



INVESTMENT INDUSTRY ASSOCIATION OF CANADA  
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

March 16, 2010

Brian Ernewein  
General Director, Tax Policy Branch  
Department of Finance  
140 O'Connor Street  
Ottawa ON K1A 0G5

Dear Brian:

**Re: Proposed Changes to the Definition of Financial Services**

Thank you for taking the time to speak to Ian and me on March 4<sup>th</sup> during the budget lock-up session. Further to our conversation, we are writing to provide the IIAC's comments on the proposed changes to the definition of "financial service" in the *Excise Tax Act* (the "Act") and the associated GST/HST Notice 250 (the "Notice")<sup>1</sup> from Canada Revenue Agency (CRA) released in February of this year.

**Background**

On December 14, 2009, the Minister of Finance released a Backgrounder containing technical legislative proposals. The Backgrounder and accompanying news release were in response to recent court decisions that created uncertainty about the taxable status of certain investment management services. In the news release, Minister Flaherty emphasized the need for clarity in the Goods and Services Tax (GST) rules, to "reduce the compliance burden on business".<sup>2</sup> The Department of Finance further explained in the Backgrounder that the proposed legislative amendments were intended to "clarify" and "reaffirm longstanding policy intent".

In February 2010, CRA published the Notice, to provide more information on the December 14 Backgrounder. The Notice gave examples of the application of GST/HST to investment management, facilitory and credit management services in respect of the proposed definition of "financial services". The Notice also confirmed that, if enacted,

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<sup>1</sup> GST/HST Notice 250: "Proposed changes to the definition of financial service" (Canada Revenue Agency, February 2010).

<sup>2</sup> News release 2009-115: "Government of Canada responds to recent court decisions on the GST and financial services" (Department of Finance, December 14, 2009).

the proposed amendments will apply to financial services retroactively as of December 14, 2009.

### **Our concerns**

Our member firms have expressed confusion about the proposed legislative changes in respect to the application of GST/HST. *In particular, we are concerned that the proposed changes to the definition of “financial service” fail to clarify the application of GST/HST and may represent a fundamental departure from the existing tax legislation.*

Certain products and services offered by investment dealers may be at risk of a change in their tax status, contrary to longstanding policy intent. We identify the following examples:

#### **Investment Dealers arranging for the purchase or sale of securities on behalf of a client**

Commissions paid to an investment dealer for buying and selling securities on behalf of a client have been exempt from GST. (Reference: *GST/HST Memoranda 17.1.1 item E-6 and GST/HST Memoranda 17.2 item D-32.*) It is unclear, however, what impact the changes to the definition of “financial services” will have on this current longstanding policy and practice.

Example 1 in the Notice clarifies that fees paid to an investment manager for accounts managed on a **full-discretion** basis are subject to GST. However, the proposed changes to the definition of “financial service” would extend the application of GST to investment management services “**without** discretionary authority”. This interpretation suggests that commissions paid on investment products, deemed investment management services without discretionary authority, could be subject to GST/HST, contrary to GST/HST Memoranda 17.1.1 and 17.2. This would contradict existing taxation policy and suggest retroactivity.

#### **Investment Dealers arranging for the purchase or redemption of mutual funds on behalf of a client**

GST/HST Memoranda 17.1.1 and 17.2 also list redemption fees and fees for arranging the purchase of mutual funds as exempt from GST. GST Policy Statement 119 extended the GST exemption to mutual fund trailers. Example 2 in the Notice, however, implies that given the changes to the definition of “financial services”, the tax treatment of these activities has changed.

If the clarification in the Notice is correctly interpreted as the application of GST on non-discretionary investment management services and mutual fund fees/trailers, contrary to existing practice, then major system changes will be required to appropriately administer

the application of GST. These changes would be occurring at a very inopportune time, as our members are already devoting significant resources to accommodate the imminent harmonization of provincial sales tax with the GST in Ontario and British Columbia. Our members would also require sufficient time to bring these changes to the attention of their staff, suppliers and customers.

## **Conclusion**

The investment industry consulted with the Department of Finance and CRA to develop a reasonable and balanced approach to implementing the GST in the area of financial services. We believe that GST/HST Memorandum 17.1.1 currently in place fairly and clearly explains taxable and exempt products and services offered by Canadian investment dealers. The December 14 Backgrounder and the Notice appear to expand the definition of “financial service” outside the scope of this initial policy intent.

While we support the need for legislative clarity to remedy confusion caused by the court decisions mentioned previously, regrettably the Backgrounder and Notice have created more confusion rather than less in the financial services industry. While we acknowledge that the Notice of Ways and Means Motions included in the annex of the recent federal budget includes provisions for prescribing certain services under the definition of “financial services”, further clarification on the application of GST is still required by our members.

We would be pleased to meet with you on this matter to discuss these issues and how they might be addressed.

Yours truly,



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