Department of Finance Canada Ministère des Finances Canada

Canada

HARMONIZED SALES TAX RULES FOR FINANCIAL INSTITUTIONS, INTERMENT RIGHTS AND STREAMLINED ACCOUNTING METHODS

This backgrounder describes proposed Harmonized Sales Tax (HST) measures in respect of:

1. clarifications and other improvements to proposed HST rules for financial institutions (FIs) following consultations on the Department of Finance news release dated May 19, 2010;
2. proposed new HST rules and rates for streamlined accounting methods used by small businesses and eligible public service bodies; and
3. proposed new HST transitional rules for Ontario and British Columbia in respect of interment rights.

PART 1: HST RULES FOR FINANCIAL INSTITUTIONS

This part of the backgrounder outlines proposed technical clarifications and other improvements to the changes proposed to the HST rules governing FIs that relate to the calculation of the provincial component of the HST (PVAT) that were announced in the May 19th release.

Details relating to the vast majority of the proposed changes applicable to FIs proposed in the May 19th release can be found in the attached draft regulations. Some of the proposed technical clarifications and other improvements proposed in this backgrounder are also included in the attached draft regulations. The remaining details of the proposed changes for FIs will be included, at an early opportunity, in regulations that will be submitted for approval by the Governor in Council or in proposed amendments to the *Excise Tax Act* (ETA).

Unless otherwise specified, the proposed changes would apply in respect of any reporting period of a person that ends after June 2010.

Proposals for Investment Plans and Segregated Funds

Small investment plans as specified investors

The May 19th release proposed that an institutional investor that is not an investment plan or a segregated fund (i.e., a non-investment corporation, partnership, or family trust) be treated as a "specified investor" where the value of the institutional investor's investment in the investment plan or segregated fund (i.e., in the investee) is less than $10 million on the attribution date (i.e., the date when investment plans and segregated funds would generally be required to determine their attribution percentages).

Unlike other institutional investors, a specified investor would not be required to look through its investments to provide investor residency information to the investee. Instead, 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 the partnership itself does not have a principal business address) or the trustee's business address (if it is a trust).

In addition, the May 19th release proposed that a "small investment plan" (e.g., a trust governed by a registered pension plan or an employee benefit plan) also be treated as a specified investor. An investment plan such as a registered pension plan or an employee benefit plan would be a "small investment plan" for a fiscal year of the investment plan if it has unrecoverable Goods and Services Tax (GST) ((A-B) in the Special Attribution Method (SAM) formula) in its immediately preceding fiscal year of less than $10,000 and it has not elected to be treated as an SLFI for the fiscal year.

As a result of comments received on the May 19th release, it is proposed that all investment plans (other than mutual fund trusts, mutual fund corporations, segregated funds, unit trusts and mortgage investment corporations) qualify as specified investors, regardless of whether they are "small investment plans" or not, provided that the plan's investment in the investee is less than $10 million on the attribution date of the investee.

A related party restriction is proposed to apply to an investment plan in determining the specified investor test in relation to particular investments of the plan in an investee, if the investment plan or a person related to the investment plan holds other investments and if those other investments combined with the particular investment of the plan in the investee would exceed the $10 million threshold. In such cases, the investment plan would be required to provide information to the investee on the residency of its individual investors and the value of their investments in the plan.

Look-through rules for institutional investors

The May 19th release proposed that a trustee or fund manager be required to obtain investor residency information for "all or substantially all" (i.e., 90% or more) of the value of investments in an investment plan or a segregated fund (e.g., for a mutual fund, the fund manager or trustee would be required to obtain the provincial distribution of 90% or more of the value of units in each series). If investor residency information for 90% or more of the value of units in a series is obtained, the portion of the value of units in the series for which the investor residency is not obtained is assumed to follow the distribution of the rest of the value of units for purposes of calculating provincial attribution percentages.

Further, it was proposed that, if the trustee or fund manager does not obtain investor residency information in respect of 90% or more of the value of units in a series, the value of units for which information is not available 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. For example, if residency can only be determined for 85% of the value of units in a series, the unallocated 15% would be subject to the highest PVAT rate among all participating provinces.

As a result of comments received on the May 19th release, an exception will be proposed to limit the extent to which an investment plan or a segregated fund would be subject to the highest PVAT rate. If the trustee or fund manager obtains investor residency information for more than 50% of the value of investments in a particular series of a fund, only the portion for which investor residency information is needed to reach the 90% threshold for that series would be subject to the highest PVAT rate, rather than to theentire unallocated portion of the series. For example, if investor residency can be determined for 65% of the value of units in a series, then 25% of the value of units in the series would be subject to the highest PVAT rate for purposes of the SAM formula. The remaining unallocated 10% would be assumed to follow the distribution of the 65% of the value of units for which investor information is obtained.

However, where the trustee or fund manager does not obtain investor residency information for more than 50% of the value of investments in the investment plan or segregated fund, the entire portion for which investor residency information is not obtained would be regarded as unallocated and would be subject to the highest PVAT rate. For example, if investor residency can only be determined for 40% of the value of units in a series, 60% of the value of units would be subject to the highest PVAT rate.

In all cases, where an investment plan or segregated fund does not request investor information from either the investors or the distribution agents (e.g., a dealer, broker, salesperson or a transfer agent that holds investor information) in respect of units of the investment plan or segregated fund held by investors and does not otherwise have the necessary residency information of the investors holding the units, those units would be subject to the highest PVAT rate among all participating provinces.

"General" method and choice of alternative methods for determining the attribution percentage

The May 19th release proposed a general rule for determining an investment plan or segregated fund's provincial attribution percentage, but also allowed them to elect to use one of two alternative methods (i.e., the "preceding year method" or the "real time method").

It is proposed that the first alternative method – the preceding year method – instead be designated as the general rule, as the majority of investment plans and segregated funds are expected to use the preceding year method. The method originally described in the May 19th release as the general rule would be available for election as an alternative, along with the real time method.

Filing of elections

Under the proposed changes, a number of new elections have been introduced and would give FIs various options to facilitate compliance with the new HST rules. It is proposed that discretion be provided for the Minister of National Revenue with respect to the deadlines for filing these elections.

Calendar year as fiscal year for investment plans and segregated funds

The May 19th release proposed that investment plans and segregated funds that are SLFIs be required to have calendar years as their fiscal years.

This document clarifies that certain investment plans and segregated funds which are already GST/HST registrants and do not have the calendar year as their fiscal year would be required to file two separate SLFI GST 494 returns during the transitional year for investment plans and segregated funds (i.e., the fiscal year that ends December 31, 2010).

Specifically, for the transitional year, an investment plan or a segregated fund that is already a GST/HST registrant and has a fiscal year ending after June 2010 but before December 31, 2010 would be required to file one SLFI GST 494 return for the fiscal year which includes July 1, 2010 and one for the rest of the transitional year ending on December 31, 2010. For example, an investment plan or a segregated fund with a fiscal year commencing October 1, 2009 and ending September 30, 2010 would file an SLFI GST 494 return for that fiscal year, and an additional SLFI GST 494 return for the period commencing October 1, 2010 and ending December 31, 2010. For subsequent reporting periods, the investment plan or segregated fund would have a calendar year as its fiscal year (e.g., January 1, 2011 to December 31, 2011 fiscal year) and would file an SLFI GST 494 return six months after that fiscal year in respect of its PVAT liability for that year.

Requirement to register for GST/HST purposes

The May 19th release proposed that, generally, investment plans and segregated funds that are SLFIs be required to register for GST/HST purposes.

It is now proposed that an SLFI investment plan or segregated fund only be required to register in cases where the SLFI investment plan or segregated fund makes a reporting entity election, a consolidated filing election, or a tax transfer adjustment election as described in the May 19th release. For reporting purposes, SLFI investment plans and segregated funds that have jointly made the consolidated filing election would be permitted to use a single GST/HST registration number.

Penalties relating to providing investor information

As discussed in the May 19th release, investment plans and segregated funds would generally be required to calculate their PVAT liability using attribution percentages calculated on the basis of the value of investments held by investors resident in participating provinces on an attribution date. In some cases, to obtain the necessary information, an investment plan or a segregated fund needs to rely on the information held by distribution agents (e.g., brokers and dealers) and/or institutional investors investing in the investment plan or segregated fund.

The May 19th release proposed that, upon request, an institutional investor in an investment plan or segregated fund be required to provide information to the investment plan or segregated fund in respect of the institutional investor's attribution percentage for each participating province for each series in the fund in which it has an investment. The investor would also be required to provide the total value of its investment in each series of the fund. The May 19th release proposed that a penalty be imposed on the institutional investor where the required information is not provided. A penalty would also be imposed, subject to a due diligence test, on distribution agents who fail to provide the necessary information to a fund manager/trustee of an investment plan or a segregated fund upon request of that information by the fund manager/trustee. The details of the penalties were not specified in the May 19th release.

It is proposed that specific penalties be imposed for the failure to provide accurate information to an investment plan or segregated fund, on or before the later of November 15 and 45 days after the information has been requested by the investment plan or segregated fund. It is proposed that the amount of the penalty be the lesser of $10,000 and 0.01% of the total value of units (determined on the attribution date) for which information was not provided or information was misstated to the investment plan or segregated fund by the person.

Attribution percentage for new funds or series within a fund created through mergers

The May 19th release proposed rules for the calculation of the provincial attribution percentage (i.e., element C of the SAM formula) where two or more predecessor funds or series of units of a fund merge to create a new fund or series. The attribution percentage 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 is the attribution percentage for the province used immediately before the merger by the predecessor fund or series; and

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

If a merger occurs after September 30th of a particular fiscal year, the attribution percentage determined for the new series or the new fund upon the merger would be used for both the first fiscal year ending after the merger and the subsequent fiscal year.

As a result of industry comments on the May 19th release, this backgrounder clarifies that the percentage determined above for the new fund or series created by way of merger would apply beginning on the day of the merger. The 90-day rule for the gross-up method (described below) does not apply for mergers.

Attribution percentage for new funds or series within a fund created otherwise than by way of a merger

The May 19th release proposed two options to calculate the attribution percentage of a fund or of a series within a fund created otherwise than by way of a merger of previously existing funds.

One of the two options is to use a gross-up method. Under this method, the attribution percentage for a new series or a new fund 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) would be grossed up to account for the PVAT attributable to the initial 90-day period. Therefore, the gross-up factor that applies to the attribution percentage for a series during the 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 series divided by the number of days that are 90 days after the initial distribution in the fiscal year.

It is proposed that the gross-up method account for the initial 90 days be spread over two fiscal years rather than just the first year of the fund or series. This new approach would prevent unreasonably high PVAT rates which could arise from the original gross-up proposed method if a new series or a fund has an attribution date which is near the end of

the year. For example, under the original gross-up method, if the attribution date (i.e., 90 days after the initial distribution of units) of a new series of a fund was December 15, its PVAT rate for the year would be grossed up by a factor of 6.6 (106 days from the initial distribution to the year-end (90 + 16) divided by the 16 days after the 90-day point which are the days during which tax for the year is assessed).

Under the new approach, using the above example, for the year the new series is created and the following fiscal year, the gross up would be 1.2, i.e., (i) 106 days from the initial distribution to the year-end plus the 365 days in the second year divided by (ii) the 16 days after the 90-day point which are the days during which tax for the year is assessed plus the 365 days in the second year.

The grossed-up attribution percentage would apply to all of the unrecoverable GST (including the unrecoverable GST for the initial 90 days) in the year the new series is created and the unrecoverable GST in the following fiscal year. However, the unrecoverable GST would be reduced based on a factor that would be the inverse of the above gross-up factor to reflect the inclusion of unrecoverable GST incurred in the initial 90-day period. Based on the above example, this factor would be (16+365)/(106+365).

The following example illustrates how the PVAT would be calculated under the gross-up method in the first and second year of a new fund series created (otherwise than by a merger of series or funds).

Example

A new single series fund is created on July 1, 2011. For its initial 90-day period (July 1 - September 28, 2011), the fund has total unrecoverable GST of $2,500. For the remaining 94 days of the fiscal year (September 29 - December 31, 2011), the fund has total unrecoverable GST of $4,000. The total unrecoverable GST for the fund for its first fiscal year, therefore, equals $6,500. The unrecoverable GST for the fund for its second fiscal year (January 1 – December 31, 2012 with 366 days in the year), equals $15,000. The attribution percentage determined on September 30, 2011 for Ontario is 50%.

The gross-up factor in this case would be: (90+94+366)/((94+366) = 1.196

The inverse of this gross-up factor would be: (94+366)/(90+94+366) = 0.836

Ontario PVAT liability for year 1:

((6,500 x 0.836) x (50% x 1.196) x (8/5)) = $5,199.25

Ontario PVAT liability for year 2:

((15,000 x 0.836) x (50% x 1.196) x (8/5)) = $11,998.27

The second option proposed by the May 19th release for new funds or series within a fund is the "modified real time method". For greater clarity, the "modified real time method" would be applied effective the first day the new series of a fund is created. The 90-day rule for the gross-up method does not apply under the modified real time method.

Exclusion of non-residents from the calculation of provincial attribution percentage

The May 19th release proposed to exclude the value of units held by non-residents when calculating the provincial attribution percentage of an investment plan or a segregated fund. This is appropriate where services provided with respect to non-residents would generally be zero-rated and an SLFI investment plan or a segregated fund would be entitled to input tax credits (ITCs) for tax paid on the inputs used to provide those zero-rated services to non-residents, resulting in no unrecoverable tax.

Based on the comments received on the May 19th release, it appears that most investment plans and segregated funds would not be claiming ITCs and would prefer to treat the non-residents in the same manner as residents and include non-resident investment holdings in the calculation of the provincial attribution percentages.

Therefore, it will be proposed to include non-residents in the calculation of the provincial attribution percentages of an investment plan or segregated fund where the non-residents are treated as residents for GST/HST purposes by the investment plan or the segregated fund with respect to the non-resident investment holdings in the plan or fund. This means that the investment plan or segregated fund would be subject to the same rules in their dealings with both residents and non-residents. The ITC restrictions and other obligations imposed under the ETA such as self-assessment of GST for imported taxable supplies that generally may not have applied in their dealings with non-residents would now apply with these proposed changes.

It is also proposed that the investment plan or segregated fund be permitted to opt out of this rule by filing an election with the Minister of National Revenue which would effectively exclude non-residents from the provincial attribution calculation and allow the investment plan or segregated fund to claim ITCs. The investment plan or segregated fund would be allowed to revoke the election after 5 years, or at an earlier date if approved by the Minister of National Revenue, in which case ITC restrictions and other obligations imposed under the Act, as referred to above, would apply.

Proposals for Selected Listed Financial Institutions Other Than Investment Plans and Segregated Funds

Coming into force date for new calculation of the provincial attribution percentage – Element C of Special Attribution

Method (SAM) formula for banks

The May 19th release proposed a number of changes to the provincial attribution percentage calculation for banks. These changes were proposed to apply for fiscal years commencing after June 2010. As a result, for most domestic banks, the rules would generally apply beginning in their November 2010 to October 2011 fiscal year.In the transitional year (i.e., the fiscal year that includes the July 1, 2010 implementation date of the HST in British Columbia and Ontario), the existing rules would continue to apply.

As a result of comments received on the May 19th release, it is proposed that the changes to the provincial attribution calculation in element C of the SAM formula apply to the transitional year as well.

Exclusion of "zero-rated financial services"

The May 19th release proposed that the salaries and wages component of the attribution percentage for banks be amended so that salaries and wages be excluded from element C of the SAM formula for banks to the extent that those salaries and wages are in respect of zero-rated financial services provided to non-residents. It is proposed that this amendment be expanded to also exclude salaries and wages related to other zero-rated supplies (i.e., exports of non-financial services) to non-residents.

Recapture of Input Tax Credits (RITC)

The May 19th release proposed that the RITC rules for SLFIs apply to the same classes of specified property and services (i.e., qualifying road vehicles (in Ontario only, including gasoline for those vehicles), specified energy, specified telecommunication services, and specified meals and entertainment) that are subject to the general RITC rules for other FIs and large businesses. Since SLFIs are generally not permitted to claim ITCs in respect of PVAT but instead recover all of the PVAT paid or payable through the special attribution method, it was proposed that SLFIs be required to determine an RITC amount for each specified class of specified property or service through a special formula.

It is proposed that the various proxies, as announced by Ontario and British Columbia, that could be used by non-SLFIs in the calculation of amounts subject to RITCs be extended to SLFIs. For example, an SLFI would be able to apply the proxies for specified telecommunication services to determine the portion of consideration that is attributable to specified telecommunication services where those services are supplied together with other property or services.

Further, the exclusions to specified property and services (e.g., property or service acquired for resupply, fuel (for purposes of BC RITC rules)) that apply under the general RITC rules for non-SLFIs and other businesses would be extended to SLFIs as well.

PART 2: STREAMLINED ACCOUNTING METHODS

Small businesses, as well as eligible public service bodies, can use a Quick or Special Quick Method of Accounting to simplify compliance. Under these methods, taxpayers multiply eligible GST/HST-included sales by a reduced percentage and remit that amount to the government in lieu of tracking and claiming input tax credits for most of the tax they pay. The percentages used are specified in the *Streamlined Accounting (GST/HST) Regulations*.

As a result of provincial flexibility in establishing the rate of the provincial component of the HST under the new harmonized value-added tax system and the implementation of an HST in Ontario and British Columbia, effective on July 1, 2010, new specified percentages will be required for the streamlined accounting methods. The proposed new percentages are provided in the tables attached as an Annex A to this backgrounder.

Changes to the regulations are also proposed with respect to eligible supplies made by a registrant through a permanent establishment of the registrant where substantially all of the supplies for the reporting period of the registrant are made in a participating province. In this circumstance, the registrant may generally treat all eligible supplies for the reporting period made through that establishment as having been made in that province and the specified percentage under the Quick or Special Quick Method for that participating province applies.

The proposed percentages and the amended "substantially all" rules would be applicable for the purpose of determining the net tax of a registrant for reporting periods ending on or after July 1, 2010. However, if the reporting period of the registrant includes July 1, 2010, the specified percentages and rules that would have applied before the proposed changes apply in respect of a supply where consideration for the supply is paid or becomes due before that day.

PART 3: INTERMENT RIGHTS

Under the general HST transitional rules for Ontario and British Columbia, the provincial component of the HST (PVAT) does not apply to a funeral or cemetery service if it is supplied pursuant to a written arrangement that is entered into before July 1, 2010 and, at the time that the arrangement is entered into, it is reasonable to expect that all or a part of the funds for the service would be paid before the individual's death.

It is proposed that, for purposes of the general HST transitional rules for Ontario and British Columbia, the PVAT would also not apply to an interment right (i.e., a real property right relating to the interment of human remains in a cemetery, mausoleum, or any similar place used for the interment of human remains) supplied under a written

agreement that is entered into before July 1, 2010. If a supplier of interment rights collected HST before the proposed announcement is made, the person acquiring the rights could seek a refund of the PVAT from the supplier or from the Canada Revenue Agency.

ANNEX A – REMITTANCE RATES FOR STREAMLINED ACCOUNTING METHODS

Table 1
Remittance Rates for Business Registrants Using the Quick Method of Accounting

	Supplies Made in			
	Non-participating province	**Ontario, New Brunswick or Newfoundland and Labrador**	**Nova Scotia**	**British Columbia**
i) Mainly Purchases Goods for Resale				
(Permanent Establishment in)				
Non-participating province	1.8%	8.8%	10.4%	8.0%
Ontario, New Brunswick or Newfoundland and Labrador	0.0%* (credit 2.8%)*	4.4%	6.1%	3.6%
Nova Scotia	0.0%* (credit 4.0%)*	3.3%	5.0%	2.5%
British Columbia	0.0%* (credit 2.3%)*	5.0%	6.6%	4.1%
ii) Mainly Provides Services				
(Permanent Establishment in)				
Non-participating province	3.6%	10.5%	12.0%	9.7%
Ontario, New Brunswick or Newfoundland and Labrador	1.8%	8.8%	10.4%	8.0%
Nova Scotia	1.4%	8.4%	10.0%	7.6%
British Columbia	2.1%	9.0%	10.6%	8.2%

* Businesses who use the 0% remittance rate for eligible sales are entitled to a credit on those sales as they generally pay HST at 12%, 13% or 15% on their inputs but collect 5% GST on those sales.

Table 2
Remittance Rates for Public Service Bodies Using the Special Quick Method of Accounting

	Supplies Made in			
	Non-participating province	**Ontario, New Brunswick or Newfoundland and Labrador**	**Nova Scotia**	**British Columbia**
i) Municipality				
(Permanent Establishment in)				
Non-participating province	4.7%	11.5%	13.0%	10.7%
Ontario	4.3%	11.1%	12.6%	10.3%
New Brunswick	3.9%	10.7%	12.3%	9.9%
Nova Scotia	3.7%	10.5%	12.1%	9.7%
British Columbia	4.3%	11.1%	12.6%	10.3%
Newfoundland and Labrador	2.8%	9.7%	11.2%	8.9%
ii) University or Public College (if Supplies Through Vending Machines Account for at Least 25% of Total Supplies)				
(Permanent Establishment in)				
Non-participating province	4.1%	10.9%	12.4%	10.1%
Ontario	3.3%	10.2%	11.8%	9.4%
New Brunswick or Newfoundland and Labrador	0.8%	7.8%	9.4%	7.0%
Nova Scotia	2.7%	9.6%	11.2%	8.8%
British Columbia	3.4%	10.2%	11.8%	9.4%
iii) University or Public College (if Supplies Through Vending Machines Account for Less Than 25% of Total Supplies)				
(Permanent Establishment in)				
Non-participating province	4.4%	11.1%	12.7%	10.3%
Ontario	3.9%	10.7%	12.3%	9.9%
New Brunswick or Newfoundland and Labrador	2.4%	9.3%	10.9%	8.5%
Nova Scotia	3.6%	10.4%	12.0%	9.6%
British Columbia	3.9%	10.7%	12.3%	9.9%
iv) School Authority				
(Permanent Establishment in)				
Non-participating province	4.4%	11.1%	12.7%	10.3%
Ontario	4.2%	11.0%	12.6%	10.2%
New Brunswick or Newfoundland and Labrador	2.4%	9.3%	10.9%	8.5%
Nova Scotia	3.6%	10.4%	12.0%	9.6%
British Columbia	4.1%	10.9%	12.5%	10.1%
v) Hospital Authority, External Supplier or Facility Operator				
(Permanent Establishment in)				
Non-participating province	4.5%	11.3%	12.8%	10.5%
Ontario	4.2%	11.0%	12.5%	10.2%
New Brunswick or Newfoundland and Labrador	2.1%	9.1%	10.7%	8.3%

Nova Scotia	4.0%	10.8%	12.4%	10.0%
British Columbia	3.6%	10.5%	12.0%	9.7%
vi) Specified Facility Operator, Qualifying Non-Profit Organization or Designated Charity				
(Permanent Establishment in)				
Non-participating province	3.6%	10.5%	12.0%	9.7%
Ontario	3.0%	9.9%	11.4%	9.1%
New Brunswick or Newfoundland and Labrador	1.8%	8.8%	10.4%	8.0%
Nova Scotia	1.4%	8.4%	10.0%	7.6%
British Columbia	2.3%	9.2%	10.8%	8.4%

Table 3
Remittance Rates for Registrants that Provide a Point-of-Sale Rebate on Eligible Supplies When Using the Quick or Special Method of Accounting

	Supplies Made in Point-of-sale eligible participating province
(Type of supplier)	
Business Mainly Purchases Goods for Resale	1.8%
Business Mainly Provides Services	3.6%
Municipality	4.7%
University or Public College (if Supplies Through Vending Machines Account for at Least 25% of Total Supplies)	4.1%
University or Public College (if Supplies Through Vending Machines Account for Less Than 25% of Total Supplies)	4.4%
School Authority	4.4%
Hospital Authority, External Supplier or Facility Operator	4.5%
Specified Facility Operator, Qualifying Non-Profit Organization or Designated Charity	3.6%

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