

# EFFECTS OF HARMONIZED SALES TAX ON BRITISH COLUMBIA FIRST NATIONS

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## ***HST Announcement and Background***

On July 23, 2009 the BC Government announced its intention to harmonize the current 7% PST with the 5% federal GST effective July 1, 2010. BC's HST will apply at the rate of 12% which will be the lowest HST rate in Canada.

By creating a harmonized sales tax ("HST"), BC will join Quebec, Nova Scotia, New Brunswick, Newfoundland and Ontario (also effective July 1, 2010). As Alberta does not have PST, this leaves only Saskatchewan, Manitoba and Prince Edward Island as the remaining Canadian provinces without a harmonized sales tax. All other provinces with an HST, including the proposed HST in Ontario, have a rate of 13%.

This report will discuss the general application of the HST and the disadvantageous effects and potential benefits it may have generally for individuals and businesses in British Columbia. The report will then focus on the specific effects of the HST on First Nations.

## ***Application of HST***

The proposed HST will, for the most part, tax the same goods and services that are currently subject to the GST. Goods and services not currently subject to GST will generally remain HST exempt.

The proposed HST rules contain certain exceptions to the combined 12% rate which will involve point of sale rebates of the 7% provincial portion of the HST. To implement this rebate, the supplier of the taxable goods or service will simply not charge the purchaser the provincial portion of the tax on the item. Proposed items subject to this instant 7% rebate include:

- books;
- children's sized clothing and footwear;
- diapers;
- children's car seats and booster seats;
- feminine hygiene products; and
- motor fuels such as gasoline and diesel fuels used in motor vehicles.

It has also been proposed that municipalities, charities and non-profit organizations which receive rebates under the GST, will receive a rebate of the provincial portion of the HST. Further details about the availability of such a HST Rebate for these non-profit institutions are expected to be forthcoming in the next few months.

## **IMPACT ON INDIVIDUALS AND BUSINESSES (NON-FIRST NATION SPECIFIC)**

### *Disadvantageous Effects of HST*

#### **Increased Tax Base**

The list of goods and services to which PST and GST currently apply are not identical. HST has the same tax base as the GST and, therefore, various goods and services that previously were PST exempt will be subject to a tax rate of 12% under the HST, rather than only being subject to the 5% GST as is the case currently. In short, far more goods and services will be taxed at a substantially higher rate. The effects will be greater in service industries which are less exposed to PST under the current system but will be subject to HST. A greater tax base is clearly the incentive for provincial governments to sign onto harmonization.

Restaurant meals is one example of a good or service that is currently only subject to GST (at a rate of tax of 5%) but will be subject to the full proposed HST (at a rate of tax of 12%). The HST will make purchases such meals further beyond the reach of fixed or low income individuals.

New housing is another item for which only GST currently applies but which will be subject to HST. In order to offset some of this extra expense to the consumer, British Columbia proposes to implement a new housing rebate such that purchasers of new homes up to \$400,000 will not pay any more provincial tax due to the introduction of the HST than is currently embedded as PST in the price of a new home. They estimate the amount of embedded PST in a new home to be 2% of the purchase price. For homes in excess of \$400,000, a maximum rebate of \$20,000 is available. This means that the price of new homes above \$400,000 will attract more sales tax under the HST system. The purchase of used housing will continue to be exempt.

#### **Elimination of PST Based Environmental Initiatives**

In addition to the above, there were some environmental based initiatives implemented through the PST which will now be lost. Subsidies for energy-efficient retrofits and appliances that are now exempt from PST will also be subject to the full HST.

#### **Regressive Tax**

Consumption taxes, such as the proposed HST, are often criticized as being regressive in that they disproportionately affect lower income households. Accordingly, BC is purporting to tailor the HST to respond to the needs of fixed and low-income British Columbians. Several products, such as books and children's clothing, will be exempt from the HST.

In addition, low income individuals and families will receive a fixed amount HST credit cheque meant to reimburse them for the HST they spend. For individuals with yearly incomes up to \$20,000, the maximum credit will be \$230; for families with yearly incomes up to \$25,000, the maximum credit will be \$230 per family member. Whether such rebate cheques offset the increased taxes as a result of the harmonization of the two taxes is difficult to predict, but unlikely.

## *Benefits of HST*

### **Input Tax Credits for Businesses**

The largest direct benefit to businesses is that they now have access to credits available to offset the full amount of HST *spent* by the business in conducting its activities. This access to credits will be available equally to First Nations' owned businesses.

In the current system, businesses are able to claim input tax credits ("ITCs") for the GST they pay on items they purchase to run their business. This, in effect, allows these businesses to recover the tax they pay on "business inputs". The businesses offset the amount of GST they have paid from the amount that they have collected and only remit the net amount to the government. The intended result of the full credit system is that the end-user consumer of the supplies pays the GST on the supply that has travelled through the economy and little or no GST is embedded (i.e. passed on to consumers) in the selling price of the goods or services. Under the current system, PST is embedded in the cost of goods and services because businesses are not able to claim a credit for the amount of PST paid on inputs into their final product.

Because of the availability of the ITC's under the HST system, the cost to a business of producing a good or service should in theory be less than the cost to produce that good or service under the current system. It is estimated that the amount of PST embedded in the cost of goods which will be eliminated will be approximately \$1.9 billion. These estimated savings have been broken down in part over the following sectors listed below: (1) Construction - \$880 million; (2) Manufacturing - \$140 million; (3) Transportation - \$210 million; (4) Forestry - \$140 million; (5) Mining, Oil and Gas - \$80 million.

To the extent that First Nations are involved in the above listed industries, they can expect, based on these projections, to realize a savings on their internal costs. However, such savings are subject to market pressures to reduce prices as discussed below.

### **Elimination of Embedded Taxes Leading to Lower Prices**

The indirect benefit to consumers of the full ITC's available to businesses is that the cost of goods being reduced to the businesses will, in a competitive environment, be passed through to the consumers as lower prices.

The British Columbia Chamber of Commerce foresees that many products will go down in price. Economic research including figures from the Atlantic Provinces that have already implemented an HST, has shown that the savings are indeed passed through to the consumer by way of lower prices.

### **Lower Administrative Burden on Small Businesses and Government**

Businesses will save on administration costs by being required to collect and remit one tax instead of two. Forecasts call for an estimated savings of \$150 million annually in administrative costs. There would also be an indirect benefit to taxpayers being a forecasted administrative savings of \$30 million to the British Columbia government as the federal government will be the sole collector of single sales tax.

## **SPECIFIC IMPACT ON FIRST NATIONS**

In addition to the impacts described above, there are certain specific impacts to First Nation individuals, Indian Bands and First Nation operated entities that may be felt due to their unique taxation situations.

Indians and Indian Bands, as defined in the *Indian Act*, are exempt from tax on personal property and real property situated on reserve. As a result, in general, goods and services purchased by First Nations on a reserve are not subject to GST or PST and will likewise not be subject to HST.<sup>1</sup>

### **Ontario Experience**

There has been a strong anti-HST sentiment by First Nation leaders in the province of Ontario since the announcement of the harmonization of sales taxes in that province in March. This is because of a particularly disadvantageous result in the harmonization of the two taxes in Ontario which is **not** present in British Columbia. The difference between First Nations in the two provinces is explained by the fact that the tax policy regarding purchases exempt from Ontario PST is wider than BC PST.

In Ontario, Indians and Indian Bands may currently purchase most goods or services without paying provincial sales tax, as long as the goods are said to be for use on the reserve. There is no requirement that the purchase of such items actually occur on reserve. This off-reserve tax free purchasing power will be lost when the HST is brought in. This is because the HST rules will follow the GST rules which require an on-reserve purchase in order to qualify for the exemption, similar to the British Columbia PST rules and policies.

In BC, a PST exemption has been available to Indians and Indian Bands for property purchased on a reserve, either because it was purchased from an on-reserve business or because it was shipped for delivery to the reserve. Sales to Indians or Indian Bands that occur off-reserve are subject to sales tax because title to the goods passes to the purchaser at an off-reserve location.

In effect, Ontario Indians and Indian Bands are, by virtue of the HST, being brought down to a reduced level of sales tax-exempt purchasing freedom that British Columbia Indians and Indian Bands were already accustomed to.

### **Advantage for Purchases by Band-Empowered Entities**

There is an advantage to the move to HST in the context of purchases made by band-empowered entities for band-management activities. Previously, such purchases, while GST exempt, would be subject to the 7% PST. Under the harmonized sales tax system, it appears that such purchases would be exempt from the entire 12% HST.

It is generally accepted that only an Indian or an Indian Band qualifies for the tax exemption provided for in section 87 of the *Indian Act* for on-reserve property. This is certainly the case for PST. However, the federal government has a favourable administrative position with regards to GST which extends the GST exemption beyond Indians and Indian Bands to what they call “band empowered entities.” The policy defines “band empowered entity” relatively broadly as follows:

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<sup>1</sup> Such goods and services may be subject to FNGST or FNST, if a First Nation has implemented either tax system on the First Nation lands in question, as discussed below.

A “band-empowered entity” is a corporation, board, council, association, society, or other organization that is owned or controlled by a band, a tribal council, or a group of bands other than a tribal council. This policy is applicable to those band-empowered entities that are situated on a reserve. A band-empowered entity is considered to be situated on a reserve when the entity maintains a presence on a reserve.

An entity is considered to be owned by a band, a tribal council or a group of bands other than a tribal council if:

- the band, tribal council or group of bands owns all or substantially all of the shares or holds all or substantially all of the memberships of the entity; or
- the band, tribal council or group of bands holds title to the assets of the entity or controls its disposition, such that in the event of wind up or liquidation, these assets are vested in the band.

An entity is considered to be controlled by a band, tribal council or group of bands if:

- the band, tribal council, group of bands or individual members of the band, tribal council or group of bands, appoint or elect a majority of the members of the governing body of the entity (e.g., directors); and
- the entity is required by legislation, by-laws, or an operating agreement, to submit to the band, tribal council or group of bands, its operating budget and where applicable, its capital budget for review and approval.

It is the above administrative policy which would extend section 87 of the *Indian Act* to make numerous aboriginal organizations in British Columbia exempt from GST.<sup>2</sup> This is not only for on reserve purchases, but also for off-reserve purchases of most goods or services that are for “band management activities,” broadly defined as follows:

“Band management activities” are activities or programs undertaken by a band or band-empowered entity that are not commercial activities for which they would otherwise be entitled to an input tax credit. ... [Emphasis Added]

This policy applies to both GST and HST. As the HST is a combination of the GST and PST, and since under PST rules, there would be no exemption for a band empowered entity, the shift to HST creates an additional exemption of 7% not present before.

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<sup>2</sup> To be assured of “band empowered entity” status a ruling from the GST Directorate should be sought. We are pleased to assist in this process for any potential “band empowered entity”.

## **EFFECTS ON FIRST NATION TAXATION**

### **FNGST**

The First Nations goods and services tax (“FNGST”) is a 5% tax on taxable supplies of goods and services imposed on certain First Nation lands when a band council or other governing body of a First Nation passes its own law imposing the tax. A full list of participating First Nations is found in Appendix A. There are currently eight First Nations in British Columbia charging the FNGST.

The FNGST has the same basic operating rules as the GST/HST. On lands where the FNGST applies, the rate of tax imposed on taxable goods and services is the federal portion of the HST (i.e. 5%) which everyone has to pay regardless of Indian status.

It is unclear what will happen with the provincial portion of the HST. The CRA have stated publically that the details have not yet been worked out. However, they have indicated to our office that where the purchaser of a taxable good or service is not exempt pursuant to section 87 of the *Indian Act* in relation to a purchase on First Nation lands, the good or service will be subject to the provincial portion of the HST.

If the UBCIC is to engage the Federal and Provincial Ministries of Finance, this would be a key topic for clarity.

### **FNST**

The First Nation Sales Tax (“FNST”) is a tax on the supply of listed products on lands of a First Nation that has passed a by-law imposing this tax. There are currently nine First Nations in British Columbia imposing this tax. A full list of participating First Nations is found in Appendix B. Listed products are alcoholic beverages, fuel and tobacco products specifically mentioned in the band’s by-law. On lands where the FNST applies, everyone, including Status Indians, must pay the FNST on taxable goods and services.

The tax rate for FNST is 5%, the same as GST, FNGST, and the federal part of HST. When FNST applies to a listed product, then GST, the federal part of the HST, and FNGST do not. The usual rules will continue to apply to supplies of other goods and services on these reserves.

As there are no First Nations in provinces that have harmonized sales taxes that have chosen to implement the FNST or FNGST, British Columbia will be the first to deal with the administrative issue. The CRA has advised that the Ministry of Finance in British Columbia is currently working through the issues and will be advising them shortly of the rules for application of FNGST and FNST in an HST environment. A source at the CRA has advised us informally that the rules will be made public on the same day that they are received by the CRA internally.

If the UBCIC is to engage the Federal and Provincial Ministries of Finance, this would be a key topic for clarity.

## CLOSING COMMENTS

The HST provokes opposition from the personal affect it will have on individual Indians residing off-reserve. Clearly, we know that our off-reserve population will be detrimentally affected by the regressive nature of sales taxes. Sales tax is a blunt instrument in the public policy financial toolkit. It is for this personal application of HST that First Nations should feel rightly frustrated in the failure of BC and Canada to consult. Of course, this sentiment is shared by Aboriginal and non-Aboriginal persons in BC.

The question is now one of turning challenge into opportunity. As set out above, there will be substantive advantages for Aboriginal businesses that may positively affect the sustainable economic development. There may also be some opportunity for preferential treatment of Indian Bands and First Nations non-profit entities.

There is a need for clarity. BC First Nations must engage the Province and Canada to ensure that First Nations with taxation powers under the FNGST and FNST are not prejudiced and hampered in their self determination.

In short, we see five key issues for engagement:

- (1) How will the Governments of Canada and BC ensure adequate consultation with adversely affected First Nations in the implementation of HST? *There needs to be an adequate consultation mechanism established with affected First Nations. If there is a BC-CAN Technical Working Group existing or established, there should be First Nations representation. It may be useful to consider an First Nation leader, a financial advisor and legal advisor.*
- (2) Will First Nations receive HST rebate treatment equal to municipalities, charities and non-profit entities? *The details of this application are being presently worked out to the exclusion of a First Nations voice. This must be addressed immediately.*
- (3) How will FNGST be affected by HST implementation? *At the UBCIC AGM discussion, it was clear that taxing First Nations had concerns, there needs to be clear non-prejudicial arrangements put in place. This may create an opportunity for First Nations to increase their taxation powers to include not only GST but PST. In other words, this might allow an expansion of tax power to 12% against non-Indians and Indian Bands.*
- (4) How will FNST be affected by HST implementation? *At the UBCIC AGM discussion, it was clear that taxing First Nations had concerns, there needs to be clear non-prejudicial arrangements put in place. This may create an opportunity for First Nations to increase their taxation powers to include not only GST but PST. In other words, this might allow an expansion of tax power to 12% against non-Indians and Indian Bands.*
- (5) Will the Governments of Canada and BC state publicly that the application and implementation of HST on First Nations and First Nations citizen will not abrogate or derogate the application of s. 87 of the *Indian Act*?

**Appendix A – First Nations Implementing FNGST**

| <b>FIRST NATIONS THAT HAVE IMPLEMENTED THE FNGST</b> |                   |
|--|-------------------|
| Champagne and Aishihik First Nations (YK)            | June 15, 2004     |
| First Nation of Nacho Nyak Dun (YK)                  | June 15, 2004     |
| Little Salmon/Carnacks First Nation (YK)             | June 15, 2004     |
| Teslin Tlingit Council (YK)                          | June 15, 2004     |
| Vuntut Gwitchin First nation (YK)                    | June 22, 2004     |
| Tr'ondek Hwech'in Government (YK)                    | June 23, 2004     |
| Ta'an Kwach'an Council (YK)                          | June 25, 2004     |
| Kluane First Nation (YK)                             | December 15, 2004 |
| Tlicho First Nation (NWT)                            | December 5, 2005  |
| Tsawout First Nation (BC)                            | October 1, 2006   |
| Selkirk First Nation (YK)                            | June 15, 2007     |
| Kwanlin Dun First Nation (YK)                        | August 20, 2007   |
| Nunatsiavut Government (Labrador Inuit)              | August 20, 2007   |
| Carcross/Tagish First Nation (YK)                    | December 17, 2007 |
| Aksiqnuq First Nation (BC)                           | January 1, 2008   |
| Lower Kootenay Indian Band (BC)                      | January 1, 2008   |
| Shuswap First nation (BC)                            | January 1, 2008   |
| St. Mary's Indian Band (BC)                          | January 1, 2008   |
| Tobacco Plains Indian band (BC)                      | January 1, 2008   |
| Nisga'a Nation (BC)                                  | July 30, 2008     |
| Tsleil-Waututh Nations (BC)                          | November 13, 2008 |
| Whitecap Dakota First Nation (SK)                    | January 2, 2009   |

**Appendix B – First Nations Implementing FNST**

| <b>FIRST NATIONS THAT HAVE IMPLEMENTED THE FNST</b> |                    |
|---|--------------------|
| Kamloops First Nation (BC)                          | August 6, 1998     |
| Sliammon First Nation (BC)                          | August 23, 1999    |
| Westbank First Nation (BC)                          | August 25, 1999    |
| Chemainus First Nation (BC)                         | August 14, 2000    |
| Buffalo Point First Nation (MB)                     | September 28, 2000 |
| Adams Lake First Nation (BC)                        | April 11, 2001     |
| Tzeachten First Nation (BC)                         | June 5, 2001       |
| Shushwap Band First Nation (BC)                     | January 7, 2002    |
| Cowichan First Nation (BC)                          | April 9, 2002      |
| Whitecap Dakota (SK)                                | May 12, 2004       |
| Little Shuswap Lake First Nation (BC)               | May 1, 2006        |