sole purpose — that is, to make money. In the case of a mutual fund, I pay a fee, I am taking my after-tax dollars, and I take some of those dollars and put them aside. I pay a fee for that; I have the expectation of growth."

He adds, "When those assets grow, I pay tax in the form of capital gains taxes. In my opinion, as an investor, to pay a second tax on something that I'm already paying tax on is unfair. You're already paying taxes on your investment dollars."

De Laurentiis points out that other countries with sales taxes similar to the GST, such as the U.K. and Australia, do allow for tax credits or exemptions on financial advisory services.

"We're just asking to have the HST harmonization revised so that the HST is the same the way it applies to other financial products. We have no objections to paying our fair level of tax; everybody has to pay tax," she says.

Intraligi says he's been hearing some strong concern also coming out of the advisor community.

"As recently as yesterday, I was at a luncheon with a group of advisors and we talked at length about this, and they have expressed significant concerns," he says. "At a time when we're looking to stay in the markets, to encourage investors to put money aside and to put new money into the markets — to add a new tax is not wise. I think advisors across the country are looking at this as bad for their clients and bad for investors."

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