CANADIAN FORUM FOR FINANCIAL MARKETS
FORUM CANADIEN DES MARCHÉS FINANCIER
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Dear Mr. Coulombe:

RE: APPLICATION OF GST/HST TO MUTUAL FUND TRAILING COMMISSIONS

The Canadian Forum for Financial Markets (CFFiM)/Forum Canadien des Marchés Financiers (FCMFi) (formerly the Investment Industry Association of Canada) is dedicated to moving forward proposals to demonstrably grow healthy, competitive financial markets in Canada.

As a solutions partner, we provide constructive analysis to drive capital raising, modernize regulation, and foster growth – strengthening national competitiveness to meet the challenges ahead.

The Canada Revenue Agency (CRA) is reviewing its position on the application of GST/HST to the "arranging for" a "financial service"[1] and has tentatively concluded that all trailing commissions would be subject to GST/HST going forward (the "Proposed Policy Change"). This is a departure from the CRA's longstanding position that trailing commissions were exempt from GST/HST under paragraph (l) of the statutory definition of financial service.

The Proposed Policy Change is inconsistent with the statutory interpretation framework mandated by the courts. It would disproportionately affect dealers and financial advisors, most of whom are not currently registered for GST/HST and qualify as "small suppliers" under the *Excise Tax Act* (Canada) [2] . If implemented, they would be required to register, file returns, and overhaul their compliance systems, resulting in substantial new administration burdens and costs.

[1] Paragraph (l) of the definition of "financial service" at subsection 123(1) of the *Excise Tax Act* (Canada).
[2] RSC 1985, c. E-15 (the "ETA").

The sections that follow offer additional insight into the practical impacts and legal considerations of the Proposed Policy Change:

TRAILING COMMISSIONS SHOULD BE TREATED AS EXEMPT

We respectfully submit that the CRA's Proposed Policy Change fails to properly engage the statutory interpretation framework required to determine whether a supply falls within the statutory definition of a "financial service".

Trailing commissions paid to a dealer constitute consideration for an exempt supply. The predominant element of the dealer's supply is the arranging for the issuance, renewal, variation, transfer of ownership, and redemption of financial instruments in the form of units of a fund. The commercial reality is that the investment fund manager pays trailing commissions because units are issued to, held by, and ultimately redeemed by investors through the dealer. Absent the successful distribution and continued holding of the units, no trailing commission would be payable.

The jurisprudence has clearly established that, for GST/HST purposes, a supply should be characterized from the perspective of the recipient of the supply.

The leading authority on the interpretive exercise required under the *Excise Tax Act* to properly characterize a supply of a financial service is *Canadian Imperial Bank of Commerce v. Canada*[3]. In this decision, the Federal Court of Appeal comprehensively articulates and reaffirms the analytical framework developed through prior jurisprudence for determining whether a supply falls within the statutory definition of a "financial service":

> [34] In *Global Cash* the test for determining what is the dominant supply was succinctly stated in paragraph 26: "what did the Casinos provide to Global to earn the commissions payable by Global?" To adopt this question for this appeal: what did Aeroplan provide to CIBC to earn the amounts payable by CIBC?
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> [35] To determine what was supplied for the commissions payable in *Global Cash*, this Court found that the "commercial efficacy of the arrangement depends critically on access to the Casinos' cash" (paragraph 28). It was necessary to consider the commercial efficacy of the arrangement because the commissions were paid for completed transactions (without any indication of which element was the predominant element) and, as noted in paragraph 27 of *Global Cash*, there were three elements to the supply:
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> > The Casinos earned commissions for completed Funds Access Service transactions. To complete those transactions, the Casinos were required to provide (1) access to the physical premises of the Casino for Global's equipment (such as its dedicated computer terminals and kiosks), (2) the clerical services of the cashiers, and (3) the cash required to pay the patrons.
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> [36] The issue was which one of these elements would justify or warrant, on a commercially reasonable basis, the payment of the commissions. This Court then concluded, at paragraphs 29 and 30, that the transactions fell within paragraph (g) [123(g)] of the definition of "financial

[3] 2021 FCA 96.

> service" in the Act "('the making of any advance, the granting of any credit or the lending of money'…) …. because the heart of each transaction is an advance of money by the Casinos, disbursed to casino patrons at Global's direction, and repayable by Global."
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> [37] In *Great-West Life*, this Court also posed the same question as set out in paragraph 26 of *Global Cash* [at paragraph 47]:
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> > The first question is simply to determine what services were provided for the consideration received.
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> [38] In paragraph 50 of *Great-West Life*, this Court confirmed that the appropriate test for determining the predominant elements of a supply was to determine "the parts of the service that resulted in the payment of the benefits."
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> [Emphasis added]

A similar test was articulated by the Tax Court in *Applewood Holding Inc. v. The Queen*[4] in which the Tax Court confirmed that the predominant element of the supply should be determined based on the end result of the service from the recipient's perspective. In support of this conclusion, the Tax Court stated as follows:

> [31] It is simply unconvincing that in evaluating a retail dealer agreement whose underlying rationale is the sale of Insurance Products to a consumer by appointing the Appellant as a dealer "to promote, offer for sale and sell" the Insurance Products of Walkaway, that somehow the predominant element of the agreement is other than the sale of the Insurance Products, but the ancillary obligations of the seller to the higher tier supplier. I find that any objective analyses of the Dealer Agreement would lead to the conclusion the main purpose of the contract is to sell insurance not provide expert advice, personnel or commercial efficacy. As CJ Rossiter opined in *Canadian Imperial Bank of Commerce*, one can look to the end result of the services provided to determine the predominant element of the services…
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> [32] It is therefore quite clear that the "purchaser" whose perspective one must objectively look through is the consumer of the end supply that is the subject matter of the transaction. In our case, that is the car buyer who buys the insurance product and he would clearly and objectively know he was buying insurance, not the expertise or training, or commercial efficacy or profitability of the Dealer or its staff as the predominant elements of the transaction, notwithstanding that such services, if provided, may have an ancillary role to play in his decision making process; if he was even aware of their existence. There is simply no merit to the Respondent's argument that the services or duties under the Dealer Agreement that may be said to be owed to Walkaway from the Appellant constitute the predominant element of the services to be provided under the Dealer Agreement, neither when analysing the terms of such agreement nor when conducting a functional analyses of the Appellant's acts in performing its Insurance Product retailer duties.
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> [Emphasis added]

Applying the above jurisprudential principles to trailing commissions, the supply by the dealer should be characterized through the lens of the recipient of the supply, i.e., the investment fund manager. From the manager's perspective and the end result of the services received by the manager, it is very clear that the manager is paying the trailing commissions as consideration for the dealer distributing the units of the fund. **The manager does not receive any separate or independent supply from the dealer; rather, the**

[4] 2018 TCC 231.

obligation to pay the trailing commissions arises solely and directly from the issuance of units to investors. The trailing commissions compensate the dealer for distributing the manager's units, which supports the conclusion that the trailing commissions are consideration for an exempt financial service.

The CRA's Proposed Policy Change not only runs counter to the well-established principles governing the characterization of supplies for GST/HST purposes but also creates significant uncertainty with respect to the long-standing statutory interpretation framework applied under the *Excise Tax Act*. If necessary, we would be pleased to work with the Department of Finance to propose draft legislative amendments that would ensure the legislation clearly aligns with the interpretative approach consistently articulated in the case law.

SIGNIFICANT ADMINISTRATIVE IMPACT WITH NO NET FISCAL BENEFIT

If trailing commissions are treated as taxable, investment fund managers are GST/HST registrants and, as such, would be entitled to recover any GST/HST paid on trailing commissions through input tax credits. Consequently, any GST/HST collectible on trailing commissions would be fully offset by corresponding input tax credits claimed by the managers, resulting in no net fiscal benefit to the government.

Moreover, dealers and financial advisors required to collect GST/HST under the Proposed Policy Change would themselves become entitled to claim additional input tax credits in respect of the costs incurred in providing their services to the manager, further reinforcing the absence of any net revenue gain. In fact, creating an obligation to collect GST/HST under the Proposed Policy Change may actually reduce government revenues by creating a currently non-existent input tax credit entitlement for dealers.

The proposed shift to treating all trailing commissions as taxable would result, inter alia, in the following additional compliance burden and costs:

- Many dealers and financial advisors would need to register for GST/HST and update their systems to include functionalities to ensure that GST/HST is collected on trailing commissions and remitted to the CRA. This could result in a significant increase in additional registration requests and GST/HST returns needing to be filed.

- New compliance obligations for dealers and financial advisors would include tracking GST/HST paid and claiming input tax credits on related expenses, requiring upgrades to accounting systems and training.

- In order to substantiate input tax credit claims, managers would need to collect certain information from dealers and advisors (including their GST/HST registration numbers). The limited interaction between dealers and investment fund managers regarding trailing commissions would make information gathering and reconciliation challenging.

Despite the significant operational changes required of dealers and financial advisors if the Proposed Policy Change is implemented, the added costs and administrative effort required would not benefit investors and would run counter to the government's goal of reducing regulatory burden. At a time where we understand the government is seeking to remove red tape across the Canadian economy, the

Proposed Policy Change risks the opposite by introducing substantial additional compliance and operational costs that would divert resources away from improving investor outcomes all while delivering no corresponding net fiscal benefit for the government.

We thank you for your attention to this matter. We would be happy to discuss our comments and recommendations at your convenience.

Respectfully submitted,

Canadian Forum for Financial Markets (CFFiM)/
Forum Canadien des Marchés Financiers (FCMFi)