GST/HST Technical Information Bulletin

B-095 **June 2011**

The Self-assessment Provisions of Section 218.01 and Subsection 218.1(1.2) for Financial Institutions (Import Rules)

NOTE: This version replaces the one dated June 2007

The information in this bulletin does not replace the law found in the *Excise Tax Act* (the Act) and its regulations. It is provided for your reference. As it may not completely address your particular operation, you may wish to refer to the Act or appropriate regulation, or contact a Canada Revenue Agency (CRA) GST/HST rulings office for more information. A ruling should be requested for certainty in respect of any particular GST/HST matter. Pamphlet RC4405, *GST/HST Rulings – Experts in GST/HST Legislation* explains how to obtain a ruling and lists the GST/HST rulings offices. If you wish to make a technical enquiry on the GST/HST by telephone, please call 1-800-959-8287.

Reference in this publication is made to supplies that are subject to the GST or the HST. The HST applies in the participating provinces at the following rates: 13% in Ontario, New Brunswick, and Newfoundland and Labrador, 15% in Nova Scotia, and 12% in British Columbia. The GST applies in the rest of Canada at the rate of 5%. If you are uncertain as to whether a supply is made in a participating province, you may refer to GST/HST Technical Information Bulletin B-103, *Harmonized Sales Tax – Place of Supply Rules for Determining Whether a Supply is Made in a Province*.

If you are located in Quebec and wish to make a technical enquiry or request a ruling related to the GST/HST, please contact Revenu Québec at 1-800-567-4692. You may also visit the Revenu Québec Web site to obtain general information.

All references are to the *Excise Tax Act* unless stated otherwise.

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La version française de la présente publication est intitulée *Dispositions prévues à l'article 218.01 et au paragraphe 218.1(1.2) relatives à l'autocotisation des institutions financières (règles sur l'importation)*.

Canada Revenue Agency Agence du revenu du Canada

Canada

Introduction

This bulletin explains the new import rules for financial institutions (FIs) in sections 217, 217.1, 217.2, 218.01, 218.1, 218.3 and 219 of Division IV of Part IX of the Act which generally apply for specified years that end after November 16, 2005.

The import rules apply to a qualifying taxpayer in addition to the rules for imported taxable supplies and the corresponding self-assessment requirement under section 218 and subsection 218.1(1) under Division IV.

The purpose of all the examples in this TIB is to demonstrate the GST/HST concepts, for example whether an amount is qualifying consideration, and not to demonstrate whether an amount would be deducted under the *Income Tax Act* (the ITA). As such, an assumption and not a determination has been made for purposes of the examples that an amount is or would be deductible under the ITA.

Import rules for FIs

Overview

The import rules for FIs apply to:

- all FIs resident in Canada,
- a non-resident FI that has a qualifying establishment in Canada,
- an FI that carries on, engages or conducts an activity in Canada where a majority of the persons having beneficial ownership of the FI's property in Canada are resident in Canada, and
- an FI that is a prescribed person or is of a prescribed class.

These FIs are referred to as "qualifying taxpayers" for purposes of the import rules.

A qualifying taxpayer is required to self-assess on each amount of "qualifying consideration" in respect of an "outlay made, or an expense incurred, outside Canada" that is greater than zero for a specified year. However, as an alternative to self-assessing on qualifying consideration, where an election is in effect, a qualifying taxpayer resident in Canada is required to self-assess on the total of each amount that is an "internal charge" that is greater than zero for a specified year, and each amount that is an "external charge" that is greater than zero for a specified year.

Generally, where the requirements for claiming an input tax credit (ITC) are met, a qualifying taxpayer may be entitled to claim ITCs in respect of the tax self-assessed under certain conditions.

Qualifying taxpayer

The term **financial institution** is defined in subsection 149(1). The definition includes FIs that are listed in paragraph 149(1)(a) such as a bank, trust corporation or an insurer, as well as *de minimis* FIs described in paragraphs 149(1)(b) and (c). See the Appendix for further information on the meaning of financial institution.

Pursuant to subsection 217.1(1), a person is a **qualifying taxpayer** throughout a specified year of the person if

(a) the person is a financial institution at any time in the specified year; and

(b) the person, at any time in the specified year

(i) is resident in Canada,

(ii) has a qualifying establishment in Canada,

(iii) where a majority of the persons having beneficial ownership of the person's property in Canada are resident in Canada, carries on, engages in or conducts an activity in Canada, or

(iv) the person is a prescribed person or a person of a prescribed class.

As a result of the proposed *Draft Regulations Amending Various GST/HST Regulations (Part 5) Financial Services (GST/HST) Regulations* issued January 28, 2011, for any specified year that begins on or after July 1, 2010, a non-resident trust is a prescribed person for the purposes of the qualifying taxpayer rules if the total value of the assets of the trust in which one or more persons resident in Canada have a beneficial interest is

(a) equal to or greater than $10,000,000; and

(b) equal to or greater than 10% of the total value of the assets of the trust.

A **specified year** of a qualifying taxpayer is the person's taxation year, calendar year or fiscal year. Generally, if the qualifying taxpayer is a taxpayer for purposes of the ITA or is a partnership described in subparagraph 249(1)(b)(ii) of the ITA, the specified year is the taxation year. If the qualifying taxpayer is a registrant but is not included in the preceding sentence (e.g., the qualifying taxpayer is not a taxpayer for purposes of the ITA), its specified year is the fiscal year. In any other case, it is the calendar year of the person.

A **qualifying establishment** under section 217 means a permanent establishment as defined in subsection 123(1) or as defined in subsection 132.1(2).

A permanent establishment of a person under subsection 123(1) generally includes

- a fixed place of business of the person such as a place of management, a branch or office of the person through which the person makes supplies, or
- a fixed place of business of another person acting in Canada on behalf of the person (other than a broker, general commission agent or other independent agent acting in the ordinary course of business), through which the person makes supplies in the ordinary course of business.

A permanent establishment of a person under subsection 132.1(2) generally includes a permanent establishment under Part IV *Taxable Income Earned in a Province by a Corporation* or Part XXVI *Income Earned in a Province by an Individual* of the *Income Tax Regulations*.

The reference to being resident in Canada in the definition of "qualifying taxpayer" does not include a non-resident with a permanent establishment under subsection 123(1) in Canada where that person is deemed under subsection 132(2) to be resident in Canada with respect to activities of the person carried on through the establishment. For example, a foreign corporation with a branch that is a permanent establishment under subsection 123(1) located in Canada is not a resident of Canada but is considered a non-resident with a permanent establishment in Canada.

Similarly, a non-resident does not include a resident with a permanent establishment under subsection 123(1) in a country other than Canada where that person is deemed under subsection 132(3) to be a non-resident in respect of activities of the person carried on through that establishment. For example, a corporation resident in Canada with a branch that is a permanent establishment under subsection 123(1) located in another country is not considered to be a non-resident.

As a result of the meaning of qualifying taxpayer, all FIs resident in Canada are qualifying taxpayers even if the resident FIs do not have any presence outside Canada (for example, they are qualifying taxpayers regardless of whether they have any branches or offices located outside Canada). All non-resident FIs that operate in Canada through a branch or office that is a qualifying establishment are qualifying taxpayers, and under certain circumstances non-resident FIs that do not have a branch or office in Canada are also qualifying taxpayers because of the definition of qualifying establishment. Finally, an FI that carries on, engages in or conducts an activity in Canada where a majority of the persons having beneficial ownership of the FI's property in Canada are resident in Canada, and an FI that is prescribed are qualifying taxpayers as well.

Examples of qualifying taxpayers

Example 1

A non-resident insurance corporation does not have an office in Canada, but is licensed to do business in a Canadian province. The insurance corporation is a qualifying taxpayer because it is a non-resident FI that has a permanent establishment under paragraph 400(2)(c) of the *Income Tax Regulations*, and therefore is a non-resident FI with a qualifying establishment in Canada.

Example 2

Canada Bank is a bank resident in Canada. Canada Bank is a qualifying taxpayer because it is an FI under subsection 149(1) and is resident in Canada.

Example 3

Mr. J's principal business is acting as an insurance broker in Canada and he is resident in Canada. Mr. J is a qualifying taxpayer because he is an FI under subsection 149(1) and is resident in Canada.

Example 4

US Bank is resident in the United States and has a branch in Canada. The branch in Canada is a permanent establishment under subsection 123(1). US Bank is a qualifying taxpayer because it is a non-resident FI with a permanent establishment and therefore a qualifying establishment in Canada.

Example 5

A non-resident mutual fund trust has a non-resident trustee. The majority of the persons having beneficial ownership of the property of the trust are resident in Canada. The non-resident trust is carrying on activities in Canada, but does not have a permanent establishment in Canada (as defined in subsections 123(1) or 132.1(2)). The non-resident trust is a qualifying taxpayer because the non-resident trust is a FI carrying on activities in Canada and the majority of the trust beneficiaries are resident in Canada.

Example 6

Partnership B's principal business is the lending of money and it is resident in Canada. Partnership B is a qualifying taxpayer because it is an FI under subsection 149(1) and is resident in Canada.

Self-assessing on qualifying consideration

Where an election under section 217.2 is not in effect, paragraph 218.01(b) requires a qualifying taxpayer to pay the GST on the total of all amounts each of which is an amount of qualifying consideration for the specified year that is greater than zero.

In addition, paragraph 218.1(1.2)(b) requires every qualifying taxpayer that is resident in a participating province to pay for each specified year and for each particular participating province the provincial part of the HST. The provincial part of the HST is determined by a formula that in general terms is the qualifying consideration multiplied by the extent (expressed as a percentage) to which the expense that corresponds to the qualifying consideration was used in carrying on an activity of the qualifying taxpayer in the particular province. However, for a specified year that ends before July 1, 2010, tax is determined based on the extent of activity in each participating province in which the qualifying taxpayer is resident at any time in the specified year.

Subsection 218.1(1.3) provides the rules for determining whether a qualifying taxpayer is resident in a province for purposes of self-assessing under subsection 218.1(1.2). Despite section 132.1 (which generally contains rules for determining when a person is resident in a province for GST/HST purposes), pursuant to subsection 218.1(1.3) a qualifying taxpayer is deemed to be resident in a province at any time if, at that time,

(a) the qualifying taxpayer has a qualifying establishment in the province; or

(b) in the case of a qualifying taxpayer that is resident in Canada, the qualifying taxpayer is

  (i) a corporation incorporated or continued under the laws of the province and not continued elsewhere,

(ii) an entity that is a partnership, an unincorporated society, a club, an association or an organization, or a branch of such an entity, in respect of which a majority of the members having management and control of the entity or branch are resident in the province, or

(iii) a trust, carrying on activities as a trust in the province, that has a local office or branch in the province.

Certain FIs (e.g., certain investment plans) should refer to the *Proposed Amendments to the GST/HST Legislation* and Part 3 *New Harmonized Value-Added System Regulations No. 2* of the proposed *Draft Regulations Amending Various GST/HST Regulations* released January 28, 2011 to determine if they are required to self-assess the provincial part of the HST under subsection 218.1(1.2).

According to the *Proposed Amendments to the GST/HST Legislation* issued January 28, 2011, it is proposed that subsection 218.1(1.2) be amended to add prescribed percentages for the internal charges, external charges and qualifying consideration of certain FIs attributable to a particular participating province. Reference should also be made to Part 3 *New Harmonized Value-added Tax System Regulations No.2* of the proposed *Draft Regulations Amending Various GST/HST Regulations* also issued January 28, 2011.

Specific to the provinces of Ontario and British Columbia, for a specified year that starts before July 1, 2010, and ends on or after that day, the qualifying taxpayer self-assesses the provincial part of the HST by also using a formula that adjusts the tax payable under subsection 218.1(1.2) by a percentage based on the number of days of the specified year that are after June 2010 relative to the number of days in the specified year.

Selected listed financial institutions (SLFIs) that fall within section 225.2 are generally not required to self-assess the provincial part of the HST imposed under subsection 218.1(1.2). These FIs continue to use the special attribution rules under section 225.2 to make adjustments in determining their liability for the provincial part of the HST in respect of the tax self-assessed. However, one of the exceptions would be an amount of tax that is prescribed for purposes of paragraph (a) of the description of F in subsection 225.2(2) (see Part 1 *Selected Listed Financial Institution Attribution Method (GST/HST) Regulations* of the proposed *Draft Regulations Amending Various GST/HST Regulations*). With respect to determining the GST or the federal part of the HST, certain SLFIs should also refer to the rules and proposed draft rules for such FIs.

Qualifying consideration

Qualifying consideration is defined in section 217 and is in respect of an outlay made, or expense incurred, outside Canada. It is determined by the following formula:

$$A - B$$

where

A is the amount of the outlay or expense that

(a) is allowed as a deduction, an allowance or an allocation for a reserve under the *Income Tax Act* in computing the qualifying taxpayer's income for the specified year, or would be so allowed if

(i) the qualifying taxpayer's income were computed in accordance with that Act,

(ii) the qualifying taxpayer carried on a business in Canada, and

(iii) that Act applied to the qualifying taxpayer, and

(b) may reasonably be regarded as being applicable to a Canadian activity of the qualifying taxpayer; and

B is the total of all amounts each of which is included in the amount determined under the description of A and is

(a) an amount (other than an amount included in paragraph (b)) that is a permitted deduction for the specified year or a preceding specified year of the qualifying taxpayer, or

(b) an amount that represents a cost to a qualifying establishment of the qualifying taxpayer in a country other than Canada, or a share of a profit of the qualifying taxpayer that is redistributed from a qualifying establishment of the qualifying taxpayer in Canada to a qualifying establishment of the qualifying taxpayer in a country other than Canada, that is solely attributable to the issuance, renewal, variance or transfer of ownership by the qualifying taxpayer of a financial instrument that is a derivative, provided that all or substantially all of the amount is

(i) an error or profit margin, or employee compensation or benefits, that is reasonably attributable to the issuance, renewal, variance or transfer of ownership, or

(ii) the estimate of the default risk premium that is directly associated with the derivative.

1) Qualifying consideration – Part A

In determining an amount of qualifying consideration for a specified year of a qualifying taxpayer, Part A of the formula A – B is generally described as the amount representing the whole or part of an outlay made, or expense incurred, outside Canada that meets the following two criteria:

1. Outlay or expense allowable as a deduction under the ITA

The first criterion is that the outlay or expense, which is described in subsection 217.1(2), is allowed as a deduction, an allowance or an allocation for a reserve under the ITA in computing the qualifying taxpayer's income for the specified year, or would be so allowed if

- the qualifying taxpayer's income were computed in accordance with the ITA,
- the qualifying taxpayer carried on a business in Canada, and
- the ITA applied to the qualifying taxpayer.

As a result, this criterion in Part A of the formula applies regardless of whether the taxpayer is required to pay any income tax or is even subject to any provision related to the computation of income under the ITA.

2. Outlay or expense applicable to a Canadian activity

The second criterion is that the outlay or expense may reasonably be regarded as being applicable to a Canadian activity of the qualifying taxpayer.

The term **Canadian activity** means an activity of the person carried on, engaged in or conducted in Canada. It would include but is not limited to a business (as defined in subsection 123(1)) carried on. The phrase "carried on, engaged in or conducted in Canada" is intended to give the term "Canadian activity" a broad meaning.

Generally, the effect of Part A of the formula is that any expense or outlay made outside Canada that would be allowed as a deduction under the ITA, and is reasonably regarded as being applicable to a Canadian activity of the qualifying taxpayer, is included and forms the base for qualifying consideration. It should be noted that an amount that falls within the meaning of Part A of the formula must be included in Part A even though the amount may also be a permitted deduction or other amount that is also included in Part B of the formula and thus subtracted from Part A.

Qualifying consideration – Outlay made, or expense incurred outside Canada

As indicated above, the term "qualifying consideration" is in respect of an outlay made, or an expense incurred, outside Canada.

Subsection 217.1(2) indicates that, for the purposes of Division IV, an outlay made, or expense incurred outside Canada includes any amount representing any of the following:

(a) an outlay made, or expense incurred, by a qualifying taxpayer in respect of

(i) property that is, in whole or in part, transferred outside Canada to the qualifying taxpayer,

(ii) property, the possession or use of which is, in whole or in part, given or made available outside Canada to the qualifying taxpayer, or

(iii) a service that is performed, in whole or in part, outside Canada for the benefit of the qualifying taxpayer or is rendered, in whole or in part, outside Canada to the qualifying taxpayer;

(b) an adjustment (within the meaning of subsection 247(2) of the *Income Tax Act*) to an outlay or expense described in paragraph (a) above.

Subsection 247(2) of the ITA is in respect of a transfer pricing adjustment.

(c) an expenditure or purchase in respect of a reportable transaction (as defined in section 233.1 of the *Income Tax Act)* in respect of which a qualifying taxpayer is required under that section to file with the Minister a return in prescribed form containing prescribed information, or would be so required if the qualifying taxpayer carried on a business in Canada and the *Income Tax Act* applied to the qualifying taxpayer.

Section 233.1 of the ITA is in respect of the reporting of transactions between certain persons not dealing at arm's length with non-resident persons. The return that is required to be filed under that section is Form T106, Information Return of Non-arm's Length Transactions with Non-Residents.

(d) in the case of a qualifying taxpayer that is resident in Canada, qualifying compensation of an employee paid in a specified year by the qualifying taxpayer if

(i) in the specified year, a duty is performed by the employee outside Canada at a qualifying establishment of the qualifying taxpayer or of a person related to the qualifying taxpayer, and

(ii) it is not the case that all or substantially all of the duties performed outside Canada by the employee in the specified year are performed elsewhere than at such qualifying establishments;

Qualifying compensation *of an employee means any salary, wages and other remuneration of the employee and any other amount that is required to be included as income from an office or employment in computing the income of the employee for the purposes of the ITA.*

As a result, in the case of a resident qualifying taxpayer, if an employee performs duties outside Canada and a significant portion of those duties is performed at a qualifying establishment of the qualifying taxpayer outside Canada (e.g. a foreign branch), any compensation paid to that employee during the taxation year is treated as an outlay made, or expense incurred, outside Canada. If the duties are performed elsewhere outside Canada and not at a foreign branch of the qualifying taxpayer or of a person related to the qualifying taxpayer, the compensation paid to the employee is not an outlay made or expense incurred outside Canada.

(e) in the case of a qualifying taxpayer that is not resident in Canada,

(i) an allocation by the qualifying taxpayer of an outlay or expense as an amount in respect of a business carried on in Canada by the qualifying taxpayer for the purpose of computing the qualifying taxpayer's income under the *Income Tax Act*, or an amount that would be such an allocation if

(A) the qualifying taxpayer's income were computed in accordance with that Act,

(B) anything done by the qualifying taxpayer through a qualifying establishment in Canada of the qualifying taxpayer were the carrying on of a business in Canada by the qualifying taxpayer, and

(C) that Act applied to the qualifying taxpayer,

(ii) an outlay or expense that may reasonably be regarded under the *Income Tax Act* as an amount that is applicable to a qualifying establishment in Canada of the qualifying taxpayer, or that would reasonably be so regarded if the qualifying establishment were a permanent establishment for purposes of that Act, the qualifying taxpayer carried on a business in Canada and that Act applied to the qualifying taxpayer, and

(iii) qualifying compensation of an employee paid in a specified year by the qualifying taxpayer.

For example, any head office expense that a non-resident qualifying taxpayer would be permitted to allocate to its Canadian branch under the ITA will be treated as an expense incurred outside Canada. In addition, any compensation that a non-resident qualifying taxpayer pays in respect of anything done by an employee (e.g., salary and wages) is treated as an outlay made, or expense incurred, outside Canada, regardless of where that employee performs his/her duties.

Examples – Qualifying consideration – Part A

Example 1

A non-resident FI has its head office outside Canada and a branch in Canada. Certain head office expenses (e.g., software consulting services) incurred outside Canada are outlays made or expenses incurred outside Canada under subsection 217.1(2) and are with respect to the non-resident FI's Canadian activity. The expenses are deductible under the ITA. Therefore the amount is included in Part A of qualifying consideration.

Example 2

A resident FI has some of its employees perform part of their duties in respect of the FI's Canadian activities at a permanent establishment of the FI outside Canada. Since the employees' duties were performed in part outside Canada at a permanent establishment, the qualifying compensation paid to the employees is an outlay made or expense incurred outside Canada under subsection 217.1(2). The amount paid is deductible under the ITA in calculating the FI's income tax. Therefore, the amount is included in Part A of qualifying consideration.

Example 3

Data processing services were performed outside Canada by a foreign parent corporation for the benefit of a qualifying taxpayer resident in Canada in the qualifying taxpayer's Canadian activities. The expense incurred in respect of these services is an outlay made or expense incurred outside Canada under subsection 217.1(2). The expense is allowed as a deduction under the ITA. Therefore, the amount of the expense is included in Part A of qualifying consideration.

In addition, pursuant to paragraph 217.1(2)(b), any adjustment, in accordance with the transfer pricing rules under the ITA , to increase the expense incurred in respect of those services is also an outlay made or expense incurred outside Canada. Any adjustment that is deducted under the ITA and is with respect to the qualifying taxpayer's Canadian activities is also included in Part A of qualifying consideration.

Example 4

A non-resident qualifying taxpayer with a head office outside Canada and a branch in Canada purchases a computer outside Canada to be used in its Canadian activity. The amount is an outlay made or expense incurred outside Canada under subsection 217.1(2). Any amount in respect of capital cost allowance that is permitted as a deduction for purposes of the ITA and that is with respect to a Canadian activity is included in Part A of qualifying consideration.

2) Qualifying consideration – Part B

Part B of the formula A – B is the total of all amounts each of which has been included in Part A of the formula, and is an amount that is a "permitted deduction", or is a specific deduction with respect to derivatives. Only the part of the outlay or expense that is included in Part A that is equal to the amount of the permitted deduction or is in respect of the derivative may be deducted under Part B.

While Part A of the formula forms the base for self-assessing, Part B reduces in whole or in part the amount included in Part A, thereby reducing the amount upon which GST/HST is assessed or calculated.

Qualifying consideration – Permitted deduction

The term **permitted deduction** is defined under section 217. An amount is a permitted deduction if the amount is included in the following list of (a) to (m):

(a) consideration for a supply of a property or a service, or the value of imported goods, upon which GST/HST (other than under section 218.01 or subsection 218.1(1.2)) became payable during the specified year by the qualifying taxpayer;

(b) tax referred to in paragraph (a) in respect of a supply or importation referred to in that paragraph;

(c) a provincial levy that is prescribed for purposes of section 154 and is in respect of a supply referred to in paragraph (a);

As a result of (a) to (c), where GST/HST has already become payable on a supply, the consideration, the GST/HST payable, and any prescribed provincial levy in respect of the supply are permitted deductions and are, therefore, deducted under Part B of qualifying consideration.

For example, a qualifying taxpayer that is a registrant non-resident FI with a Canadian branch acquired a licence to use software from an American software provider who was also a registrant and charged the GST/HST. The expense for the supply of the intangible personal property was incurred outside Canada and therefore was an outlay made or expense incurred outside Canada pursuant to subsection 217.1(2). It was acquired for use by the Canadian branch and therefore was with respect to the qualifying taxpayer's Canadian activities, and the amount is an expense that is deductible under the ITA. As such, the amount is included in Part A of qualifying consideration. However, the GST/HST has already become payable on the supply, and therefore the consideration, the GST/HST, and any prescribed provincial levy referred to in section 154 that was charged would be deducted under Part B and would not represent qualifying consideration.

(d) an amount that is deemed, under subsection 248(18) or (18.1) of the *Income Tax Act*, to be assistance repaid by the qualifying taxpayer in respect of property or a service referred to in paragraph (a);

(e) consideration for a supply of property or a service (other than a financial service) made to the qualifying taxpayer as part of a transaction or series of transactions in which all participants deal at arm's length with the qualifying taxpayer, unless

   (i) that consideration is included in paragraph (a), or

   (ii) an activity carried on, engaged in or conducted outside Canada, through a qualifying establishment of the qualifying taxpayer or of a person related to the qualifying taxpayer, relates in any manner to the supply;

For example, a qualifying taxpayer that is a resident FI incurs expenses related to services consumed by employees while on business travel outside Canada, other than training services (training services are subject to tax under section 218) and financial services. The services were acquired from persons who were dealing at arm's length. The services were not subject to GST/HST. An activity carried on, engaged in or conducted outside Canada through a permanent establishment of the qualifying taxpayer, or of a person related to the qualifying taxpayer, does not relate in any manner to the supply. In other words, no permanent establishment outside Canada of the resident FI or of a person related to the resident FI was involved in any manner with the supply of the services by the persons who were dealing at arm's length to the employees of the qualifying taxpayer. The amounts of consideration for these services are expenses incurred outside Canada in respect of an outlay made or expense incurred outside Canada under subsection 217.1(2). They are deductible as an expense under the ITA, and they were incurred by the Canadian FI with respect to the qualifying taxpayer's Canadian activity. The amount therefore is required to be included in Part A of qualifying consideration but is also a permitted deduction that would be deducted under Part B.

(f) qualifying compensation of an employee of the qualifying taxpayer that is paid in the specified year by the qualifying taxpayer if the employee was primarily in Canada while performing its duties during the specified year;

(g) interest that is paid or payable by the qualifying taxpayer as the consideration for a supply of a financial service made to the qualifying taxpayer (other than an amount paid or credited by the qualifying taxpayer, or deemed by Part I of the *Income Tax Act* to have been paid or credited in the specified year by the qualifying taxpayer, to a person as, on account or in lieu of payment of, or in satisfaction of, a management or administration fee or charge (within the meaning of subsection 212(4) of the *Income Tax Act*));

For example, a qualifying taxpayer that is a non-resident FI has a branch located in Canada and a head office located outside Canada. It issues debentures to persons outside Canada with which it is dealing at arm's length. The part of the interest cost (related to the part of the debenture principal used in Canada) is allocated to the Canadian branch. The amount allocated to the Canadian branch is an outlay made or expense incurred outside Canada under subsection 217.1(2). It is with respect to its Canadian activities and is deductible by the qualifying taxpayer under the ITA. The amount is therefore included in Part A of qualifying consideration, but would also be deducted under Part B and so there would not be an amount subject to self-assessment.

(h) dividends;

(i) consideration (other than interest referred to in paragraph (g) or dividends referred to in paragraph (h)) for a specified arm's length supply made to the qualifying taxpayer;

A ***specified arm's length supply*** *is a supply of a financial service made to a qualifying taxpayer as part of a transaction or series of transactions in which all participants deal at arm's length with the qualifying taxpayer. It does not include a specified derivative supply, or the supply of a specified financial service, which are defined below.*

For example, a qualifying taxpayer that is a non-resident FI incurred an expense for an insurance premium for property outside Canada used in part in respect of its Canadian branch. Part of the insurance premium is allocated to the Canadian branch. The insurance policy was acquired from a party that was dealing with the FI at arm's length. The amount of the premium allocated to the branch is an outlay made or expense incurred outside Canada under subsection 217.1(2). It is with respect to the qualifying taxpayer's Canadian activities and is deductible under the ITA. Therefore, the amount is included in Part A of qualifying consideration, but since the supply of the insurance policy was made by an unrelated third party it would also be deducted under Part B, and so there would not be an amount subject to self-assessment.

(j) consideration (other than interest referred to in paragraph (g) or dividends referred to in paragraph (h)) for a supply (other than a specified derivative supply) of a specified financial service made to the qualifying taxpayer;

A ***specified financial service*** *is a financial service supplied to a qualifying taxpayer by an agent, salesperson or broker of arranging for the issuance, renewal, variation or transfer of ownership of a financial instrument that is property of a person other than the agent, salesperson or broker.*

For example, a qualifying taxpayer that is an FI resident in Canada pays commissions to a broker in the United States to arrange for the sale of bonds from the FI to an unrelated third party. The amount paid is an outlay made or expense incurred outside Canada under subsection 217.1(2). The expense is in respect of the qualifying taxpayer's Canadian activities and is deductible by the qualifying taxpayer under the ITA. The amount is therefore included in Part A of qualifying consideration.

Since the commission is paid to a broker who arranges for the transfer of ownership for the qualifying taxpayer of a security owned by a person other than the broker, the amount paid is consideration for the supply of a specified financial service and is deducted under Part B, and so there is no amount subject to self-assessment.

(k) consideration (other than interest referred to in paragraph (g), dividends referred to in paragraph (h) or loading) for a specified non-arm's length supply made to the qualifying taxpayer;

A specified non-arm's length supply is a supply of a financial service that includes the issuance, renewal, variation or transfer of ownership of a qualifying instrument (defined under section 217 to mean money, a credit card voucher, a charge card voucher or a financial instrument), made to a qualifying taxpayer as part of a transaction or series of transactions in which any participant does not deal at arm's length with the qualifying taxpayer. It does not include a specified derivative supply, or the supply of a specified financial service.

Loading *applies to a specified non-arm's length supply. It must be excluded from the consideration for the supply of a specified non-arm's length supply before the consideration for the specified non-arm's length supply can be a permitted deduction in paragraph (k) above (however, as a transitional provision, where consideration for a specified non-arm's length supply became due or was paid without having become due, on or before November 16, 2005, loading is not required to be excluded).*

Loading is any part of the value of the consideration for a supply of a financial service that is attributable to administrative expenses, an error or profit margin, business handling costs, commissions, communications expenses, claims handling costs, employee compensation or benefits, execution or clearing costs, management fees, marketing or advertising costs, occupancy or equipment expenses, operating expenses, acquisition costs, premium collection costs, processing costs or any other costs or expenses of a person that makes the supply, other than commissions for a specified financial service or the part of the value of the consideration that is equal to

a) *if the financial service includes the issuance, renewal, variation or transfer of ownership of an insurance policy but not of any other qualifying instrument, the estimate of the net premium of the insurance policy;*
b) *if the financial service includes the issuance, renewal, variation or transfer of ownership of a qualifying instrument (other than an insurance policy), the estimate of the default risk premium that is directly associated with the qualifying instrument; and*
c) *if the financial service includes the issuance, renewal, variation or transfer of ownership of an insurance policy and a qualifying instrument (other than an insurance policy), the amount determined by the formula*

$$A + B$$

where

A is the estimate of the net premium of the insurance policy, and

B is the estimate of the default risk premium that is directly associated with the qualifying instrument.

For example, a qualifying taxpayer that is a non-resident FI has a head office in the United States and a branch in Canada. The qualifying taxpayer acquires insurance from a related corporation outside Canada. Part of the insurance premium it pays is allocated to the Canadian branch and therefore is an outlay made or expense incurred outside Canada under subsection 217.1(2). The amount is also deducted by the qualifying taxpayer under the ITA. The amount is therefore required to be included in Part A of the formula.

The insurance premium is paid to a related corporation, and as such the premium is consideration for a specified non-arm's length supply and is a permitted deduction under paragraph (k) of the definition of permitted deduction. However, paragraph (k) states that the consideration for the supply does not include an amount that is loading. Therefore, any portion of the insurance premium covering the related corporation's expenses of doing business, profit margins and any of the other items listed in the definition of loading above are not included in the amount for the permitted deduction. But any portion of the insurance premium covering the net premium of the insurance policy is excluded from the amount determined to be loading because of the exclusion in the definition of loading, and therefore would be part of the consideration for the specified non-arm's length supply that is a permitted deduction.

(l) consideration (other than interest referred to in paragraph (g) or dividends referred to in paragraph (h)) for a specified derivative supply made to the qualifying taxpayer;

A ***specified derivative supply*** *is a supply of a financial service of issuing, renewing, varying or transferring the ownership of a financial instrument that is a derivative, or that is a supply made by an agent, salesperson or broker of arranging for the issuance, renewal, variance or transfer of ownership of a financial instrument that is a derivative; and for which all or substantially all of the value of the consideration is attributable to*

(i) any error or profit margin, employee compensation or benefits, reasonably attributable to the supply, and

(ii) amounts that are not loading.

A specified derivative supply is the supply of a derivative that is a financial instrument as defined under certain paragraphs of the definition of financial instrument in subsection 123(1). For GST/HST purposes, depending on the particular derivative contract, a derivative may be a financial instrument under

- *paragraph (a) if the contract is a right to be paid money;*
- *paragraph (f) if the contract is an option or a contract for the future supply of a commodity, where the option or contract is traded on a recognized commodity exchange; or*
- *paragraph (i) if the contract is an option or contract for the future supply of money or any financial instrument described in any of the paragraphs (a) to (h) of the definition of financial instrument.*

Provided the consideration paid by the qualifying taxpayer for the derivative is all or substantially all in respect of an error or profit margin, or employee compensation or benefits, reasonably attributable to the supply of the derivative, and amounts that are not loading, the amount paid is in respect of a specified derivative supply and is therefore be a permitted deduction under paragraph (l) of the definition of permitted deduction.

For example, a mutual fund that is a qualifying taxpayer resident in Canada acquires 100,000 shares of Company A when the price was $30 per share. Since that time, the price has risen to $50 per share. In order to protect the existing profit of $20 per share, the manager buys a put option (the right to sell) on the stock at $50 and pays a $2 per share premium. The supply of this put option is a specified derivative supply and the premium paid for the supply made to the fund is a permitted deduction.

(m) a prescribed amount.

Currently no amounts have been prescribed.

Qualifying consideration – derivatives

In addition to a permitted deduction under paragraph (a) of Part B, Part B also permits a deduction for certain amounts in respect of derivatives under paragraph (b). Specifically, an amount included in Part A is a cost to a qualifying establishment of the qualifying taxpayer in a country other than Canada, or a profit redistribution from a permanent establishment of the qualifying taxpayer in Canada to one of its permanent establishments in a country other than Canada. The amount must be solely attributable to the issuance, renewal, variance or transfer of ownership by the qualifying taxpayer of a financial instrument that is a derivative. Further, all or substantially all of the amount must be an error or profit margin, or employee compensation or benefits, that is reasonably attributable to the issuance, renewal, variance or transfer of ownership; or be the estimate of the default risk premium directly associated with the derivative. For example, if 10% or more of the cost was attributable to other administrative costs being allocated, this requirement is not met and a deduction under Part B may not be made.

An amount meeting the requirements of paragraph (b) of Part B of qualifying consideration may be included in Part B, provided the amount has already been included in Part A.

Self-assessing on the total of internal and external charges

Where an election under subsection 217.2(1) is in effect, paragraph 218.01(a) requires the qualifying taxpayer to pay GST on the total of all amounts each of which is an internal charge and each of which is an external charge, for a specified year that is greater than zero rather than paying GST on each amount that is qualifying consideration.

In addition to the tax imposed under paragraph 218.01(a), paragraph 218.1(1.2)(a) requires every qualifying taxpayer that is resident in a participating province to pay for each specified year and for each particular participating province the provincial part of the HST. The provincial part of the HST is determined by a formula that in general terms is the total of the internal and external charges multiplied by the extent (expressed as a percentage) to which the expense that corresponds to the total of the internal and external charges was used in carrying on an activity of the qualifying taxpayer in the particular province. For specified years ending before July 1, 2010, tax is determined for each participating province in which the taxpayer is resident at any time in the specified year.

Subsection 218.1(1.3) provides the rules for determining whether a qualifying taxpayer is resident in a province for purposes of self-assessing under subsection 218.1(1.2). Despite section 132.1 (which generally contains rules for determining when a person is resident in a province for GST/HST purposes), pursuant to subsection 218.1(1.3), a qualifying taxpayer is deemed to be resident in a province at any time if, at that time,

(a) the qualifying taxpayer has a qualifying establishment in the province; or

(b) in the case of a qualifying taxpayer that is resident in Canada, the qualifying taxpayer is
   (i) a corporation incorporated or continued under the laws of the province and not continued elsewhere,
   (ii) an entity that is a partnership, an unincorporated society, a club, an association or an organization, or a branch of such an entity, in respect of which a majority of the members having management and control of the entity or branch are resident in the province, or
   (iii) a trust, carrying on activities as a trust in the province, that has a local office or branch in the province.

Certain FIs (e.g., certain investment plans) should refer to the *Proposed Amendments to the GST/HST Legislation* and Part 3 *New Harmonized Value-Added System Regulations No. 2* of the proposed *Draft Regulations Amending Various GST/HST Regulations* released January 28, 2011 to determine if they are required to self-assess the provincial part of the HST under subsection 218.1(1.2).

According to the *Proposed Amendments to the GST/HST Legislation*, it is proposed that subsection 218.1(1.2) be amended to add prescribed percentages for internal charges, external charges and qualifying consideration of certain FIs attributable to a particular participating province. Reference should also be made to Part 3 *New Harmonized Value-added Tax System Regulations No.2* of the proposed *Draft Regulations Amending Various GST/HST Regulations.*

A qualifying taxpayer is required to self-assess the provincial part of the HST for Ontario and British Columbia for a specified year that begins before July 1, 2010, and ends on or after June 2010, using a formula that adjusts the tax payable under subsection 218.1(1.2) by a percentage based on the number of days in the specified year after June 2010 relative to the number of days in the specified year.

As with self-assessing qualifying consideration, SLFIs that fall within section 225.2 are generally not required to self-assess the provincial part of the HST imposed under subsection 218.1(1.2). These FIs continue to use the special attribution rules under section 225.2 to make adjustments in determining their liability for the provincial part of the HST in respect of the tax self-assessed. However, one of the exceptions would be an amount of tax that is prescribed for purposes of paragraph (a) of the description of F in subsection 225.2(2) (see the proposed *Draft Regulations Amending Various GST/HST Regulations* (Part 1) *Selected Listed Financial Institution Attribution Method (GST/HST) Regulations).* With respect to determining the GST or the federal part of the HST, certain selected listed FIs should also refer to the rules and proposed draft rules for such FIs.

The internal charge addresses allocations between Canadian and foreign qualifying establishments (e.g. branches) of the Canadian entity whereas the external charge addresses amounts between entities.

Only a qualifying taxpayer that is a resident in Canada may make an election to determine tax in accordance with paragraph 218.01(a) and where applicable, paragraph 218.1(1.2)(a). For example, a non-resident qualifying taxpayer with a branch that is a permanent establishment under subsection 123(1) located in Canada is not eligible to make the election and would therefore be required to self-assess on each amount that is an amount of qualifying consideration for a specified year as discussed above.

External charge

As stated above, under a valid election made pursuant to subsection 217.2(1), a qualifying taxpayer is required to self-assess tax on the total of each amount that is an internal charge and each amount that is an external charge.

The external charge for a specified year of a qualifying taxpayer in respect of an outlay or expense described in any of paragraphs 217.1(2)(a) to (c) means the amount in respect of the outlay or expense determined by the formula

$$A - B$$

where

A is the amount of the outlay or expense that

- (a) is allowed as a deduction, an allowance or an allocation for a reserve under the *Income Tax Act* in computing the qualifying taxpayer's income for the specified year, or would be so allowed if
  - (i) the qualifying taxpayer's income were computed in accordance with the *Income Tax Act*,
  - (ii) the qualifying taxpayer carried on a business in Canada,
  - (iii) the *Income Tax Act* applied to the qualifying taxpayer, and
- (b) may reasonably be regarded as being applicable to a Canadian activity of the qualifying taxpayer; and

B is the total of all amounts, each of which is included in the amount determined under the description of A and is a permitted deduction for the specified year or a preceding specified year of the qualifying taxpayer.

External charge – Part A

Part A of the formula is generally described as the amount representing the whole or part of an outlay made, or expense incurred, outside Canada that meets the following two criteria:

1. Outlay or expense allowable as a deduction under the ITA

The first criterion is that the outlay or expense is allowed as a deduction, an allowance or an allocation for a reserve under the ITA in computing the qualifying taxpayer's income for the taxation year, or would be so allowed if

- the qualifying taxpayer's income were computed in accordance with the ITA,
- the qualifying taxpayer carried on a business in Canada, and
- the ITA applied to the qualifying taxpayer.

This criterion applies regardless of whether the taxpayer is required to pay any income tax or is even subject to any provision related to the computation of income under the ITA.

2. Outlay or expense applicable to a Canadian activity

The second criterion is that the outlay or expense may reasonably be regarded as being applicable to a Canadian activity of the qualifying taxpayer.

The Canadian activity of a qualifying taxpayer resident in Canada is an activity carried on, engaged in or conducted in Canada.

The determination of Part A of external charge is similar to the determination of Part A of qualifying consideration, but is limited to outlays and expenses described in paragraphs 217.1(2)(a) to (c) as opposed to including all of the paragraphs of subsection 217.1(2) (described under "Qualifying consideration – Outlay made, or expense incurred outside Canada"). Generally, paragraphs 217.1(2)(a) to (c) are in respect of an amount that is an outlay or expense incurred in respect of property transferred and services performed outside Canada, transfer pricing adjustments to such an outlay or expense, and an expenditure or purchase regarding a reportable transaction under section 233.1 of the ITA.

External charge – Part B

Part B is the total of all amounts, each of which is included in the amount determined under the description in Part A and is a permitted deduction for the specified year or a preceding specified year of the qualifying taxpayer. Therefore, outlays and expenses included in Part A can only be reduced if those amounts fall within the list of permitted deductions. Permitted deduction was discussed under "Qualifying consideration – Permitted deduction".

Example of external charge

A qualifying taxpayer resident in Canada has made an election under subsection 217.2(1) to self-assess on the total of its internal and external charges for a specified year. It acquires research services performed outside Canada, for use in Canada, from one of its subsidiaries outside Canada, and pays GST under section 218 on the imported taxable supply. The expense for the supply of the services was incurred outside Canada and therefore was an outlay made or expense incurred outside Canada under paragraph 217.1(2)(a). The expense is in respect of the qualifying taxpayer's Canadian activities and is also deductible under the ITA. Therefore, the expense is an amount that is included in Part A of external charge.

Since GST was already payable on the supply, the amount of the consideration is a permitted deduction under paragraph (a) of permitted deduction, and the GST payable is a permitted deduction under paragraph (b). As a result the whole of the amount may be included in Part B of external charge. The result is that the amount included in Part A is reduced in whole by the amount included in Part B, and no amount remains as an external charge subject to self-assessment.

Internal charge

The term "internal charge" is defined under subsection 217.1(4). An internal charge is generally an amount that is treated for income tax purposes both as income in a country other than Canada and as a deduction from income in Canada. An internal charge is not based on an outlay made, or expense incurred outside Canada, in contrast with the external charge. Rather, it is based on an amount in respect of a transaction (a transaction includes an arrangement or event) between a qualifying establishment (e.g. branch) of a qualifying taxpayer resident in Canada and its foreign qualifying establishment located in another country.

An internal charge is an amount that is described in paragraph 217.1(4)(a) and is not excluded under paragraph 217.1(4)(b). An amount is described in paragraph 217.1(4)(a) if it meets either the criteria in subparagraphs 217.1(4)(a)(i) and (ii), or, where subparagraph 217.1(4)(a)(ii) does not apply, the criteria in subparagraphs 217.1(4)(a)(i) and (iii).

Under subsection 217.1(4), for the purposes of Division IV, any part of an amount in respect of a transaction or dealing between a particular qualifying establishment of a qualifying taxpayer in Canada and another qualifying establishment of the qualifying taxpayer in a particular country other than Canada is an internal charge for a specified year of the qualifying taxpayer if

(a) the amount meets the following criteria:

- (i) the amount would be allowed as a deduction, an allowance or an allocation for a reserve under the *Income Tax Act* in computing the income of the particular qualifying establishment for the specified year if
  - (A) that Act applied to the particular qualifying establishment,
  - (B) the income of the particular qualifying establishment were computed in accordance with that Act, and

(C) for the purposes of that Act,

(I) anything done by the qualifying taxpayer through the particular qualifying establishment were the carrying on of a business in Canada,

(II) the particular qualifying establishment were a permanent establishment, and

(III) the specified year were the particular qualifying establishment's taxation year,

(ii) where the qualifying taxpayer has not specified pursuant to paragraph 217.2(2)(c) that subparagraph (iii) is to apply in all cases in determining the internal charges for the specified year and the particular country is a taxing country (as defined in subsection 126(7) of the *Income Tax Act*) that has a tax treaty (as defined in subsection 248(1) of that Act) with Canada, the amount would be required to be included in computing, under a taxing statute of the particular country that applies to the qualifying taxpayer, or that would apply if the other qualifying establishment were a permanent establishment for the purposes of that statute, the other qualifying establishment's income or profits for any period (in this paragraph referred to as a "taxing period") that ends during the specified year if

(A) the taxing statute applied to the other qualifying establishment,

(B) the other qualifying establishment's income or profits were computed in accordance with the taxing statute, and

(C) for the purposes of the taxing statute,

(I) anything done by the qualifying taxpayer through the other qualifying establishment were the carrying on of a business in the particular country, and

(II) the other qualifying establishment were a permanent establishment and had the same taxing periods that the qualifying taxpayer would have under the taxing statute, and

(iii) where subparagraph (ii) does not apply, the amount would be required to be included in computing under the *Income Tax Act* the other qualifying establishment's income for the specified year if

(A) the laws of Canada, and not the laws of the particular country, applied, with any modifications that the circumstances require, in the particular country,

(B) that Act applied to the other qualifying establishment,

(C) the other qualifying establishment's income were computed in accordance with that Act, and

(D) for the purposes of that Act,

(I) anything done by the qualifying taxpayer through the other qualifying establishment were the carrying on of a business in the particular country,

(II) the other qualifying establishment were a permanent establishment, and

(III) the specified year were the other qualifying establishment's taxation year;

Generally, subparagraphs 217.1(4)(a)(i) and (ii) provide that the amount in respect of the transaction is an amount that would both be included as income or profit of the qualifying establishment (e.g. the foreign branch) under a taxing statute in another country that is a taxing country with which Canada has a tax treaty, and allowed as a deduction (or allowed as an allowance or an allocation for a reserve) in Canada under the ITA. A taxing statute is defined in section 217 to mean a statute of the country, or of a state, province or other political subdivision of the country, that imposes a levy or charge of general application that is an income or profits tax.

If the qualifying taxpayer does not want to use the foreign tax statutes in determining whether the amount is included in determining the foreign qualifying establishment's income or profit under the authority of the taxing country, it may specify in its election that it will make such a determination using the ITA with respect to all its internal charges as if that Act applied to the foreign qualifying establishment.

Where the foreign qualifying establishment does not fall under the tax statutes of a taxing country with which Canada has a tax treaty (i.e. the requirements of subparagraph 217.1(4)(a)(ii) are not met), the amount included in the foreign qualifying establishment's income would generally be determined as if the ITA applied to that establishment (i.e. subparagraph 217.1(4)(a)(iii) would apply).

Generally, for purposes of paragraph 217.1(4)(a) only, subsection 217.1(5) isolates the qualifying establishment in Canada and the qualifying establishment in another country from each other and from the remainder of the qualifying taxpayer (e.g. any other branches). It deems the two particular qualifying establishments each to be separate and distinct enterprises from the qualifying taxpayer, to be engaged in similar activities as the qualifying taxpayer, and to be dealing wholly independently with each other and the remainder of the qualifying taxpayer. Further, any transactions or dealings between the qualifying establishment in Canada and the particular qualifying establishment in another country are deemed to be supplies made on terms as would have been agreed upon between parties dealing at arm's length.

An amount falling within paragraph 217.1(4)(a) described above does not include the part of the amount that is within paragraph 217.1(4)(b). As a result, the amount that is an internal charge does not include:

(i) an amount determined under the description of A in the formula in the definition "external charge" in section 217 in calculating an external charge of the qualifying taxpayer for the specified year or a preceding specified year of the qualifying taxpayer,

(ii) a permitted deduction of the qualifying taxpayer for the specified year or a preceding specified year of the qualifying taxpayer, other than a permitted deduction of the qualifying taxpayer that is included in determining an amount under the description of B in the formula in the definition "external charge" in section 217 in calculating an external charge of the qualifying taxpayer for the specified year or a preceding specified year of the qualifying taxpayer,

(iii) an amount that represents a cost to the other qualifying establishment, or a share of a profit of the qualifying taxpayer that is redistributed from the particular qualifying establishment to the other qualifying establishment, that is solely attributable to the issuance, renewal, variance or transfer of ownership by the qualifying taxpayer of a financial instrument that is a derivative, provided that all or substantially all of the amount is

    (A) an error or profit margin, or employee compensation or benefits, that is reasonably attributable to the issuance, renewal, variance or transfer of ownership, or

    (B) the estimate of the default risk premium that is directly associated with the derivative, or

(iv) a prescribed amount. (There are currently no prescribed amounts.)

The internal charge determined under subsection 217.1(4) is added together with the external charge determined under section 217 to form the amount upon which to self-assess tax under the election pursuant to subsection 217.2(1).

Example of internal charge

A qualifying taxpayer resident in Canada has made an election under subsection 217.2(1) to self-assess on the total of its internal charges and external charges for a specified year. An amount is allocated by the qualifying taxpayer to its head office located in Canada for research services performed in the U.S. by the U.S. branch for use by the head office in Canada. The amount is deducted by the qualifying taxpayer in computing the income of the head office under the ITA and therefore meets the requirements of subparagraph 217.1(4)(a)(i). The amount is also required by the qualifying taxpayer to be included as income under the taxing statutes of the U.S. in computing the income of the U.S. branch and meets the requirements of subparagraph 217.1(4)(a)(ii).

Since no part of the amount was accounted for under an external charge, no part was a permitted deduction, and the amount was not with respect to derivatives, the exclusions in paragraph 217.1(4)(b) do not apply. As a result, the whole amount allocated to the Canadian head office is an internal charge under paragraph 217.1(4)(a) and is subject to self-assessment.

Filing the election

The election form for the election under subsection 217.2(1), Form RC4600, *Election or Revocation of an Election Under Subsection 217.2(1)*, must be filed with the Minister on or before the day on or before which the qualifying taxpayer's return under section 219 in respect of tax under section 218.01 or subsection 218.1(1.2) for the first specified year during which the election is in effect is required to be filed.

The election is effective on the first day of the specified year set out in the form, and ceases to have effect the earlier of

- the first day of the specified year of the qualifying taxpayer in which the qualifying taxpayer ceases to be resident in Canada; and
- the day on which a revocation becomes effective.

However, once an election is made, a qualifying taxpayer may only revoke the election effective on the first day of a specified year after the election has been in effect for at least two years. The qualifying taxpayer who wishes to revoke an election must file Form RC4600 with the Minister not later than the day on which the revocation is to become effective.

Further, if the qualifying taxpayer revokes an election and then subsequently wishes to make another election under subsection 217.2(1), any subsequent election is not a valid election unless the first day of the specified year set out in the subsequent election is at least two years after the day on which the revocation became effective.

Transitional rules exist for a qualifying taxpayer who was required to file a return under section 219 on or before July 12, 2010. The qualifying taxpayer may subsequently make the election in respect of a specified year for which a return has already been filed provided the election is filed with the Minister by the day that is sixty days after July 12, 2010. Further, the qualifying taxpayer may recover the amount by which the total tax previously remitted exceeds the total tax payable as a result of making the election for the specified year provided the qualifying taxpayer requests in writing no later than two years after July 12, 2010 that the Minister make an assessment, reassessment or additional assessment for the excess amount of tax remitted as a result of subsequently making the election under subsection 217.2(1) in respect of the specified year.

Input tax credits

If the qualifying taxpayer is engaged in commercial activities and the external charge, internal charge or the qualifying consideration is attributable to those activities, the qualifying taxpayer may be entitled to claim input tax credits (ITCs) in respect of the amount of tax self-assessed.

ITCs for qualifying consideration and external charge

Subsection 217.1(6) contains a special rule which generally converts the tax payable or paid without having become payable (i.e. the tax self-assessed) on an amount that is qualifying consideration or an external charge into tax paid on a supply of a property or qualifying service (i.e. a service or duty) in order that the rules for determining an ITC under section 169 can be applied. Both qualifying consideration and an external charge are based on outlays or expenses made outside Canada as described in subsection 217.1(2), and such outlays are generally in respect of property and qualifying services. The qualifying consideration or external charge in respect of an outlay made, or expense incurred outside Canada that is greater than zero for a specified year of the qualifying taxpayer is referred to as a qualifying expenditure for purposes of the rules in subsection 217.1(6).

Subsection 217.1(6) provides that the following rules apply to a qualifying expenditure:

(a) the whole or part of property (in this subsection and subsection (8) referred to as "attributable property") or a qualifying service (in this subsection and subsection (8) referred to as an "attributable service") to which the qualifying expenditure is attributable is deemed to have been acquired by the qualifying taxpayer at the time at which the outlay was made or the expense was incurred;

(b) the tax is deemed to be tax in respect of a supply of the attributable property or attributable service; and

(c) the extent to which the qualifying taxpayer acquired the attributable property or attributable service for consumption, use or supply in the course of commercial activities of the qualifying taxpayer is deemed to be the same extent as that to which the whole or part of the outlay or expense, which corresponds to the qualifying expenditure, was made or incurred to consume, use or supply the attributable property or attributable service in the course of commercial activities of the qualifying taxpayer.

The effect of the rules is that a qualifying taxpayer is required to analyze the extent to which the qualifying taxpayer acquired an attributable property or attributable service for consumption, use or supply in the course of the qualifying taxpayer's commercial activities. Then, to the extent the requirements in section 169 are met, an ITC may be claimed for the tax self-assessed on the qualifying consideration or the external charge.

ITCs for an internal charge

Subsection 217.1(7) contains a special rule which generally converts the tax payable or paid without having become payable (i.e. the tax self-assessed) on certain amounts that are included as an internal charge into tax paid on a supply of property or qualifying service in order that the rules for determining an ITC under section 169 may be applied.

As noted above under internal charge, an internal charge is based on an amount for a transaction or dealing between permanent establishments of a qualifying taxpayer, and is not based on an outlay made or expense incurred outside Canada. It excludes amounts that are an external charge, and certain other amounts as discussed above. Only where an internal charge is determined based in whole or in part on the inclusion of an outlay made, or an expense incurred outside Canada, will the rules in subsection 217.1(7) apply.

For purposes of subsection 217.1(7), the amount of tax to be self-assessed on an internal charge is referred to as "internal tax". The following rules apply where there is internal tax in respect of an internal charge determined based in whole or in part on the inclusion of an outlay made, or expense incurred outside Canada:

(a) the whole or part of property (in this subsection and subsection (8) referred to as "internal property") or of a qualifying service (in this subsection and subsection (8) referred to as an "internal service") to which the outlay or expense is attributable is deemed to have been supplied to the qualifying taxpayer at the time the outlay was made or the expense was incurred;

(b) the amount of the internal tax that can reasonably be attributed to the outlay or expense is deemed to be tax (in this paragraph referred to as "attributed tax") in respect of the supply of the internal property or the internal service, and the attributed tax is deemed to have become payable at the time the internal tax becomes payable by the qualifying taxpayer or is paid by the qualifying taxpayer without having become payable; and

(c) the extent to which the qualifying taxpayer acquired the internal property or internal service for consumption, use or supply in the course of commercial activities of the qualifying taxpayer is deemed to be the same extent as that to which the outlay or expense was made or incurred to consume, use or supply the internal property or internal service in the course of commercial activities of the qualifying taxpayer.

In general, a qualifying taxpayer would be required to analyze the extent to which it acquired an internal property or internal service for the purpose of making a taxable supply or for consumption or use during that specified year in the course of the qualifying taxpayer's commercial activities. If an amount of internal tax is not attributable to an outlay made, or expense incurred, outside Canada, no ITC is available in respect of that internal tax.

When tax is payable

Section 218.3 provides that the tax that the qualifying taxpayer determined under section 218.01 and subsection 218.1(1.2) for a specified year becomes payable by the qualifying taxpayer on

(a) if the specified year is a taxation year of the qualifying taxpayer for the purposes of the *Income Tax Act* and the qualifying taxpayer is required under Division I of the Act to file a return of income for the specified year, the filing due date for the specified year for the purposes of that Act; and

(b) in any other case, the day that is six months after the end of the specified year.

Filing returns

Section 219 provides that a qualifying taxpayer is required to file a return and remit the tax payable that was determined under section 218.01 and subsection 218.1(1.2).

If the qualifying taxpayer is a registrant, the qualifying taxpayer is required to pay the tax and file a prescribed return regarding the tax on or before the day on or before which the registrant's GST/HST return for the GST/HST reporting period in which the tax became payable is required to be filed (section 219). The amount of tax payable would be included on line 405 of Form GST34, *Goods and Services Tax/Harmonized Sales Tax (GST/HST) Return for Registrants*.

If the qualifying taxpayer is not a registrant, the qualifying taxpayer is required to pay the tax and file a prescribed return regarding that tax on or before the last day of the month following the calendar month in which the tax became payable (section 219). The amount of qualifying consideration for a specified year would be included on line 401 of Form GST59, *Return for Imported Taxable Supplies and Qualifying Consideration* and the appropriate tax calculated.

If the qualifying taxpayer is a registrant SLFI and an annual filer, the amount of tax payable under section 218.01 would be included on line 405 of Form GST494, *Goods and Services Tax/Harmonized Sales Tax Final Return for Selected Listed Financial Institutions*. A qualifying taxpayer that is a registrant SLFI and a monthly or quarterly filer would include the amount of tax payable under section 218.01 (included on line 405 of Form GST34) on line 405 of Form GST494.

If the qualifying taxpayer is a non-registrant SLFI, the total amount of tax payable under section 218.01 included on line 402 of Forms GST59 would be included on line 405 of Form GST494.

Enquiries by telephone

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

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

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

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

Appendix – Meaning of financial institution

A financial institution includes:

- a listed financial institution under paragraph 149(1)(a); or
- a *de minimis* financial institution under paragraphs 149(1)(b) or (c).

Listed financial institutions

A person is generally a listed financial institution throughout its particular fiscal year if an any time in the particular year the person is included in any one of the categories in subparagraphs 149(1)(a)(i) through (xi).

Examples of listed financial institutions are:

- a bank;
- a corporation that is authorized to carry on in Canada the business of offering to the public its services as a trustee;
- an investment broker;
- a credit union;
- an insurer;
- a segregated fund of an insurer;
- the Canada Deposit Insurance Corporation;
- a person whose principal business is the lending of money;
- an investment plan;
- a tax discounter; and
- a corporation that has made an election under section 150.

A person that is a listed financial institution may also be a selected listed financial institution (SLFI) if section 225.2 applies. Pursuant to the proposed changes to the Act and the proposed draft *Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations*, a financial institution would generally be considered to be an SLFI throughout a reporting period in a fiscal year that ends in a particular tax year of the financial institution if it is a listed financial institution described in any of subparagraphs 149(1)(a)(i) to (x) at any time during the particular tax year, and the financial institution has a permanent establishment in a participating province and a permanent establishment in any other province, at any time during the tax year. It is proposed that the definition of what constitutes a permanent establishment be expanded.

A person who is only a financial institution because the person is deemed to be one when an election under subsection 150(1) is in effect, is not an SLFI.

For additional information on the different types of listed financial institutions, refer to GST/HST Memorandum 17.6, *Definition of "Listed Financial Institution"*.

De minimus financial institutions

Under paragraph 149(1)(b) a person is generally a financial institution if the person's "financial revenue" in the immediately preceding fiscal year exceeds 10% of its total revenues (other than from sales of capital property) and exceeds $10 million. "Financial revenue" generally includes interest, dividends or a separate fee or charge for a financial service that is included in computing the person's income for purposes of the *Income Tax Act*, but excludes the following:

- interest or dividends from a related corporation;
- a dividend in kind or a patronage dividend; or
- a separate fee for a zero-rated supply of a precious metal.

For example, a holding corporation may be considered a financial institution if it earns financial revenues such as dividends from an unrelated corporation for the previous fiscal year to the extent that it meets the thresholds mentioned above.

Under paragraph 149(1)(c), a person is generally a financial institution if the person's income for purposes of the *Income Tax Act* from interest or separate fees related to credit cards issued by the person, or related to loans, advances or credit granted by the person, exceeded $1 million in its preceding fiscal year. For the purpose of this de minimus test, penalties levied by a vendor for late payment of an account receivable generated in the normal course of the vendor's business would not be considered to be a fee for the provision of credit. In addition, interest from a related corporation is not included in this total.

For example, a department store that issues credit cards to its customers and that receives interest related to those credit cards could be a financial institution if the income it earns from the interest exceeds $1 million in its preceding fiscal year.