



Proposed Changes to the Definition of Financial Service

This notice provides information on the proposed legislative amendments as announced in the News Release and Backgrounder issued by the Department of Finance on December 14, 2009 clarifying the application of the goods and services tax/harmonized sales tax (GST/HST) in respect of the definition of "financial service". At the time of publication, Parliament had not enacted these proposed amendments. Any commentary in this notice should not be taken as a statement by the Canada Revenue Agency (CRA) that these amendments will in fact be enacted into law in their current form.

Background

Financial services are defined in subsection 123(1) of the *Excise Tax Act* (Act) and are generally exempt. Services in the nature of management, administration, marketing or promotional activities are intended to be taxable as they are not themselves financial services. The legislative proposals announced by the Department of Finance on December 14, 2009¹ reaffirm this longstanding policy intent and provide certainty with respect to the application of GST/HST by specifically excluding these services from the definition of financial service under the Act.

Legislative proposals

The proposals specify that the following services are **not** financial services:

- investment management services;
- facilitatory services; and
- credit management services.

Investment management services

It is proposed that the definition of "financial service" be amended to clarify that investment management services are excluded from that definition.

A service is a financial service where it is included in any of paragraphs (a) to (m) of the definition of "financial service" in subsection 123(1) and is not otherwise excluded from that same definition.

Investment management services comprise the management by one person of the assets or liabilities of another person, with or without discretionary authority granted by the other person to manage those assets or liabilities. Investment management services include a full range of investment portfolio management and administration activities such as:

- researching, analyzing and advising;
- determining and directing which assets or liabilities of an investment portfolio are to be acquired or disposed of; and
- acting to realize performance targets in respect of an investment portfolio.

¹ www.fin.gc.ca/n08/09-115-eng.asp

Management or administrative service

It is also proposed that paragraph (q) of the definition of “financial service” be amended to clarify that the term “management or administrative service” in paragraph (q) includes an investment management service as described above.

Paragraph (q) excludes from the definition of “financial service” a management or administrative service or any other service (other than a prescribed service), provided by a person to a recipient that is either an investment plan (as defined in subsection 149(5)) or any corporation, partnership or trust whose principal activity is the investing of funds, where the person is providing such management or administrative services to the recipient. Examples of investment plans include a trust governed by:

- a registered pension plan;
- a registered retirement savings plan;
- a registered education savings plan; and
- a mutual fund trust.

The effect of the proposed amendment to paragraph (q) would be to clarify and reaffirm the longstanding policy intent that investment management services, provided to an investment plan, or any corporation, partnership or trust whose principal activity is the investing of funds, are considered to be management or administrative services and therefore excluded from the definition of “financial service”.

The following examples, though not exhaustive, further illustrate how GST/HST would apply to investment management services.

Example 1

An individual enters into an agreement with an investment manager. Under that agreement the investment manager agrees to provide investment management services to the individual. The investment manager has full discretion to buy and sell securities and other financial instruments and invest the monies in the individual's portfolio of assets under management. The individual will pay the investment manager a fee based on the net asset value of the portfolio managed. The supply provided under the agreement by the investment manager is not a supply of a financial service.

Example 2

In the course of providing services to investors, an investment dealer arranges to purchase units of a mutual fund for an investor. A commission is paid to the investment dealer at the time the units are purchased. In addition, the investment dealer will receive a fee referred to as a "trailer commission or fee" from the fund manager. The prospectus describes these fees as being paid in recognition of the investment advice and ongoing administrative services rendered by the investment dealer to the investors. The "trailer commission or fee" is paid annually subsequent to the arrangement for the purchase of the units.

The services provided by the investment dealer, including advice, arranging for the purchase of the units and on-going administrative services for which the investment dealer is paid the commission and subsequent fees would not be a supply of a financial service.

Example 3

A corporation engaged in commercial activities sets up a registered pension plan governed by a trust for its employees. The contributions to this plan are invested and administered using the services of investment managers, who in turn charge investment management fees in respect of those services. The investment managers report monthly on the performance of the assets and are compensated based on the value of the assets they manage. The investment managers have discretion to purchase or sell securities, to retain such securities in trust, to purchase, enter, hold and generally deal in any contractual manner for the immediate or future delivery of financial instruments and to convert monies into various currencies. This discretion is limited by investment guidelines established by the corporation. As clarified in the proposed amendment, the supply of services provided by the investment managers to the corporation would not be a supply of a financial service.

Coming into force

These proposed amendments would apply to investment management services rendered under an agreement for a supply if any consideration for the supply becomes due or is paid without becoming due after December 14, 2009. They would also apply to an investment management service rendered under an agreement for a supply if all the consideration for the supply became due or was paid on or before December 14, 2009, unless the supplier did not, on or before that day, charge, collect or remit any amount as or on account of tax in respect of the supply or in respect of any other supply that includes an investment management service and that is made under the agreement.

Example – Consideration paid after December 14, 2009

ServiceCo and InvestCo, registrants for GST/HST purposes, enter into an agreement on March 24, 2008. Under that agreement ServiceCo agrees to provide InvestCo discretionary investment management services in Canada. ServiceCo will be paid 0.4% of the net asset value of the portfolio managed. On July 2, 2010, ServiceCo issues an invoice to InvestCo in the amount of \$4000 for services provided from April 1, 2010 through June 30, 2010. As consideration for the supply of the investment management services is payable after December 14, 2009 GST/HST will apply to the supply.

Example – Consideration paid before December 14, 2009

An investment manager, a registrant for GST/HST purposes, enters into an agreement with an investor on October 27, 2008. Under that agreement the investment manager agrees to provide investment management services in Canada to the investor. The investment manager invoices the investor quarterly and indicates on the invoices that GST/HST is payable on the services. The investor pays the total amount on each invoice as well as the GST/HST. The investment manager remitted the GST/HST collected. In June 2009, the investment manager stopped collecting GST/HST from the investor and has not remitted any GST/HST with respect to its supply of investment management services since that date. In such a case, the investment manager would still be required to collect GST/HST and would have to remit GST/HST in respect of the consideration paid by the investor for the investment management services provided prior to December 14, 2009 as well as in respect of the consideration paid after December 14, 2009.

Persons may have filed a *General Application for a Rebate of GST/HST* (Form GST189) where they believed they had paid GST/HST in error with respect to GST/HST paid on investment management services. The CRA is currently holding in abeyance all rebate applications that may be affected by the proposed legislative amendments. Claimants will be advised as to the status of their rebate application at such time as Parliament has completed its consideration of the proposed amendments.

Facilitatory services and credit management services

It is also proposed to amend the definition of “financial service” to clarify that a facilitatory service that is preparatory to an actual or intended financial service is excluded from that definition.

A facilitatory service comprises the performance or provision of one or more of the following services:

- market research, product design, document preparation or processing, customer assistance, advertising, promotional or similar activities; and
- collection, collation or provision of information.

The proposed amendments also clarify that a service of managing credit in respect of a credit or charge card or similar payment card, or in respect of a credit, charge or loan account or an account in respect of any advance, where the service is supplied by one person to another person that is granting, or prospectively granting, credit is excluded from the definition of “financial service”.

Managing credit includes:

- credit checking;
- valuation;

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- authorization services;
 - making decisions relating to a grant or an application for a grant of credit;
 - creating and maintaining records relating to a grant or an application for a grant of credit on behalf of the credit provider; and
 - monitoring payment record or dealing with payments.

The following examples, though not exhaustive, further illustrate how GST/HST would apply to facilitatory and credit management services.

Example 1

A merchant enters into an agreement with a bank who is a credit card issuer. The bank agrees to provide to the merchant the service of advancing money (with respect to the merchant's sales that are charged through credit cards) and the merchant agrees to provide to the bank a service of promoting the bank's credit card in its stores. The supply made by the merchant to the bank of promoting the bank's credit card in the merchant's stores would not be a supply of a financial service.

Example 2

Company A enters into an agreement with a financial institution to provide marketing and advertising services for the financial institution's credit card. Company A will design and produce advertising material, design and emboss the credit cards, and distribute advertising materials to households and other locations in a specified city. Company A will collect applications from potential customers and provide information on the credit card offered by the financial institution as well as answer questions. Company A will be paid a percentage of the fees charged by the financial institution to the cardholders for its services. The supply made by Company A to the financial institution would not be a supply of a financial service.

Example 3

An automobile dealership has a financing department where employees assist customers in obtaining financing for the purchase of an automobile. For every successful loan, the dealership receives a commission from the financial institution. The employees of the dealership perform the following activities:

- obtaining the credit information from the customer;
- completing a loan application form;
- explaining to the customer the different loan terms and interest rates available;
- helping the customer select the type of loan which best suits the customer's needs;
- determining the interest rate and payment stream; and
- screening and verifying the loan application, making a recommendation on acceptance or rejection of the application and forwarding it for final approval to the financial institution which will grant the credit.

The supply made by the automobile dealership to the financial institution would not be a supply of a financial service.

Example 4

A financial institution enters into an agreement with PromoCo whereby PromoCo agrees to distribute the financial institution's credit card application form to university students. In providing the service to the financial institution, PromoCo distributes credit card applications to students at various university events, through direct mail, campus take-one dispensers, bookstore displays, campus bulletin boards and free-standing poster units. Completed application forms are returned to PromoCo for screening and review to ensure that all key information has been provided. If not, PromoCo makes three attempts to call the applicant to obtain the missing information. PromoCo forwards all completed forms to the financial institution for approval.

The supply made by PromoCo to the financial institution would not be a supply of a financial service.

Example 5

InsuranceCo provides specialized group insurance coverage for members affiliated with particular organizations such as banks, large retailers, or associations (the group policyholder). A group insurance master policy is issued by InsuranceCo to a retailer, the group policyholder, who makes the coverage available to its members (certificate holders) under the terms and conditions of the master policy. The group policyholder offers

access to specialized insurance coverage at a reduced rate to its members in order to enhance the value of the membership relationship.

InsuranceCo is required by contract with the retailer to conduct the necessary insurance coverage-placing activities with members and is usually permitted to use a telemarketing agency for this purpose. TeleMarketCo is contracted by InsuranceCo to conduct the necessary insurance coverage-placing activities with the group members.

The insurance coverage-placing activities consist of a marketing process which follows a predetermined script jointly prepared by InsuranceCo and TeleMarketCo. The retailer and/or InsuranceCo may approve/monitor this marketing process. TeleMarketCo contacts the member by telephone, presenting themselves as calling on behalf of InsuranceCo and the retailer, explaining the insurance coverage available, answering questions regarding the insurance coverage, screening the eligibility of the person, preparing the application and forwarding the completed applications to InsuranceCo who grants final approval, underwrites and issues the insurance to the member. TeleMarketCo is compensated on a per-hour basis.

The supply made by TeleMarketCo to InsuranceCo would not be a supply of a financial service.

Example 6

A bank issues credit cards to its cardholders. The bank enters into an agreement with ServiceCo. Under the agreement, ServiceCo agrees to manage the bank's credit card portfolio. Specifically, ServiceCo agrees to provide the following services: performing credit checks on each new applicant; creating and maintaining records of current and new applications for credit cards by entering the data and storing such data; making decisions on increasing or decreasing the credit limit of current cardholders; and providing record-keeping services for all account information.

The supply made by ServiceCo to the bank of managing its credit card portfolio would not be a supply of a financial service.

Example 7

As part of a reorganization of its business Company D wants to sell the business carried on by its subsidiary. Company D enters into an agreement with BBCo, a GST/HST registrant, whereby BBCo will provide a business broker service in order to facilitate the sale of Company D's subsidiary by means of a sale of the shares of Company D's subsidiary. BBCo performs the following:

- obtains "listing" for the sale of the business;
- assists Company D in calculating the likely worth of the subsidiary and the price at which the subsidiary's shares will be offered;
- assists Company D in putting together financial and operating information sufficient to allow BBCo to solicit expressions of interest;
- advertises the subsidiary's business as being for sale;
- contacts likely purchasers and/or persons who might identify likely purchasers, such as lawyers, accountants and bankers;
- prepares or obtains an offer to purchase the subsidiary's business from a potential purchaser;
- acts as intermediary between Company D and the purchaser in negotiating the terms of purchase and sale;
- assists a purchaser in arranging financing and advising Company D on providing financing; and,
- liaises with legal counsel for Company D, the purchaser or both in preparing sales documentation.

The supply made by BBCo to Company D would not be a supply of a financial service.

Coming into force

These proposed amendments would apply to a service of managing credit, or a facilitatory service, rendered under an agreement for a supply, if any consideration for the supply becomes due or is paid without becoming due after December 14, 2009. They would also apply to any such service, rendered under an agreement for a supply, if all the consideration for the supply became due or was paid on or before December 14, 2009, unless the supplier did not, on or before that day, charge, collect or remit any amount as or on account of tax in respect of the supply or in respect of any other supply that includes a service of managing credit or a facilitatory service and that is made under the agreement.

Reassessment by Minister of National Revenue

In respect of all the proposed amendments discussed above, the Minister of National Revenue would be able to reassess the net tax of a person under Part IX of the Act in respect of a reporting period of the person to take

into account any difference between the net tax that was reported by the person for the reporting period and the net tax of the person for the reporting period that would result after applying the proposed amendments.

Any such reassessment would have to be made on or before the later of:

- the day that is one year after the day on which an Act containing these proposed amendments is assented to; and
- the last day of the period for reassessment otherwise allowed under section 298 of the Act for making the reassessment.

However, the proposed amendments would not affect any case that has been subject to a final determination by the courts before December 14, 2009.

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 on GST/HST are available on the CRA Web site at www.cra.gc.ca/gsthstech.