GST/HST Memoranda Series

17.1 Definition of "Financial Instrument"

April 1999

Overview	This memorandum explains the components of the definition of "financial instrument" as it relates to the provision of financial services under the Goods and Services Tax (GST)/Harmonized Sales Tax (HST).

Note

This memorandum replaces GST/HST Memorandum 17.1, *Definition of "Financial Instrument"*, dated January 1995. Significant changes have been side-barred.

Note - HST

Reference in this memorandum is made to supplies taxable at 7% or 15% (the rate of the HST). The 15% HST applies to supplies made in Nova Scotia, New Brunswick and Newfoundland (the "participating provinces"). If a person is uncertain as to whether the supply is made in a participating province, the person may refer to Technical Information Bulletin B-078, *Place of Supply Rules under the HST*, available from any Revenue Canada tax services office.

General

1. The definition of financial instrument is relevant for the definition of financial service. A financial service generally involves a transaction relating to a financial instrument or money.

Financial services

2. Supplies of financial services are exempt under Part VII of Schedule V unless specifically listed as zero-rated under Part IX of Schedule VI. Services for which fees are charged and which relate to financial instrument transactions are exempt where these transactions fall within the definition of financial service found in subsection 123(1).

Definition of financial instrument
ss 123(1)

3. "Financial instrument" means:

(a) a debt security;

(b) an equity security;

(c) an insurance policy;

(d) an interest in a partnership, a trust or the estate of a deceased individual, or any right in respect of such an interest;

(e) a precious metal;

(f) an option or a contract for the future supply of a commodity, where the option or contract is traded on a recognized commodity exchange;

(g) a prescribed instrument;

(h) a guarantee, an acceptance or an indemnity in respect of anything described in paragraphs (a), (b), (d), (e) or (g); or

(i) an option or a contract for the future supply of money or anything described in any of paragraphs (a) to (h).

Components of financial instrument

4. The following paragraphs explain the components of the definition of a financial instrument.

Debt security

Definition of debt security
ss 123(1)

5. "Debt security" means a right to be paid money and includes a deposit of money, but does not include a lease, licence or similar arrangement for the use of, or the right to use, property other than a financial instrument.

Right to be paid money

6. Financial obligations representing a right to be paid money are by definition a debt security for GST/HST purposes. A debt security generally includes a deposit of money, debentures, notes, convertible notes, mortgages, treasury bills, bonds, etc. It also includes book debts and accounts receivable.

Exclusions

7. The payment of money relating to leases, licences or similar arrangements, or the right to use property other than a financial instrument, is specifically excluded from the definition of debt security. Therefore, such a payment is not in respect of a financial instrument. For example, the leasing of commercial property is treated as a supply of that property, and not a debt security, for GST/HST purposes pursuant to subsection 136(1). Similarly, an automobile lease payment although partially consisting of a financing component is not exempt as consideration for a supply of a financial instrument.

Contingent right
Policy statement P-170, *Whether or Not a Debt Security Includes Contingent Amounts Owing*.

8. "Debt security" does not include a contingent right. A right to be paid money is a possibility but not a certainty where a contingent right is involved. The payment is conditional upon the occurrence or non-occurrence of some future event that may never happen.

Late payment charges

9. A late payment charge occurs where a supplier of property or services charges the recipient (customer) an additional amount if payment for the supply is not made within the time required on the invoice. The late payment is a financial service as it relates to the operation of an overdue account (which is a debt security, and therefore a financial instrument).

Equity security

Definition of equity security
ss 123(1)

10. "Equity security" means a share of the capital stock of a corporation or any interest in or right to such a share.

11. A share of capital stock in a corporation representing ownership in the corporation or an interest in or right, claim or title to such a share is, for GST/HST purposes, a financial instrument.

Insurance policies

Definition of insurance policy
ss 123(1)

12. For GST/HST purposes, "insurance policy" means:

(a) a policy or contract of insurance, including life, property and casualty policies, but excluding a warranty contract (as explained in paragraph 23), that is issued by an insurer, including

(i) a reinsurance policy,

(ii) an annuity contract or a contract that would be an annuity contract except that the payments under the contract

- are payable on a periodic basis at intervals that are longer or shorter than one year, or

- vary in amount depending on the value of a specified group of assets or changes in interest rates, and

(iii) a segregated funds contract;

(b) a policy or contract relating to accident and sickness insurance whether issued or entered into by an insurer; and

(c) certain types of construction bonds (see paragraph 17 for more information).

Definition of insurer
ss 123(1)

13. "Insurer" means a person who is licensed or otherwise authorized under the laws of Canada or a province to carry on in Canada an insurance business or under the laws of another jurisdiction to carry on in that other jurisdiction an insurance business.

14. Generally, an insurance policy is a contract whereby one person undertakes to indemnify another against loss, damage or liability arising from an unknown or contingent event, and applies only to some contingency or act that may occur in the future. It is an agreement by which one party, for a consideration, promises to pay money or its equivalent, or to perform an act valuable to the other party upon destruction, loss or injury of something in which the other party has an insurable interest.

Health insurance contracts

15. Health insurance contracts such as accident or sickness insurance pertain to reimbursement for eligible medical, hospital, nursing, dental and certain other health-related expenses. These contracts cover payment for the cost of specified medical or dental services and loss of earnings, and provide an amount in compensation for accidental death or dismemberment. These contracts are included in the definition of an insurance policy whether or not provided by an insurer.

Supplementary health insurance

16. Contracts or policies issued by certain organizations that are not insurers, but provide supplementary health insurance in Canada and are licensed under the *Prepaid Hospital and Medical Act* (e.g., Blue Cross as well as certain corporations or associations providing accident and sickness policy benefits to their employees under self-insurance plans administered by a third party) are also included in the definition of an insurance policy.

Construction bonds

17. Construction bonds are bid, performance, maintenance or payment bonds issued in respect of a construction contract. These bonds are generally three-party contracts between a surety company, a contractor and an owner or developer of a project. The bonds, as a form of financial guarantee, are used in the construction industry to guarantee performance of a construction contract or the payment of suppliers.

- Bid bond

18. A bid bond guarantees that the contractor, if selected, will enter into the contract for the bid amount and will provide the required contract security.

- Performance bond

19. A performance bond guarantees completion of the construction contract.

- Maintenance bond

20. A maintenance bond guarantees against defects in the contractor's workmanship or materials for a period of time following completion of the construction contract.

- Payment bond

21. A payment bond guarantees that the contractor will pay its subcontractors, labourers and suppliers on the bonded construction contract.

22. The issuers (usually surety companies) of these construction bonds are normally required to be licensed under the same legislation as insurers. Even though these unique bonds are not normally considered to be contracts of insurance, they do strongly resemble insurance policies. Therefore, for GST/HST purposes, they are treated as insurance and included in the definition of an insurance policy.

Exclusions

23. The definition of insurance policy, however, excludes a warranty in respect of the quality, fitness or performance of tangible property where the warranty is supplied to a person who acquires the property otherwise than for resale (i.e., for personal use) whether or not it is provided by an insurer.

24. Insurance services provided by non-licensed persons are also excluded from the definition of insurance policy except in the case of:

a) accident and sickness insurance as described in paragraphs 15 and 16, and

b) in some instances, construction bonds as described in paragraph 17.

Interest in a partnership, trust or estate of a deceased individual

Terms

25. A partnership is created where two or more persons enter into a relationship to carry on business for profit. A trust is a fiduciary relationship imposed by contract or by law with respect to property or money held by one person for the benefit of one or more persons. A partnership, a trust and the estate of a deceased individual are treated as separate persons under the Act.

26. Any interest, or any right in respect of an interest, in a partnership, a trust or the estate of a deceased individual is a financial instrument. This interest or right represents a claim, title or legal share of an **investment** in a partnership, a trust or the estate of a deceased individual and not in the underlying assets of the partnership, trust or the estate of a deceased individual.

Precious metals

Definition of precious metal
ss 123(1)

27. A "precious metal" is a bar, ingot, coin or wafer of gold, platinum or silver that is refined to a purity level of at least

a) 99.5% in the case of gold and platinum, and

b) 99.9% in the case of silver.

Policy statement P-192, *Supplies of Precious Metals*

28. A precious metal in the form of a bar, ingot or wafer at the required purity levels must generally be recognized and accepted for trading on Canadian financial markets. Ordinarily, these will bear markings indicating their purity level. They will also have an identification mark of the issuing financial institution or refinery. With respect to coins, only those metals at the required purity levels that have been issued by a government authority and that may be used as currency will qualify.

29. Any supply of a precious metal (i.e., gold, platinum or silver) meeting the purity requirements, as set out in the definition of precious metal in subsection 123(1), is a supply of a financial service and generally exempt. Metals of this quality are normally investment-related and are usually bought and sold on international exchanges that establish world-wide precious metal prices.

30. The sale or purchase of a precious metal, in the course of a commercial activity, that does not comply with the defined requirements is not considered a supply of a financial instrument, but rather a supply of property. Generally, the sale of gold, platinum or silver in bar, ingot, coin or wafer form with a purity level of less than 99.5% for gold and platinum, and less than 99.9% for silver is taxable at 7% or 15%. The sale of gold, platinum or silver at the defined purity levels, but not in the form of a bar, ingot, coin or wafer (e.g., in granular form), is taxable at 7% or 15%.

Refiner

31. A refiner of precious metals is considered to be any person who in the regular course of business converts or refines gold, platinum or silver regardless of the degree of purity.

Zero-rated supply
Sch. VI, Part IX, s 3

32. A supply of precious metals, as described in paragraphs 27 and 28, made by the refiner thereof or by the person on whose behalf the precious metals were refined is a zero-rated financial service. Accordingly, the first sale of newly refined precious metal by the refiner or its owner is zero-rated. Subsequent supplies of the precious metal are exempt.

Refiner's fee

33. Where a refining or a manufacturing fee is charged by a refiner of precious metals to the owner of the precious metals, this fee is taxable. However, where it is standard practice for a refiner to charge a separate premium fee when selling its own precious metal that is over and above the intrinsic precious metal value of the product, this fee is considered part of the selling price, and therefore would take on the tax status of the sale of the precious metal.

Non-precious metals

34. Carat gold, sterling silver or platinum in jewellery or chattel form are examples of metals that do not meet the purity and form requirements established under subsection 123(1), and therefore are not considered to be precious metals. Supplies of these goods are taxable at 7% or 15%, unless otherwise zero-rated in Schedule VI or exempted under Schedule V.

Supplies to non-residents
Sch. VI, Part IX, s 1

35. Precious metals supplied by a financial institution to a non-resident person are zero-rated.

Imports
Sch. VII, s 8

36. Precious metals imported under any circumstances are prescribed by the *Non-Taxable Imported Goods (GST) Regulations*, and are therefore non-taxable imports by virtue of section 8 of Schedule VII.

Options or contracts traded on recognized commodity exchanges

Financial instruments

37. A commodity option or commodity future contract is a financial instrument for GST/HST purposes when traded on a recognized commodity exchange, such as the Winnipeg Commodity Exchange.

Options

38. An option for the future supply of a commodity includes a right, but not an obligation, to buy or sell a commodity at a specified price within a stipulated future time period. The option buyer pays a premium to the dealer for this right, in addition to the usual commission. The supply of a commodity option where sold on a recognized commodity exchange is a financial service provided under paragraph (d) of the definition of financial service in subsection 123(1). However, the taxable status of the underlying commodity, if the option is exercised, is either taxable at 7% or 15% or exempt depending on the nature of the supply.

Futures contract

39. A futures contract is an agreement to buy or sell a specific amount of a commodity at a particular price on a stipulated future date. Contrary to a commodity option, a futures contract obligates the buyer to purchase the underlying commodity and the seller to sell it, unless the contract is sold to another before the exercise date. The supply of a futures contract where sold on a recognized commodity exchange is also a financial service provided under paragraph (d) of the definition of financial service in subsection 123(1). However, the taxable status of the underlying commodity when the exercise date becomes due is either taxable or exempt depending on the nature of the supply.

Prescribed instruments

40. Paragraph (g) of the definition of financial instrument provides for additional categories of financial instruments. To date, no regulations have been promulgated.

Guarantees, acceptances or indemnities

Guarantee

41. A guarantee includes an undertaking by a person to pay money or perform obligations with respect to a financial instrument provided under paragraphs (a), (b), (d), (e), and (g) of the definition of financial instrument in subsection 123(1), should the person primarily liable for the payment of a debt or obligation fail to execute that person's responsibility. For example, a guarantee bond is considered to be a financial instrument. A guarantee bond is a guarantee wherein the principal and interest may be guaranteed by a party other than the issuer. This situation may arise in parent-subsidiary relationships where bonds issued by a subsidiary are guaranteed by the parent.

Acceptance

42. An acceptance in respect of paragraphs (a), (b), (d), (e) and (g) of the definition of financial instrument will include a formal indication by a person of its acceptance or guarantee that a financial instrument will be paid (e.g., Banker's Acceptance). An acceptance agreement is created, for example, when the drawee of a financial instrument writes "accepted" and a designated date of payment on the instrument and the drawee is responsible for payment at maturity.

Indemnity

43. An indemnity in respect of paragraphs (a), (b), (d),(e) and (g) of the definition of financial instrument refers to a collateral contract or agreement by which one person agrees to indemnify another against an anticipated loss. It is an undertaking to be liable to pay money or perform an obligation in respect of the financial instrument (e.g., indemnity bond).

44. Guarantees, acceptances or indemnities pertaining to financial instruments defined in paragraphs (a), (b), (d), (e) or (g) of the definition of financial instrument are also defined (in paragraph (h)) to be themselves financial instruments for GST/HST purposes. Therefore, financial services relating to these guarantees, acceptances or indemnities will generally be exempt.

Options and contracts

Options

45. An option for the future supply of money or a financial instrument described in paragraphs (a) to (h) of the definition of financial instrument refers to a right, but not an obligation, to buy or sell money or a financial instrument at a specified price within a stipulated future time period.

Contract

46. A contract for the future supply of money or a financial instrument described in paragraphs (a) to (h) of the definition of financial instrument refers to an agreement to buy or sell the above at a stipulated future date. For example, a future contract to purchase or sell US dollars at a specified price on a stipulated future date is a financial instrument.

All GST/HST memoranda and other Revenue Canada publications are available on Internet at the Revenue Canada site http://www.rc.gc.ca/ under the heading "Technical Information" in "General Information".