

Because of related content, this newsletter is also being sent to those with an interest in investment funds, structured finance and financial products.

## **CRA responds to the new GST/HST legislative proposals on financial services**

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On February 11, 2010, the Canada Revenue Agency (the “CRA”) released GST/HST Notice No. 250 (the “CRA Notice”) in response to the proposal to change the definition of “financial services” in the *Excise Tax Act* (the “Act”) announced in a News Release and Backgrounder issued by the Department of Finance on December 14, 2009 (the “Backgrounder”). The Department of Finance stated that such proposal is intended to “clarify” and confirm the government’s policy intent that certain services such as management, administration, marketing and promotional services do not constitute financial services and are therefore subject to GST/HST.

In the CRA Notice, the CRA states that the proposals to change the legislation “reaffirm the longstanding policy intent and provide certainty with respect to the application of GST/HST”. Surprisingly, the CRA uses the CRA Notice to completely reverse a number of its own published positions with respect to what constitutes an exempt service of “arranging for” a financial service. Financial institutions and businesses dealing with financial institutions should carefully examine whether or not they are affected by these policy changes, and whether services previously considered exempt from GST/HST are now taxable.

### **The new legislative proposals**

According to the Backgrounder, the legislative proposals, once drafted, will specifically provide that the following activities will not constitute exempt financial services under the Act and will therefore be subject to GST/HST: (i) investment portfolio management and administration activities, (ii) certain facilitatory services that are preparatory to an actual or intended financial service such as market research, product design, document preparation or processing, customer assistance, advertising, promotional or similar activities; and the collection, collation or provision of information, and (iii) credit management services such as credit checking, valuation, authorization services, making decisions relating to a grant or an application for credit, creating and maintaining records relating to a grant or an application for a grant of credit on behalf of the credit provider, and monitoring payment records or dealing with payments. The Backgrounder also states that “The proposals would apply to all supplies of these services made after today, as well as to past transactions where the suppliers treated these services as taxable.”

This newsletter was prepared by members of the Tax Group at Stikeman Elliott.

## The CRA Notice

### ***Investment portfolio management and administration services***

In the CRA Notice, several examples are provided to illustrate the CRA's interpretation of how certain investment management services will be subject to GST/HST once the proposed changes have been drafted and enacted. In one example, the CRA examines services rendered by an investment dealer who arranges to purchase units of a mutual fund for an investor and who receives a commission for such purchase as well as a "trailer commission or fee" paid annually from the fund manager. It is specified in this example that the prospectus states that the trailer commission or fee is "being paid in recognition of the investment advice and ongoing administrative services rendered by the investment dealer to the investors". Based on these facts, the CRA concludes that these services would not be a supply of a financial service, and that the trailer commission or fee would be subject to GST/HST. This answer is contrary to the CRA's previously published position in GST Policy Statement P-119 (dated February 22, 1994) where the CRA stated in an identical fact situation that trailer commissions or fees are not subject to tax.

According to the Backgrounder, the amendments will apply to all supplies of investment management services rendered under an agreement where (i) consideration for the supply becomes due or was paid without becoming due after December 14, 2009; or where (ii) all the consideration for the supply became due or was paid on or before December 14, 2009, unless the supplier did not charge, collect or remit GST/HST in respect of the supply or in respect of any other supply that includes an investment management service and that is made under the agreement. In other words, according to the Backgrounder, the amendments, once drafted, should treat all future supplies of these services, all current supplies which have not yet been billed, and all past supplies where the manager charged GST/HST, as being taxable.

Notwithstanding the wording in the Backgrounder, the CRA appears to be taking a fairly aggressive stand on the retroactivity of the legislation. Indeed, in the CRA Notice, the example is provided of an investment manager who enters into an agreement with an investor to provide management advice, collects and remits GST/HST for a certain period of time under the agreement, and then decides to stop collecting and remitting GST/HST in June 2009 under that same agreement. According to the CRA, the investment manager would still have been required to collect and remit GST/HST in respect of the consideration paid by the investor for the investment management services provided prior to December 14, 2009, notwithstanding they may have stopped charging GST/HST based on case law which held that their services were not subject to GST/HST. In this example, the CRA essentially takes the position that if tax was ever charged under a particular agreement, all services that have ever been rendered under that agreement will retroactively become taxable. This is particularly troubling, as companies which stopped charging GST/HST on their supplies in good faith, will now be subject to interest and penalties for failing to collect a tax which the courts had said was not payable. Further, they will now have to go back to their customers to claim several months of additional GST/HST, if they are able to do so under their agreements.

Finally, we had indicated in a previous Tax Law Update that, based on the proposals to change the legislation, the rebate claim of a person for GST/HST charged by an investment manager in good faith on discretionary investment management fees would now appear to be obsolete. In this respect, the CRA mentions that rebate application forms for GST/HST "paid in error" with respect to GST/HST paid on investment management services will not be processed at this time, and if the proposals to change the legislation are enacted as they are described in the Backgrounder, such rebate claims will be denied.

### ***Facilitatory services and credit management services***

The CRA also provides certain factual examples to illustrate how GST/HST will apply to so-called facilitatory services and credit management services pursuant to Finance's proposals. Several of the examples set out in the CRA Notice appear to be virtually identical to examples previously published by the CRA in GST/HST Policy Statement P-239 dated January 30, 2002 ("P-239"), with the only real difference being that where the CRA formerly stated that these services were exempt financial services, the CRA now states that they are taxable.

In the first example of facilitatory and credit management services, an automobile dealership has a financing department where employees assist customers in obtaining financing for the purchase of an automobile (i.e. obtaining credit information, completing loan application forms, explaining the different types of loans, determining the interest rate, making recommendations to the bank, etc.). For every loan provided to a customer, the dealership receives a commission from the financial institution. While the CRA formerly considered that this

service fell within the definition of “arranging for” a financial service, and was thus exempt from GST/HST, the CRA is now of the view that such supply would be taxable for GST/HST purposes.

In the second example, a corporation that provides specialized group insurance coverage for members affiliated with particular organizations such as banks and large retailers hires a telemarketing agency to conduct the necessary insurance coverage-placing activities with the group members. The telemarketing agency explains the insurance coverage available, answers questions regarding the insurance coverage, screens the eligibility of the person, prepares the application and forwards the completed applications to the corporation who grants final approval. The telemarketing agency is compensated on a per-hour basis. In this example, the CRA has also changed its position from P-239 and now considers that these supplies will be taxable.

In a third example, a corporation wants to sell the business carried on by its subsidiary and enters into an agreement with a business broker service whereby the broker will facilitate the sale of the shares of the subsidiary. In this respect, the broker has to perform various services including: obtaining "listing" for the sale of the business; assisting the corporation in calculating the price at which the subsidiary's shares will be offered; assisting the corporation in putting together financial and operating information; advertising the subsidiary's business as being for sale; contacting potential purchasers; acting as intermediary between the corporation and the purchaser in negotiating the terms of purchase and sale; etc. Again, contrary to what is provided for in P-239, the CRA states that such brokerage services would now be taxable.

The CRA also provides numerous other examples of services which will now be considered taxable. We note that the CRA did not provide a single example of a service which would still be considered to be “arranging for” a financial service under paragraph (l) of the definition of “financial services” in the Act and thus exempt from GST/HST, and based on the CRA's interpretation of the proposed (but not yet drafted) legislation, it is unclear what services would still be exempt from GST/HST under this provision. In this respect, the CRA confirmed to the authors during a phone conversation that facilitatory services offered by an intermediary in the financial services industry, such as mortgage brokerage services, are likely to be taxable under the new regime.

### ***Reassessment by the CRA***

In respect of all the legislative proposals, the Department of Finance indicated in the Backgrounder that any reassessments based on the proposed amendments would have to be made on or before the later of: (1) the day that is one year after the day the proposed amendments enter into force; and (2) the last day of the period for reassessment otherwise allowed under the Act for making the reassessment. While we would expect that the additional one year period should only apply to periods which are not already statute-barred, the wording in the Backgrounder implies that the CRA could assess periods which were already statute-barred so long as the assessment is made within a year of the proposed amendments receive royal assent. In the CRA Notice, the tax authorities simply restate Finance's comments without any further explanation. In any event, service providers to financial institutions who previously regarded their services as exempt should be aware that they might be reassessed beyond the normal reassessment period.

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