

Tax Memo

GST and the Financial Services Sector —Updated Draft Legislation Released

On September 23, 2009, the Honourable Jim Flaherty, Minister of Finance, released updated draft legislation on the proposed changes to the application of the Goods and Services Tax (GST) to the financial services sector. The draft legislation updates the proposals that were released on January 26, 2007, some of which were first announced on November 17, 2005.

Despite industry concerns and appeals to revise the proposals that were released on January 26, 2007, the latest release is in most respects substantially similar. That said, the Department of Finance appears to believe that the new release does address the major concerns raised by the financial services sector, especially in connection with imported taxable supplies. Key features of the latest draft legislation and differences from the previous draft legislation are outlined below.

Imported Taxable Supplies

The revised draft legislation is substantially the same as the previous proposals (released on January 26, 2007) but contains several changes that address some of the concerns raised by financial institutions (FIs). These include the following:

- FIs resident in Canada that conduct business through foreign branches can elect to use a simpler alternative approach to self-assess tax on services a foreign branch provides to a Canadian branch. A FI that makes the election for a particular year would self-assess tax on an internal charge that, for income tax purposes, is generally treated as:
 - income or profit in a particular country other than Canada; and
 - a deduction from income in Canada.
- The more detailed cost-based approach outlined in the January 26, 2007 draft legislation remains an option.
- FIs can exclude certain qualifying financial derivative transactions from the self-assessment rules that apply to imported services if all or substantially all of the value of the financial derivative transaction attributable to Canada is made up of financial elements, profit margin and employee compensation.

The concept of loading remains. In addition, a new term, “qualifying instrument,” is used in determining the extent to which the consideration for a financial service is subject to tax.

Input Tax Credit Allocation Methods

The proposed amendments released on January 26, 2007, provided detailed ITC allocation rules for FIs, which would allow most FIs to use their own fair and reasonable methods, if their design conformed to CRA guidelines. The revised draft legislation contains the following modifications to the original proposed legislation:

- Large banks, insurance companies and securities dealers can use their own proposed methods to allocate input tax credits, in certain circumstances.
- If the Canada Revenue Agency (CRA) directs an FI (other than a large bank, insurer or securities dealer) to use an allocation method, the FI would be able to challenge it at the Tax Court of Canada and the CRA would be required to prove that its proposed method is fair and reasonable.
- FIs and the CRA are given more flexibility to use the process for pre-approving an input tax credit allocation method. The CRA is permitted to extend the deadline for pre-approval at the request of the FI.

Annual Information Schedule

In the January 26, 2007 release, the Department of Finance announced the introduction of an Annual Information Schedule (AIS) for FIs, but proposed no draft legislation. The September 23, 2009 announcement now sets out a legislative framework for the AIS, including the following key features:

- Penalties would be imposed for failure to report or for misstatement of amounts required to be reported on the AIS, for tax years commencing after 2008. Exceptions to the penalty would apply when due diligence has been exercised by the taxpayer.
- The penalty would be up to \$1,000:
 - for failure to report or for misstatement without exercising due diligence in respect of **each** "actual amount" required to be reported in an AIS; and
 - for failure to provide a reasonable estimate for **each** amount that is not an actual amount. How many actual amounts are included in an AIS remains unclear.
- The fields on the AIS would be classified into tax amounts and non-tax amounts. FIs would be permitted to provide estimates of non-tax amounts for which actual values are not reasonably ascertainable at the time of filing the AIS.
- The CRA has the authority to allow FIs to provide estimates of tax amounts and to exempt FIs or classes of FIs from filing the return altogether.

Extension of GST/HST Return Filing Due Dates for FIs

The due dates for filing annual GST/HST returns and special GST/HST returns for FIs are extended from three to six months after year end, thereby coinciding with the filing for FI annual income tax returns.

Interested parties may provide comments on the draft legislation by October 23, 2009.

New GST Rebate for Registered Pension Plan Trusts

The release also includes draft legislation for the introduction of a new GST rebate for registered pension plan trusts. Details of that proposed change are included in our *Tax Memo* "GST Rebate for Registered Pension Plan Trusts" (to be issued shortly).

For further information, please contact the following or your local PwC Indirect Tax representative.

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