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BACKGROUNDER

FINANCIAL INSTITUTION RULES FOR THE HARMONIZED SALES TAX (HST)

This Backgrounder provides details of proposed changes to the Harmonized Sales Tax (HST) rules governing financial institutions (FIs) that relate to the calculation of the provincial component of the HST (PVAT) contained in the federal *Excise Tax Act* (ETA) and its regulations. These changes are proposed to ensure that the ETA and its regulations function properly in the context of the expanded and modernized HST framework, which gives additional flexibility to provinces in areas such as rate flexibility.

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1. Background – Current exempt treatment of financial services under the GST/HST

a. Basic Approach

Currently, under the Goods and Services Tax (GST)/Harmonized Sales Tax (HST), supplies of financial services are generally exempt supplies.[1] As such, financial service providers (e.g., financial institutions (FIs)) do not charge GST/HST on their supplies of exempt financial services and are not eligible to claim input tax credits (ITCs) for GST/HST paid on goods and services acquired for consumption, use or supply in the course of providing these services.

Like other businesses, FIs pay GST/HST on their inputs based on place of supply rules.[2] Where, under place of supply rules, a taxable supply of property or a service is made to an FI in a participating province,[3] the FI pays HST on the supply. Where the supply is made in a non-participating province, the FI pays only the 5% GST.

Absent other provisions, the fact that FIs cannot generally claim ITCs to recover GST/HST paid on their inputs creates an incentive for FIs to acquire goods and services through supplies made outside the participating provinces so as to pay only the GST.

To avoid this outcome, a special attribution method (SAM) applies to FIs operating in both participating and non-participating provinces[4] (referred to as selected listed financial institutions or SLFIs) to calculate the provincial component of the HST (Provincial Value Added Tax or PVAT) for a participating province based on a formula approach.[5] The elements of the SAM formula are explained below.

b. SAM — Current Rules

Under the current rules, SAM determines an SLFI's net tax liability in respect of the PVAT. An SLFI is a listed financial institution (LFI)[6] that would generally be required to allocate income both to any of the participating provinces and to

any of the non-participating provinces under the *Income Tax Regulations* (IT Regulations). (See section 2.a below for additional information.) The SAM formula is contained in subsection 225.2 of the ETA.

The computation of an SLFI's PVAT liability under SAM for a participating province involves allocating the SLFI's unrecoverable GST[7] (generally, GST paid by the SLFI in excess of its ITCs) to the participating province based on a formula. The unrecoverable GST amount allocated to the participating province is grossed up by a factor to reflect the PVAT rate in the province (e.g., currently, 8/5 in each participating province) to determine the PVAT liability for that province. If the amount determined as a PVAT liability for a participating province for a reporting period of an SLFI is less than the PVAT for the province that is actually paid or payable by the SLFI in the period (i.e., under the general place of supply rules), the SLFI will be entitled to a refund. Conversely, if the amount of PVAT liability determined under the SAM formula is more than the actual PVAT for the province that is paid or payable by the SLFI in the period, an additional PVAT liability will arise.

The SAM formula is applied to calculate the PVAT liability in respect of each participating province for a reporting period of an SLFI:

$[(A – B) \times C \times D/E] – F + G$

where

(A – B) serves to measure the unrecoverable GST for the period. In general terms, A is the GST paid or payable by the SLFI in that period across Canada; and B is the total of ITCs claimed in that period by the SLFI in respect of its GST paid or payable;

C is the attribution percentage determined in respect of the participating province. The rules for determining this attribution percentage are based on the specific type of SLFI in question (e.g., banks, insurance corporations, and trust and loan corporations). These rules are explained in more detail in section 2.b below;

D/E is the ratio of the tax rate in the province to the GST rate where: D is the tax rate for the particular participating province; and E is the tax rate for the 5% GST (e.g., 8/5 for New Brunswick);

F is, in general terms, the PVAT for the province paid or payable by the SLFI in that period; and

G is used for PVAT adjustments specific to certain situations.[8]

For purposes of complying with the requirements of the SAM formula, SLFIs are required under the current rules to track separately actual GST and PVAT payable (or paid without having become payable) by them in respect of each participating province. As a result, they may require their suppliers to disclose the amount of GST and PVAT separately on their invoices.

SLFIs are not entitled to use certain recovery-of-tax rules relating to PVAT, such as the claiming of ITCs or rebates in respect of PVAT, as the SAM formula approach takes into account these amounts.

2. Proposed changes to existing SLFI rules

a. Definition of SLFI

Under the current rules, a person is an SLFI throughout a fiscal year if the person meets two tests.

- LFI test — the person must be an LFI described in any of subparagraphs 149(1)(*a*)(i) to (x) of the *Excise Tax Act* (ETA) during the taxation year in which the fiscal year ends and during the preceding taxation year of the person.[9]
- Provincial income allocation test — the person generally must have been a taxpayer required to allocate taxable income (or, in the case of an individual, the estate of a deceased individual or a trust, income) both to any of the participating provinces and to any of the non-participating provinces in each of those taxation years under provincial income allocation rules prescribed in the IT Regulations.[10] These rules generally require taxable income (or income) to be allocated to a province if the person has a permanent establishment (PE) in the province. Alternatively, the person must either be a specified partnership[11] described in subsection 225.2(8) of the ETA in each of those taxation years or a prescribed FI.[12]

As a result of these rules, an LFI that is required to allocate taxable income (or income) both to any of the participating provinces and to any of the non-participating provinces, for both a taxation year of the LFI ending in a fiscal year of the LFI and its immediately preceding taxation year, is an SLFI for the fiscal year.

British Columbia and Ontario's decision to join the HST, effective July 1, 2010, will significantly increase the number of FIs that are SLFIs. For example, a bank with branches in Ontario and Manitoba and in no other provinces would become an SLFI only as a result of Ontario harmonization.

As discussed below, changes are necessary to the existing SLFI rules to ensure that the rules achieve the intended result in the context of the expanded and modernized HST framework.

i. One-year test for determination of SLFI status

As noted above, under the current rules, a two-year test applies to determine if a person is an SLFI throughout a particular fiscal year of the person.

The application of the two-year test has resulted in compliance and administrative uncertainty, for example, where an LFI corporation or trust is formed as the result of a merger or an amalgamation. The LFI would be a new corporation or trust and therefore have no taxation year immediately preceding its first taxation year to meet the two-year test. As a result, in that first taxation year, the LFI would not be an SLFI. This would mean that the LFI would be subject to general rules (e.g., rules for self-assessment of PVAT and for ITCs or rebates in respect of PVAT) in that first year and may be subject to SLFI rules in subsequent years. Similarly, a newly incorporated corporation or a new trust with PEs in participating and non-participating provinces would not be an SLFI in its first taxation year, though it could be in the following year. These results are disruptive for an LFI as it may have to apply general rules in one year before switching to the special SLFI rules in subsequent years.

To address these issues, it is proposed that the SLFI test be amended to provide that a person would be an SLFI throughout a reporting period of the person if the person meets both the LFI test and the PE test (discussed below in section 2.a.iii) at any time in the particular fiscal year that includes that reporting period. Generally, the provincial income allocation test would no longer be used to determine if a person is an SLFI.

The proposed amendments would apply in respect of any reporting period of a person that ends after June 2010.

ii. Multi-jurisdiction FIs in participating provinces only

Under the current rules, LFIs operating only in participating provinces are not subject to SLFI rules. However, modifications to the HST framework effective July 1, 2010 will allow a participating province to have a tax rate that is different from those of the other participating provinces. Differences in tax rates create an incentive for an LFI operating only in participating provinces to acquire inputs in the participating province with the lowest PVAT rate, as the existing SLFI rules would not apply to the LFI. Therefore, there is now a need to apply SLFI rules to include an LFI that operates only in two or more participating provinces.

Specifically, it is proposed that the SLFI Regulations be amended to also treat an LFI, other than an LFI described in subparagraph 149(1)(*a*)(xi)[13] of the ETA, as an SLFI throughout a reporting period of the LFI if, at any time in the fiscal year that includes the reporting period, it has PEs in two or more participating provinces.

Under the current rules, an LFI is treated as an SLFI throughout a reporting period in a fiscal year that ends in a taxation year of the LFI if the LFI is a "specified partnership" during the taxation year and the preceding taxation year. Generally, a partnership is a specified partnership during a taxation year under subsection 225.2(8) of the ETAif, at any time in the taxation year, it has at least one member that has taxable income (or income in the case of a member that is an individual, estate or trust) in that year earned in any of the participating provinces from a business carried on through the partnership, and has at least one member (whether or not the same member) that has taxable income (or income) in that year earned in any of the non-participating provinces from such a business. An amendment is proposed to extend the definition of "specified partnership" so that a partnership would be a specified partnership during a taxation year if, at any time in the taxation year, it has at least one member that has a PE, at which the member carried on a business through the partnership, in a participating province, and has at least one member (whether or not the same member) that has a PE, at which the member carried on a business through the partnership, in another province.

The proposed amendments would apply in respect of any reporting period of an FI that ends after June 2010.

Example 1: An insurer has PEs only in New Brunswick, Newfoundland and Labrador and Nova Scotia. Under the proposed changes to the SLFI Regulations, the insurer would be an SLFI.

iii. PE test

As explained above, under the current rules, the SLFI test depends on an LFI meeting the provincial income allocation test and, hence, on having a PE in any of the participating provinces and a PE in any of the non-participating provinces. The current term "PE", as provided in the SLFI Regulations, relies on the meaning of the term "PE" in subsection 400(2) of the IT Regulations and generally means a fixed place of business of the LFI, including an office or a branch, or an established place of an employee or agent of the LFI that has general authority to contract for the LFI.

The PE test is proposed to be amended, as described below, for each specific type of SLFI: banks, insurance corporations, trust and loan corporations, investment plans and segregated funds, and other corporations, individuals and trusts.

For purposes of the proposed PE test discussed below, an individual would be considered to reside in the province where the individual's mailing address is situated and a person other than an individual would be considered to reside in the province where its principal business is located.

A. Banks

Under the current rules, a bank will be treated as an SLFI only if it is required to allocate taxable income under provincial income allocation rules prescribed in section 404 of the IT Regulations both to any of the participating provinces and to any of the non-participating provinces. Section 404 requires a bank to allocate taxable income to a province only if it has a PE in the province (generally, a fixed place of business).

The current fixed place of business requirement in the SLFI test for banks generates inappropriate tax results where a bank has customers across Canada, but is not an SLFI under the existing rules because it does not have fixed places of business both in any of the participating provinces and in any of the non-participating provinces. This case could arise, for example, where a bank has a fixed place of business in only one province but provides loan and deposit-related financial services to customers in all provinces using internet and telephone banking portals. In such a case, the appropriate GST/HST result is that the bank be subject to SLFI rules and be required to calculate PVAT in respect of each participating province where its customers reside.

Under the proposed amendments discussed above, the provincial income allocation test would no longer apply to determine if a bank is an SLFI and a bank would instead be treated as an SLFI throughout a reporting period in a fiscal year of the bank if, at any time in that fiscal year, it has a PE in a participating province and a PE in any other province. In addition, it is proposed that, for the purposes of the SLFI rules, a bank would, in addition to any PE it would have under subsection 400(2) of the IT Regulations, be deemed to have a PE in each province where

- land, that acts as security for loans issued by the bank, is situated; or
- a recipient of a loan (other than a loan secured by land) issued by the bank, or an account holder of a deposit account or similar account of the bank, resides.

All loans and deposits of the bank that meet the above description would be deemed for the purposes of the SLFI rules to be loans and deposits of the deemed PE and not of any other PE of the bank.

Example 2: A bank which provides banking services through its internet website has a fixed place of business in Ontario only but has deposit holders who reside in Ontario, Quebec and New Brunswick. Under the proposed changes to the SLFI Regulations, the bank would be an SLFI.

The proposed amendments would apply in respect of any reporting period of a bank that ends after June 2010.

B. Insurance corporations

Under the current rules, an insurance corporation (i.e., an insurer, as defined in subsection 123(1) of the ETA, that is a corporation) is treated as an SLFI only if it is required to allocate taxable income under provincial income allocation rules prescribed in section 403 of the IT Regulations both to any of the participating provinces and to any of the non-participating provinces. Section 403 requires an insurance corporation to allocate taxable income to a province only if it has a PE in the province. In addition to having a PE in a province if it has a fixed place of business in the province, an insurance corporation is also deemed to have a PE in a province if it is licensed or registered to do business in the province.

Under the proposed amendments discussed above, the provincial income allocation test would no longer apply to determine if an insurance corporation is an SLFI and an insurance corporation would instead be treated as an SLFI throughout a reporting period in a fiscal year of the insurance corporation if, at any time in that fiscal year, it has a PE in a participating province and a PE in any other province.

The existing PE test works well for most insurance corporations. However, it may not work satisfactorily, for example, for insurance corporations that are reinsurers – i.e., an insurer that provides insurance coverage to a primary insurer which reduces the risk exposure of the primary insurer against large losses on risks it has already insured. Unlike primary insurers, reinsurers may provide insurance coverage in respect of property or personssituated in a participating province without having a fixed place of business or being registered or licensed to do business in that province. In such a case, the reinsurer would be providing insurance coverage in respect of property or personssituated in a particular participating province but would not be considered to have a PE in that province. This could result in the reinsurer not being an SLFI and/or having a nil attribution percentage for that province.

In order to ensure that insurance corporations, including reinsurers, pay the appropriate amount of PVAT for each participating province, it is proposed that an insurance corporation would, in addition to any PE it would have under subsection 400(2), be deemed to have a PE in a province if it provides insurance coverage of a risk in respect of property or personssituated in the province.

Example 3: A reinsurer that is a corporation based in Ontario is not licensed or registered to do business in Newfoundland and Labrador and does not have a fixed place of business in Newfoundland and Labrador. However, the reinsurer provides reinsurance coverage to other insurers of risks in respect of property situated in Newfoundland and Labrador. Under the proposed changes to the SLFI Regulations, the reinsurer would be deemed to have a PE in Newfoundland and Labrador and would be an SLFI.

The proposed amendments would apply in respect of any reporting period of an insurance corporation that ends after June 2010.

C. Trust and Loan Corporations

Under the current rules, a trust and loan corporation[14] is treated as an SLFI only if it is required to allocate taxable income both to any of the participating provinces and to any of the non-participating provinces under provincial income allocation rules prescribed in section 405 of the IT Regulations. Section 405 requires a trust and loan corporation to allocate taxable income to a province only if it has a PE in the province (generally, a fixed place of business of the corporation).

Under the proposed amendments discussed above, the provincial income allocation test would no longer apply to

determine if a trust and loan corporation is an SLFI and a trust and loan corporation would instead be treated as an SLFI throughout a reporting period in a fiscal year of the corporation if, at any time in that fiscal year, it has a PE in a participating province and a PE in any other province. It is proposed that, for the purposes of determining whether a trust and loan corporation is an SLFI, a trust and loan corporation in addition to any PE it would have under subsection 400(2), be deemed to have a PE in each province where

- land, that acts as security for loans issued by the corporation, is situated; or
- recipients, of loans (other than loans secured by land) issued by the corporation, reside.

All gross revenue arising from loans secured by land in the province and from loans (other than loans secured by land) made to persons residing in the province would be deemed to be gross revenue of the deemed PE and not of any other PE of the trust and loan corporation.

The proposed amendments would apply in respect of any reporting period of a trust and loan corporation that ends after June 2010.

D. Investment plans and segregated funds

Investment plans[15] and segregated funds of insurers[16] are LFIs under subparagraph 149(1)(*a*)(vi) or (ix) of the ETA. They are structured as (or are deemed to be) trusts or corporations and, as a result, the rules applicable to trusts and general corporations currently apply to determine if they are SLFIs.

Under the current rules, a corporation that is not a bank, an insurance corporation or a trust and loan corporation is an SLFI only if it is required to allocate taxable income under provincial income allocation rules prescribed in section 402 of the IT Regulations to both any of the participating provinces and to any of the non-participating provinces. Section 402 requires the corporation to allocate taxable income to a province only if it has a PE in the province. Similarly, an individual, estate or trust will currently be treated as an SLFI only if it is required to allocate income under provincial income allocation rules prescribed in section 2603 of the IT Regulations both to any of the participating provinces and to any of the non-participating provinces. Section 2603 requires the individual, estate or trust to allocate income to a province only if it has a PE in the province. For these corporations, individuals, estates and trusts, the term PE, as defined in subsection 400(2) (for corporations) or 2600(2) (for individuals, estates or trusts) of the IT Regulations, generally means a fixed place of business.

As a result, under the current rules, many investment plans and segregated funds would not be SLFIs, even where they have investors across Canada, because they would not have a PE (i.e., a fixed place of business) in more than one province.

Under the proposed amendments discussed above, the provincial income allocation test would no longer apply to determine if an investment plan or a segregated fund is an SLFI and an investment plan or a segregated fund would instead be treated as an SLFI throughout a reporting period in a fiscal year of the plan or fund if, at any time in that fiscal year, it has a PE in a participating province and a PE in any other province.

It is further proposed that, for the purposes of the SLFI rules, a segregated fund of an insurer would be deemed, in addition to any PE it would have under subsection 400(2), to have a PE in each province where contracts of the segregated fund could be sold.

It is also proposed that, for the purposes of the SLFI rules, an investment plan would be deemed, in addition to any PE it would have under subsection 400(2) or 2600(2), to have a PE in each province in which

- in the case of an investment plan that is a mutual fund trust (MFT) (including an MFT that is an exchange traded fund (ETF)), a mutual fund corporation (MFC), mortgage investment corporation (MIC), an investment corporation or a unit trust, it is qualified to sell or distribute units or shares of the investment plan under Canadian securities law;
- in the case of an investment plan that is a pension entity (i.e., a trust governed by a registered pension plan or a corporation that administers a registered pension plan), members of the registered pension plan reside;
- in the case of an investment plan that is a trust governed by a deferred profit sharing plan (DPSP), an employee profit sharing plan (EPSP) or a retirement compensation arrangement (RCA), members or beneficiaries of the DPSP, EPSP or RCA reside; and
- in the case of an investment plan that is a trust governed by an employee trust (ET), employee benefit plan (EBP), health and welfare trust (HWT) or registered supplementary unemployment benefit plan (RSUBP), members or beneficiaries of the plan reside.

The proposed amendments would apply in respect of any reporting period of an investment plan or segregated fund that ends after June 2010.

E. Other corporations, trusts and individuals

No changes are proposed to the definition of PE for these persons, other than for investment plans and segregated funds. As a result, the existing SLFI test for these persons, discussed in section 2.a.iii.D above, will not change except as a consequence of the proposed amendments discussed in sections 2.a.i and ii above.

iv. Investment plans and segregated funds – Removal of allocating income test

Under the current rules, an investment plan or segregated fund is treated as an SLFI only if it is a taxpayer under the

Income Tax Act and if it allocates income both to any of the participating provinces and to any other province.

It is proposed that the SLFI test be amended for investment plans and segregated funds to remove both these requirements. The effect of the proposed changes, after also taking into account proposed amendments discussed in sections 2.a.i and ii above, would be that an investment plan or a segregated fund would be an SLFI for its current taxation year if it has a PE in any of the participating provinces and a PE in any other province in that taxation year.

The proposed amendments would apply in respect of any reporting period of an investment plan or segregated fund that ends after June 2010.

> *Example 4: An MFT, which has a fixed place of business in British Columbia, is qualified under provincial securities laws to distribute units through independent mutual fund dealers in Alberta. In addition to the PE in British Columbia, the MFT would be deemed to have a PE in Alberta. Therefore, as the MFT has a PE in a participating province (effective July 1, 2010) and in another province, the MFT would be an SLFI for the fiscal year ending after June 2010.*

v. Investment plans and segregated funds – Small investment plans

In order to facilitate compliance for certain investment plans, it is proposed that a "small plans rule" be provided whereby a "small investment plan" would not be required to use the SLFI approach if a specific threshold is met. An investment plan would be a small investment plan for a particular fiscal year of the plan if it has unrecoverable GST ((A-B) in the SAM formula) of less than a threshold of $10,000 in its immediately preceding fiscal year.

An exception to the preceding fiscal year rule would apply to new investment plans. For the first fiscal year of an investment plan, its threshold would be determined under the rules similar to those applicable in determining whether a person becomes an SLFI during the fiscal year. Specifically, if the plan is a monthly filer, the threshold would be $10,000/12 in the first full month of the plan after it was established and for each month thereafter in the fiscal year; in the case of a quarterly filer or an annual filer with quarterly instalments, the threshold for each quarter would be $10,000/4 in the first full fiscal quarter of the plan after it was established and for each fiscal quarter thereafter in the fiscal year.

A small investment plan would not be an SLFI, and would be subject to the general self-assessment and rebate rules in respect of PVAT. However, if the plan satisfies the other requirements (i.e., the LFI and PE tests) of being an SLFI for a fiscal year of the plan, it would be permitted to make an election to be an SLFI for the fiscal year for the purposes of the ETA. Where an investment plan makes the election to be treated as an SLFI for one of its fiscal years, the election would remain in effect for all subsequent fiscal years of the investment plan until the investment plan revokes the election or fails to meet the LFI and PE tests. The election would have to have been in effect for a minimum of three years before the investment plan could revoke it.[17] Both the election to be treated as an SLFI and the revocation of the election would be required to be made in prescribed form containing prescribed information and to be filed in prescribed manner with the Minister before the beginning of the first fiscal year in which the election or revocation is to become effective.

The small plans rule would not apply to MFTs (including ETFs), MFCs and segregated funds.

The proposed amendments would apply in respect of any reporting period of an investment plan that ends after June 2010.

vi. Investment plans and segregated funds – Trusts governed by a registered retirement savings plan, a registered retirement income fund or a registered education savings plan

The rules proposed in this Backgrounder would not apply to treat as SLFIs investment plans of individuals that are trusts governed by a registered retirement savings plan, a registered retirement income fund or a registered education savings plan. These investment plans would be subject to the proposed general place of supply rules.[18]

b. Provincial attribution percentage – Element C of SAM formula

As discussed in section 1.b above, SLFIs are required to determine, for each of their reporting periods, their PVAT liability in respect of each participating province using the SAM formula. Element C of that formula (the provincial attribution percentage) is currently the percentage for the province determined in accordance with the rules that apply to the particular class of SLFI (e.g., banks, insurance corporations, trust and loan corporations) under the SLFI Regulations.

For the purposes of determining the PVAT liabilities of SLFIs, it is proposed to modify the rules for determining provincial attribution percentages for each specific type of SLFI in order to better reflect the consumption in each province of the financial services supplied by each of these SLFI types.

For purposes of the proposed provincial attribution percentage rules discussed below, an individual would be considered to reside in the province where the individual's mailing address is situated and a person other than an individual would be considered to reside in the province where its principal business is located.

i. Banks

Under the current rules, in the case of an SLFI that is a bank, its attribution percentage for a reporting period for a participating province in which the bank has a PE is one-third of the total of

(a) the percentage that the total of all salaries and wages paid in the reporting period by the bank to employees of its PEs in the participating province is of the total of all salaries and wages paid in the reporting period by the bank to employees of all of its PEs in Canada, and

(b)twice the percentage that the total amount of loans and deposits of its PEs in the participating province for the reporting period is of the total amount of all loans and deposits of all of its PEs in Canada for the particular period.

It is proposed that the salaries and wages component of the attribution percentage be amended to provide that salaries and wages, to the extent that they are in respect of zero-rated financial services, would be excluded from consideration in the determination of the attribution calculation.[19]

As well, for the purposes of the salaries and wages component of the attribution calculation for banks, a rule, similar to that contained in section 402.1 of the IT Regulations, which would apply in certain cases where an individual employed by one corporation provides services for the benefit of another corporation, is proposed to be added.

It is also proposed that the loans and deposits component of the attribution percentage for banks be amended to provide that the amount of loans and deposits would no longer be attributed in all cases to the province where the loan or account is booked but instead would be attributed to,

- in the case of loans secured by lands, the province where the land is situated;
- in the case of loans (other than loans secured by lands) and deposits, the province where the loan recipient or account holder resides; and
- in the case of loans (other than loans secured by lands) and deposits held by non-residents, if the debt arises in Canada, the PE in the province where the debt is booked.[20]

In addition, changes are proposed to the weighting of the salaries and wages and loans and deposits components to ensure that the provincial attribution percentage better reflects the consumption of a bank's exempt financial services in a province. It is proposed that a bank's attribution percentage for a participating province be weighted on the basis of one-fifth the salaries and wages component and four-fifths the loans and deposits component.

Taking all these proposed changes into account, a bank's attribution percentage for a reporting period for a participating province in which the bank has a PE would be one-fifth of the total of

(a) the percentage that the total of all salaries and wages paid in the reporting period by the bank to employees of its PEs in the province is of the total of all salaries and wages paid in the reporting period by the bank to employees of all of its PEs in Canada, and

(b) four times the percentage that the total amount of

- loans secured by land situated in the province;
- loans (other than loans secured by lands) and deposits of the loan recipients and deposit holders resident in the province; and
- loans (other than loans secured by lands) and deposits of the loan recipients and deposit holders who are non-residents (i.e., not resident in Canada) where the debt in respect of those loans and deposits is booked at a PE in the province;

for the reporting period is of the total amount of all loans and deposits of all of its PEs in Canada for that period.[21]

These proposed amendments would apply in respect of a fiscal year of a bank that begins after June 2010.

ii. Insurance corporations

Under the current rules,in the case of an SLFI that is an insurance corporation, its attribution percentage for a reporting period for a participating province in which it has a PE is the percentage that is

(a) the total of the insurance corporation's net premiums for the period in respect of insurance on property situated in that province and of its net premiums, in respect of its insurance other than on property, from contracts with residents in that province;

is of

(b) the total of the insurance corporation's net premiums for the period in respect of insurance on property situated in Canada and of its net premiums, in respect of its insurance other than on property, from contracts with residents in Canada.

Under the current rules, where an insurance corporation does not have a PE in a particular province, a secondary rule requires it to attribute any net premiums in respect of insured property situated in, or persons resident in, the particular province to another province in which the insurer has a PE and to which the premiums are reasonably attributable. However, changes to the definition of PE for insurance corporations (see section 2.a.iii.B above) would make this secondary rule unnecessary since an insurance corporation would, for purposes of determining its provincial attribution percentage for the SAM formula, always attribute net premiums to the province in which the insured property is situated, or in which the insured person resides.

In addition, it is proposed that certain insurance premiums in respect of zero-rated financial services be excluded from

the determination of the attribution percentage for insurance corporations (e.g., in the case of a group life, accident and sickness insurance policy, if it relates to non-resident individuals). Similarly, where the insurance policy is a policy that relates to risks that are ordinarily situated outside Canada, the related premiums would be excluded from the SAM formula.

The proposed amendments would apply in respect of a fiscal year of an insurance corporation that begins after June 2010.

iii. Trust and Loan Corporations

Under the current rules,in the case of an SLFI that is a trust and loan corporation, its attribution percentage for a reporting period for a participating province in which it has a PE is the percentage that is

(a) the corporation's gross revenue for the reporting period of all of its PEs in the participating province;

is of

(b) the total of the corporation's gross revenue for the reporting period of its PEs in Canada.

A trust and loan corporation's gross revenue of all of its PEs in a participating province means the total of the gross revenue of the corporation for the reporting period arising from

- loans secured by land situated in the participating province;
- loans, other than loans secured by land, made to persons residing in the participating province;
- loans
    - to persons residing in a province or country other than Canada in which the corporation has no PE, and
    - administered by a PE in the participating province,
    except loans secured by land situated in a province or country other than Canada in which the corporation has a PE; and
- business conducted at its PEs in the participating province other than business that gives rise to revenue in respect of loans.

Under the current rules, where a trust and loan corporation does not have a PE in a particular province, a secondary rule provides that the corporation's attribution percentage for that province is nil and any gross revenue arising from loans secured by land in the particular province, loans (other than loans secured by land) made to persons residing in the particular province, and business conducted in the particular province are instead attributed to another province in which the corporation has a PE. However, changes to the definition of PE for trust and loan corporations discussed in section 2.a.iii.C above would make this secondary rule unnecessary, since gross revenue arising from loans secured by land in a particular province andloans (other than loans secured by land) made to persons residing in the particular province would now always be attributed to the particular province.

The proposed amendments would apply in respect of a fiscal year of a trust and loan corporation that begins after June 2010.

iv. Investment plans and segregated funds

Under the current rules,in the case of an SLFI that is an investment plan or segregated fund, its attribution percentage for a reporting period for a participating province in which it has a PE is generally one-half of the total of:

(a) the percentage that the total gross revenue of the SLFI that is reasonably attributable to its PEs in the participating province for the reporting period is of the total gross revenue of the SLFI that is reasonably attributable to its PEs in Canada for the reporting period, and

(b) the percentage that the total of all salaries and wages paid in the reporting period by the SLFI to employees of its PEs in the participating province is of the total of all salaries and wages paid in the reporting period by the SLFI to employees of its PEs in Canada.

This attribution percentage generally reflects the province of performance of the plan's or fund's services, rather than the province of residence of the final consumers of the plan's or fund's services.

It is proposed that the attribution percentage rules for investment plans and segregated funds be amended to provide that they be based on the value of investments (and, where applicable, the value of entitlements) of their investors, members or beneficiaries in a province, who are final consumers of the plans' and funds' services.

Rules will be discussed first in the context of their application to MFTs. However, these rules generally apply to segregated funds and other investment plans such as an MFC, a pension entity, an MIC, or a trust governed by a DPSP, an EPSP, an RCA, an ET, an EBP, an HWT or an RSUBP. Section 2.b.iv.B below discusses in what circumstances special rules, which deviate from the general rules discussed in section 2.b.iv.A immediately below, apply to segregated funds and other investment plans.

A. Attribution percentage

As discussed below, it is proposed that the attribution percentage rules for MFTs be amended to provide that they be based on the value of investments of an MFT's unit holders in a participating province. Therefore, an MFT would need

to know the location of its unit holders and the value of their investments in a particular participating province.[22]

1. Calculation of attribution percentage at series level

It is proposed that an MFT with more than one series of units be required to calculate its attribution percentage for each series.[23] Therefore, the SAM formula would be applied to each series of units if there are two or more series of units in the fund.

Where a fund manager has created a provincial fund or series of units, where none of the units in the series or fund are qualified for sale outside a particular province, the SAM formula would not be applied to the provincial fund or series of units and the general self-assessment and rebate rules would apply instead.

The proposed amendments would apply in respect of a fiscal year of an MFT that ends after June 2010.

2. Attribution calculation method

It is proposed that the attribution percentage for a participating province that is to be calculated for each series of units in an MFT be expressed as a percentage that is

J / K

where

- J is the value of units of a series held by unit holders located in a participating province; and
- K is the value of units of a series held by unit holders located in Canada.[24]

Where an MFT does not have a PE (actual or deemed) in a province in a reporting period of the MFT, the attribution percentage of the MFT for the province would be nil.

The proposed amendments would apply in respect of a fiscal year of an MFT that ends after June 2010.

3. Look-through rules for institutional investors

For the calculation of the attribution percentage for a participating province, an MFT would be required to obtain individual unit holder information. However, the investors in an MFT could be institutional investors (i.e., investors other than retail investors that are individuals).[25] As the value of units held by an institutional investor is for the benefit of individuals that are its unit holders, contract holders, members, shareholders and beneficiaries in the case of segregated funds or other investment plans, the MFT would need to 'look-through' the institutional investor to determine the location and value of investments held by these individuals.

An institutional investor would, subject to the specified investor rules discussed in section 2.b.iv.A.7.A, be required to provide to the MFT its attribution percentages for each participating province that would apply in respect of its investments in the MFT. In determining these attribution percentages, the institutional investor may be required to look through other institutional investors.

For example, in a situation where MFT 3 invests in MFT 2 which invests in MFT 1, MFT 3 would be required to transfer its attribution percentage regarding its investors, in relation to its investment in MFT 2, to MFT 2. In relation to its investment in MFT 1, MFT 2 would then be required to transfer its attribution percentage, which would in part reflect the attribution percentage information obtained from MFT 3, regarding its own investors to MFT 1. This type of information transfer would apply in respect of all levels in a multi-tiered investment situation.

The information requirements of institutional investors[26] are summarized in the following table:

Type of institutional investor	Information required to be provided by institutional investor to MFT[27] within three months of MFT's attribution date (i.e., September 30 – see section 2.b.iv.A.4 below)
1. SLFIs	
a. Investment plans that are MFTs, MFCs, unit trusts, segregated funds	Attribution percentage determined on September 30 (MFT's attribution date)
b. Investment plans other than MFTs, MFCs, unit trusts, or segregated funds	Most recent attribution percentage determined for SLFI purposes prior to the MFT's attribution date
c. Banks, partnerships, corporations and trusts that are neither investment plans nor "specified investors" (value of investment in MFT is $10 million or more)	Most recent attribution percentage determined for SLFI purposes prior to the MFT's attribution date

2. Non-SLFIs	
a. Banks, partnerships, corporations and trusts that are not "specified investors" (value of investment in MFT is $10 million or more)	Most recent attribution percentage determined for income tax purposes prior to the MFT's attribution date
b. Specified investors (either (a) investor is not an investment plan or segregated fund and value of its investment in MFT is less than $10 million; or (b) investor is a small investment plan that has not elected to be an SLFI)	Where the entity is a trust, the trustee's business address Where the entity is a corporation, the principal business address of the corporation Where the entity is a partnership, the principal business address of the partnership, or, where it does not have a principal business address, the principal business address of its general partner

As discussed in section 2.c below, all SLFI investment plans and segregated funds would be required to use the calendar year as their fiscal year for SLFI purposes. This would facilitate the exchange of information between plans and segregated funds that are SLFIs and that have invested in each other's funds that would be necessary to determine their attribution percentages and file their GST/HST returns by the filing due-date (i.e., within six months following the fiscal year-end).

If the trustee or fund manager is not able to obtain investor information in respect of all or substantially all (i.e., 90% or more) of the value of units in a series of units or in a fund in order to allocate all of the value of units in Canada to each province in Canada, the value of units in Canada for which information is not available would be required to be reported as 'unallocated'. These units would, in determining the PVAT liability under the SAM formula, be subject to the highest provincial tax rate among all participating provinces on January 1 of the fiscal year for which the fund is reporting.

The proposed amendments would apply in respect of a fiscal year of an MFT that ends after June 2010.

4. Attribution date – Point in time calculation

It is proposed that MFTs be required to calculate the attribution percentage for a particular participating province at least once (i.e., at a point in time) in each fiscal year in respect of each series of the fund.[28] This single point in time calculation will be referred to as the "attribution date" of the MFT. To ensure sufficient time for the information exchange to take place before the end of the fiscal period, it is proposed that the attribution date be September 30 of each fiscal year.[29]

While the attribution date would be set by regulation as September 30, this would not prevent an MFT from using an annual average when determining its attribution percentage. It would be allowed to calculate the attribution percentage as an average of quarterly, monthly, weekly or daily percentages with September 30 as the end date for averaging for a 12-month period.[30]

The proposed amendments would apply in respect of a fiscal year of an MFT that ends after June 2010.

5. Attribution calculation method – First year of new fund or series

Where a new MFT or a new series of units of an MFT is created (through a merger or otherwise), for the fiscal year (i.e., calendar year) of the MFT in which the fund or series of units was created, it is proposed that the attribution date for the calculation of the attribution percentage (discussed in section 2.b.iv.A.2) for that fund or series of units be the day that is 90 days after the initial distribution of the new series or the new fund as the case may be.[31]

It is proposed that, where two or more predecessor funds or series of units of a fund merge to create a new fund or series of units, the attribution percentage (i.e., element C of the SAM formula) for a province for the new fund or series in the fiscal year in which the merger occurred would be the percentage obtained by adding the percentages, each of which is determined for a predecessor fund or series of units that merged to create the new fund or series of units by multiplying A by B, where

A = the attribution percentage used immediately before the merger by the predecessor fund or series of units for the province; and

B = the predecessor fund's or series' proportion of the total value of units in the new fund or series immediately after the merger.

For other new funds or series of units of an MFT, one of the following two methods could be used to determine the attribution percentage for the fiscal year of the MFT in which the fund or series of units of the fund was created:

- Where the MFT makes an election for the first year of the fund or series, the MFT would use a modified real time

method similar to that provided under the ongoing rules (see section 2.b.iv.6.c below). However, the requirement in the ongoing real time method election that all or substantially all of the value of units in the series or the fund be held by retail investors would not apply. As well, unlike the ongoing real time method, the units held by institutional investors would not be ignored in the determination of the MFT's provincial attribution percentage and the MFT would be required to account for units held by institutional investors in determining this percentage. In the case of an institutional investor, the location of the institutional investor would be the location of the institution unless the MFT opts to look through for all or substantially all of the institutional investors. (The rules discussed in the ongoing real time method would apply in respect of units held by retail investors.)

The election to use the modified real time method would be required to be made in prescribed form containing prescribed information and maintained in the MFT's books and records;

- Where the MFT has not made the election to use the modified real time method for the first year of the fund or series, the MFT would use a gross-up method. Under this method, the attribution percentage for a new fund or a series of units in the period that is 90 days after the initial distribution (including the initial distribution date) would be nil. However, the attribution percentage calculated on the attribution date (which would be the day that is 90 days after the initial distribution date) of the units would be grossed up to account for the PVAT attributable to unit holders in participating provinces during the initial 90-day period. Therefore, the gross-up factor that applies to the attribution percentage for the MFT in respect of the new fund or series during its first fiscal year (i.e., including the day of distribution) would be the number of days in the fiscal year after the initial distribution of the units in the new fund or new series divided by the number of days that are 90 days after the initial distribution in the fiscal year.

  If the MFT's initial distribution date and the initial attribution date do not fall within the same fiscal year, the attribution percentage determined on the attribution date would apply to the fiscal year that includes the initial distribution date and to the fiscal year following the initial distribution date. In this case, both the numerator and the denominator of the gross-up factor would include the number of days in the fiscal year following the initial attribution date. As a result, the September 30 attribution date will not apply in the fiscal year of the MFT in which the fund or series of units of the fund was created.

  For determining the attribution percentage for new series or new funds for the first fiscal year under the gross-up method, look-through rules (discussed in section 2.b.iv.A.3 above) would not apply. It is also proposed that the 'all or substantially all' threshold would be lowered to 80% (i.e., if the location of individual investors holding 80% or more of the value of the units is identified, the attribution percentage for that 80% or more of the units would be used to determine the attribution percentage of 100% of the value of the units).

The proposed amendments would apply in respect of a fiscal year of an MFT that ends after June 2010.

Example 5: A new series is created on January 1, 2012. The MFT opts to use the gross-up method. Under this method, the attribution date for the new series for the 2012 fiscal year would be March 31, 2012. The attribution percentage for New Brunswick is determined on March 31, 2012 to be 5%. That attribution percentage will be grossed up based on the factor of the number of days from January 1, 2012 to December 31, 2012 divided by the number of days that are 90 days after the initial distribution (i.e., March 31, 2012) until December 31, 2012 (i.e., 366/276), to 6.63% (i.e., 5% x 366/276). For the period from March 31, 2012 to December 31, 2012, that grossed-up attribution percentage calculated on March 31, 2012 (6.63%) will be applied to the series to calculate instalments for its PVAT liability under the SAM formula.

6. Application of attribution percentage

An MFT would be allowed to use one of three methods for determining its attribution percentage for its fiscal year.

Where, for the purposes of satisfying the requirements of certain elections described below, an MFT is required to have information on the location of investors holding all or substantially all of the units of a series of units of a fund, an MFT would satisfy this requirement where it obtains the location of individuals (ultimate investors) holding 90% or more of the value of the units of a fund series using look-through rules.

For all three methods, if the MFT obtains the location of individuals (ultimate investors) for 90% or more of the value of the units of a fund series, then the provincial distribution of the value of those units would be considered as the representation of the provincial distribution of 100% of the value of units in that series.

Example 6: The distribution of the value of investments held by investors in series A of mutual fund ABC is as follows: 60% retail investors (i.e., individuals), 20% segregated funds, 10% pension plans, 5% corporations, and 5% other mutual funds. Prior to December 31, 2012, mutual fund ABC obtained investor information relating to retail investors and individual beneficiaries of segregated funds and pension plans. It did not look through the corporations and other mutual funds. Since mutual fund ABC has met the 'all or substantially all' test, it can use investor information of the retail investors, segregated funds, and pension plans for calculating the attribution percentage for each participating province for the 2013 fiscal year.

a. General rule (with reconciliation)

Under the proposed general rule, MFTs would be allowed to use the attribution percentage calculated with preceding year values to estimate instalments for the current fiscal year with a reconciliation on the final SLFI return based on

the attribution percentage calculated using current year values and the current year's unrecoverable GST. The estimated attribution percentage for a participating province determined using preceding year values would be used to determine instalments for annual filers in the current year (unless the MFT estimates the instalments for the current year to be less than the preceding year). However, the actual PVAT liability for the current year would be determined based on the attribution percentage for the participating province determined using current year values.[32] The final SLFI return(s) based on current year values would need to be filed within six months after the fiscal year-end. This would allow sufficient time to obtain information for the current fiscal year.

Where the MFT has the information on the location of investors holding all or substantially all of the value of units (after look-through) for a particular series on a quarterly, monthly, weekly or daily basis, under the general rule, an MFT would be permitted to make an election to use quarterly, monthly, weekly or daily values, with September 30 of the year as the last point in time, to create an average to determine its attribution percentage for that year. Where an MFT makes this election for one of its fiscal years, the election would remain in effect for all subsequent fiscal years of the MFT until either the MFT revokes the election or elects to use either the preceding year method or the real time method. The election would have to have been in effect for a minimum of three years before the investment plan could revoke it.[33] The election would be required to be made in prescribed form containing prescribed information. The election would be required to be maintained in the books and records of the MFT and would not be required to be filed with the Minister.

> *Example 7: An MFT that is an annual filer using quarterly averaging would determine its attribution percentage for the instalment base calculation for 2015 (calendar year) using the average of the value of the units in a particular series on December 31, 2013; March 31, 2014; June 30, 2014; and September 30, 2014. The MFT would use this average to calculate its provincial attribution percentage to calculate its PVAT instalments for the particular participating province.*
>
> *For the reconciliation for 2015, the MFT would determine its attribution percentage using the average of value of investments on December 31, 2014; March 31, 2015; June 30, 2015 and September 30, 2015. The reconciliation between amounts paid by instalments and the final PVAT liability would be made on the MFT's SLFI return due on June 30, 2016.*

The proposed amendments would apply in respect of a fiscal year of an MFT that ends after June 2010.

b. Preceding year method (without reconciliation)

It is proposed that MFTs be allowed to elect to calculate an attribution percentage for a particular series of the fund for a particular fiscal year based on the value of units in that series held by investors in a participating province at September 30 of the year immediately preceding the particular fiscal year (i.e., single point in time).[34]

Where the MFT has information by using the look-through rules if necessary, on the location of its individual unit holders representing all or substantially all of the value of units for a particular series, the MFT could make a second election to use averaging based on quarterly, monthly, weekly or daily points in time with the last point in time being the attribution date of September 30 of the preceding year. The average attribution percentage calculated for the 12-month period ending on September 30 of the preceding year will be used to calculate the MFT's PVAT liability for the particular series for the current fiscal year.

Both the election to apply the preceding year method and the election to use averaging would be required to be made before the beginning of the first fiscal year to which the particular election applies. Once an MFT has made the election to apply this preceding year method for a particular fiscal year of the MFT, the MFT would be required to continue to use the preceding year method for at least three consecutive fiscal years before it could revoke the election. Similarly, once an MFT has made the election to use averaging for a particular fiscal year of the MFT, the MFT would be required to continue to use averaging for at least three consecutive fiscal years before it could revoke the election,[35] unless, before that time, the preceding year election ceases to be in force. A revocation of either election would be required to be made before the beginning of the first fiscal year of the MFT to which the revocation applies. Both the elections and the revocations would be required to be made in prescribed form containing prescribed information. Neither election would be required to filed by the MFT with the Minister of National Revenue.[36] Both elections would be required to be kept in the MFT's books and records.

If the MFT uses a single point in time to determine the attribution percentage for a particular series of units and more than 10% of the total value of the units in the series are held by institutional investors, the series would be subject to specific anti-avoidance rules which would apply to disregard transactions intended to modify the attribution percentage for a participating province.

Unlike the general rule, under this preceding year election an MFT would not be required to reconcile its PVAT liability at the end of the fiscal year.

> *Example 8: An MFT that is an annual filer would be required to calculate its attribution percentage for the 2012 fiscal year based on the value of units for a particular series held in a participating province on September 30, 2011, unless the MFT elects to use more points in time. The MFT will be required to use this attribution percentage to determine instalments for the calendar year January 1, 2012 to December 31, 2012. The amounts charged during the 2012 fiscal year will remain its PVAT liability for the fiscal year, when it files the final SLFI return due on June 30, 2013.*

Example 9: An MFT is an SLFI for its 2011 fiscal year and has an attribution date of September 30, 2010.

Series A of the MFT has 10,000 units with a value on September 30, 2011 of $10 per unit or $100,000 in total value of units. On September 30, 2011, these 10,000 units are held as follows:

- *1,000 by a segregated fund with an Ontario attribution percentage of 10% on September 30, 2011 and no attribution percentage for other participating provinces.*
- *1,000 by a pension entity with an Ontario attribution percentage of 10% on September 30, 2011 and no attribution percentage for other participating provinces.*
- *8,000 by retail/individual investors in non participating provinces.*

The MFT is required to determine its Ontario attribution percentage for series A on September 30, 2011 (attribution date) to determine its liability for the Ontario PVAT for the relevant reporting period.

The MFT would include the information received from the pension entity and segregated fund in calculating its attribution percentage for series A for Ontario under the SLFI formula on the attribution date of September 30, 2011. The attribution percentage for Ontario for series A, would be determined as follows

J / K

$2000/$100,000

where

- *J is the sum of*
    - *the value on units held by Ontario investors in the segregated fund based on the segregated funds attribution percentage for Ontario (10% X 1000 units X $10/unit = $1000 net asset value) at September 30, 2011;*
    - *the value of units held by Ontario investors in the pension entity based on the pension entity's attribution percentage for Ontario (i.e., 10% X 1000 units X $10/unit = $1000 net asset value) at September 30, 2011; and*
    - *the value of units held by Ontario retail/individual investors (i.e., 0% X 8000 units X $10/unit = $0 net asset value) at September 30, 2011.*
- *K is the value of units of series A distributed in Canada as of December 31, 2010 which is $100,000.*

The attribution percentage (i.e., element C of the SLFI formula) for series A would be 2% for Ontario. The MFT would use this attribution percentage to determine its liability for the Ontario PVAT for series A.

The proposed amendments would apply in respect of a fiscal year of an MFT that ends after June 2010.

c. Real time method

This method could be used where all or substantially all of the value of units in a series are held by retail investors (i.e., individuals) and the MFT elects to apply this rule for a fiscal year of the MFT for the series. No look-through rules would apply under the real time method and the provincial distribution of the retail investors would be applied to determine the attribution percentage of 100% of the value of the units.

An MFT could elect to determine its attribution percentage for a participating province based on the location of unit holders determined either on a daily basis or on the first day of each month. Where the attribution percentage is determined on the first day of each month, it would be applied for the whole month.

Example 10: All the investors in series A of mutual fund XYZ are retail investors (i.e., individuals). The location of investors is tracked daily, and therefore, could be used to determine the attribution percentage for each participating province daily on a real time basis. Mutual fund XYZ could therefore elect to use the real time rule.

The MFT would be required to make this election, which would be required to be made in prescribed form containing prescribed information and maintained in the MFT's books and records, before the beginning of the fiscal year to which the election applies. The election would be valid only if, on the first day of the fiscal year, all or substantially of the value of units in the series in respect of which the election is made were held by retail investors. If the election is made and then on a particular day in the fiscal year the proportion of units in the series that are held by retail investors falls below the 'all or substantially all' threshold (i.e., 90%), the MFT would be required to apply, for the remainder of the fiscal year, an attribution percentage obtained by averaging its daily or monthly attribution percentages from the first day of the fiscal year until the day before the particular day.

The proposed amendments would apply in respect of a fiscal year of an MFT that ends after June 2010.

7. Information requirements

Specific information requirements are proposed to facilitate compliance and information flows between investors and investment entities/fund managers as well as between investment entities/fund managers and intermediaries such as agents, brokers, and dealers involved in selling and distributing fund units.

a. Requirement to provide information

Upon request, an investor in an MFT (other than retail investors) would be obligated to provide information in respect

of the investor's attribution percentage for each participating province for each series in which it has an investment. The investor would also be required to provide the total value of its investment held in each series.

The investors in the MFT from whom information would be requested may include other investment plans or corporations, partnerships or trusts. See section 2.b.iv.B below for the different provincial attribution percentage rules for other investment plans such as a pension plan.

It is proposed that a "specified investor", unlike other institutional investors, would not be required to provide its attribution percentage for each participating province for its preceding fiscal year to an MFT of a mutual fund that it invests in. A specified investor in respect of a mutual fund would be an institutional investor that is not an investment plan or a segregated fund (e.g., a corporation, partnership, or family trust) where the value of the institutional investor's investment in the mutual fund does not exceed $10 million on the attribution date of the MFT. A specified investor could also be a small investment plan[37] where no election is in effect for the fiscal year to treat the small investment plan as an SLFI. A specified investor would only be required to provide its principal business address (if it is a corporation or partnership), its general partner's principal business address (if it is a partnership and it does not have a principal business address) or its trustee's business address (if it is a trust). The MFT would then determine its attribution percentage on the basis that the value of the specified investor's investment in the mutual fund on the attribution date is solely attributable to the province in which the address is located.

A penalty would be applicable where the required information is not provided.

Special rules are proposed to assist MFTs with obtaining the required unit holder information from distribution agents (i.e., brokers, dealers, salespersons or other intermediaries) where, for example, accounts are registered in the distribution agent's name or where the distribution agent is the party in the distribution network that has access to the unit holder information.

Specifically, it is proposed that a distribution agent that distributes the MFT's units be required, upon request of the MFT, to provide information on the number and value of units of each particular series of the MFT held by the clients of the distribution agent in each participating and non-participating province at the attribution date (September 30 of the preceding taxation year), as specified in the request from the MFT.

The distribution agent would be required to provide the information requested to the MFT as at the September 30 attribution date or more frequently as agreed between the dealer and the MFT. Where the attribution date is September 30, the distribution agent would generally be required to provide this information by December 31 of the same year to the MFT so that the MFT would be able to determine the provincial attribution percentage to be used commencing January 1 in the following year.

The proposed amendments would apply in respect of any reporting period of a person that ends after June 2010.

b. Failure to provide information – penalties

It is proposed that a penalty be imposed, subject to a due diligence test, on a broker, agent or any intermediary that sells or distributes fund units in the series if the broker, agent or intermediary fails to provide information described in the preceding section when requested.

The proposed amendments would apply in respect of any reporting period of a person that ends after June 2010.

Example 11: An MFT located in Alberta distributes its units through a network of independent dealers registered under provincial securities laws. The MFT has made an election to use only the September 30 attribution date. It intends to calculate its attribution percentage for each series for the taxation year January 1, 2012 to December 31, 2012. The MFT has sent a request to the dealers that distributed the units to provide information on the number and value of units held per series in each province on September 30, 2011 to be forwarded to the MFT by November 30, 2011. If a dealer does not provide the information by December 31, 2011, a penalty provision would apply.

8. MFTs that are ETFs

The proposed rules set out above for MFTs will apply for ETFs with certain adjustments to take into account the fact that these funds are exchange traded rather than distributed by the MFT.

As with other MFTs, where an ETF elects to use the attribution date of September 30 to determine the attribution percentages for the participating provinces (i.e., element C of the SAM formula), it will be required to estimate the value of its units held in a participating province as a proportion of the value of all of its units held in Canada. However, due to the fact that these funds are traded on exchanges, there is limited investor information available. For example, where an MFT invests in another MTF that is an ETF, the ETF would not have information on the identity of the MFT. As a result, it is not proposed that ETFs be required to look through its institutional investors.

It is proposed that an ETF be required to use at least two points in time in its immediately preceding fiscal year, one of which must be September 30, to determine its provincial attribution percentage for its current fiscal year (i.e., calendar year). The ETF would use the average of the provincial attribution percentages determined at these multiple points in time to determine its current fiscal year provincial attribution percentage. Where two points in time are used, the other date would have to be at least three months before or after September 30 (e.g., April 30, June 30, or December 31). Where more than two points in time are used, the dates would have to be equidistant from one another (for example, the ETF could determine its provincial attribution percentage on a daily, monthly or quarterly basis).

Where the 'all or substantially all' test for determining the value of investments held in provinces cannot be met, an ETF would be allowed to seek pre-approval for the calculation of the attribution percentage of a participating province from the CRA.

The proposed amendments would apply in respect of a fiscal year of an ETF that ends after June 2010.

B. Attribution percentage — Segregated funds and other investment plans

Other SLFI investment plans and segregated funds would determine their provincial attribution percentages for participating provinces (element C) using the same general rules discussed above, with the exceptions listed below. These rules are proposed to apply in respect of any reporting period of an investment plan or segregated fund that ends after June 2010.

1. Pension entities[38]

The attribution percentage for a pension entity of a pension plan (i.e., a trust governed by a registered pension plan or a corporation that administers a registered pension plan) would depend on whether the registered pension plan is a defined contribution (also known as money purchase) plan or a defined benefit plan as specified below.

It is proposed that, in the case of a defined contribution pension plan,[39] the provincial attribution percentage of the pension entity for a participating province for a fiscal year of the pension entity would be the percentage that is determined by the formula:

J / K

where

- J is the value of assets held by the pension entity that is reasonably attributable to plan members resident in the participating province; and
- K is the value of assets held by the pension entity that is reasonably attributable to plan members resident in Canada.

The attribution date for pension entities of a defined contribution pension plan would be September 30 of the immediately preceding fiscal year of the pension entity.

It is proposed that, in the case of a defined benefit pension plan, the provincial attribution percentage of the pension entity for a participating province for a fiscal year of the pension entity would be the percentage that is determined by the formula:

J / K

where

- J is the total liabilities of the pension entity (i.e., based on actuarial information) that are reasonably attributable to plan members resident in the participating province; and
- K is the total liabilities of the pension entity (i.e., based on actuarial information) that are reasonably attributable to plan members resident in Canada.

The attribution date for pension entities of a defined benefit pension plan would be September 30 of the immediately preceding fiscal year of the pension entity. However, provincial distribution data used to determine the provincial attribution percentage could be the information from the most recent year for which actuarial calculations of liabilities have been completed for the plan before the attribution date.

The proposed amendments would apply in respect of a fiscal year of a pension entity that ends after June 2010.

2. Mortgage investment corporations

The rules proposed for calculating an MIC's attribution percentage will be similar to those proposed for MFCs. Specifically, the attribution percentage will be the percentage that the total value of shares of an MIC attributable to shareholders in a province is of the total value of shares that is attributable to shareholders in Canada.

MICs would be permitted to use the general rule and the preceding year method, but not the real time method. It is proposed that the attribution date for MICs would be September 30 of the immediately preceding year.

The proposed amendments would apply in respect of a fiscal year of an MIC that ends after June 2010.

3. Deferred profit sharing plans, employee profit sharing plans and retirement compensation arrangements

Generally, the benefits available to members or beneficiaries of a trust governed by a DPSP, an EPSP or an RCA are based on the assets in these plans. Therefore, it is proposed that the attribution percentage for these trusts will be the percentage that the total assets that are reasonably attributable to members or beneficiaries in a province is of the total assets of the plan that are either directly or indirectly attributable to members or beneficiaries in Canada.

A trust governed by a DPSP, an EPSP or an RCA would be permitted to use the general rule and the preceding year method, but not the real time method. These trusts would not be required to use September 30 of the immediately

preceding year as their attribution date.

The proposed amendments would apply in respect of a fiscal year of a trust governed by a DPSP, EPSP or RCA that ends after June 2010.

4. Employee trusts, employee benefit plans, health and welfare trusts or registered supplementary unemployment benefit plans

A trust that is governed by an ET, an EBP, an HWT or an RSUBP is often structured to provide benefits to plan members or beneficiaries in participating and non-participating provinces. As the assets held in the plan do not always correlate to the benefits paid under these plans, an asset-based attribution percentage does not necessarily represent consumption in a participating province. Therefore, the proposed attribution percentage for a trust governed by an ET, EBP, HWT or a RSUBP would be the percentage that the total number of the plan members or beneficiaries located in a particular province is of the total number of the plan members or beneficiaries in Canada.

A trust governed by an ET, an EBP, an HWT or an RSUBP would be permitted to use the general rule and the preceding year method, but not the real time method. These trusts would not be required to use September 30 of the immediately preceding year as their attribution date.

The proposed amendments would apply in respect of a fiscal year of a trust governed by an ET, EBP, HWT or RSUBP plan that ends after June 2010.

C. Attribution calculation method - Transitional year

Generally, under the proposed SAM rules, MFTs would be GST/HST registrants having the calendar year as their fiscal year and would be filing SLFI returns annually. Since the proposed rules would be effective July 1, 2010, the six-month period commencing July 1, 2010 and ending December 31, 2010 would generally be the transitional period for MFTs.

Many MFTs may not possess information on individual unit holders (using look-through rules) on a province-by-province basis in the transition period and hence would not be able to correctly determine their provincial attribution percentage on July 1, 2010. A specific calculation method is proposed to facilitate compliance for the transitional year. This transitional year method would be in addition to the methods available under the ongoing rules (i.e., current year, preceding year or real time option discussed in section 2.b.iv.A.6). The MFT would be required to make an election in order to use the transitional year method. The election would be required to be made in prescribed form containing prescribed information and maintained in the MFT's books and records.

Under the transitional year method:

- No "look through" of institutional investors would be required if all or substantially all of the value of units of a series of units (i.e., 90% or more) are held by retail investors that are individuals. In that case, the provincial distribution of the value of units held by individuals could be applied to determine the provincial attribution percentage of 100% of the value of units in that series; and
- If more than 10% of the value of units of a series of units is held by institutional investors and the MFT is able to look through all or substantially all of the value of units in that series held by institutional investors, the MFT can apply the provincial distribution of the value of the units held by institutional investors in respect of which the MFT can look through to determine the provincial attribution percentage of 100% of the value of units in that series that are held by institutional investors. However, if more than 10% of the value of units of a fund series is held by institutional investors and the MFT is unable to look through all or substantially all of the value of units held by institutional investors, the fund would use the location of each institutional investor to determine the provincial attribution percentage of 100% of the units of the fund series held by institutional investors. The location of an institutional investor would be determined as follows: a corporation – principal business address; a trust - the residence of the trustee; a partnership – principal business address of the partnership, and, if that is not applicable, principal business address of its general partner. (The ongoing rules would apply in respect of units held by retail investors.)

It is proposed that the transitional year method be available for the July 1 to December 31, 2010 transition period. The attribution date for calculating the provincial attribution percentage could be a point in time prior to the Announcement Date but after July 1, 2009 (e.g., September 30, 2009 or December 31, 2009) or any point in time after the Announcement Date but before July 1, 2010 (e.g., May 31, 2010).

v. Other Corporations, Individuals and Trusts

Under the current rules,in the case of an SLFI that is a corporation, individual or trust and that is not a bank, insurer or trust and loan corporation, its attribution percentage for a reporting period for a participating province in which it has a PE is generally one-half of the total of:

(a) the percentage that the total gross revenue of the SLFI that is reasonably attributable to its PEs in the participating province for the reporting period is of the total gross revenue of the SLFI that is reasonably attributable to all of its PEs in Canada for the reporting period, and

(b) the percentage that the total of all salaries and wages paid in the reporting period by the SLFI to employees of its PEs in the participating province is of the total of all salaries and wages paid in the reporting period by the SLFI to employees of all of its PEs in Canada.

It is proposed that, for the purposes of the salaries and wages component of the attribution calculation for corporations only, a rule similar to that contained in section 402.1 of the IT Regulations, which would apply in certain cases where an individual employed by one corporation provides services for the benefit of another corporation, be added.

The modified attribution percentage would no longer apply to a corporation or trust that is an investment plan or segregated fund as such a corporation or trust would be governed by the provincial attribution percentage rules discussed in section 2.b.iv.

The proposed amendment would apply in respect of a fiscal year of a person that ends after June 2010, except that the proposed amendment providing a rule similar to that contained in section 402.1 would apply in respect of a fiscal year of a person that begins after June 2010.

c. Timing of PVAT determination under SAM for SLFI investment plans and segregated funds

An SLFI's PVAT liability for each participating province is determined for a reporting period of the SLFI. In order to facilitate the implementation of the proposed SLFI rules for investment plans and segregated funds effective July 1, 2010, it is proposed to provide that, for the purposes of determining the PVAT liability of an investment plan or a segregated fund under the SAM formula contained in subsection 225.2(2), the SLFI would not include any amount of GST or PVAT payable before July 1, 2010, or any amount of an ITC in respect of GST payable before July 1, 2010, unless the investment plan or segregated fund were an SLFI under the current rules.

In addition, to facilitate the required exchange of information that would be necessary between plans and segregated funds that are SLFIs and that have invested in each other's funds, and to assist investment plans and segregated funds to complete and file their GST/HST returns at a common time (i.e., within six months from the calendar year-end), it is proposed to standardize the reporting periods of all SLFI investment plans and segregated funds for the purposes of the subsection 225.2(2) net tax adjustment. Under these proposed rules, an investment plan or segregated fund would be deemed, for the purposes of subsection 225.2(2) (including provincial attribution percentage determination) and filing requirements under section 238 of the ETA, to have their calendar year as their fiscal year if the plan or fund is an SLFI at any time in the calendar year.

The proposed amendments apply to reporting periods of an investment plan or segregated fund that end after June 2010.

d. Compliance rules for SLFI investment plans and segregated funds

As a result of proposed amendments discussed above, more investment plans and segregated funds would become SLFIs on July 1, 2010.

In general, this will result in SLFI investment plans and segregated funds having to register for GST/HST and, in the absence of an election to file monthly or quarterly, becoming annual filers. The current rules permit an election to be made so that the entity may file on a monthly or quarterly basis.

An SLFI that is an annual filer is required to make quarterly instalment payments of GST/HST based on its preceding year's net tax liability or an estimated amount of net tax for the current year. Under the current rules, an SLFI is required to file its GST/HST return[40] within three months after the end of its fiscal year and determine its net tax adjustments. The filing due-date for GST/HST returns for SLFI annual filers is proposed to be extended to six months after the end of the fiscal year under the legislation contained in Bill C-9, the *Jobs and Economic Growth Act.*

i. Reporting entity election

It is proposed that an election (referred to as "reporting entity election") be provided to allow a fund manager to file the SLFI GST/HST return on behalf of the MFT.[41] Generally, the mutual fund trustee would be responsible for the filing of returns, payment of any tax owing or claiming of any refund. With this election, those duties are transferred to the fund manager.[42]

The proposed amendments would apply in respect of any reporting period of a person that ends after June 2010.

ii. Consolidated filing election

It is proposed that where the reporting entity election has been made, a second election (referred to as "consolidated filing election") be provided to allow a fund manager to file a single consolidated GST/HST SLFI return for all MFTs.

The consolidated filing would have to include all MFTs with whom the fund manager has made the reporting entity election. As a result of this election, the GST/HST returns for all the MFTs for which the fund manager has the authority to file returns (under the reporting entity election) would be consolidated into a single return. The fund manager would be required to use a single GST/HST registration number for all the MFTs that are under consolidated filing.[43] Where a single GST/HST registration number is assigned for all the MFTs under consolidated filing, each of these MFTs would be relieved of the obligation to register separately for GST/HST purposes.

Under consolidated filing, the fund manager would be required to determine the PVAT for the fiscal year for each series of units of each MFT by using the SAM formula. The PVAT liability and all elements of the SAM formula (i.e., attribution percentage for each participating province and unrecoverable GST) determined for each series of units for all funds under consolidation would be aggregated on a single SLFI return.

Example 12: Fund ABC and fund XYZ are mutual funds managed by the same fund manager. Fund ABC has 2 series – Series A and B and fund XYZ has 2 series – Series X and Y. The trustee(s) of funds ABC and XYZ have made both the reporting entity election and consolidated filing election with the fund manager. Therefore, on behalf of the fund, the fund manager would be required to file a single consolidated GST/HST return for both funds ABC and XYZ. The fund manager would be required to determine PVAT for each series of funds ABC and XYZ that would be aggregated to a single consolidated return for both funds.

Detailed records of the calculations (using the SAM formula) for each series of units for all MFTs under consolidation would be required to be maintained in the books and records of the fund manager. These records are necessary to support the tax liability computation and the tax transfer (discussed in iii below) allowed in respect of each series of the fund(s).

The proposed amendments would apply in respect of any reporting period of a person that ends after June 2010.

iii. Tax transfer election under consolidated filing

It is proposed that where a fund manager and a mutual fund trustee have made the reporting entity election and consolidated filing election, a third election (referred to as "tax transfer election") be provided to avoid cash flow issues for the fund that could arise as a result of the application of the general place of supply rules. Under those rules, the fund manager would be required to charge and collect PVAT on the management fees. The PVAT paid by the fund throughout the year would be subtracted from the PVAT otherwise determined under the SAM formula, giving rise to a refund or tax liability (referred to as the 'net tax adjustment amount') for the fund. This could create cash flow issues as the trustee may have to wait over one year to get a refund or face a significant tax liability at year-end.

Generally, the tax transfer amount would be the positive or negative net tax adjustment amounts determined by the application of the SAM formula to each series of the fund, as the management fees are charged to the trustee.[44] The net tax adjustment amount determined for each series of units of the fund(s) would be aggregated under the tax transfer election. The transfer could be made on an aggregated basis under the consolidated filing election.

As a practical matter, these tax transfers could be made at the time the tax is charged to the fund. Under the tax transfer election, if there is a positive net tax adjustment (i.e., an amount owed by the fund), the fund manager would be required to remit the PVAT liability of the fund upon filing its GST/HST return. If there is a negative net tax adjustment (i.e., the fund would be eligible for a rebate), the fund manager would be required to credit/refund that PVAT amount to the fund. In other words, the net tax adjustment would be made on an ongoing basis, with the net PVAT charged on the management fees adjusted to reflect the tax refund or tax liability resulting from the application of the SAM formula.

Where a tax transfer has been made, it would be allowed to be included in the fund manager's GST/HST return as an adjustment to ITCs or GST/HST collected, as the case may be. There would not be a requirement to have the reporting periods of the fund manager and the MFT coincide (e.g., the fund manager could be a monthly filer but the MFT could be an annual filer) for the tax transfer election to be applicable.

Example 13: Fund XYZ is located in Ontario. The total value of the units of Series A of the fund is $1,000,000. Fund XYZ's fund manager charges annual management fees of 2% charged daily to the fund based on the total value of units. Based on the information obtained on the attribution date (September 30, 2010), the fund determines that its provincial attribution percentages for Series A for its 2011 fiscal year is as follows – 40% for Ontario; 60% for non-participating provinces.

On January 1, 2011, the fund manager (a monthly filer) charges HST of $7.12 ($1,000,000 x 2%/365 x 13%), composed of $2.74 GST and $4.38 Ontario PVAT, to the fund. On that day, there are no other charges made to the fund. The management services relate exclusively to the exempt activities of the fund which is an annual filer for GST/HST purposes. Using the SAM formula, the Ontario PVAT liability of the fund in respect of the January 1, 2011 fund management fee would be determined in the following manner:

[($2.74 - $0) x 40% x 8%/5%] - $4.38= -$2.63

As the SAM formula yields a negative amount, the fund would be entitled to a refund of $2.63. Under normal rules, the fund would have to wait until its SLFI return is processed to receive the $2.63 rebate.

While the fund may not have any tax to report on its SLFI return, it would nevertheless be required to file its SLFI return and report all the calculations done on the return. Where the fund has made the reporting entity election with the fund manager, the fund manager would be responsible for filing the fund's return on its behalf.

Where a tax transfer election is made, the fund manager would be allowed to credit the refund of $2.63 to the fund. This would result in the net tax adjustment (using the SAM formula) of the fund to be nil. The fund manager would be entitled to claim a deduction of $2.63 from its net tax when it files its GST/HST return for the reporting period. If the fund manager has no other amount to report on its GST/HST return for its January 2011 reporting period, the fund manager would have a net tax liability of $4.49 ($7.12 GST/HST collected minus $2.63 net tax deduction).

Where a tax transfer election is not made, the fund manager would collect $7.12 from the fund and remit that amount to the Government in its January 2011 return due on or before February 28, 2011. The fund would be allowed to claim a refund of $2.63 (as a deduction from net tax) when it files its GST/HST return for the 2011 fiscal

year on or before June 30, 2012.

Example 14: Fund XYZ is located in Alberta. The total value of the units of Series A of the fund is $5,000,000. Fund XYZ's fund manager charges annual management fees of 1.75% charged daily to the fund based on the total value of units. Based on the information obtained on the attribution date, the fund determines that its provincial attribution percentages for Series A for its 2011 fiscal year is as follows – 50% for Ontario; 50% for non-participating provinces.

On January 1, 2011, the fund manager (a monthly filer) charges GST of $11.99 ($5,000,000 x 1.75%/365 x 5%) to the fund and no PVAT as the fund is in Alberta. On that day, there are no other charges made to the fund. The management services relate exclusively to the exempt activities of the fund which is an annual filer for GST/HST purposes. Using the SAM formula, the Ontario PVAT liability of the fund in respect of the January 1, 2011 fund management fee would be determined in the following manner:

[($11.99- $0) x 50% x 8%/5%] - $0= $9.59

As the SAM formula yields a positive amount, the fund would have a PVAT liability of $9.59.

Where a tax transfer election is made, the fund manager would be allowed to assume the PVAT liability of $9.59 of the fund. This would result in a net tax adjustment (using the SAM formula) of the fund to be nil. The fund manager would be required to add $9.59 to its net tax when it files its GST/HST return for the reporting period. If the fund manager has no other amount to report on its GST/HST return for its January 2011 reporting period, the fund manager would have a net tax liability of $21.58 ($11.99 GST/HST collected plus $9.59 net tax addition). However, the fund manager could recover the additional $9.59 tax liability from the fund.

Where a tax transfer election is not made, the fund manager would collect $11.99 in GST from the fund and remit that amount to the Government in its January 2011 return due on or before February 28, 2011. The fund would have a tax liability of $9.59 (as an addition to net tax) when it files its GST/HST return for the 2011 fiscal year on or before June 30, 2012.

Therefore, the tax transfer election provides cash flow relief for the fund and simplified accounting for both the fund manager and the fund.

Detailed records of the net tax adjustments made by the fund manager for each series and each fund and tax adjustments made at the aggregated level (under consolidated filing) would be required to be maintained in the books and records of the fund by the fund manager.

The proposed amendments would apply in respect of any reporting period of a person that ends after June 2010.

iv. Tax transfer election– other cases

It is proposed that where the fund manager and the trustee have made the reporting entity election but not the consolidated filing election, the fund manager and mutual fund trustee could still make the tax transfer election, allowing the fund manager to credit/refund PVAT amounts to the fund or assume PVAT liabilities of the fund.

Where a reporting entity election has not been made, the trustee on behalf of the MFT will be required to register and do the relevant tax calculations and file the SLFI GST/HST return. While the fund manager and the mutual fund trustee could make a tax transfer election, the amount of PVAT that can be credited/refunded or assumed as liability would be limited to the management fees charged by the fund manager to the MFT.

In these cases, the MFT would be required to have a calendar year as its fiscal year and if the MFT is an annual filer, it would be required to make quarterly instalments. The MFT may elect to file on a monthly or quarterly basis.

The proposed amendments would apply in respect of any reporting period of a person that ends after June 2010.

v. Rules for elections

It is proposed that for each of the elections (described above under section 2.d) including revocations of the elections, the following rules would apply:[45]

- it would be a joint election made by the fund manager and the trustee and both parties would be jointly and severally liable for any tax amounts assessed in connection with the election and any related obligations;
- it would be required to be made before the beginning of the MFT's fiscal year;
- it would be made in a prescribed form and contain prescribed information; and
- it would be required to be filed in prescribed manner with the Minister of National Revenue.

The proposed amendments would apply in respect of any reporting period of a person that ends after June 2010.

e. Supplies between closely-related SLFIs

Generally, element A of the SAM formula is all of the GST paid or payable by the SLFI during a reporting period and element B of the SAM formula is all of the ITCs claimed in the reporting period by the SLFI in respect of the GST paid or payable.

Section 150 of the ETA entitles two corporations that are members of the same closely related group that includes an

LFI to make a joint election to treat certain supplies of property and services between them as exempt supplies of financial services. An SLFI that is the recipient of a supply, in respect of which a section 150 election has been made, is currently required to include an amount in respect of the supply in determining the amount of element A of the SAM formula. The amount that is required to be included in element A is either the GST that would have applied on the supply, had the section 150 election not been made, or, where the SLFI recipient has made a second joint election under section 225.2 of the ETA with the supplier, an amount equal to tax calculated on the supplier's cost of making these supplies (excluding any remuneration to employees, the cost of financial services and any GST or HST payable on inputs). As well, the SLFI recipient would be required to make certain adjustments to element B (ITCs) and, where the election under section 225.2 has been made, to element F (PVAT paid or payable) of the SAM formula.

However, under the current rules, the SLFI recipient is not required to make any of the adjustments noted above where the supplier is itself an SLFI.

It is proposed to extend the current rule to require an SLFI that has made an election under section 150 to make the adjustments in respect of all supplies made to it on an exempt basis under that election to include cases where the supplier was another SLFI. The proposed extension of the rule would apply regardless of whether the election under section 225.2 is made or not.

As a result of this proposed amendment, where two SLFIs have made an election under section 150 in respect of an otherwise taxable supply made by one SLFI to another SLFI, the SLFI recipient of the supply would

- be required to include in element A,
  - where the two SLFIs have made the election under section 225.2, the SLFI supplier's cost of making the supplies (excluding any remuneration to employees, the cost of financial services and any GST or HST payable on its inputs); and
  - where the two SLFIs have not made the election under section 225.2, the GST that would have become payable by the SLFI recipient if the election under section 150 had not been made; and
- be permitted to include in element B any ITCs to which the SLFI supplier would have been entitled if that amount of GST so included in element A was actually paid by the SLFI; and
- be permitted, where the two SLFIs made the election under section 225.2, to include in element F an amount in respect of unrecoverable PVAT that is included in the SLFI supplier's cost of making the supply.

It is proposed that the SLFI making the supply would

- not include, where the two SLFIs have made the election under section 225.2, any amount in elements A, B and F that relate to an amount that the SLFI recipient would be required to include with respect to the supply in the recipient's SAM calculation; and
- include, where the two SLFIs not made the election under section 225.2, in element B, the ITC that it would have been permitted to claim in respect of the supply if the election under section 150 had not been made.

The proposed amendments would apply in respect of any reporting period of an SLFI that ends after June 2010.

f. Extension of time limit for deduction of PVAT paid – Element F of SAM formula

Any actual PVAT paid or payable by an SLFI is refundable to it if the PVAT is included in element F of the SAM formula in the reporting period in which the tax becomes payable or is paid without having become payable.

It is proposed to extend the time for including PVAT paid or payable in element F of the SAM formula to two years. An SLFI would be entitled, in determining its PVAT liability in respect of a participating province for a particular reporting period of the SLFI, to include PVAT paid or payable in a prior reporting period, provided that (1) the particular reporting period ends within two years after the end of the SLFI's fiscal year that included the prior reporting period; and (2) the SLFI was an SLFI throughout the prior reporting period.

> *Example 15: An investment dealer which is an SLFI pays $800 of Ontario PVAT on September 15, 2010. The investment dealer is a monthly filer and its reporting periods end on the last day of each month. Its fiscal years end on October 31 of each year. The investment dealer would have until its October 2012 reporting period to claim the $800 PVAT refund.*

The proposed amendments would apply in respect of any reporting period of an FI that ends after June 2010.

g. Instalment base for new SLFIs in their first fiscal year

Existing subsection 237(5) provides a transitional method for determining the instalments payable by an FI that is an annual filer for the fiscal year in which it becomes an SLFI.[46] Under the transitional method, the FI's first instalment for the fiscal year is equal to the lesser of one-quarter of its estimated net tax for the fiscal year and one-quarter of its total net tax for all reporting periods ending in the preceding 12-month period.

For each of the remaining fiscal quarters in the year, the FI's required instalment is equal to the lesser of one-quarter of its estimated net tax for the year and the amount determined under the formula in subparagraph 237(5)(*b*)(ii). The amount under the formula is equal to one-quarter of the FI's total net tax for all reporting periods ending in the preceding 12-month period determined without reference to the PVAT and grossed up by the total of the FI's attribution percentages for the participating provinces for the preceding fiscal quarter, as determined under regulations made pursuant to subparagraph 237(5)(*b*)(ii).

These rules are proposed to be amended to provide that subsection 237(5) would not apply to an MFT, MFC or segregated fund of an insurer.

The proposed amendment would apply to a fiscal year of a person that ends after June 2010.

h. Amalgamations and Winding-Up Regulations

It is proposed that section 225.2 of the ETA (i.e., the SLFI rules) be included in the *Amalgamations and Windings-Up Continuation (GST/HST) Regulations* so that SLFIs would be treated in a manner similar to other corporations that are not SLFIs.

The proposed amendment would apply effective July 1, 2010.

3. Transitional Rules for SLFIs re Ontario and British Columbia Harmonization

a. General transitional rules

British Columbia and Ontario have chosen to join the HST framework effective July 1, 2010. As a result of these decisions, British Columbia's and Ontario's Provincial Sales Tax will be replaced with the HST with a resulting combined GST/HST rate of 12% for British Columbia and 13% for Ontario.

The British Columbia and Ontario governments announced general transitional rules respecting the implementation of the HST in their respective provinces on October 14, 2009. Full details of these rules are outlined in the October 14, 2009 Ontario HST Information Notice 3 and in the October 14, 2009 British Columbia Ministry of Finance HST Information Notice 1. These rules will apply to all persons, including SLFIs, and may require the recipient of a supply to pay PVAT on certain transactions that straddle the July 1, 2010 implementation date of the HST in British Columbia and Ontario. PVAT will generally apply to consideration that becomes due, or is paid without having become due, on or after May 1, 2010 for property and services provided on or after July 1, 2010. In addition, the proposed general transitional rules may require certain persons, including SLFIs, to self-assess the British Columbia and Ontario PVAT on consideration that becomes due, or is paid without having become due, after October 14, 2009 and before May 2010 for property and services provided after June 2010.

b. SLFI rules

The following proposed rules describe adjustments that SLFIs would be required to make in the G component of the SAM formula contained in subsection 225.2(2) of the ETA in respect of the implementation of the HST in British Columbia and Ontario effective July 1, 2010, in order to implement for SLFIs the policy decisions British Columbia and Ontario have made with respect to transition rules. In addition, they describe the SLFI's transitional instalment base rules which would apply to most SLFIs for their fiscal year that includes July 1, 2010.

i. Prorating of transitional reporting period

Under the existing SAM formula, an SLFI accounts for its PVAT liability for a complete reporting period of the SLFI, based on all tax paid, ITCs and rebates claimed and adjustments made during the reporting period.

It is proposed that a prorating rule apply for the transitional reporting period of an SLFI. The transitional reporting period of an SLFI is its reporting period that begins before, and ends on or after, the July 1, 2010 implementation date of the HST in British Columbia and Ontario.[47] Specifically, for the purpose of determining an SLFI's PVAT liability in respect of British Columbia and of Ontario for the transitional reporting period of the SLFI, the PVAT liability determined under the SAM formula for this transitional reporting period would be prorated according to the number of days in the reporting period that are after June 2010. As a result, for each of British Columbia and Ontario, the SLFI would, after first determining its PVAT liability for the province for the entire transitional reporting period, make an adjustment to reduce its PVAT liability for the province by an amount equal to:

$[(A – B) \times C \times D/E \times H/I] + G$

where

A, B, C and E would have the same values as calculated for the SAM formula contained in existing subsection 225.2(2) of the ETA;

D would be 7% for British Columbia and 8% for Ontario;

H would be the number of days in the reporting period before July 2010;

I would be the number of days in the reporting period; and

G would have the same value as under existing subsection 225.2(2) of the ETAexcept that current adjustments in respect of tax prescribed in the SLFI Regulations would be similarly prorated.

> *Example 16: An SLFI is an annual filer with the calendar year as its fiscal year. In its January 1 to December 31, 2010 transitional reporting period, it pays a total of $100,000 in GST (of which it recovered $10,000 as ITCs). The SLFI's provincial attribution percentage for Ontario is 40% and it has no element G adjustments for that reporting period. The SLFI's prorating adjustment for the Ontario PVAT for its January 1 to December 31, 2010 transitional reporting period would be:*

[($100,000 - $10,000) x 181 days/365 days x 40% x 8%/5%] + $0 = $28,563.87.

The SLFI would be permitted to deduct the $28,563.87 from its net tax for its January 1 to December 31, 2010 transitional reporting period.

These proposed transitional rules would be consistent with the transitional rules that were used as part of the implementation of the HST in New Brunswick, Nova Scotia and Newfoundland and Labrador in 1997.

The proposed amendments would apply in respect of the reporting period of an FI that begins before, and ends on or after, July 1, 2010.

ii. Interaction of general transitional rules and SLFI rules

SLFIs may have to pay or self-assess the British Columbia or Ontario PVAT, under the general transitional rules discussed in section 3.a above.

A. PVAT paid or self-assessed during transitional reporting period

An SLFI may be required to include GST payable in respect of a supply of property or a service in element A of the SAM formula for the purposes of determining its liability for British Columbia or Ontario PVAT where the supply would also have been subject to the British Columbia or Ontario PVAT under the general transitional rules. As a result, the SLFI would be required to determine its liability for British Columbia or Ontario PVAT under SAM in respect of the supply when it would have already self-assessed British Columbia or Ontario PVAT on the same supply and that self-assessed PVAT would not be included in element F of the SAM formula to reduce the SLFI's PVAT liability under SAM.

In order to ensure that there is not an element of "double taxation" under the ETA, proposed amendments to SLFI rules would ensure that, for the purposes of determining an SLFI's PVAT liability under the SAM formula for British Columbia or Ontario, the SAM formula would provide a deduction for the British Columbia or Ontario PVAT payable or self-assessed under the general transitional rules in respect of a supply of property or a service, if GST in respect of the same supply were payable in a reporting period of the SLFI that ends on or after July 1, 2010. This would effectively negate the imposition of tax on the SLFI under the general transitional rules for these supplies and ensures that the SLFI pays the British Columbia or Ontario PVAT in respect of these supplies under the SAM rules rather than under the general transitional rules.

Example 17: A bank is both an SLFI and an annual filer and its reporting period ends October 31 of each year. On April 1, 2010, the bank pays $10,000 plus $500 GST to purchase a computer which will be delivered to its Toronto office on August 1, 2010. Under general transitional rules, the bank is required to self-assess $800 Ontario PVAT, since the computer was delivered after July 1, 2010 and consideration for the supply of the computer was paid after October 14, 2009 and before May 2010. The bank would be entitled to deduct, in determining its liability for Ontario PVAT under the SAM formula, the self-assessed $800 Ontario PVAT, since Ontario PVAT in respect of the supply would be determined under the SAM formula by reference to the $500 GST in respect of the same supply.

The proposed amendments would apply in respect of any reporting period of an FI that ends after June 2010.

B. PVAT paid or self-assessed on transactions occurring prior to transitional reporting period

SLFIs may also have a liability to pay or self-assess the British Columbia or Ontario PVAT under the general transitional rules in respect of a supply of property or a service where consideration in respect of the supply is payable after October 14, 2009 but before the beginning of the SLFI's transitional reporting period (this period is referred to in this section as "pre-transitional reporting period PVAT"). In this case, an SLFI would not be accounting for the British Columbia and Ontario PVAT in respect of the supply under the SAM formula. As a result, the SLFI would account for the pre-transitional reporting period PVAT in respect of the supply (i.e., self-assessment) under general rules including reporting requirements applicable to non-SLFIs.

It is proposed to allow an adjustment to the pre-transitional reporting period PVAT in respect of a supply of property or services to be made in the case where the property or services are used exclusively in British Columbia or Ontario and the SLFI has also included GST payable in respect of the supply in determining its tax liability for New Brunswick, Newfoundland & Labrador and Nova Scotia PVAT for the reporting period in which the GST became payable. This adjustment would reduce the pre-transitional reporting period PVAT by an amount equal to the total of all amounts, each of which is determined for a participating province that is New Brunswick, Newfoundland & Labrador or Nova Scotia by the formula

A x B x C/D

where

A = unrecoverable GST in respect of the supply (i.e., GST payable minus ITCs claimed in respect of that GST)

B = the SLFI's provincial attribution percentage for the province

C = the tax rate for the province; and

D = the tax rate for the GST.

Example 18: A trust company is both an SLFI and a monthly filer and its reporting periods end on the last day of

each month. The trust company has PEs in New Brunswick and Newfoundland and Labrador and its provincial attribution percentages are 4% for New Brunswick and 6% for Newfoundland and Labrador. On April 1, 2010, the trust company pays $10,000 plus $500 GST to purchase a computer which will be delivered to its Kelowna office on August 1, 2010 and will be used exclusively in the Kelowna office. Under general transitional rules, the trust company is required to self-assess $700 British Columbia PVAT, since the computer was delivered after July 1, 2010 and consideration for the supply of the computer was paid after October 14, 2009 and before May 2010. The trust company is not entitled to deduct, in determining its liability for British Columbia PVAT under the SAM formula, the self-assessed $700 British Columbia PVAT, since the $500 GST in respect of the same supply was not payable in a reporting period ending after July 1, 2010 (since the GST was paid in the trust company's reporting period ending on April 30, 2010) and would not be taken into account in computing the trust company's SLFI liability in the SAM formula in a reporting period ending after July 1, 2010.

However, since the $500 was included in the SAM formula for determining PVAT for New Brunswick and Newfoundland and Labrador for the trust company's April 1 to 30, 2010 reporting period, to the extent that PVAT is determined under SAM in respect of those three provinces in respect of the supply, the trust company would be able to deduct from its net tax, for the reporting period in which it self-assesses and reports the self-assessed tax, an amount equal to $80 [($500 x 4% x 8/5 for New Brunswick) and ($500 x 6% x 8/5 for Newfoundland and Labrador). This effectively ensures that the trust company is not liable for New Brunswick and Newfoundland and Labrador PVAT when it is also liable for full British Columbia pre-transitional reporting period PVAT in respect of the same supply.

It is proposed that the pre-transitional reporting period PVAT, as adjusted above, be a "prescribed amount of tax" for the purposes of subsection 169(3) of the ETA. As the normal restrictions contained in subsection 169(3) on SLFIs claiming ITCs in respect of PVAT do not apply to prescribed amounts of tax, an SLFI would be permitted to claim an ITC in respect of the pre-transitional reporting period PVAT, provided the property or services are used in commercial activities of the SLFI and other conditions for claiming an ITC are met (e.g., the amount has not been recovered as a rebate, refund or adjustment under another provision in the ETA). General ITC recapture rules would apply to the pre-transitional reporting period PVAT and the special ITC recapture rules for SLFIs, discussed in section 1.a.vi below, would not apply in respect of the supply.

The proposed amendments would apply in respect of any reporting period of an FI that begins before October 15, 2009 and ends after June 2010.

iii. Tax paid during transitional reporting period but attributable to subsequent reporting period

As discussed in section 3.b.i above, under the proposed transitional rules, an SLFI's liability for the British Columbia or Ontario PVAT, as determined by the SAM formula, for its transitional reporting period that begins before, and ends on or after, July 1, 2010 would be prorated based on the number of days in that reporting period that are after June 2010.

However, this rule would produce an inappropriate result where an SLFI pays GST in its transitional reporting period in respect of a supply of property or a service but the property is made available under a lease, licence or similar arrangement or the service is rendered following the end of the transitional reporting period. In such a circumstance, it would be appropriate that there be no prorating of the British Columbia or Ontario PVAT determined under the SLFI rules in respect of that supply to the extent property is made available (e.g., under a lease) or a service is rendered after the transitional period.

As a result, where GST is payable by an SLFI in its transitional reporting period in respect of a supply of property or a service and the property is made available or the service is rendered in a subsequent reporting period, a proposed amendment would require the SLFI, in determining its liability for British Columbia or Ontario PVAT, to add, in the transitional reporting period an amount equal to:

$(A - B) \times C \times D/E \times F/G \times H$

where

A = GST payable on the supply

B = ITCs claimed in respect of the supply

C = the SLFI's provincial attribution percentage for British Columbia or Ontario, as the case may be

D = the tax rate for British Columbia or Ontario, as the case may be

E= the tax rate for the GST

F= the number of days in the SLFI's transitional reporting period that were before July 2010

G = the number of days in the SLFI's transitional reporting period

H = the extent, expressed as a percentage, to which the property is made available or the service is rendered after the SLFI's transitional reporting period.

If, for example, the supply is a supply of a service in respect of a billing period that ends after the transitional reporting period, element H in the formula would be the proportion, expressed as a percentage, that total number of

days in the billing period that are after the end of the SLFI's transitional reporting period is of the total number of days in the billing period.

If, for example, the supply is a supply of property that is made available under a lease, element H of the formula would be determined by dividing the total number of days in the lease interval that are after the end of the SLFI's transitional reporting period by the total number of days in the lease interval.

If, for example, the supply is a supply of property that is made by sale, element H of the formula would be 100%.

The proposed amendments would apply in respect of the reporting period of an FI that ends after June 2010.

iv. Post-implementation payments for transitional or pre-transitional reporting period supplies

Under the proposed transitional rules, an SLFI would be required to determine its liability for the British Columbia or Ontario PVAT under the SAM formula beginning from its first reporting period that includes July 1, 2010. However, this rule would result in an inappropriate result where an SLFI pays GST in its transitional reporting period (or a later reporting period) in respect of a supply of property delivered or a service rendered before the beginning of the transitional reporting period. If, in these circumstances, no British Columbia or Ontario PVAT would have been payable by the SLFI under the general transitional rules in respect of the supply or tax would have been prorated under the SAM formula, it would be appropriate that the SLFI not be required to determine its liability for the British Columbia or Ontario PVAT under the SAM formula in respect of the supply in excess of the amount of PVAT that otherwise would have been payable under the transitional rules.

As a result, where GST is payable by an SLFI in a reporting period that ends after June 2010 in respect of a supply of property or a service and where the property is delivered or the service is rendered in a reporting period that ends before July 2010 and no PVAT would have been payable, a proposed amendment would allow the SLFI, in determining its liability for British Columbia or Ontario PVAT, to make a deduction as a prescribed amount under element G of the SAM formula, for the reporting period in which the GST is payable, of an amount equal to:

(A – B) x C x D/E x F/G

where

A = GST payable on the supply;

B = ITCs claimed in respect of the supply;

C = the SLFI's provincial attribution percentage for British Columbia or Ontario, as the case may be, for the reporting period;

D = the tax rate for British Columbia or Ontario, as the case may be;

E= the tax rate for the GST;

F= the number of days in the reporting period of the SLFI, in which the GST became payable, that are after June 2010; and

G = the number of days in the reporting period of the SLFI in which the GST became payable

The proposed amendments would apply in respect of any reporting period of an FI that ends after June 2010.

v. ITC stockpiling rule

The SAM formula in subsection 225.2(2) of the ETA generally provides that an SLFI, in computing its PVAT liability for a participating province for a reporting period of the SLFI must add all GST paid or payable in the reporting period (in element A of the SAM formula) and may deduct ITCs claimed in the reporting period in respect of GST (in element B of the SAM formula). There may be up to a two-year lag between the time GST is included in element A and the time an ITC in respect of that GST is included in element B.

The time differential between the payment of GST and the claiming of an ITC in respect of that GST could lead to inappropriate results in the context of the introduction of the HST in British Columbia and Ontario. If GST became payable by an SLFI in a reporting period of the SLFI ending before July 1, 2010, that GST would not be included in element A of the SAM formula computation for either the British Columbia or the Ontario PVAT. However, if the SLFI subsequently claimed an ITC in respect of that GST in a later reporting period ending after June 2010, that ITC would be included in component B of the SAM formula for purposes of the computation of both the British Columbia and the Ontario PVAT. Such a result would reduce the PVAT payable and constitute an inappropriate windfall gain for the SLFI.

To ensure that this tax result does not occur, proposed transitional rules would require a tax adjustment to be made, for the purposes of determining the British Columbia and the Ontario PVAT under the SAM formula. These rules would apply where an ITC amount, in respect of GST paid or payable in a reporting period ending before July 2010, is included in element B of the SAM formula for a particular reporting period ending after June 2010. For the purposes of determining the British Columbia and the Ontario PVAT for the particular reporting period, the SLFI would be required to include a tax adjustment effectively adding back the GST that gave rise to the ITC. The adjustment that the SLFI would have to make for the particular reporting period would be the amount of the GST paid, multiplied by the SLFI's provincial attribution percentage for British Columbia (or Ontario), multiplied by the ratio of the tax rate for British

Columbia (or Ontario) to the 5% GST rate. This rule would be similar to the provision that was provided as part of the implementation of the HST in New Brunswick, Nova Scotia and Newfoundland and Labrador in 1997.

Example 19: An insurer is an SLFI and a quarterly filer and has a fiscal year-end of December 31. Therefore, its reporting periods end on March 31, June 30, September 30 and December 31. On February 1, 2010, the insurer pays $1,000 plus $50 GST to purchase paper of which 10% is used in commercial activities. The insurer could have claimed the $5 ITC in its return for the reporting period ending March 31 but instead claims it on its return for the reporting period ending December 31, 2010. The insurer includes $5 in element B of the SAM formula but not $50 in element A of the SAM formula. As a result, the insurer would be required to include a tax adjustment to effectively add back the $50 GST paid on February 1, 2010 in the SAM formula for the purposes of determining its PVAT liability for British Columbia and Ontario for its October 1 to December 31, 2010 reporting period.

The proposed amendments would apply in respect of a reporting period of an FI that ends after June 2010.

vi. Recaptured ITC

A. General rules

British Columbia and Ontario have chosen to use the flexibility provided under the HST framework to mandate the recapture of ITCs that certain business are entitled to in respect of PVAT. British Columbia and Ontario have each decided that, during the initial implementation of the HST in their respective province, large businesses – generally those making taxable supplies in Canada worth more than $10 million annually, and certain FIs - are required to repay or 'recapture' the ITCs available to them in respect of PVAT paid or payable. The recapture rules, which would be implemented under the ETA, would apply to the extent that the ITCs are attributable to the acquisition, or bringing into British Columbia or Ontario, of certain specified property and services for consumption or use in the province. This would include ITCs available in respect of supplies that are zero-rated under the ETA. Full details respecting these provinces' rules can be found in British Columbia HST Notice 4 and Ontario Information Notice 5.

B. Recaptured ITC rules for SLFIs

While British Columbia's and Ontario's policy intent is that all FIs (as explained in the two Notices mentioned above) be subject to these rules, the RITC rules would not work effectively for FIs that are also SLFIs, as they are generally not permitted to claim ITCs in respect of PVAT but instead recover all of the PVAT paid or payable through the SAM formula. Therefore, technical modifications are proposed to be made to the SLFI rules to ensure that SAM is adjusted to reflect British Columbia's and Ontario's decision to impose RITC rules on large businesses that are SLFIs.

SLFIs, unlike other FIs and large businesses, would not be subject to the general RITC rules and would instead "recapture" ITCs, in respect of the British Columbia and Ontario PVAT payable on specified property and services, through modifications to the SAM formula. These RITC-SLFI rules would apply for a reporting period of an SLFI only if the SLFI is a GST/HST registrant, is not a public service body (as defined in subsection 123(1) of the ETA) and either

- made more than $10 million in taxable supplies in the last fiscal year of the person ending before the reporting period; or
- is one of the following FIs (or a person related to one of the following FIs): a bank, a corporation that is licensed or otherwise authorized under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as a trustee, a credit union, an insurer or any other person whose principal business is providing insurance under insurance policies, a segregated fund of an insurer or an investment plan.

The RITC-SLFI rules would apply to the same classes of specified property and services that are subject to the general RITC rules:

- specified road vehicles, including certain vehicle parts and services and, in Ontario only, motive fuel (other than diesel fuel) for use in road vehicles;
- specified energy;
- specified telecommunication services; and
- specified meals and entertainment.

An exception to the RITC-SLFI rules would be made for specified property and services that relate exclusively to the investigation, settlement or defence of a claim in relation to property and casualty insurance. These insurance inputs are carved out of the SAM formula, with the result that the application of the PVAT, and the claiming of ITCs, in respect of these inputs are determined under the general HST rules. As a result, SLFIs would be subject to general RITC rules, in respect of the British Columbia or Ontario PVAT paid on specified property and services that relate exclusively to the investigation, settlement or defence of property and casualty insurance claims.

An exception would also be made for supplies of specified property and services where British Columbia or Ontario PVAT in respect of the supply is payable or required to be self-assessed under the general transitional rules (as discussed in section 3.b.ii.B above) and GST in respect of the supply is payable before the transitional reporting period of the SLFI. In this case, the SLFI would potentially be permitted to claim an ITC in respect of the British Columbia or Ontario PVAT. If the SLFI were eligible to claim an ITC in respect of the PVAT, the SLFI would then be subject to the general RITC rules, in respect of that PVAT.

It is proposed to require an SLFI to make an adjustment to its net tax relating to specified property of the SLFI for the purposes of determining RITCs in respect of British Columbia and Ontario PVAT. The amendment would provide that, in determining its PVAT for British Columbia or Ontario for a reporting period of the SLFI, it would add the total of all

amounts, each of which is an amount in respect of a specified class of specified property or service determined by the formula:

A x B x C x D/E x F x G

where

A is the total GST paid or payable across Canada by the SLFI in the reporting period in respect of supplies of specified property and services (other than those that relate exclusively and directly to the investigation, settlement or defence of property and casualty insurance claims, as noted above) of that class;

B is the tax recovery rate of the SLFI, which is

- in the case where the SLFI makes an election ("the total tax recovery election") in respect of the reporting period, the amount (expressed as a percentage) determined by dividing (1) all ITCs of the SLFI, in respect of GST paid or payable across Canada by the SLFI, for the reporting period (element B of the SAM formula); by (2) all GST paid or payable across Canada by the SLFI for the reporting period (element A of the SAM formula); or
- in any other case, the amount (expressed as a percentage) determined by dividing (1) all ITCs of the SLFI for the reporting period, in respect of GST paid or payable across Canada by the SLFI in respect of the class of the specified property or service; by (2) all GST paid or payable across Canada by the SLFI for the reporting period in respect of that class of specified property or services.

Note: The total tax recovery election would be required to be made in prescribed form and contain prescribed information and to be filed in prescribed manner with the Minister of National Revenue before the beginning of the reporting period in respect of which the election is made. If an SLFI were not to make the total tax recovery election (described above) for a particular reporting period, it would not be entitled to make the election for any subsequent reporting period of the SLFI after the particular reporting period.

C is the SLFI's provincial attribution percentage for British Columbia or Ontario, as the case may be, for the reporting period;

D is the tax rate for the particular participating province (8% in Ontario; 7% in British Columbia);

E is the tax rate for the GST (5%); and

F is the RITC reduction factor which applies on the day that an ITC, in respect of the GST payable in respect of the supply, first becomes available. The RITC factor would be:

- 100% for the period from July 1, 2010 to June 30, 2015,
- 75%, for the period from July 1, 2015 to June 30, 2016,
- 50% for the period from July 1, 2016 to June 30, 2017,
- 25% for the period from July 1, 2017 to June 30, 2018,
- 0% on or after July 1, 2018.

and

G equals

- 50% where the class of the specified property or service is specified meals and entertainment; and
- 100% in any other case.

In its final GST/HST return (GST494) for the reporting period, the SLFI would be required to add the total amount determined above to its net tax and report that amount on the RITC Schedule to be filed with the return for the reporting period.

Example 20: A bank is an SLFI and an annual filer. During the November 1, 2012-October 31, 2013 reporting period, the bank pays $200,000 plus $10,000 GST for specified telecommunication services purchased across Canada. The bank's overall ITC recovery rate is 10% and its provincial attribution percentage for Ontario is 50%. The bank has made the total tax recovery election in respect of its November 1, 2012-October 31, 2013 reporting period. In determining its liability for the Ontario PVAT for its November 1, 2012-October 31, 2013 reporting period, the bank would be required to add an amount to its net tax in respect of the telecommunication services equal to:

$10,000 x 10% x 50% x 8% / 5% x 100% x 100% = $800

Example 21: A trust company is an SLFI and a monthly filer. During its June 1, 2016-June 30, 2016 reporting period, the trust company pays $5,000 plus $650 HST ($250 GST+$400 PVAT) for specified restaurant meals purchased in New Brunswick. The trust company has not made the total tax recovery election in respect of its June 1, 2016-June 30, 2016 reporting period . The trust company's ITC recovery rate in respect of the specified meals and entertainment class is 25% and its provincial attribution percentage for British Columbia is 20%. In determining its liability for the British Columbia PVAT for its June 1, 2016-June 30, 2016 reporting period, the trust company would be required to add an amount to its net tax in respect of the meal services equal to:

$250 x 25% x 20% x 7% / 5% x 75% x 50% = $6.56

Under the current rules, the SAM formula contains adjustments, for the purposes of determining the New Brunswick,

Newfoundland and Labrador, and Nova Scotia PVAT, which are in respect of ITCs claimed in respect of certain leased passenger vehicle expenses and certain meals and entertainment expenses. These adjustments reflect that 50% of ITCs claimed in respect of GST paid on these expenses are generally recaptured under sections 235 and 236 of the ETA and essentially provide, through the SAM formula, a similar 50% recapture of PVAT. These existing adjustments would continue to apply for the purposes of determining the British Columbia and Ontario PVAT in addition to the temporary RITC rules discussed above.

The proposed amendments would apply in respect of the reporting period of an FI that begins before July 2010 and ends after June 2018.

vii. SLFI transitional instalment base

SLFIs that are annual filers are generally required to pay quarterly instalments in respect of a fiscal year of the SLFI which are equal to the lesser of (a) the SLFI's net tax for that fiscal year, and (b) the SLFI's net tax for all reporting periods ending in the 12-month period immediately preceding the fiscal year.

In order to ensure that an SLFI's instalment base for its transitional year reflects British Columbia and Ontario harmonization, a transitional rule is proposed for SLFIs that are annual filers. This transitional rule would apply for the purpose of determining the instalments for fiscal quarters that end on or after July 1, 2010 in the SLFI's transitional year (the fiscal year of the SLFI that begins before, and ends after, July 1, 2010). The SLFI would be required to elect to use one of the four methods, which would be similar to the four methods provided under subsection 363(2) of the ETA for the implementation of the HST in New Brunswick, Nova Scotia and Newfoundland and Labrador effective April 1, 1997, with minor modifications to reflect the different PVAT rates of the five participating provinces. As was the case with the methods provided under subsection 363(2), the first two proposed methods would be based on the SLFI's net tax while the last two proposed methods would be based on the SLFI's unrecoverable GST for the transitional year.

The first method would permit the SLFI to calculate its instalments on the basis of the previous year's results, but permit the SLFI, where it anticipates a decline in net tax in the transitional year or a decline in its attribution percentages, to base its instalment payments on an estimate of the current year's net tax or attribution percentages, as the case may require. Provided that the SLFI has not underestimated the transitional year's net tax or attribution percentages and the amounts payable were paid on time and in full, no penalty or interest would be payable.

The second method would permit the SLFI to calculate its instalments solely on the basis of the previous year's results.

The third method would generally permit an SLFI to calculate the portion of each instalment that is attributable to GST on the basis of its actual results in the previous year and the portion that is attributable to the PVAT on the basis of PVAT that actually was paid or payable by the SLFI, or that was collected or became collectible by the SLFI, during the fiscal quarter to which the instalment relates. Where the SLFI anticipates an overall decline in net tax in the transitional year, it would also be permitted to base its instalment payments on an estimate of the transitional year's net tax. However, if the SLFI had underestimated its required instalments for the transitional year, it would be subject to penalty and interest.

The fourth method would generally be similar to the third method. However, the instalment would be determined on the basis of the SLFI's results for the reporting periods ending in the 12-month period preceding the transitional year. As under the third method, the portion of the instalment that would be attributable to the PVAT that actually was paid or became payable by the SLFI, or that was collected or became collectible by the SLFI, would be based on the SLFI's actual payments and collections during the fiscal quarter to which the instalment relates. Unlike the third method, this method would not permit the SLFI to base its instalments on an estimate of its net tax for the transitional year.

The proposed transitional rules would not apply to an MFT, MFC or segregated fund of an insurer.

The proposed amendments would apply to reporting periods that end after June 2010.

4. Other FI Rules

a. Imported supplies – Non resident trusts

Legislation contained in Bill C-9, the *Jobs and Economic Growth Act*, proposes that certain FIs, referred to as "qualifying taxpayers", be required to self-assess GST on certain cross-border transactions under a special set of rules. In addition, where the qualifying taxpayer is not an SLFI and is resident in a participating province, the qualifying taxpayer would be required to self-assess PVAT on these cross-border transactions, to the extent the transaction relates to the province.

A person would generally be a qualifying taxpayer throughout the person's specified year (generally its taxation year) if it is an FI throughout the specified year and, at any time in the specified year, it is either: (1) resident in Canada; (2) has a PE in Canada; (3) in the case of a non-resident trust, a majority of persons having beneficial interest of the trust's property are resident in Canada; or (4) a prescribed person or a person of a prescribed class.

Consistent with other changes applicable to investment plans in respect of PVAT, it is proposed to provide that a non-resident trust would be a prescribed person for the purposes of the qualifying taxpayer rules if one or more persons, each of which is resident in Canada, together have beneficial interest of 10% or more of the trust's property where the value of the property in which those persons have beneficial interest is equal to or exceeds $10 million. This amendment would generally ensure that GST/HST would be self-assessed on inputs that are consumed or used with respect to the Canadian interest in the trust property as would be the case were the trust resident in Canada.

The proposed amendment would apply in respect of any specified year of a person that begins after June 2010.

b. SLFI rules respecting deemed pension supplies and pension rebate

Legislative amendments contained in Bill C-9, the *Jobs and Economic Growth Act*, would implement measures to streamline and clarify GST/HST rules respecting employer sponsored registered pension plans (RPPs). These amendments would deem a pension entity (a trust governed by an RPP or a corporation that administers an RPP) in certain circumstances to have received a taxable supply from a participating employer of an RPP and, for certain purposes, to have paid tax (both GST and PVAT) in respect of that deemed supply. The pension entity, if certain circumstances are met, would be entitled to claim an ITC, or a rebate under section 261.01 of the ETA, in respect of tax it would be deemed to have paid in respect of the deemed supply. Tax adjustment note provisions contained in proposed sections 232.01 and 232.02 of the ETA would apply to effectively reduce that deemed tax, and any ITC or rebate claimed in respect of that deemed tax, in the case where an employer makes both an actual and a deemed supply to a pension entity in respect of the same property or service.

Consequential to the proposed changes respecting the application of SLFI rules to pension entities which would apply SLFI rules to most pension entities, amendments to the SAM formula are proposed to ensure that it interacts appropriately with the new proposed pension rules where these rules apply to an SLFI pension entity.

Specifically, these proposed amendments to the SAM formula would:

- ensure that both GST and deemed PVAT that an SLFI pension entity may be deemed to have paid under the pension rules contained in Bill C-9 are taken into account in the SAM formula;
- amend the SAM formula to provide a deduction for the GST amount of section 232.01 or 232.02 tax adjustment notes received by an SLFI pension entity and an addition for the PVAT amount of section 232.01 or 232.02 tax adjustment notes received by an SLFI pension entity; and
- amend the SAM formula to reflect recoveries by SLFI pension entities, of ITCs and pension rebates, as a result of the issuance of a tax adjustment note.

These proposed amendments to the SAM formula would apply in respect of a reporting period of an SLFI pension entity that begins on or after September 23, 2009.

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[1] Supplies of financial services are exempt unless specifically zero-rated under Part IX of Schedule VI of the *Excise Tax Act* (ETA). Part IX zero-rates certain supplies of financial services made to non-residents.

[2] For details of proposed new HST place of supply rules, see Finance News Release 2010-014 and Canada Revenue Agency (CRA) Bulletin B-103. The proposed rules would generally apply to taxable (other than zero-rated) supplies made in Canada on or after May 1, 2010, and may also apply under certain circumstances to supplies made before May 1, 2010. For details of existing HST place of supply rules, see CRA Bulletin B-078.

[3] Participating provinces are those provinces in which the HST applies. The current participating provinces are New Brunswick, Nova Scotia and Newfoundland and Labrador. British Columbia and Ontario will be participating provinces effective July 1, 2010.

[4] The term "province" means a province or territory in Canada.

[5] If an FI is not required to use SAM, it is required to comply with the general provisions of the ETA including self-assessment and rebates of tax where goods or services are brought into or removed from a participating province. FIs that are required to use SAM are generally not subject to these self-assessment and rebate rules. See Canada Revenue Agency Bulletins B-079 (Self-Assessment of the HST on Supplies Brought into a Participating Province), B-080R (Rebates of HST on Supplies Made From the Participating Provinces) and B-081 (Application of the HST to Imports) for more information respecting these rules.

[6] The term LFI means a person referred to in paragraph 149(1)(*a*) of the ETA and includes such FIs as banks, investment dealers, insurers, trust and loan corporations, investment plans and segregated funds of insurers. Note that, while corporations that are solely deemed to be FIs as a result of making an election under section 150 of the ETA are also LFIs, they are not regarded as SLFIs.

[7] Unless otherwise specified, any reference to the GST in this Backgrounder is also a reference to the 5% federal component of the HST where HST applies.

[8] See CRA Bulletin B-083R for more detailed information respecting element G of the SAM Formula, as well as other existing rules governing SLFIs.

[9] The terms "taxation year" and "fiscal year" are defined in the ETA. Unless a person elects to have fiscal years that are calendar years where the taxation year of the person is not a calendar year, both the taxation year (which is determined under the *Income Tax Act* – ITA) and the fiscal year of the person would be the same.

[10] The provisions also include persons who would be required to allocate taxable income (or income) if the person had taxable income (or income) and is a taxpayer under the ITA.

[11] Generally, a "specified partnership" is a partnership that is an LFI and that has members that carry on business through the partnership in any of the participating provinces and in any of the non-participating provinces from such a business. The term "estate" in this document refers to an estate of a deceased individual.

[12] Part I of the *Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations* (SLFI Regulations) prescribes certain federal Crown corporations for this purpose.

[13] Subparagraph 149(1)(a)(xi) describes a corporation that is deemed under section 151 of the ETA to be an FI. Such a corporation would not be an SLFI.

[14] The rules apply whether the corporation is a trust corporation, a loan corporation or a trust and loan corporation. Unless otherwise specified, any reference in this document to a trust and loan corporation is also a reference to a trust corporation or to a loan corporation.

[15] Investment plans are defined in subsection 149(5) of the ETA and generally include entities that are flow-through entities for income tax purposes. Investment plans include mutual fund trusts (MFTs) and tax deferral entities such as a trust governed by a registered retirement savings plan (RRSP) or a registered retirement income fund (RRIF).

[16] A segregated fund of an insurer is deemed to be a trust and the insurer is deemed to be the trustee of that trust under section 131 of the ETA. Essentially, the treatment of segregated funds is similar to that of an MFT with the investor being the contract holder of the segregated fund whereas for an MFT the unit holder is the investor.

[17] It is proposed that the Minister of National Revenue have the discretion to revoke an election prior to the end of the three year period upon application by the investment plan.

[18] For details of proposed new HST place of supply rules, see Finance News Release 2010-014 and CRA Bulletin B-103.

[19] A similar amendment would be proposed to the general rules for corporations and rules for individuals in the SLFI Regulations.

[20] This is to ensure that only loans and deposits that are attributable to zero-rated financial services made to non-residents would be excluded from the proxy for determining the provincial attribution percentage.

[21] As under the current rules, the value of loans and deposits would be determined at the close of business on the last day of each month that ends in a reporting period and the loans and deposit percentage for the reporting period would be determined by averaging these monthly determinations.

[22] Anti-avoidance rules would be provided to ensure that the provincial attribution percentage of an MFT would not be altered by a transaction, or a series of transactions (including related transactions completed in contemplation of the series) in which the participants to the transactions do not deal at arm's length with one another, completed in contemplation of altering provincial attribution percentage of the MFT.

[23] For tax reporting purposes, where reporting is on a consolidated basis as described in section 2.d.ii, the attribution percentage for the MFT (or MFTs where consolidated) would be determined under a prescribed formula.

[24] The unit holders in Canada would not include non-residents to whom the financial services provided by the MFT would be zero-rated financial services.

[25] Institutional investors may include segregated funds, pension plans, other mutual funds, corporations, partnerships etc.

[26] The MFT receiving this institutional investor information would be required to treat it as confidential.

[27] Where the MFT is an ETF, institutional investors would not be required to provide attribution percentage information. However, upon request of the ETF, the institutional investor would be required to provide its location.

[28] This rule will also apply to MFCs and segregated funds.

[29] The attribution date of September 30 would not apply in the transitional year (i.e., fiscal year straddling the July 1, 2010 implementation date) or to new funds during their first fiscal year.

[30] Anti-avoidance rules would apply to prevent inappropriate tax planning around the attribution date.

[31] These rules would also apply to segregated funds and MFCs.

[32] The general rule would be the default rule where no election to use either the preceding year or real time methods has been made. Under the default rule where no election to use averaging has been made, the attribution percentage would be calculated at a single point in time (i.e., September 30).

[33] It is proposed that the Minister of National Revenue have the discretion to revoke an election prior to the end of the three year period upon application by the investment plan.

[34] As ETFs would not be required to look through institutional investors, they would not be allowed to use a single point in time. They would be required to calculate the attribution percentage based on an aggregate of two or four points in time.

[35] It is proposed that the Minister of National Revenue have the discretion to revoke a preceding year method election or an election to use averaging prior to the end of the three year period upon application by the MFT.

[36] With respect to some of the elections referred to in this Backgrounder, an SLFI may be required to indicate on the SLFI return if it has made those particular elections.

[37] As provided in section 2.b.v, an investment plan would be a "small investment plan" for a fiscal year of the investment plan if it has unrecoverable GST ((A-B) in the SAM formula) in its immediately preceding fiscal year of less than $10,000 and has not made an election to be treated as an SLFI for the fiscal year.

[38] While provincial attribution rules that are similar to those rules proposed for MFTs are generally proposed to be applied to pension entities, the tax accounting and reporting for pension entities may not be the same as for MFTs, given that fund management and other taxable expenses may not be charged in the same manner as MFTs and that certain pension plan-specific GST/HST rules apply to pension entities.

[39] These provincial attribution rules would also apply to a pension entity of a pension plan that is neither a defined contribution pension plan or a defined benefit pension plan but that is similar in structure to a defined contribution pension plan.

[40] Every SLFI, whether or not it is a registrant, is required to file an interim GST/HST return (where applicable) and a final GST/HST return for each of its reporting periods.

[41] While the reporting entity election, consolidated filing election and tax transfer election are described in terms of MFTs, they can also be made by other SLFI investment plans and segregated funds.

[42] The duties of the fund manager and the trustee are often carried out by the same person.

[43] The Minister of National Revenue would have the authority to allow a fund manager to file more than one consolidated return where it meets the criteria for separating groups of MFTs. In such cases, the Minister may require each consolidated group to use a separate GST/HST registration number.

[44] The positive or negative net tax adjustment would apply to all amounts of PVAT paid by the fund including PVAT paid to the fund manager on management fees as well as third party charges to the fund (e.g., audit fees, custodial fees).

[45] These elections would also be available to MFCs and segregated funds.

[46] An FI that is a monthly or quarterly filer is required, under subsection s 228(2.1) and (2.2) of the ETA, to make interim payments for each of its reporting periods that end in the fiscal year in which it becomes an SLFI. No changes are proposed to these rules.

[47] As discussed in section 2.c, for the purposes of subsection 225.2(2) of the ETA, including this proposed rule, investment plans and segregated funds would account for PVAT liability for the reporting period that begins before July 2010 and ends after June 2010 (e.g., a fiscal year running from January 1, 2010 to December 31, 2010) only taking into account the GST and PVAT paid without becoming payable, or becoming payable, after June 2010.

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