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For discussion purposes only

Draft GST/HST technical information bulletin, *Input Tax Credit Allocation Methods for Financial Institutions for Purposes of Section 141.02 of the* Excise Tax Act

This publication is being disseminated by the Canada Revenue Agency in draft form for comments.

Comments or suggestions should be sent by October 31, 2008 to:

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Input Tax Credit Allocation Methods for Financial Institutions for Purposes of Section 141.02 of the *Excise Tax Act*

The information in this bulletin does not replace the law found in the *Excise Tax Act* and its Regulations. It is provided for your reference. As it may not completely address your particular operation, you may wish to refer to the *Excise Tax Act* or its Regulations, or contact a Canada Revenue Agency (CRA) GST/HST Rulings Centre for more information. These centres are listed in GST/HST Memorandum 1.2, *Canada Revenue Agency GST/HST Rulings Centres*. A ruling should be requested for certainty in respect of any particular GST/HST matter.

If you are located in Quebec and wish to make a technical enquiry or request a ruling related to the GST/HST, please contact Revenu Québec by calling 1-800-567-4692. For general information, please visit their Web site at **www.revenu.gouv.qc.ca**.

This bulletin reflects proposed amendments to the *Excise Tax Act* contained in the draft legislation and the draft *Input Tax Credit Allocation Methods (GST/HST) Regulations* announced on January 26, 2007, that provide new rules for financial institutions. At the time of publication, Parliament has not enacted these proposed amendments. Any commentary in this bulletin should not be taken as a statement by the CRA that such amendments will in fact be enacted into law in their current form.

Reference in this publication is made to supplies taxable at 5% (the rate of the GST) or 13% (the rate of the HST). The HST applies to supplies made in Nova Scotia, New Brunswick, and Newfoundland and Labrador (the "participating provinces"). If you are uncertain as to whether a supply is made in a participating province, you may refer to GST/HST Technical Information Bulletin B-078, *Place of Supply Rules Under the HST*.

Note: Legislative references in this bulletin refer to the *Excise Tax Act* (the Act) or proposed amendments to the Act unless otherwise specified.

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Introduction

This bulletin explains some of the specific rules in section 141.02 regarding input tax credit (ITC) allocation methods that are to be used by financial institutions, including both listed and *de minimis* financial institutions as described in subsection 149(1), when calculating ITCs for the GST/HST paid or payable on their inputs.

Section 141.02 applies in conjunction with existing ITC provisions such as section 169, and generally applies for the purpose of determining a financial institution's net tax for any of its fiscal years beginning after March 2007.

Section 169 generally provides that when a person acquires property or a service, and tax in respect of the supply becomes payable or is paid without becoming payable at any time when the person is a registrant, the person may claim an ITC for the tax paid or payable to the extent that the property or service was acquired for consumption, use or supply in the course of the person's commercial activities where all of the other conditions for claiming an ITC are met.

Section 141.02 provides clarification on determining the extent to which property or a service is for use in making taxable supplies for consideration, and includes provisions that apply to financial institutions that are qualifying institutions, provisions that apply to financial institutions that are not qualifying institutions, and provisions that apply to all financial institutions.

To determine if a particular financial institution is a qualifying institution (i.e., certain banks, insurers and securities dealers), refer to GST/HST Technical Information Bulletin B-097, *Determining Whether a Financial Institution is a Qualifying Institution for Purposes of Section 141.02*.

Financial institutions that are qualifying institutions should refer to GST/HST Technical Information Bulletin B-098, *Application of Section 141.02 to Financial Institutions That Are Qualifying Institutions,* for additional information on the ITC allocation rules that apply to qualifying institutions. This bulletin also provides information on the process for a qualifying institution to use particular methods pre-approved by the Minister of National Revenue (the Minister) to determine the procurative extent or operative extent of each of its inputs.

Financial institutions that are not qualifying institutions should refer to GST/HST Technical Information Bulletin B-099, *Application of Section 141.02 to Financial Institutions That Are Not Qualifying Institutions,* for additional information on the ITC allocation rules that apply to financial institutions that are not qualifying institutions.

Definitions

A **direct attribution method** is a method, conforming to criteria, rules, terms and conditions specified by the Minister for determining in the most direct manner the operative extent and procurative extent of property or a service.

A **direct input** is property or a service that is not an excluded input, an exclusive input, or a non-attributable input. Generally, a direct input is property or a service that is neither capital property nor an improvement to capital property, that can be attributed in whole or in part to the making of a particular supply or supplies, and that is acquired, imported or brought into a participating province, or consumed or used, both for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration.

An **excluded input** of a person is property (i.e., personal property or real property) that is for use by the person as capital property and any property or service that is acquired, imported or brought into a participating province by the person for use as an improvement to capital property. An excluded input may also include a prescribed property or service. At this time, regulations have not been made to prescribe any particular property or service.

An **exclusive input** of a person is property or a service (other than an excluded input) that is acquired, imported or brought into a participating province by the person for consumption or use either directly and exclusively for the purpose of making taxable supplies for consideration, or directly and exclusively for purposes other than making taxable supplies for consideration. For financial institutions, exclusively means 100%.

A **non-attributable input** of a person is property or a service that is acquired, imported or brought into a participating province by the person, and is neither an excluded input nor an exclusive input of the person and is not attributable to the making of any particular supply by the person.

The **operative extent** of a particular property or a service is the extent to which the consumption or use of the property or service is for the purpose of making taxable supplies for consideration, or the extent to which the consumption or use of the property or service is for purposes other than making taxable supplies for consideration.

The **procurative extent** of a particular property or a service is the extent to which property or a service is acquired, imported or brought into a participating province for the purpose of making taxable supplies for consideration, or the extent to which the property or service is acquired, imported or brought into a participating province by the person for purposes other than making taxable supplies for consideration.

A **specified method** is a method, conforming to the criteria, rules, terms and conditions specified by the Minister for determining the operative extent and the procurative extent of property or a service.

ITC allocation for financial institutions

ITCs are generally available to a financial institution on a particular input to the extent that the financial institution acquired or used the particular input in the course of a commercial activity. In determining this extent, a financial institution must do the following:

1. **Categorize** the input.
   - Determine whether the input is an excluded input (i.e., capital property and improvements thereto).
     - For inputs that are not excluded inputs:
       - first determine whether the input is:
         - an exclusive input,
       - second determine whether the input is:
         - a direct input, or
         - a non-attributable input.
2. **Determine** the ITC allocation methods appropriate for the particular category of input such as:
   - a specified method for excluded inputs (for all financial institutions);
   - a direct attribution method for direct inputs (for financial institutions that are not qualifying institutions); and
   - a specified method for non-attributable inputs (for financial institutions that are not qualifying institutions).
3. **Apply** the appropriate type of allocation(s) within the ITC allocation method, for example:
   - a specified method for excluded inputs based on tracking, causal allocation, input-based allocation, or output-based allocation;
   - a direct attribution method for direct inputs based on tracking, causal allocation, input-based allocation, or output-based allocation;
   - a specified method for non-attributable inputs based on input-based allocation or output-based allocation; or
   - another method where an exception applies (e.g., where the Minister has directed the financial institution to use a particular method).

The criteria, rules, terms and conditions contained in this bulletin also apply in determining whether any method that a qualifying institution is requesting to have pre-approved by the Minister, using form GST116, *Application, Renewal or Revocation of the Authorization for a Qualifying Institution to Use Particular Methods*, is appropriate.

ITC allocation by input category

Categorizing the input (i.e., excluded input, exclusive input, direct input or non-attributable input) is an important component in determining the ITC allocation method that should be used in the circumstances. The terms “tracking”, “causal allocation”, “input-based allocation” and “output-based allocation” are explained under the heading “Overview of the criteria, rules, terms and conditions for direct attribution methods and specified methods”.

In categorizing inputs it must first be determined whether the input is an excluded input. Then, if the input is not an excluded input, it must be determined whether the input is:

- an exclusive input;
- a direct input (if the input is not an exclusive input); or
- a non-attributable input (if the input is neither an exclusive input nor a direct input).

Excluded inputs might be used exclusively for the purpose of making taxable supplies for consideration or exclusively for purposes other than making taxable supplies for consideration, in which case the extent of use in commercial activities would generally be either 100% or 0%.

The extent of use in making taxable supplies for consideration of excluded inputs that are used in part for the purpose of making taxable supplies for consideration and in part for purposes other than making taxable supplies for consideration must be determined using a specified method for excluded inputs. A method is a specified method if it provides an accurate reflection of the use of an excluded input for the purpose of making taxable supplies for consideration and is based on:

- first, tracking to the extent possible;
- second, causal allocation to the extent possible; and
- third, input-based allocation or output-based allocation to the extent that the use of the excluded input cannot be allocated based on tracking or causal allocation.

For inputs that are not excluded inputs, it must first be determined whether the input is an exclusive input. If the input is an exclusive input, the particular input is deemed to be for consumption or use either 100% or 0% in commercial activities depending on whether the particular input was acquired for consumption or use directly and exclusively for the purpose of making taxable supplies for consideration, or directly and exclusively for purposes other than making taxable supplies for consideration.

For inputs that are neither excluded inputs nor exclusive inputs, it must be determined whether the input is a direct input or a non-attributable input. A direct input is attributable, at least in part, to the making of a particular supply or supplies. The extent of use in making taxable supplies for consideration of a direct input must be determined using a direct attribution method. A direct attribution method is one that provides an accurate reflection of the use of a direct input for the purpose of making taxable supplies for consideration and is based on:

- first, tracking to the extent possible;
- second, causal allocation to the extent possible; and
- third, input-based allocation or output-based allocation to the extent that the use of the direct input cannot be allocated based on tracking or causal allocation.

For non-attributable inputs (inputs that are not excluded inputs, exclusive inputs or direct inputs), the extent of use in making taxable supplies for consideration must be determined using a specified method for non-attributable inputs. A method is a specified method if it accurately reflects the use of the non-attributable input for the purpose of making taxable supplies for consideration, and is based on input-based allocation or output-based allocation. As a non-attributable input is not attributable to the making of any particular supply or supplies, a specified method for non-attributable inputs would not be based on tracking or on causal allocation.

Overview of ITC allocation methods for excluded inputs, direct inputs and non-attributable inputs

The concept underlying ITC allocation methods is that a method or methods used must link a particular property or service on which tax was paid or payable to its use for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration.

Where the use of a particular type of input has been established by the financial institution's past use of that type of input, the use of the input for ITC allocation purposes should be an accurate reflection of its actual use. Although the procurative extent of an input is based on the purpose for which the particular input was acquired, imported or brought into a participating province, the actual consumption or use of the input (the operative extent) should reflect the procurative extent of the input. The operative extent of inputs should be periodically reconciled to the procurative extent of the inputs and appropriate adjustments should be made.

Direct attribution methods and specified methods must accurately reflect the actual extent to which a particular input was acquired, imported or brought into a participating province for consumption or use, or was consumed or used ("acquired or used") for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration.

Direct attribution methods for direct inputs, specified methods for non-attributable inputs, and specified methods for excluded inputs are all methods conforming to criteria, rules, terms and conditions specified by the Minister for determining the procurative extent and the operative extent of property or a service.

The procurative extent of a particular input is the extent to which the property or service is acquired, imported or brought into a participating province (acquired) for the purpose of making taxable supplies for consideration, or the extent to which the property or service is acquired for purposes other than making taxable supplies for consideration. The procurative extent of a particular input is relevant in determining the extent, under subsection 141.01(2), to which property or a service is deemed to have been acquired by a financial institution for use in the course of its commercial activities, or otherwise than in the course of commercial activities. For example, under subsection 141.01(2), where a person acquires property or a service for use in its business, the person is deemed to have acquired it for use otherwise than in the course of the person's commercial activities to the extent it was acquired for purposes other than making taxable supplies for consideration (e.g., for the purpose of making exempt supplies).

The operative extent of a particular input is the extent to which the use of the property or service is for the purpose of making taxable supplies for consideration, or the extent to which the use of the property or service is for purposes other than making taxable supplies for consideration. The operative extent of a particular input is relevant in determining the extent, under subsection 141.01(3), to which property or a service is deemed to have been used by a financial institution in the course of its commercial activities or otherwise than in the course of its commercial activities. The extent to which property or a service is used in the course of commercial activities is pertinent to those provisions (e.g., change-in-use rules for capital property) that depend on whether, and to what extent, property or a service is, at any particular time, used in commercial activities.

Overview of the criteria, rules, terms and conditions for direct attribution methods and specified methods

The criteria, rules, terms and conditions that a direct attribution method for direct inputs, a specified method for non-attributable inputs, and a specified method for excluded inputs must conform to are:

1. The method must employ an objective measure of use which is
    - meaningful,
    - unbiased, and

- verifiable.

2. The method must be applied in a manner that accurately reflects the use of the input, including
   - providing comparable results, and
   - using cost pools only if they are appropriate cost pools.

Although the principles underlying the criteria, rules, terms and conditions for direct attribution methods for direct inputs, specified methods for non-attributable inputs, and specified methods for excluded inputs are similar, the application may vary depending on the type of input. Categorizing the input (i.e., excluded input, exclusive input, direct input or non-attributable input) is an important component in determining the ITC allocation method that should be used in the circumstances.

The criteria, rules, terms and conditions contained in this bulletin also apply in determining whether any method that a qualifying institution is requesting to have pre-approved by the Minister, using form GST116, *Application, Renewal or Revocation of the Authorization for a Qualifying Institution to Use Particular Methods,* is appropriate.

An allocation is a means of attributing an input to a particular supply or supplies. ITC allocations that are meaningful include tracking, causal allocation, input-based allocation and output-based allocation, depending on the particular circumstances.

A financial institution will generally use different ITC allocation methods (e.g., direct attribution methods and specified methods) and different types of allocation (e.g., tracking and causal allocation) depending on what is appropriate for a particular input. The ITC allocation method that is appropriate in a particular circumstance depends on the category of the particular input that is being allocated. Further, the type of allocation that is appropriate in the circumstances depends on the use of the input. Additionally, where it is not appropriate to use the same type of allocation for an entire input (e.g., where 90% of the use of a particular direct input can be tracked, but 10% cannot), the types of allocations used must provide an accurate reflection of the use of the input (e.g., if 90% of the input can be tracked, it must be tracked and if causal allocation can be used for the remaining 10%, it must be used).

The sum of the extent to which an input was acquired or used for the purpose of making taxable supplies for consideration and the extent to which an input was acquired or used for purposes other than making taxable supplies for consideration (calculated using the same method) must be equal to 100%. For example, if the extent to which a particular input is used for the purpose of making taxable supplies for consideration is equal to 3%, the extent to which that same input is used for purposes other than making taxable supplies for consideration must be equal to 97%.

To the extent that a financial institution's cost accounting system uses a method that meets the criteria, rules, terms, conditions, and requirements (the requirements are explained under the heading "Additional Requirements") for a direct attribution method, a specified method for non-attributable inputs, or a specified method for excluded inputs, the financial institution must use its cost accounting allocation method as a direct attribution method, a specified method for non-attributable inputs, or a specified method for excluded inputs. For example, if a financial institution's cost accounting system tracks the extent to which certain inputs are used in making taxable supplies for consideration on an input-by-input basis, then the financial institution must use its cost accounting allocation method for these particular inputs.

Tracking

Tracking is recording to the extent possible the actual use of a particular input so that the actual use is linked to the purpose of making taxable supplies for consideration and to purposes other than making taxable supplies for consideration.

Example

Bank A purchases a software licence package that allows 100 employees to use the software. Ninety-seven of these employees make exempt supplies and three make taxable supplies for consideration. Bank A records the use of the software licence (97% for the purpose of making exempt supplies and 3% for the purpose of making taxable supplies for consideration) to the appropriate cost centres in its cost accounting system. This is an example of tracking the use of a particular input.

Causal allocation

Causal allocation directly approximates to the extent possible the use of a particular input using a systematic approach and an appropriate allocation base. An allocation base is a factor used to link a particular input to a particular output or outputs where there is a link between the allocation base and the output or outputs, which is logical and where the use of the particular input has a correlation to the allocation base (an example of a correlation would be where the input is used equally over the allocation base). For example, the number of employees making taxable supplies for consideration or exempt supplies might be used as an allocation base for a particular input where it is logical that the input be used equally by the relevant employees. Where an increase in the allocation base (e.g., square footage) leads to an increase in input costs (i.e., a cause and effect relationship exists between an allocation base and an output), it would generally be appropriate to use this allocation base.

Example

Insurance Company F hired five new employees (one to work in Department A making taxable supplies for consideration and four to work in Department B making exempt supplies). All the applicants, regardless of which department they would be working for, went through the same hiring process. The costs related to the hiring process (e.g., the cost of the standardized exams) are allocated to either Department A or Department B based on the number of employees that were hired in each department. This is an example of causal allocation.

Input-based allocation

An input-based allocation uses a calculation based on the use of other inputs to allocate inputs to the extent that they cannot be allocated using either tracking or causal allocation. This might include a ratio of the value of inputs allocated to taxable supplies for consideration to the value of total inputs allocated. If an input-based allocation is used, the property and services allocated through the rules for exclusive inputs and through tracking of direct inputs and causal allocation of direct inputs must represent a substantial portion of the inputs that relate to the financial institution’s business or the relevant part of the business. What constitutes a substantial portion will vary depending on the circumstances of each particular financial institution, but a substantial portion will generally be almost all of the financial institution’s inputs.

An input-based allocation must provide a reasonable approximation of the use of the particular input. To provide results that are more reliable, input-based allocation must be calculated using exclusive inputs and direct inputs that have either been tracked or allocated through the use of causal allocation (i.e., it would not include excluded inputs, non-attributable inputs or direct inputs allocated using input-based allocation or output-based allocation). This is because the allocation of exclusive inputs and of direct inputs through tracking or causal allocation is more accurate than input-based allocation and output-based allocation because it involves less approximation. Additionally, the use of an excluded input is generally over a longer period than the use of a direct input or a non-attributable input.

Example

Insurance Company C purchases a non-attributable input. The non-attributable input is for use in Insurance Company C’s whole business.

The value of Insurance Company C's inputs allocated to the making of taxable supplies for consideration and to the making of supplies other than taxable supplies for consideration (exempt supplies, in this case) for its whole business is as follows:

	Inputs for taxable supplies	Inputs for exempt supplies
Exclusive inputs	$31,000	$411,500
Direct inputs that are tracked	$500,000	$4,471,200
Direct inputs allocated using causal allocation	$171,800	$1,811,600
Total	$702,800	$6,694,300

[$702,800 / ($702,800 + 6,694,300)] = 9.5%

Insurance Company C calculates the extent to which it uses the particular non-attributable input for the purpose of making taxable supplies for consideration as 9.5%. This is an example of an input-based allocation.

Output-based allocation

An output-based allocation uses a calculation based on an output measure (e.g., revenue) to allocate the use of inputs to the extent that they cannot be allocated using tracking or causal allocation. If an output-based allocation is used, the calculation must give a reasonable approximation of the use of the inputs for the purpose of making taxable supplies for consideration. For example, inputs should be used in the same proportion in making the supplies included in the calculation and the average profit margin for the supplies included in the calculation should be the same.

Example

Securities Dealer D purchases an excluded input the use of which cannot be tracked and cannot be allocated using causal allocation. The excluded input is for use in Securities Dealer D's Department H. The revenues in Department H give a reasonable approximation of the use of inputs in that department. Securities Dealer D's total revenue of $400,000 for Department H is:

- $60,000 from taxable supplies for consideration, and
- $340,000 from exempt supplies.

$60,000/$400,000 = 15%.

Securities Dealer D calculates the extent to which it uses the excluded input for the purpose of making taxable supplies for consideration as 15%. This is an example of an output-based allocation.

Distorting factors must be excluded from ITC allocation calculations to avoid distortion of the results. Examples of distorting factors are:

- including any amount receivable for the supply of capital property used in the business (e.g., proceeds from the sale of fixed assets/lands) in a revenue calculation;
- including the value of the sale of a business or part of a business as a going concern in a revenue calculation; or
- including proceeds from the sale of financial instruments held in the registrant's own account in a revenue calculation.

It must also be determined on a case-by-case basis whether a particular factor (e.g., revenues that include amounts that relate to prior periods such as the recovery of a bad debt) causes distortions in the particular circumstances. It is a question of fact whether the financial institution has made adequate adjustments for all distorting factors. The elements of any ratios used must not produce distorted results (e.g., using gross revenue from taxable supplies for consideration for the whole business over net revenue from all sources for the whole business clearly produces distorted results).

EXCLUSIVE INPUTS

An exclusive input of a financial institution is property or a service (other than an excluded input, i.e., capital property, an improvement to capital property or any prescribed property or service) that is acquired or used either directly and exclusively for the purpose of making taxable supplies for consideration, or directly and exclusively for purposes other than making taxable supplies for consideration. For financial institutions, exclusively means 100%.

The attribution of an exclusive input may be done at successive levels of the organization (e.g., business lines or units) before being ultimately attributed to a particular supply or supplies. For example, a financial institution sends a particular employee on technical training related to an exempt product. The cost of the training is entered in the financial institution's cost accounting system first in the cost centre applicable to the department and then it is further allocated to the particular product line and product. This input is an exclusive input because it is consumed or used directly and exclusively for the purpose of making exempt supplies (a purpose other than making taxable supplies for consideration).

If it is clear that a particular cost relates to a single input (i.e., a single supply to the financial institution) and this input is consumed or used directly and exclusively for the purpose of making taxable supplies for consideration, or directly and exclusively for purposes other than making taxable supplies for consideration, it is an exclusive input. If, for example, a financial institution acquires a single supply for use directly and exclusively in making exempt supplies, the supply would be an exclusive input.

In some cases, where it is not clear whether a particular cost relates to a single input or multiple inputs (i.e., multiple supplies to the financial institution), it is necessary to make that determination before applying the relevant rules. If, for example, a financial institution receives an invoice with a number of line items, it is necessary to determine whether each of these line items refers to a separate supply (i.e., whether it is an invoice for multiple supplies or whether the invoice is for a single supply). If a financial institution receives two supplies (i.e., multiple supplies) of a particular type of input that are billed on the same invoice and uses one supply directly and exclusively in making taxable supplies for consideration and the other supply directly and exclusively in making exempt supplies, these supplies would each be exclusive inputs. However, if a financial institution receives a single supply for use in making both taxable supplies for consideration and exempt supplies, that single input would be a direct input, rather than an exclusive input.

GST/HST Policy Statement P-077R2, *Single and Multiple Supplies,* provides guidance regarding whether a transaction consisting of several elements is a single supply or two or more supplies.

Examples

1. Corporation J is a financial institution as a result of an election under subsection 150(1). The only supplies that Corporation J makes are supplies of services to Financial Institution B, which are exempt financial services as a result of the election under subsection 150(1). Corporation J hires a third party to provide a consulting service that forms part of a service that Corporation J supplies to Financial Institution B. The third party's supply to Corporation J is an exclusive input because it is acquired directly and exclusively for purposes other than making taxable supplies for consideration.

2. Financial Institution Q makes taxable supplies for consideration and exempt supplies. Financial Institution Q enters into a rental agreement with a landlord for a downtown office building. Financial Institution Q uses the building 10% in making taxable supplies for consideration and 90% in making exempt supplies. This supply is a direct input rather than an exclusive input because the rent is paid for a single supply that is used both for the purpose of making taxable supplies for consideration and for the purpose of making exempt supplies.

Rules for exclusive inputs

Subsection 141.02(6) applies both to financial institutions that are qualifying institutions and that have not received authorization from the Minister to use a pre-approved method and to financial institutions that are not qualifying institutions.

Subsection 141.02(6) provides that, if an exclusive input is acquired, imported or brought into a participating province for consumption or use directly and exclusively for the purpose of making taxable supplies for consideration, the financial institution is deemed to have acquired, imported or brought into the participating province the whole of the exclusive input for consumption or use exclusively in the course of commercial activities of the financial institution. As a result, for the purpose of determining an ITC under section 169 in respect of that exclusive input, the extent to which the property or service is for consumption, use or supply in the course of commercial activities is generally equal to 100%. A financial institution will generally be eligible to claim an ITC equal to 100% of the GST/HST paid on an exclusive input that is for consumption or use directly and exclusively for the purpose of making taxable supplies for consideration where all other conditions for claiming an ITC are met.

Subsection 141.02(6) also provides that, if an exclusive input is acquired, imported or brought into a participating province for consumption or use directly and exclusively for purposes other than making taxable supplies for consideration, the financial institution is deemed to have acquired, imported or brought into the participating province the whole of the exclusive input for consumption or use otherwise than in the course of commercial activities of the financial institution. As a result, for the purpose of determining an ITC in respect of that exclusive input under section 169, the extent to which the property or service is for consumption, use or supply in the course of commercial activities is generally equal to 0%. A financial institution will generally not be eligible to claim an ITC for any of the GST/HST paid on an exclusive input that is for consumption or use directly and exclusively for purposes other than making taxable supplies for consideration.

A proposed consequential amendment to section 185 references subsection 141.02(6) to clarify that even where subsection 141.02(6) applies, section 185 may also apply to persons who are financial institutions under paragraph 149(1)(c) in determining the extent to which an input is acquired, imported or brought into a participating province for consumption, use or supply in the course of commercial activities.

Examples

1. Insurance Company R is a financial institution that hires a printing company to print its resident life insurance forms and its non-resident life insurance forms. Insurance Company R uses different forms for its resident and non-resident insurance customers. Insurance Company R's supplies of insurance to residents are exempt supplies and its supplies of insurance to non-residents are zero-rated supplies for consideration. Insurance Company R purchases a supply of resident insurance forms as well as a separate supply of non-resident forms. Insurance Company R's purchases of the forms are two exclusive inputs because each supply is directly and exclusively related to the making of either taxable supplies for consideration or to the making of exempt supplies. As a result, the extent to which the resident insurance forms are for consumption in the course of Insurance Company R's commercial activities is 0% and Insurance Company R is not eligible to claim an ITC in respect of this input. Additionally, the extent to which the non-resident insurance forms are for consumption in the course of Insurance Company R's commercial activities is 100% and Insurance Company R is eligible to claim a full ITC in respect of this input where all other conditions for claiming an ITC are met.

2. Securities Dealer G is a financial institution, makes a taxable supply of providing professional advice and research prior to a contemplated merger or acquisition and charges a fee for this service. Securities Dealer G acquires accounting services as an input into its supply of professional advice and research. This supply of accounting services to Securities Dealer G is an exclusive input because it is acquired directly and exclusively for the purpose of making a taxable supply for consideration. As a result, for the purpose of determining an ITC in respect of the accounting services under section 169, the extent to which the accounting services are for consumption in the course of commercial activities is 100% and Securities Dealer G is eligible to claim a full ITC in respect of this input where all other conditions for claiming an ITC are met.

DIRECT INPUTS

A direct input is property or a service other than an excluded input, an exclusive input or a non-attributable input. Generally, therefore, direct inputs are inputs that:

- are neither capital property nor acquired for use as improvements to capital property;
- can be attributed to the making of particular supplies; and

- are acquired or used, both for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration.

Direct inputs are inputs that can be attributed in whole or in part to the making of a particular supply or supplies even where this attribution may be done at successive levels of the organization (e.g., business lines or units) before ultimately being attributed to a particular supply. For example, a financial institution acquires a direct input for one of its departments that uses the input in making both taxable and exempt supplies. This direct input is attributed first to the department, and then to the particular taxable and exempt supplies.

Direct inputs also include inputs that can be attributed in part to the making of a particular supply. Although the input may not be attributable in whole to the making of any particular supply or supplies, the input is a direct input if it is not an excluded input, an exclusive input or a non-attributable input.

An input that might be considered an indirect input for cost allocation purposes (e.g., certain overhead expenses) is a direct input for purposes of section 141.02 if the input can be attributed to the making of a particular supply or supplies in whole or in part.

In some cases, where it is not clear whether a particular cost relates to a single input (i.e., a single supply to the financial institution) or multiple inputs (i.e., multiple supplies to the financial institution), it is necessary to make that determination before applying the relevant rules. If, for example, a financial institution receives an invoice with a number of line items, it is necessary to determine whether each of the line items refers to a separate supply (i.e., whether it is an invoice for multiple supplies) or whether it is an invoice for a single supply. If a financial institution receives an invoice for a single supply for use in making both taxable supplies for consideration and exempt supplies, that single input would be a direct input.

Examples

1. Financial Institution E purchases a large quantity of office paper for use by two departments (Department 1 and Department 2). Department 1 makes only exempt supplies of financial services and Department 2 makes a mix of supplies that are exempt supplies and taxable supplies for consideration. The single supply of office paper is a direct input because it is not an excluded input, it is not an exclusive input, and it can be attributed to the making of particular supplies (e.g., both to Department 1's exempt supplies of financial services and to Department 2's mixed supplies).

2. Securities Dealer R receives a natural gas bill each month for the heating of a particular building. In this building, Securities Dealer R has employees who are directly involved in making exempt supplies of financial services and taxable supplies for consideration. In this building, it also has employees who work in a division responsible for company-wide employee wellness events. Although the input relates in part to the operation of a division that is not responsible for the making of any particular supplies, the natural gas is a direct input because it is not an excluded input and it is not an exclusive input. It can, at least in part, be attributed to the making of taxable supplies for consideration and to the making of exempt supplies.

3. Corporation D, a corporation that is a financial institution as a result of entering into a subsection 150(1) election, purchased a single supply of legal services for $15,000 plus $750 GST that relates both to its exempt supplies of financial services and to its taxable supplies of services to unrelated persons. The invoice for the supply of legal services includes detailed billing information showing that 10% ($1,500 plus $75 GST) of the billed amount related to Corporation D's supply of data entry services to Corporation V, an unrelated person, and 90% ($13,500 plus $675 GST) related to Corporation D's supply of data entry services to Financial Institution X, the supply of which is an exempt supply of a financial service as a result of the subsection 150(1) election. The supply of legal services to Corporation D is a direct input because it is not an excluded input or an exclusive input, and it can be attributed to the making of particular supplies.

Direct attribution method

If a financial institution is not a qualifying institution in a particular fiscal year and has not made an election under subsection 141.02(9), subsection 141.02(12) provides that the financial institution is required to use a direct attribution method to determine the procurative extent or operative extent of each direct input. There are certain situations (e.g., where the Minister has directed the financial institution to use a particular method) where subsection 141.02(12) would not apply to the direct inputs of a financial institution that is not a qualifying institution. These situations are explained in TIB B-099, *Application of Section 141.02 to Financial Institutions That Are Not Qualifying Institutions*.

A direct attribution method is a method, conforming to the criteria, rules, terms and conditions specified by the Minister for determining in the most direct manner the operative extent and procurative extent of property or a service.

The concept underlying the criteria, rules, terms and conditions is that a method used must accurately reflect the actual use of the input in the making of the supplies to which the input can be attributed. A direct attribution method is a method of determining the operative extent and the procurative extent of property or a service in the most direct manner. It is a question of fact whether a particular method determines use in the "most direct manner" in particular circumstances. For example, where an input is clearly used in making particular supplies, its use must be tracked to these supplies.

Criteria, rules, terms and conditions

The criteria, rules, terms and conditions that a direct attribution method must conform to are:

1. A direct attribution method must employ an objective measure of use which is
   - meaningful,
   - unbiased, and
   - verifiable.
2. A direct attribution method must be applied in a manner that accurately reflects the use of the direct input, including
   - providing comparable results, and
   - using cost pools only if they are appropriate cost pools.

To the extent that a financial institution's cost accounting system uses a method that meets the criteria, rules, terms, conditions, and requirements, the financial institution must use its cost accounting allocation method as a direct attribution method.

Objective measure

An objective measure of use is meaningful, unbiased, and verifiable.

Meaningful

A meaningful measure of use for a direct input is one that accurately reflects the actual extent to which a particular input was acquired or used for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration.

A direct input can, at least in part, be attributed to the making of a particular supply. A direct attribution method must be based on:

- first, tracking to the extent possible;
- second, causal allocation to the extent possible; and
- third, input-based allocation or an output-based allocation to the extent the input cannot be allocated based on tracking or causal allocation.

The terms “tracking”, “causal allocation”, “input-based allocation” and “output-based allocation” apply as explained under the heading “Overview of the criteria, rules, terms and conditions for direct attribution methods and specified methods”.

Tracking the use of a particular input is more direct than approximating the use of the input. A direct attribution method requires that a determination be made in the most direct manner. As a result, where tracking specific inputs is possible, the most direct method would be a method that tracks the use of the input in making particular supplies. Any method used to track the use of a particular input must be logical and take a systematic approach to track the link between the direct input and the supplies to which the input relates.

If a link between a direct input and particular supplies cannot be tracked, any approximation(s) used must reasonably reflect the extent to which the direct input is acquired or used for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration.

Causal allocation must also be logical and must use a systematic approach to link the direct input to the supplies to which it relates. Causal allocation utilizes an allocation base (e.g., square footage, employee numbers). The allocation base used must be appropriate to the circumstances and must provide a reasonable approximation of the use of the particular input. For example, an allocation based on square footage could be used where it is logical that the input be used equally over the relevant floor space.

While not as direct as tracking or causal allocation, an input-based allocation or an output-based allocation may be appropriate in circumstances where the link between a direct input and particular supplies cannot be tracked or allocated using causal allocation, and either an input-based allocation or an output-based allocation would provide a reasonable approximation of the use of the direct input. For example, if 80% of the use of a particular input can be tracked to making exempt supplies, and 20% cannot be tracked or allocated using causal allocation, the 20% can be allocated using input-based allocation or output-based allocation, depending on the circumstances.

As a direct attribution method requires that a determination be made in the most direct manner, any method chosen to provide a reasonable approximation must be as direct as possible in the circumstances. For example, if an input relates to a portion of a business rather than the whole business, the use of the input must be allocated based on the particular portion of the business and not the whole business.

An **input-based allocation** uses a calculation based on the use of other inputs to allocate the use of a particular direct input to the extent that it cannot be allocated using tracking or causal allocation. For example, an input-based allocation may be a ratio of the value of inputs allocated to taxable supplies for consideration to the value of total inputs allocated, which is used to allocate the remainder of a direct input that cannot be directly allocated. An input-based allocation must provide a reasonable approximation of the use of the particular input. If an input-based allocation is used as a direct attribution method, the property and services allocated as exclusive inputs or through tracking of direct inputs and causal allocation of direct inputs must represent a substantial portion of the inputs that relate to the financial institution’s business or the relevant part of the business. An input-based allocation for direct inputs should be calculated using exclusive inputs and direct inputs that have either been tracked or allocated through the use of causal allocation (i.e., it would not include excluded inputs, non-attributable inputs or direct inputs allocated using input-based allocation or output-based allocation).

An **output-based allocation** uses a calculation based on an output measure (e.g., revenue) to allocate the use of a particular direct input to the extent that the input cannot be allocated using tracking or causal allocation. If an output-based allocation is used as a direct attribution method, the calculation must give a reasonable approximation of the use of the inputs for the purpose of making taxable supplies for consideration.

Distorting factors (as explained under the heading "Overview of the criteria, rules, terms and conditions for direct attribution methods and specified methods") must be excluded from ITC allocation calculations to avoid distortion of the results.

Examples

1. Financial Institution X enters into an annual contract to purchase a supply of printer servicing for $15,000 plus $750 GST. For cost allocation purposes, Financial Institution X tracks the use of printers and printer servicing for each printer in making taxable supplies for consideration and for the purpose of making exempt supplies. This extent has remained constant each year. Financial Institution X uses this same method for ITC allocation purposes. This measurement is meaningful because it accurately reflects the actual extent to which the printer servicing was acquired or used for the purpose of making taxable supplies for consideration and for the purpose of making exempt supplies.

2. Securities Dealer F enters into an annual contract to purchase a supply of printer servicing for $15,000 plus $750 GST. For cost accounting purposes, Securities Dealer F tracks the use of printers and printer servicing for each printer in making taxable supplies for consideration and for the purpose of making exempt supplies using electronic printing logs. Each of Securities Dealer F's taxable supplies requires approximately the same amount of printer use as each of Securities Dealer F's exempt supplies, but a higher percentage of the square footage of the building is used in making taxable supplies. Securities Dealer F uses square footage as an allocation base for ITC allocation purposes. This measurement is not meaningful because there is no correlation between the allocation base used and the input that is being allocated.

3. Financial Institution D uses square footage as an allocation base to allocate its heating costs for its 10,000 square foot office building. Financial Institution D makes both taxable supplies for consideration and exempt supplies in the office building. Nine per cent of the square footage (900 square feet) of Financial Institution D's office space is common space (e.g., aisles, hallways, washrooms). Financial Institution D treats all the common space as being used for making taxable supplies for consideration. This method is not meaningful because it does not accurately reflect the connection between the input and the supplies to which the input relates.

4. Financial Institution J uses square footage as an allocation base to allocate heating costs for its 10,000 square foot office building. Nine per cent of the square footage (900 square feet) of Financial Institution J's office space is common space. The remaining 91% of the square footage (9,100 square feet) is used specifically for making either taxable supplies for consideration or exempt supplies. Fifteen per cent of the square footage that is not common space is used by Financial Institution J in making taxable supplies for consideration. Based on this, Financial Institution J allocates 15% of the common space (15% × 900 square feet = 135 square feet) as being used for making taxable supplies for consideration. This method is meaningful because it accurately reflects the connection between the input and the supplies to which the input relates.

Unbiased

An objective measure of use is also unbiased.

An unbiased measure of use is impartial, is based on the facts surrounding the use of the direct input and is not a measure designed to achieve a particular result (e.g., an allocation method would be biased if it produces a pattern of higher ITC claims than a reasoned review of the facts would substantiate).

A direct attribution method requires that the method must determine in the most direct manner the procurative extent and the operative extent of property or a service. An unbiased measure uses a logical and systematic approach to produce a result that is supported by the facts surrounding the use of a particular input. If assumptions concerning an input or output are made in allocating a direct input, these assumptions must be probable and not merely possible. Where an allocation base is chosen for inputs that cannot be tracked, the allocation base must be one that logically relates the use of the direct input to the output rather than one that produces a particular ITC result.

Examples

1. Insurance Company K makes taxable supplies of rental space and exempt supplies of insurance. Three years ago, Insurance Company K entered into a five-year rental agreement with a landlord for 5,000 square feet within an office building. As a result of a recent reorganization, Insurance Company K reduced the number of insurance agents within that particular city, and is no longer making full use of the rented space. Insurance Company K has four agents within the rented office space and these agents have entered into rental agreements with Insurance Company K to receive a taxable supply of 200 square feet each. Insurance Company K's long-term plans are to have three to four agents in that particular city, and it does not intend to lease any of the vacant space to third parties. Insurance Company

K has reviewed its rental agreement with the landlord and has chosen to continue renting the office space under the current agreement. Insurance Company K has determined that these four agents are contractors. It also has employees working in the same office building, who make exempt supplies. Insurance Company K has determined that 1,600 of the 5,000 square feet is currently vacant space. Insurance Company K allocates 800 square feet (the space that it is renting to agents) and 1,600 square feet (the space that is vacant) as being for the purpose of making taxable supplies for consideration. This method is not an unbiased method because the assumption regarding the use of the vacant space is not probable (i.e., Insurance Company K is not using, nor is it probable that it will be using, the vacant space for the purpose of making taxable supplies for consideration).

2. Insurance Company V makes taxable supplies of space rental and exempt supplies of insurance. Three years ago, Insurance Company V entered into a five-year rental agreement with a landlord to rent 5,000 square feet within an office building. As a result of a recent reorganization, Insurance Company V reduced the number of insurance agents within that particular city, and is no longer making full use of the rented space. Insurance Company V has four agents within the rented office space and these agents have entered into rental agreements with Insurance Company V to receive a taxable supply of 200 square feet each. Insurance Company V's long-term plans are to have three to four agents in that particular city, and it does not intend to lease any of the vacant space to third parties. Insurance Company V has reviewed its rental agreement with the landlord and has chosen to continue renting the office space under the current agreement. Insurance Company V has determined that these four agents are contractors. It also has employees working in the same office building, who make exempt supplies. Insurance Company V has determined that 1,600 of the 5,000 square feet is currently vacant space. Insurance Company V allocates 800 square feet of the office space as being for the purpose of making taxable supplies for consideration. This method is an unbiased method because it accurately reflects the connection between the office space and the taxable supplies to which the space relates.

Verifiable

An objective measure of use is also verifiable.

A verifiable measure is one that a knowledgeable independent third party could use to arrive at the same procurative extent or operative extent using accurate information regarding the use of the direct input. The data and method used must be comprehensive, understandable, available for review, and must lead to an accurate result. Any method used is subject to audit and verification.

Where the use of a particular type of direct input in making particular supplies has been established by a financial institution's past use of this type of direct input, the use of the direct input for ITC allocation purposes should be an accurate reflection of its actual use. If there is a discrepancy between the use for ITC allocation purposes and the actual use of the direct input, the method used for ITC allocation purposes must be reviewed and revised as required. It is a question of fact whether it was appropriate to use that particular method.

A registrant must be able to support with documentation any method that it chooses (e.g., there must be sufficient documentation to show that it is appropriate in the registrant's particular circumstances). The supporting documentation must demonstrate how the method meets the criteria, rules, terms, conditions, and requirements for direct attribution methods.

A financial institution's books and records must be in an appropriate form and contain sufficient information to allow the determination of the amount of tax to be paid or collected, or the amount to be refunded, rebated or deducted from net tax. Accordingly, the books and records, including electronic records, must be in an appropriate form and contain sufficient information to allow a determination and verification of the amount of any ITC that is claimed. For additional information regarding books and records, refer to GST/HST Memorandum 15.1, *General Requirements for Books and Records,* and GST/HST Memorandum 15.2, *Computerized Records.*

Example

Financial Institution R, a *de minimis* financial institution, has an annual computer support contract. Financial Institution R has 1,500 full-time employees and 25 of these employees make exempt supplies. Each employee has a computer and, over the course of the year, the computer support services are used to the same extent by each employee. Financial Institution R uses the number of employee as an allocation base for the computer support contract for ITC allocation purposes. This method is used by Financial Institution R for cost accounting and ITC allocation purposes and this information is available for review on audit. This measure is a verifiable measure because it is comprehensive, understandable, and available for review, and leads to an accurate result.

Accurate application

A direct attribution method must apply an objective measure of use in a manner that accurately reflects the use of the direct input. It is applied in a manner that accurately reflects the use of the input if it provides comparable results and any cost pools used are appropriate cost pools.

Comparability

The ITC allocation method used must accurately and consistently reflect the use of the direct input in making taxable supplies for consideration. For example, if two direct inputs are used to the same extent for the purpose of making taxable supplies for consideration, the ITC allocation method or methods used for these two inputs must provide the same result in terms of their extent of use. Conversely, if two inputs are not acquired or used to the same extent for the purpose of making taxable supplies for consideration, the ITC allocation method or methods used to allocate these two inputs must provide different results in terms of the extent of use.

As a direct attribution method requires that a determination be made in the most direct manner, the method used would also generally be consistent from year-to-year. If the method were not consistent from year-to-year, a financial institution would need to show that there are changes in the business that affect what would constitute the most direct manner of attributing the use of the particular input.

Examples

1. Financial Institution Y purchases a supply of 4,000 customized desk calendars and a supply of 4,000 pens with Financial Institution Y's logo on them. Financial Institution Y purchases these items to provide one desk calendar and one pen to each of its employees. Financial Institution Y has 3,950 full-time employees making exempt supplies and 50 full-time employees making taxable supplies for consideration. For ITC allocation purposes, Financial Institution Y tracks the distribution of these calendars and pens (one calendar and one pen are provided to each employee). This is a comparable application because both inputs (the desk calendars and the pens) are used to the same extent for the same purposes and the ITC allocation method produces the same results in terms of the extent of use.

2. Financial Institution W purchases a supply of 4,000 customized desk calendars and a supply of 4,000 pens with Financial Institution W's logo on them. Financial Institution W purchases these items to provide one desk calendar and one pen to each of its employees. Financial Institution W has 3,950 full-time employees making exempt supplies and 50 full-time employees making taxable supplies for consideration. Eighty-five per cent of Financial Institution W's revenue is derived from exempt supplies and 15% of its revenue is derived from taxable supplies. For cost accounting purposes, Financial Institution W records the distribution of the pens and the calendars (one pen and one calendar to each employee). For ITC allocation purposes, Financial Institution W tracks the distribution of the pens and Financial Institution W uses a revenue-based method as an allocation method for the desk calendars. This is not a comparable application because both inputs (the desk calendars and the pens) are used to the same extent for the same purposes and the ITC allocation method produces different results in terms of the extent of use.

Appropriate cost pools

Generally, the use of individual direct inputs must be tracked to a particular supply or supplies. Direct inputs must not be grouped with other categories of inputs (e.g., non-attributable inputs or excluded inputs) for ITC allocation purposes because the category of input (e.g., a direct input or a non-attributable input) is important in determining an ITC allocation method that is appropriate in the circumstances.

If direct inputs are grouped together for ITC allocation purposes, all the direct inputs within the cost pool must:

- be for use to the same extent for the purpose of making taxable supplies for consideration if the inputs in the pool are **tracked** (e.g., a pool of inputs that are tracked cannot include an input that is used 2% for the purpose of making taxable supplies for consideration with an input that is used 30% for the purpose of making taxable supplies for consideration);
- be allocated using the same allocation base if the inputs in the pool are allocated using **causal allocation**;

- apply to the same portion of the business if the input is allocated using **input-based allocation**; and
- apply to the same portion of the business and use the same appropriate output measures (e.g., revenue) if the input is allocated using **output-based allocation**.

For example, it may be appropriate to pool rent and heating costs using square footage as an allocation base where both costs apply equally for each square foot. Any use of grouping or pooling must result in the same ITC allocation result as would be arrived at if each individual input was allocated without the use of pooling. If direct inputs within a cost pool do not have the same tax status (e.g., a cost pool that includes both inputs on which GST/HST is not payable and inputs on which tax is payable), the use of the cost pool must not distort the ITC results (e.g., ITCs must not be claimed on exempt inputs). In situations where it is not appropriate to include particular inputs in a single pool, a separate pool or pools must be created or the inputs must be allocated input by input.

As noted previously, if the link between a particular direct input and the particular supplies to which the input is attributed cannot be tracked, any approximation(s) used must reasonably reflect the extent to which the input is acquired or used for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration. As a result, it is only appropriate to pool particular inputs if pooling does not distort the results.

Examples

1. Financial Institution T pools its heating costs and telephone costs. The heating costs relate to the use of space, but the telephone costs are not related to the use of the space. Financial Institution T allocates ITCs for these inputs based on square footage. This use of pooling is inappropriate because the basis on which the inputs must be allocated is not the same (e.g., one of these inputs relates directly to the use of the space and one does not).

2. Financial Institution Z pools its rent and cleaning costs. The rent is charged based on the square footage of the office space and all the square footage is rented for the same rate. Financial Institution Z determines that the cleaning costs apply equally based on the square footage. Financial Institution Z allocates ITCs for both of these inputs using square footage as an allocation base. This pooling is appropriate because both inputs in the pool relate directly to the use of the space.

Summary

A direct attribution method must use an objective measure of use that is meaningful, unbiased and verifiable. It must be applied in a manner that accurately reflects the use of the direct input through comparable results and the use of cost pools only if they are appropriate cost pools.

A direct attribution method used under subsection 141.02(12) must also satisfy the conditions contained in subsection 141.02(16), which are discussed below under the heading “Additional requirements”.

Examples

1. Insurance Company Z hires a printing company to print its life insurance forms and pays $1,200 plus $60 GST. Insurance Company Z uses the same forms for its resident and non-resident insurance customers. Insurance Company Z’s supplies of insurance to residents are exempt supplies and its supplies of insurance to non-residents are zero-rated supplies for consideration. Insurance Company Z purchases a large volume of forms as a single supply to receive a special volume-based printing rate. Eighty per cent of these forms are for resident life insurance and 20% are for non-resident life insurance. Insurance Company Z’s purchase of insurance forms is a direct input because it is a single supply and can be attributed to the making of particular supplies some of which are exempt supplies and some of which are taxable supplies for consideration. It is possible to track the use of this particular input (20% for the purpose of making taxable supplies for consideration and 80% for the purpose of making exempt supplies) and this is the most direct allocation method in the circumstances. The data and method used are comprehensive, understandable, available for review, and lead to accurate results. This method is meaningful, unbiased and verifiable, and does not use inappropriate cost pools. As a result, this is a direct attribution method and Insurance Company Z is eligible to claim an ITC of $12 in respect of the supply of forms where all other conditions for claiming an ITC are met.

2. Financial Institution L (not a selected listed financial institution) pays $7,500 plus $975 HST for phone service in its downtown location for a particular month. Five thousand dollars is for general phone service and $2,500 is for long distance phone service. Financial Institution L

has 125 full-time employees, and 120 of these employees make exempt supplies while 5 make taxable supplies for consideration. The long distance charges are itemized and can be attributed to the employees who made the calls. For that particular month, $1,000 (plus $130 HST) of long distance calls were made by employees making taxable supplies for consideration and $1,500 (plus $195 HST) of long distance calls were made by employees making exempt supplies. The general phone service charge is the same for each phone in use ($40 plus $5.20 HST) and each full-time employee has a phone. Financial Institution L tracks the use of long distance calls and claims $130 in ITCs for them. Financial Institution L uses the number of full-time employees as an allocation base for general phone service and claims an ITC of $26 for general phone service. The data and method used are comprehensive, understandable, available for review, and lead to accurate results. This method is meaningful, unbiased and verifiable, and does not use inappropriate cost pools. This is a direct attribution method and Financial Institution L is eligible for the ITC where all other conditions for claiming an ITC are met.

3. Financial Institution F purchased a supply of a box of 1000 DVDs containing computer software for $50,000 plus $2,500 GST. The computer software is designed to test and develop personal effectiveness and priority setting skills, and is included in Class 12 of Schedule II to the *Income Tax Regulations*. The DVDs are for the use of four different departments and an employee who coordinates work/life balance workshops. Department 1 (cost centre 40012) receives 400 of the DVDs and makes only exempt supplies. Department 2 (cost centre 40015) receives 250 of the DVDs and makes only exempt supplies. Department 3 (cost centre 40035) receives 100 DVDs and makes both exempt supplies and taxable supplies for consideration (70 DVDs are for use in making exempt supplies and 30 DVDs are for use in making taxable supplies for consideration). Department 4 receives 200 DVDs and provides support functions for each of the other three departments. It cannot track the use of these DVDs to each of the departments. Departments 1, 2 and 3 have a combined total of 1,000 employees; 960 of these employees make exempt supplies and 40 make taxable supplies for consideration. Based on a systematic and logical analysis, Financial Institution F determines that it is appropriate to allocate the DVDs that Department 4 receives by using causal allocation with employees as an allocation base. Department 4 allocates 192 of the DVDs to the making of exempt supplies and 8 of the DVDs to the making of taxable supplies for consideration. The other 50 DVDs are used by an employee (cost centre 50023) to create a series of “balance” workshops (e.g., life/work balance) that are available to all employees. At the request of employees, Financial Institution F does not track which employees attend various balance workshops.

   Of the 950 DVDs for which the use can be tracked, 650 are used by the departments that make only exempt supplies; 100 are used by the department that makes mixed supplies (70 in making exempt supplies and 30 in making taxable supplies); and 200 are allocated using causal allocation (192 in making exempt supplies and 8 in making taxable supplies). The four per cent of the DVDs used by employees who are engaged in making taxable supplies for consideration is consistent with the use of DVDs in past years. Financial Institution F determines that it is reasonable to expect that the percentage of employees who attend the “balance” workshops and make taxable supplies for consideration would be consistent with the number of employees making taxable supplies for consideration (i.e., 4%). As a result, Financial Institution F allocates 4% of the 50 DVDs for use in the “balance” workshops to the making of taxable supplies for consideration, and claims an ITC of $100 (4% × $2,500) for the 1000 DVDs. The data and method used are comprehensive, understandable, available for review, and lead to accurate results. This method is meaningful, unbiased and verifiable, and does not use inappropriate cost pools. This is a direct attribution method and Financial Institution F is eligible to claim the ITC where all other conditions for claiming an ITC are met.

4. Financial Institution C enters all of its purchases in its accounting system, but accounts for all amounts of GST/HST paid separately from the inputs to which it relates (i.e., the accounting system does not maintain the link between the inputs and the GST/HST paid on the inputs). Financial Institution C later estimates the extent to which all of the inputs are used in making taxable supplies for consideration and for purposes of making exempt supplies based on revenue from taxable supplies for consideration and revenues from exempt supplies. Financial Institution C then applies this percentage to the GST/HST it paid even though Financial Institution C uses relatively few taxable inputs for the purpose of making taxable supplies for consideration (i.e., Financial Institution C uses more taxable inputs for the purpose of making exempt supplies), and there is a higher profit margin on Financial Institution C’s taxable supplies. There is no direct link between revenue from any particular supply or supplies and the cost or tax status of inputs used in making supplies. This is not a direct attribution method that conforms to the criteria, rules, terms and conditions specified by the Minister for determining in the most direct manner the operative and procurative extent of property or a service.

NON-ATTRIBUTABLE INPUTS

A non-attributable input is property or a service that is neither an excluded input nor an exclusive input, and is not attributable to the making of any particular supply. Non-attributable inputs are, therefore, inputs that are acquired, imported or brought into a participating province by a person both for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration, and that are neither capital personal property nor capital real property (nor improvements to capital property) and that cannot be attributed to the making of any particular supply.

Examples

1. Financial Institution G makes both taxable supplies for consideration and exempt supplies. Financial Institution G has an in-house sustainable development program to encourage employees to make more environmentally sustainable choices in their home and work lives. As part of this program, Financial Institution G hires an external consulting firm to conduct anonymous electronic surveys to determine how the employees feel about the current sustainable development program and to provide ideas on how the program could be improved. The supply of conducting the electronic surveys that Financial Institution G receives is a non-attributable input because it is not an excluded input or an exclusive input, and it cannot be attributed to the making of any particular supply.

2. Financial Institution P makes both taxable and exempt supplies. It hires an external contractor (a corporation that provides employee assistance program (EAP) services) to provide taxable EAP services. Financial Institution P receives a monthly bill from its EAP provider, which includes the number of employees who received services that month, but for confidentiality purposes, Financial Institution P does not receive the names of the employees who used the EAP provider or the name of department where they work. As a result, it is not possible to attribute the EAP services to the making of any particular supply. The supply of EAP services that Financial Institution P receives is a non-attributable input because it is not an excluded input or an exclusive input, and it cannot be attributed to the making of any particular supply.

3. Insurance Company H requires data entry services in respect of the information provided by clients on its various forms. Some forms relate to taxable supplies for consideration and some forms relate to exempt supplies. Insurance Company H purchases these data entry services from an unrelated company. This is a direct input rather than a non-attributable input because it can be attributed to the making of particular supplies.

4. Corporation M is a financial institution as a result of an election under subsection 150(1). Corporation M makes supplies of services to Financial Institution B, which are exempt financial services as a result of the election under subsection 150(1). Corporation M also makes taxable supplies of services to an unrelated company. Corporation M purchases pamphlets that demonstrate ergonomic principles and illustrate various stretching techniques for its office staff. These pamphlets are left in a central location where employees can take one if they wish. The pamphlets are non-attributable inputs for Corporation M because they cannot be attributed to the making of any particular supply.

Specified method for non-attributable inputs

Subsection 141.02(10) provides that a financial institution that is not a qualifying institution in a particular fiscal year and has not made an election under subsection 141.02(9) is required to use a specified method to determine the procurative extent or operative extent of each non-attributable input. There are certain situations (e.g., where the Minister has directed the financial institution to use a particular method) where subsection 141.02(10) would not apply to the non-attributable inputs of a financial institution that is not a qualifying institution. These situations are explained in TIB B-099, *Application of Section 141.02 to Financial Institutions That Are Not Qualifying Institutions*.

A specified method for non-attributable inputs is a method, conforming to the criteria, rules, terms and conditions specified by the Minister for determining the operative extent and the procurative extent of property or a service.

The concept underlying the criteria, rules, terms and conditions is that a method used must provide a reasonable approximation of the use of the non-attributable input in the making of taxable supplies for consideration or otherwise. The criteria, rules, terms and conditions for a specified method for non-attributable inputs rely on the same general principles as the direct attribution method, but the application is somewhat different because, unlike a direct input, a non-attributable input cannot be attributed to the making of any particular supply.

Criteria, rules, terms and conditions

The criteria, rules, terms and conditions that a specified method for non-attributable inputs must conform to are:

1. A specified method for non-attributable inputs must employ an objective measure of use which is
   - meaningful,
   - unbiased, and

- verifiable.

2. A specified method for non-attributable inputs must be applied in a manner that accurately reflects the use of the input, including
   - providing comparable results, and
   - using cost pools only if they are appropriate cost pools.

To the extent that a financial institution's cost accounting system uses a method that meets the criteria, rules, terms, conditions, and requirements, the financial institution must use its cost accounting allocation method as a specified method for non-attributable inputs.

Objective measure

An objective measure of use is meaningful, unbiased and verifiable.

Meaningful

A meaningful measure of use for a non-attributable input is one that provides a reasonable approximation of the extent to which a particular input was acquired or used for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration.

Because a non-attributable input is one that cannot be attributed to the making of a particular supply or supplies, it would not be tracked or allocated using causal allocation. However, any approximations used must still reasonably reflect the extent to which an input is acquired or used for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration. In general, a substantial portion of a financial institution's inputs that are not excluded inputs will be allocated through the rules for exclusive inputs or the direct attribution method for direct inputs. As a result, few inputs will be allocated using a specified method for non-attributable inputs.

An input-based allocation or output-based allocation (as these terms are explained under the heading "Overview of the criteria, rules, terms and conditions for direct attribution methods and specified methods") is appropriate for non-attributable inputs where the allocation provides a reasonable approximation of the use of the input.

An **input-based allocation** uses a calculation based on the use of other inputs to allocate the use of a particular non-attributable input. For example, an input-based allocation may be a ratio of the value of inputs allocated to taxable supplies for consideration to the value of total inputs allocated. An input-based allocation must provide a reasonable approximation of the use of the particular input. An input-based allocation for non-attributable inputs should be calculated using exclusive inputs and direct inputs that have either been tracked or allocated through the use of causal allocation (i.e., it would not include excluded inputs, non-attributable inputs or direct inputs allocated using input-based allocation or output-based allocation).

An **output-based allocation** uses a calculation based on an output measure (e.g., revenue) to allocate the use of a particular non-attributable input. If an output-based allocation is used as a specified method for non-attributable inputs, the calculation must give a reasonable approximation of the use of the inputs for the purpose of making taxable supplies for consideration.

Distorting factors (as explained under the heading "Overview of the criteria, rules, terms and conditions for direct attribution methods and specified methods") must be excluded from ITC allocation calculations to avoid distortion of the result.

Unbiased

An objective measure of use is also unbiased.

An unbiased measure of use is impartial, is based on the facts surrounding the use of the non-attributable input and is not a measure designed to achieve a particular result. An unbiased measure uses a logical and systematic approach to produce a result that is supported by the facts surrounding the use of a particular non-attributable input (e.g., if a particular non-attributable input relates to a distinct portion of a particular financial institution's business it would be inappropriate to use a method that applied to the whole business to allocate that particular non-attributable input). If assumptions concerning the use of a non-attributable input are made in allocating the input, these assumptions must be probable and not merely possible.

Verifiable

An objective measure of use is also verifiable.

A verifiable measure is one that a knowledgeable independent third party could use to arrive at the same procurative extent or operative extent using accurate information regarding the use of the non-attributable input. The data and method used must be comprehensive, understandable, available for review, and must lead to an accurate result. Any method used is subject to audit and verification.

Where the use of a particular type of non-attributable input in making supplies has been established by a financial institution's past use of this type of non-attributable input, the use of the non-attributable input for ITC allocation purposes should be an accurate reflection of its actual use. For example, if an input is acquired to contribute to the operation of the whole business, the actual use of the input would generally be in contributing to the operation of the whole business. If there is a discrepancy between the use for ITC allocation purposes and the actual use of the non-attributable input, the method used for ITC allocation purposes must be reviewed and revised as required. It is a question of fact whether it was appropriate to use that particular method.

A registrant must be able to support with documentation any method that it chooses. The supporting documentation must demonstrate how the method meets the criteria, rules, terms, conditions and requirements for a specified method for non-attributable inputs.

A financial institution's books and records must be in an appropriate form and contain sufficient information to allow a determination of the amount of tax to be paid or collected, or the amount to be refunded, rebated or deducted from net tax. Accordingly, the books and records, including electronic records, must be in an appropriate form and contain sufficient information to allow a determination and verification of the amount of any ITC that is claimed. For additional information regarding books and records, refer to GST/HST Memorandum 15.1, *General Requirements for Books and Records,* and GST/HST Memorandum 15.2, *Computerized Records*.

Accurate application

A specified method for a non-attributable input must apply an objective measure of use in a manner that accurately reflects the use of the non-attributable input. It is applied in a manner that accurately reflects the use of the input if it provides comparable results and any cost pools used are appropriate cost pools.

Comparability

The ITC allocation method used must accurately and consistently reflect the use of the input in making taxable supplies for consideration. For example, if two non-attributable inputs are acquired or used to the same extent for the purpose of contributing to the whole business, the ITC allocation method or methods used for these two inputs must provide the same result in terms of the extent of use.

Appropriate cost pools

If non-attributable inputs are grouped together for ITC allocation purposes, it must be appropriate to use the same ITC allocation method for these inputs, and the method must apply in the same manner (i.e., produce the same result). Any use of grouping or pooling must result in the same ITC allocation result as would be arrived as if each individual input was allocated without the use of pooling (e.g., if a particular non-attributable input relates to the whole business, it must not be pooled with other inputs that only relate to a portion of the business).

Non-attributable inputs must not be grouped with other categories of inputs (e.g., direct inputs or excluded inputs) for ITC allocation purposes because the category of input (e.g., a non-attributable input or a direct input) is important in determining an ITC allocation method that is appropriate in the circumstances.

Non-attributable inputs within a cost pool that is used for purposes of calculating an ITC must relate to the same portion of the business (e.g., the whole business or a specific part of the business). If non-attributable inputs within a cost pool do not have the same tax status, the use of pooling must not distort the ITC results. In situations where it is not appropriate to use the same method, a separate pool or pools must be created, or the inputs must be allocated input by input.

Approximations used must reasonably reflect the extent to which the input is acquired or used for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration. As a result, it is only appropriate to pool particular non-attributable inputs if pooling does not distort the results.

Summary

A specified method for non-attributable inputs must use an objective measure of use that is meaningful, unbiased and verifiable. It must also be applied in a manner that accurately reflects the use of the non-attributable input through comparable results and the use of cost pools only if they are appropriate cost pools.

A specified method for non-attributable inputs used under subsection 141.02(10) must also satisfy the conditions contained in subsection 141.02(16), which are discussed below under the heading “Additional requirements”.

Examples

1. Insurance Co. makes both taxable supplies for consideration and exempt supplies. Insurance Co. paid the travel expenses of its board of directors to attend a meeting at which the board members discussed various topics not related to any specific supplies. The supply of the travel that Insurance Co. receives is a non-attributable input because it is not an excluded input or an exclusive input, and it cannot be attributed to the making of any particular supply. In the course of the year, the board of directors contributes to all the business of Insurance Co. equally. It would not be appropriate for Insurance Co. to use an output-based method using revenue because it does not provide a reasonable approximation of the use of the travel expenses in Insurance Co.’s activities. Insurance Co. uses an input-based method based on the whole business. A substantial portion of Insurance Co.’s inputs has been allocated through the rules for exclusive inputs and through tracking or causal allocation of direct inputs. The data and method used are comprehensive, understandable, available for review, and lead to accurate results. This method is meaningful, unbiased and verifiable, and does not use inappropriate cost pools. As a result, the use of an input-based method based on the whole business is a specified method for this non-attributable input.

2. Financial Institution N uses an output-based method (a ratio of foreign interchange transactions to total interchange transactions) to allocate all its inputs (e.g., capital property and inputs that can be attributed to particular supplies) for its credit card division. Most of Financial Institution N’s revenue from its credit card division is from interest income from cardholders and annual credit card fees. There is no proportionate increase in interchange transactions with an increase in inputs on which GST/HST is paid. Not all of Financial Institution N’s inputs are non-attributable inputs (e.g., some are excluded inputs and some are direct inputs). As a result, tracking and causal allocation would apply to many inputs, and it would not be appropriate to use an output-based method for all the inputs. The method used by Financial Institution N would not be a specified method for a non-attributable input.

EXCLUDED INPUTS

An excluded input is property (i.e., personal property or real property) that is for use as capital property and any property or service that is acquired for use as an improvement to capital property. An excluded input may also include a prescribed property or service. At this time, regulations have not been made to prescribe any particular property or service.

Under subsection 123(1), the term "capital property" means, in respect of a person, property that is, or would be if the person were a taxpayer under the *Income Tax Act*, capital property of the person within the meaning of that Act, other than property described in Class 12, 14 or 44 of Schedule II to the *Income Tax Regulations*.

Under subsection 123(1), the term "improvement", in respect of property of a person, means any property or service supplied to, or goods imported by, the person for the purpose of improving the property, to the extent that the consideration paid or payable by the person for the property or service or the value of the goods is, or would be if the person were a taxpayer under the *Income Tax Act*, included in determining the cost or, in the case of property that is capital property of the person, the adjusted cost base to the person of the property for the purposes of that Act.

Paragraph 169(1.1)(a) provides that, where a person acquires or imports property or a service, or brings it into a participating province partly for use in improving capital property of the person and partly for another purpose, for the purpose of determining an ITC in respect of the property or service, notwithstanding section 138, that part of the property or service that is for use in improving the capital property is deemed to be a separate property or service from the remaining part of the property or service.

Examples

1. Financial Institution M owns an office building that it uses exclusively in making exempt supplies. Financial Institution M decides to move the employees in this building to a more central location, and will be renting out the office building to third parties. To rent the office building, Financial Institution M hires a contractor to complete certain improvements to make the office building appropriate for commercial rental. This input is an excluded input because it is acquired for use as an improvement to capital real property.

2. Financial Institution H purchases a building to use as a new office location that it will use exclusively in making exempt supplies. This input is an excluded input because it is capital real property.

3. Company K operates a retail store and is a *de minimis* financial institution. Company K purchases uniforms for all its employees (i.e., the employees that make taxable supplies of the retail store's goods and services and those that make exempt supplies of financial services). Company K owns the uniforms and does not require its employees to pay for them. The supply of uniforms is a direct input and not an excluded input because it is excluded from the definition of capital property for GST/HST purposes (i.e., it is described in Class 12 of Schedule II to the *Income Tax Regulations*). It is not an exclusive input. It can be attributed to the making of particular supplies.

4. Securities Dealer N purchases a single supply of a new security system and one year of monitoring service for its office building. In subsequent years, Securities Dealer N will pay the annual monitoring fee. The security system is for use in improving Security Dealer N's capital property. Under subsection 169(1.1), the security system is deemed to be a separate property that does not form part of the monitoring service. The security system is an excluded input because it is acquired for use as an improvement to capital property.

5. Financial Institution V purchases an automated bank machine (ABM) to replace a broken machine in one of its retail banking locations. The ABM is an excluded input because it is capital personal property.

Specified method for excluded inputs

Subsection 141.02(14) requires that a financial institution use a specified method to determine the procurative extent and the operative extent of each excluded input of the financial institution. There are certain situations (e.g., where the Minister has directed the financial institution to use a particular method) where subsection 141.02(14) would not apply to the excluded inputs of a financial institution. These situations are explained in TIB B-098, *Application of Section 141.02 to Financial Institutions That Are Qualifying Institutions*, for qualifying institutions and in TIB B-099, *Application of Section 141.02 to Financial Institutions That Are Not Qualifying Institutions*, for financial institutions that are not qualifying institutions.

A specified method is a method, conforming to the criteria, rules, terms and conditions specified by the Minister for determining the operative extent and the procurative extent of property or a service.

The concept underlying the criteria, rules, terms and conditions is that a method used must accurately reflect the actual use of the input in the making of the supplies to which the input can be attributed. Wherever possible, the purpose for which a particular excluded input is acquired or used must be tracked. Where it is not possible to track the purpose of a particular excluded input, the method used must reflect the connection between the input and the supply or supplies for which the input is acquired or used.

To the extent that a financial institution's cost accounting system uses a method that meets the criteria, rules, terms, conditions, and requirements, the financial institution must use its cost accounting allocation method as a specified method for excluded inputs.

An excluded input is different from a direct input or a non-attributable input in that capital property and improvements to capital property generally have a longer period of use than either a direct input or a non-attributable input. Excluded inputs may be used exclusively for the purpose of making taxable supplies for consideration or for purposes other than making taxable supplies for consideration. Excluded inputs may also be tracked or allocated using causal allocation. Inputs or portions of inputs that cannot be attributed to the making of any particular supply may be allocated using an input-based allocation or an output-based allocation. Excluded inputs are also subject to change-in-use provisions that do not apply to direct inputs or non-attributable inputs. As a result, although the criteria, rules, terms and conditions for the specified method for excluded inputs rely on the same general principles as the direct attribution method and the specified method for non-attributable inputs, the application is somewhat different.

The extent to which a particular excluded input can be attributed to the making of particular supplies will depend on the circumstances. For example, some excluded inputs may be used exclusively for the purpose of making exempt supplies while other excluded inputs may be used for the purpose of making both exempt supplies and taxable supplies for consideration.

Criteria, rules, terms and conditions

The criteria, rules, terms and conditions that a specified method for excluded inputs must conform to are:

1. A specified method for excluded inputs must employ an objective measure of use which is
   - meaningful,
   - unbiased, and
   - verifiable.
2. A specified method for excluded inputs must be applied in a manner that accurately reflects the use of the input, including
   - providing comparable results, and
   - using cost pools only if they are appropriate cost pools.

Objective measure

An objective measure of use is meaningful, unbiased and verifiable.

Meaningful

A meaningful measure of use for an excluded input is one that accurately reflects the actual extent to which a particular input was acquired or used for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration.

In general, a substantial portion of a financial institution's excluded inputs is used exclusively for particular purposes, or can be tracked or be allocated using causal allocation. As a result, few excluded inputs will be allocated using either an input-based allocation or an output-based allocation.

The terms "tracking", "causal allocation", "input-based allocation" and "output-based allocation" apply as explained under the heading "Overview of the criteria, rules, terms and conditions for direct attribution methods and specified methods".

If an excluded input is acquired or used exclusively for the purpose of making taxable supplies for consideration, the procurative extent and the operative extent of the particular excluded input is 100% for the purpose of making taxable supplies for consideration. If an excluded input is acquired or used exclusively for purposes other than making taxable supplies for consideration, the procurative extent and the operative extent of the particular input is 100% for purposes other than making taxable supplies for consideration.

To provide an accurate reflection of the use of an excluded input, if it is possible to allocate the input by **tracking** the use of the particular excluded input in making particular supplies, the ITC allocation method used must track the use of the particular input. Any method used to track the use of a particular input must be logical and take a systematic approach to track the link between the excluded input and the supplies to which the input relates.

If a link between an excluded input and particular supplies cannot be tracked, any approximation(s) used must reasonably reflect the extent to which the input is acquired or used for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration.

Causal allocation must also be logical and must use a systematic approach to link the excluded input to the supplies to which it relates. Causal allocation utilizes an allocation base (e.g., square footage, employee numbers). The allocation base used must be appropriate to the circumstances and must provide a reasonable approximation of the use of the particular input. For example, the number of employees might be used as an allocation base for an excluded input where it is logical that the excluded input be used equally by the relevant number of employees.

An input-based allocation or an output-based allocation may be appropriate in circumstances where the link between an excluded input and particular supplies cannot be tracked or allocated using causal allocation, and either an input-based allocation or an output-based allocation would provide a reasonable approximation of the use of the excluded input.

An **input-based allocation** uses a calculation based on the use of other inputs to allocate the use of a particular excluded input to the extent that it cannot be allocated using tracking or causal allocation. An input-based allocation must provide a reasonable approximation of the use of the particular input. An input-based allocation for excluded inputs should be calculated using exclusive inputs and direct inputs that have either been tracked or allocated through the use of causal allocation (i.e., it would not include excluded inputs, non-attributable inputs or direct inputs allocated using input-based allocation or output-based allocation).

An **output-based allocation** uses a calculation based on an output measure (e.g., revenue) to allocate the use of excluded inputs to the extent that it cannot be allocated using tracking or causal allocation. If an output-based allocation is used as a specified method for excluded inputs, the calculation must give a reasonable approximation of the use of the excluded inputs for the purpose of making taxable supplies for consideration.

Distorting factors (as explained under the heading "Overview of the criteria, rules, terms and conditions for direct attribution methods and specified methods") must be excluded from ITC allocation calculations to avoid distortion of the results.

Unbiased

An objective measure of use is also unbiased.

An unbiased measure of use is impartial, is based on the facts surrounding the use of the excluded input, and is not a measure designed to achieve a particular result. An unbiased measure uses a logical and systematic approach to produce a result that is supported by the facts surrounding the use of a particular excluded input. If assumptions concerning an input or output are made in allocating an excluded input, these assumptions must be probable and not merely possible. Where an allocation base is chosen for inputs that are not exclusively for a particular purpose and cannot be tracked, the allocation base must be one that logically relates the use of the excluded input to the output rather than one that produces a particular ITC result.

Verifiable

An objective measure is also verifiable.

A verifiable measure is one that a knowledgeable independent third party could use to arrive at the same procurative extent or operative extent using accurate information regarding the use of the excluded input. The data and method used must be comprehensive, understandable, available for review, and must lead to an accurate result. Any method used is subject to audit and verification.

Where the use of a particular type of excluded input in making particular supplies has been established by the financial institution's past use of that type of excluded input, the use of the excluded input for ITC allocation purposes should be an accurate reflection of its actual use. If there is a discrepancy between the use for ITC allocation purposes and the actual use of the excluded input, the method used must be reviewed and revised as required. It is a question of fact whether it was appropriate to use that particular method.

The operative extent of an excluded input is based on the extent of use for the purpose of making taxable supplies for consideration or for purposes other than making taxable supplies for consideration. Upon verification, the extent to which an excluded input is used for the purpose of making taxable supplies for consideration or for purposes other than making taxable supplies for consideration must be the same as the operative extent used for the purpose of calculating ITCs. As a result, any ITC claimed on a change-in-use based on the calculation of the use of a particular excluded input must be the result of a change in how the particular excluded input is actually used.

The operative extent of an excluded input is particularly important in the application of the change-in-use provisions that apply to certain capital property (e.g., capital personal property having a cost to the financial institution of more than $50,000). If the use of a particular excluded input changes, various existing change-in-use provisions (e.g., sections 204 and 205) may apply.

A registrant must be able to support with documentation any method that it chooses. The supporting documentation must demonstrate how the method meets the criteria, rules, terms, conditions, and requirements for a specified method for excluded inputs.

A financial institution's books and records must be in an appropriate form and contain sufficient information to allow a determination of the amount of tax to be paid or collected, or the amount to be refunded, rebated or deducted from net tax. Accordingly, the books and records, including electronic records, must be in an appropriate form and contain sufficient information to allow a determination and verification of the amount of any ITC that is claimed. For additional information regarding books and records, refer to GST/HST Memorandum 15.1, *General Requirements for Books and Records* and GST/HST Memorandum 15.2, *Computerized Records*.

Accurate application

A specified method for an excluded input must apply an objective measure of use in a manner that accurately reflects the use of the excluded input. It is applied in a manner that accurately reflects the use of the excluded input if it provides comparable results and any cost pools used are appropriate cost pools.

Comparability

The ITC allocation method used must accurately and consistently reflect the use of the excluded input in making taxable supplies for consideration. For example, if two excluded inputs are used to the same extent for the purpose of making taxable supplies for consideration, the ITC allocation method or methods used for these two inputs must provide the same result in terms of the extent of use. Conversely, if two excluded inputs are not used to the same extent for the purpose of making taxable supplies for consideration, the ITC allocation method or methods used to allocate these two excluded inputs must provide different results in terms of the extent of use.

Appropriate cost pools

Generally, the use of individual excluded inputs must be tracked to a particular supply or supplies.
Excluded inputs must not be grouped with other types of inputs (e.g., direct inputs or non-attributable inputs) for ITC allocation purposes because the type of input (e.g., an excluded input or a non-attributable input) is important in determining an ITC allocation method that is appropriate in the circumstances.

If excluded inputs are grouped together for ITC allocation purposes, all the excluded inputs within the cost pool must:

- be for use to the same extent for the purpose of making taxable supplies for consideration if the inputs in the pool are **tracked** (e.g., a pool of inputs that are tracked cannot include an input that is used 5% for the purpose of making taxable supplies for consideration with an input that is used 80% for the purpose of making taxable supplies for consideration);
- be allocated using the same allocation base if the inputs in the pool are allocated using **causal allocation**;
- apply to the same portion of the business if the input is allocated using **input-based allocation**; and
- apply to the same portion of the business and use the same appropriate output measures (e.g., revenue) if the input is allocated using **output-based allocation**.

Any use of grouping or pooling must result in the same ITC allocation result as would be arrived at if each individual input was allocated without the use of pooling. If excluded inputs within a cost pool do not have the same tax status (e.g., a cost pool that includes both inputs on which GST/HST is not payable and inputs on which tax is payable), the use of the cost pool must not distort the ITC results (e.g., ITCs must not be claimed on exempt inputs). In situations where it is not appropriate to include particular inputs in a single pool, a separate pool or pools must be created, or the inputs must be allocated input by input.

As noted previously, if the link between a particular excluded input and the particular supplies to which the input is attributed cannot be tracked, any approximation(s) used must reasonably reflect the extent to which the input is acquired or used for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration. As a result, it is only appropriate to pool particular excluded inputs if pooling does not distort the results.

Summary

A specified method for excluded inputs must use an objective measure of use that is meaningful, unbiased and verifiable. It must be applied in a manner that accurately reflects the use of the excluded input through comparable results and the use of cost pools only if they are appropriate cost pools.

A specified method used under subsection 141.02(14) must also satisfy the conditions contained in subsection 141.02(16), which are discussed below under the heading "Additional requirements".

Examples

1. Financial Institution U (not a selected listed financial institution) is engaged exclusively in making exempt supplies. It purchases a single supply (i.e., a single input) of file cabinets for $23,000 plus $2,990 HST. Financial Institution U's purchase of file cabinets is an excluded input because it is a purchase of capital personal property. Financial Institution U is not eligible to claim an ITC for this purchase because the file cabinets are not used, even in part, in making taxable supplies for consideration.

2. Financial Institution S purchases replacement desks for one of its offices. Financial Institution S used a specified method for excluded inputs to claim ITCs when it purchased the original desks (i.e., it allocated the desks based on the tax status of the supplies made by each employee who received a desk). This method continues to meet the criteria, rules, terms and conditions for a specified method for excluded inputs. The replacement desks will be used in the same manner. It is, therefore, appropriate for Financial Institution S to use the same method for the replacement property that it used for the original property. If Financial Institution S uses another method, the method must meet the criteria, rules, terms and conditions for a specified method for excluded inputs. Financial Institution S must also provide a logical and reasonable explanation for the change in method and explain why it is appropriate in the circumstances.

3. Financial Institution K purchases a piece of equipment for its network storage for one of its offices for $65,000 plus $3,250 GST. At the time of purchase, 97% of this equipment will be used for the purpose of making exempt supplies and 3% will be used for the purpose of making taxable supplies for consideration. For the first two years after the purchase, Financial Institution K uses the equipment 97% for the purpose of making exempt supplies and 3% for the purpose of making taxable supplies for consideration. Financial Institution K claims an ITC of $97.50 on the purchase of the equipment, which is audited and confirmed. Three years after the equipment purchase, Financial Institution K expands a department that makes taxable supplies at that particular office. As a result, the subsequent use of the equipment is 15% in making taxable supplies for consideration and 85% in making exempt supplies. At that time, the basic tax content of the equipment is $2,000 and the cost of the equipment to Financial Institution K is $65,000.

   Subsection 204(2) applies because the cost to Financial Institution K of the equipment is greater than $50,000 and the equipment was acquired by Financial Institution K for use as capital property. The extent to which Financial Institution K is deemed to have used the equipment in commercial activities under subsection 141.01(3) was 3%, and it is now 15% (an increase of 12%). Subsection 206(3) applies because Financial Institution K last acquired the equipment for use as capital property in commercial activities and increased the extent to which the equipment is used in commercial activities by 12%. Accordingly, Financial Institution K is deemed to have received a supply of a portion of the equipment for use as capital property exclusively in its commercial activities and to have paid $240 GST ($2,000 x 12%). The data and method used are comprehensive, understandable, available for review, and lead to accurate results. This method is meaningful, unbiased and verifiable, and does not use inappropriate cost pools. As a result, this is a specified method for this excluded input and Financial Institution K is eligible to claim an ITC of $240 for the change-in-use of the equipment.

4. Financial Institution A records the cost of all its desks at a particular office in a single cost pool for ITC allocation purposes. It has reorganized its offices such that employees who are engaged in making taxable supplies for consideration at other offices have been moved to this office. The office was previously used 5% in making taxable supplies for consideration (and 5% of the desks were used in making taxable supplies for consideration). It is now used 20% in making taxable supplies for consideration (and 20% of the desks are now used for making taxable supplies for consideration). The cost pool for desks at that office includes desks with a cost to Financial Institution A of $75,000 plus $3,750 GST. The cost to Financial Institution A of each individual desk is $2,500 plus $125 GST. Although the use of the desks in the pool in making taxable supplies for consideration has increased from 5% of the desks to 20% of the desks, the individual desks have a cost to Financial Institution A of less than $50,000. Financial Institution A has not entered into or revoked an election under section 150, subsection 167(1) or 167.11(2). It has also not recently become a financial institution and has not been party to a merger, amalgamation or winding-up. As a result, the change-in-use provisions do not apply, and there is no additional ITC available for Financial Institution A to claim.

5. Financial Institution B purchases a single supply of 30 computers for its 30 full-time employees on a single floor of one of its offices for $45,000 plus GST of $2,250. Each full-time employee receives a single computer and the cost of each computer is equal. Twenty-nine full-time employees make exempt supplies and one full-time employee makes taxable supplies for consideration. Financial Institution B's purchase of the computers is an excluded input because it is a purchase of capital personal property. Financial Institution B calculates its ITCs for this supply of computers based on the number of full-time employees. The data and method used are comprehensive, understandable, available for review, and lead to accurate results. This method is meaningful, unbiased and verifiable, and does not use inappropriate cost pools. As a result, this is a specified method for this excluded input and Financial Institution B is eligible to claim an ITC of $75 where all other ITC conditions are met.

6. Bank D makes taxable supplies of safety deposit box rentals for consideration and provides 5% of its safety deposit boxes to certain customers for no consideration. The customers who receive the safety deposit boxes for no consideration are customers who are receiving exempt supplies of financial services from Bank D (e.g., customers with large mortgages or large deposit accounts). Bank D has historically provided 5% of its safety deposit boxes for this purpose, and projects that this will continue to be the case in the future. Bank D spent $20,000 plus $1,000 GST to upgrade the locking system for the safety deposit box safe. Bank D's purchase of the locking system upgrade is an excluded input because it is an improvement to Bank D's capital property. Bank D uses a specified method for this excluded input as it tracks the use of the safety deposit boxes in the safe. Bank D allocates the entire cost as being for the purpose of making taxable supplies for consideration and claims $1,000 in ITCs. Bank D is not eligible to claim full ITCs because the entire cost is not attributable to the making of taxable supplies for consideration. More specifically, 5% of the safety deposit boxes are used for the purpose of making taxable supplies for no consideration for the purpose of facilitating, furthering or promoting the acquisition, consumption or use of exempt supplies by certain customers. As a result, subsection 141.01(4) applies and, to the extent (5%) that Bank D acquired the excluded input for the purpose of making these supplies of safety deposit boxes for no consideration, Bank D is deemed to have acquired the excluded input in the course of making exempt supplies of financial services.

7. Securities Dealer B chooses to update its heating system to reduce energy consumption and purchases an energy efficient heating system with a centralized control to maintain the same temperature throughout the building. Securities Dealer B pays $30,000 plus $1,500 GST for the heating system upgrade. The use of the heating system cannot be tracked. It is logical that this particular heating system will be used equally over the square footage of Securities Dealer B's office space. Securities Dealer B uses a systematic approach to allocate the use of the heating system using square footage as an allocation base (i.e., based on an analysis of the office square footage, Securities Dealer B determines that 93% of the square footage of the office is used for the purpose of making exempt supplies and 7% of the square footage of the office is used for the purpose of making taxable supplies for consideration). Securities Dealer B uses the same allocation method to allocate monthly heating costs. Securities Dealer B's purchase of the heating system upgrade is an excluded input because it was purchased for use as an improvement to capital property. Securities Dealer B calculates its ITCs on this purchase based on the square footage used in making taxable supplies for consideration. The data and method used are comprehensive, understandable, available for review, and lead to accurate results. This method is meaningful, unbiased and verifiable, and does not use inappropriate cost pools. As a result, this is a specified method for this excluded input, and Financial Institution F is eligible to claim an ITC of $105 ($1,500 x 7%) where all other conditions for claiming an ITC are met.

Additional requirements

Subsection 141.02(16) provides that a specified method, a direct attribution method or another method used by a financial institution in accordance with subsection 141.02(10), (11), (12), (13), (14) or (15) must:

- be fair and reasonable;
- be used consistently by the financial institution throughout the fiscal year; and
- be determined by the financial institution no later than the day on or before which the financial institution is required to file a return with the Minister for the first reporting period in the fiscal year.

In addition, the ITC allocation method used by a financial institution in respect of a fiscal year for purposes of any of subsections 141.02(10), (11), (12), (13), (14) or (15) may not be altered or substituted with another method for that year at any time after the day the financial institution is required to file its return for the first reporting period of that fiscal year unless the Minister consents in writing to the alteration or substitution.

Example

Four years ago, Insurance Company Q purchased a photocopier for $60,000 plus GST. Insurance Company Q requires all its employees to enter a cost code to use the photocopier. All these cost codes relate either to the making of taxable supplies for consideration or to the making of exempt supplies. From the time the photocopier was purchased, Insurance Company Q calculated the operative extent of the photocopier, for

GST/HST change-in-use purposes, based on the actual use of the photocopier as supported by the photocopier usage logs. This is a specified method for excluded inputs that conforms to the criteria, rules, terms and conditions specified by the Minister. This method is fair, reasonable in the circumstances, used consistently throughout the fiscal year, and was determined by Insurance Company Q before the day on or before which Insurance Company Q was required to file a return for that fiscal year.

Enquiries by telephone

Technical enquiries on the GST/HST: 1-800-959-8287.

General enquiries on the GST/HST: 1-800-959-5525 (Business Enquiries)

If you are located in Quebec: 1-800-567-4692 (Revenu Québec)

All technical publications related to the GST/HST are available on the CRA Web site at www.cra.gc.ca/gsthsttech.