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# The Canadian GST Treatment of Financial Services - What Lessons are there for Australia?

## **Abstract**

This article discusses the judicial development of the Canadian GST over the past 10 years. It focuses on the treatment of financial services. The author believes the Canadian experiences and the resulting legislative actions can assist Australia. Further, he argues that, if there were some commonality of charging GST/VAT on financial transactions, there would be considerably less discord in the application of the GST/VAT in the affected nations.

## **Keywords**

Canada, GST, financial services, goods and services tax

## **THE CANADIAN GST TREATMENT OF FINANCIAL SERVICES - WHAT LESSONS ARE THERE FOR AUSTRALIA?**

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**This article discusses the judicial development of the Canadian GST over the past 10 years. It focuses on the treatment of financial services. The author believes the Canadian experiences and the resulting legislative actions can assist Australia. Further, he argues that, if there were some commonality of charging GST/VAT on financial transactions, there would be considerably less discord in the application of the GST/VAT in the affected nations.**

Australia embarked on a new era of taxation with the introduction of the Goods and Services Tax<sup>1</sup> on 1 July 2000. Canada is approaching the tenth anniversary of the introduction of its Goods and Services Tax.<sup>2</sup> The Canadian experience should be of interest to Australia due to the similarity or circumstances leading to the introduction of the GST. Canada had a very inefficient Manufacturers Sales Tax, introduced prior to the introduction of the Wholesale Sales Tax in Australia. The narrow range of transactions that were covered by these taxes was an issue of considerable concern for both Canadian and Australian politicians and bureaucrats. The fact that Canada has had 10 years of experience with the operation of the GST should be of interest to Australia since the Canadians have had the opportunity to utilise the legislation and have seen what has been contentious and what the results from litigation have been.

This article offers a history of the judicial development of the Canadian GST over the past 10 years with a focus on the treatment of financial services. The

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<sup>1</sup> A New Tax System (Goods and Services Tax) Act 1999. Hereafter referred to as the Australian GST.

<sup>2</sup> Excise Tax Act, RSC 1985, c E-15. Hereafter referred to as the Canadian GST. The date of the Excise Tax precedes the introduction of the GST in 1991. This is because the Canada government performs office consolidations of all of their legislation from time to time. Sometimes (as in the case of the Excise Tax) the consolidation takes place considerably later than the official date of the "RSC".

article goes on to explain how the experiences of the Canadians and the resulting legislative actions can assist Australia. There is no value in Australia experiencing the same problems as Canada and then having to amend the legislation *ex post facto*. The problems associated with the special treatment of financial transactions can be avoided if the legislation giving this special treatment to financial transactions is not kept in place.

## BRIEF POLITICAL HISTORY OF THE CANADIAN GST

The political fight in relation to the introduction of the GST in Canada was very similar to that in Australia. The then Progressive Conservative government asserted that the *Manufacturers Sales Tax*<sup>3</sup> was inefficient and in need of replacement. The Minister of Finance, Michael Wilson, then stated, as if it were axiomatic, that the MST would have to be replaced by a Goods and Services Tax. There was no discussion as to alternatives to the GST as a replacement for the MST. There were many studies and political manoeuvring and controversy prior to its introduction on 1 January 1991.<sup>4</sup>

## WHAT ARE FINANCIAL SERVICES (SUPPLIES)?

Characterisation of a transaction as a financial service can have a very important effect from the perspective of the application of the GST laws. In almost all jurisdictions, financial services are exempt from GST.<sup>5</sup> Canada is no exception. The significance of exemption is that GST is not charged on the provision of the goods or services and input tax credits cannot be sought. The definition of “financial service” in the Canadian GST is long and extensive.<sup>6</sup> The manner in which the definition is considered in the following cases is most varied.

<sup>3</sup> The Canadian *Manufacturer's Sales Tax* is hereafter referred to as the MST.

<sup>4</sup> An excellent detailed discussion of the politics of the GST and the history of events leading up to its introduction is to be found in Brooks N, *The Canadian Goods and Services Tax: History, Policy and Politics* (1992 Australian Tax Research Foundation Research Study No 16) especially ch 2.

<sup>5</sup> “Exempt” is the term used throughout the world to show where no GST is to be charged on the transaction and the business is not permitted to seek input tax credits on GST that they have paid in the carrying on of their business. This category is called “input taxed” under the Australian legislation.

<sup>6</sup> Excise Tax Act, s 123, relevant parts of the definition are to be found in the Appendix.

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The structure of the definition of financial service describes both what it is as well as what it is not. The relevant portions of the definition will be discussed in each of the cases.

Although each of the cases to be discussed had unique issues and unique facts, they all have at their core the question “is this activity an exempt financial service”? As will be seen in most of these cases, the taxpayer/appellant did not charge GST on transactions and sought to justify this on the basis that the transaction was exempt. The article will look at each of the cases in sequence and an attempt will be made to draw issues of comparison between the cases.

***Locator of Missing Heirs Inc v R* [1995] GSTC 63 TCC (Informal)<sup>7</sup> What is of commercial activity under the GST law?**

The taxpayer was a firm that carried on the business of finding missing heirs to property. They would go through the records of public companies and look for deceased shareholders. They would then search for heirs to the deceased and tell them that they are entitled to assets from the deceased estate and that they should have their lawyers contact them. The firm would then negotiate a fee for service from the lawyers representing the heirs. The fee would usually represent a percentage of the value of the asset found.

The taxpayers failed to charge GST for the heir finding service. They were penalised for violating the GST legislation. The question before the Court was to determine whether the taxpayer was obliged to charge and remit GST for the provision of these services.

The discussion in the case revolved around whether the service provided by the taxpayer was a financial service under the definition in the GST legislation. If what they were doing was a financial service, it would be exempt from the GST and they would have been correct not to have charged and collected GST. The additional issue arose in relation to the fact that many of the persons served resided outside Canada. The inference was that as the service was provided to persons off-shore GST would not be chargeable. The Court was not convinced by this argument and concluded that regardless of where the potential heirs were located the investigative work was performed in Canada and hence the supply of the service was deemed to have been made in Canada.<sup>8</sup> The taxpayer lost the case at the first level of the Tax Court.

<sup>7</sup> There are two forms of procedure before the Taxation Court of Canada. Informal procedure is a sort of simplified Tax Court procedure. One of the key differences when a case is heard in the informal venue is that the decision has no precedential value. The general procedure is more formal.

<sup>8</sup> *Locator* [1995] GSTC 63 at 63-3.

The case was appealed by the taxpayer to the Federal Court of Appeal.<sup>9</sup> At trial the taxpayer argued that they effected the transfer of shares and thus were providing an exempt financial service.<sup>10</sup> At appeal, the argument of the appellant was modified to say that they were arranging for the transfer of shares.<sup>11</sup> The Court of Appeal concluded that the trial court had not erred in concluding that the taxpayer had not engaged in the providing exempt financial services.<sup>12</sup>

The Court had to grapple with what the central activity of the taxpayer was. Here the Court concluded that the service was the searching for heirs and thus taxable, and not, as they asserted, the provision of an exempt financial service.

***Sir Wynne Highlands Inc v R* [2000] GSTC 6 TCC (General Procedure)  
What is interest?**

The taxpayer was a house builder. There were a number of issues being litigated in the case. The one relevant to this discussion is GST treatment of a fee collected by the taxpayer to allow a buyer of a house to extend the closing date for the purchase of a house for 30 days. The Revenue department was of the view that the charging of this fee was taxable. The taxpayer argued that it was a payment of interest and hence an exempt financial service.<sup>13</sup> The Court concluded that the payment represented compensation for extending the closing date and was in no way interest. The judge pointed out that there had been no money advanced to the purchaser to base the interest argument.<sup>14</sup> This conclusion is of importance because it shows that, even if a payment is akin to interest and the quantum is based on the time cost of money, it may not be characterised as interest if the payment is not in relation to a loan or some other similar amount.

***Elgin Mills Leslie Holdings Ltd v R* [2000] GSTC 8 TCC (Informal)  
What is a financial service?**

This taxpayer carried on a number of activities. In the relevant year, the taxpayer collected \$42.00 of GST and sought input credits of \$3,053.40,

<sup>9</sup> *Locator of Missing Heirs Inc v Canada*; *Locator of Missing Heirs Inc v R* [1997] GSTC 16 (FCA).

<sup>10</sup> *Ibid* at para 7.

<sup>11</sup> *Ibid* at para 8, referring to the interpretation section of the Excise Tax Act s 123(1) "financial service" (d) and (l).

<sup>12</sup> *Ibid* at para 16.

<sup>13</sup> *Sir Wynne Highlands Inc v R* [2000] GSTC 6 at para 39.

<sup>14</sup> *Ibid* at para 40.

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hence claiming a refund of \$3,011.40. The Minister permitted input credits totalling \$72.45.<sup>15</sup>

The business carried on a wide variety of activities including the sale of lottery tickets and bus passes, providing postal boxes, sending money orders and cashing cheques.<sup>16</sup>

The Court found that of \$22,000 in gross revenue, only \$600 of transactions were taxable (the rental of postal boxes and sending faxes).<sup>17</sup> The balance of the transactions were not in respect of GST taxable services.<sup>18</sup>

The largest single component of the business was cheque cashing. The taxpayer would cash a cheque and take a commission. Of the \$22,000 in revenue reported, over \$18,000 was attributable to the cheque cashing business.<sup>19</sup>

The appellant argued that the cheque cashing service was not a financial service. The Court then commented that it would be very difficult for the appellant to explain why they did not collect GST in relation to the commissions charged.<sup>20</sup>

The Court concluded that cashing cheques and charging a commission was a financial service. The Court found that two definitions of financial service could be used: that financial service includes “the exchange, payment, issue or transfer of money...”<sup>21</sup> (the definition of “money” in the legislation includes cheques) or the “...transfer of ownership or repayment of a financial instrument”.<sup>22</sup> The Crown asserted that the cashing of cheques was a financial service under the first definition. The Court added that the second definition could be used, too, because the cheque could be characterised as debt security under the definition of financial instrument.<sup>23</sup>

The Court concluded that the predominant activity was exempt financial services, thus the bulk of the input tax credits sought could not be claimed. The appeal was dismissed.<sup>24</sup>

<sup>15</sup> *Elgin Mills Leslie Holdings Ltd v R* [2000] GSTC 8 TCC at para 2.

<sup>16</sup> *Ibid* at para 3.

<sup>17</sup> *Ibid* at para 4.

<sup>18</sup> *Ibid* at para 5.

<sup>19</sup> *Ibid* at para 6.

<sup>20</sup> *Ibid* at para 7.

<sup>21</sup> Excise Tax Act at s 123(1) “financial service” (a).

<sup>22</sup> Excise Tax Act at s 123(1) “financial service” (d).

<sup>23</sup> Paragraph 10.

<sup>24</sup> Paragraph 24.

Revenue Canada provided an interpretation of exempt financial service to include the service charge by some financial institutions associated with the use of their ATM machines.<sup>25</sup> This meant that the service charge would not be subject to GST. There was really no explanation given as to why that approach was taken. It is not absolutely clear from the definition of “financial service” that this charge should be so characterised.

***Bombay Jewellers Ltd v Canada; Bombay Jewellers v R* [1998] GSTC 94  
Tax Court of Canada (General Procedure) What is a financial service?<sup>26</sup>**

The following case is interesting because of the discussion of what should be considered ingot or gold bars for the purposes of the GST legislation. This is important because precious metals in these forms are considered exempt financial instruments. These forms of gold are seen as distinctive financial instruments because of their format (with Assayer stamps and official weights). The taxpayer attempted to use this provision to their financial advantage. This is of limited relevance to Australia but nevertheless of interest.

The taxpayer was a maker of custom jewellery. When making a piece of jewellery for a client they would cut a wafer of gold from a gold brick.<sup>27</sup> There was no GST charged on this gold. This was based on the assertion that the cutting represented an “ingot or bar” and thus was an exempt financial instrument. The gold would then be fashioned into jewellery. GST would only be charged on the cost of the labour, not on the value of the gold. The revenue authority was of the view that the sales of the gold pieces was not an exempt activity as contemplated by the GST legislation and hence should attract GST as well. This was the core issue in the litigation.

The appellant cut smaller pieces of gold from larger pieces, since they could sell the smaller pieces for proportionately more money, and thus increase their profits.<sup>28</sup> The appellant admitted that it would be difficult for someone to sell a cut piece of gold in the form that he removed it from the gold brick.<sup>29</sup>

<sup>25</sup> Sherman D, *Goods and Services Tax Service* (2000 Carswell Publishing) para 213-413.

<sup>26</sup> The relevance of this case may be limited in Australia. Under the Australian GST, the rules regarding the inclusion of cut gold are in the definition of financial instrument. This is shown in the definition section of the Australian legislation (s 195). The definition of gold says that it is “gold (in any form) that is at least of 99.5% fineness”. The fact is that the gold can be in any form so long as it meets the fineness requirements of the definition.

<sup>27</sup> *Bombay Jewellers Ltd v Canada; Bombay Jewellers Ltd v R* [1998] GSTC 94 (Tax Court of Canada-General Procedure) para 4.

<sup>28</sup> *Ibid* at para 9.

<sup>29</sup> *Ibid* at para 9.

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The appellant had engaged in the business practice of cutting smaller portions from a gold brick. The portions were marked for weight but not purity.

The revenue authority had an expert witness from a major bank, who was formerly a geologist and then Manager at the Royal Canadian Mint, to discuss the meaning of terms such as “bar”, “ingot” and “wafer”. He took the view that, as far as the terms were used in the Canadian GST legislation,<sup>30</sup> they had a specific technical meaning that they must be produced by approved mints or smelters and stamped by an assayer. He further asserted that bars of precious metal were marked for weight, purity and source of manufacture and that these features made it a traceable financial product.<sup>31</sup> It was pointed out that there are 58 accredited gold refineries in the world. It was also pointed out that, if a gold brick or other form of gold were tampered with from its original condition, it would cease to be a marketable financial instrument. It was also pointed out that other forms of gold, such as gold wire and gold granules, were not exempted as financial instruments and hence were subject to GST on their sale.<sup>32</sup> The expert witness explained that the policy rationale for the exemption of gold bars was to protect the Canadian gold industry.<sup>33</sup> When shown the cut wafers of gold that the appellant had prepared, the expert said that these were not in a marketable form and hence GST should have been charged on their removal from the brick or ingot.<sup>34</sup>

The appellant asserted that the cut pieces were of the same level of purity as the original gold brick and, as such, the purity requirements were met. Furthermore, it was asserted that the terms “bar”, “ingot” and “wafer” only had their standard dictionary meaning and not the technical meaning asserted by the expert witness. The appellant further asserted that the Parliament did not intend the technical industry meanings of these terms to apply.<sup>35</sup>

The appellant set out definitions from a number of dictionaries of the terms “bar”, “wafer” and “ingot”.<sup>36</sup> It was then asserted that none of these definitions led one to the conclusion that a “bar” was anything other than a rectangular piece of metal.<sup>37</sup> The appellant further argued that the appropriate interpretation of the terms is to be their general meaning in

<sup>30</sup> The definition of financial instrument in the Excise Act at s 123(1) includes:  
 (e) a precious metal, precious metal means a bar, ingot, coin or wafer that is composed of gold, silver or platinum and that is refined to a purity level of at least:  
 (a) 99.5% in the case of gold and platinum, and  
 (b) 99.9% in the case of silver.

<sup>31</sup> Ibid at para 24.

<sup>32</sup> Ibid at para 25.

<sup>33</sup> Ibid at para 26.

<sup>34</sup> Ibid at para 27.

<sup>35</sup> Ibid at para 29.

<sup>36</sup> Ibid at para 30-32.

<sup>37</sup> Ibid at para 33.

society, since the GST legislation is applicable to the general society. Only with legislation that is aimed at a specific industry should the industrial meanings be used, according to the appellant.<sup>38</sup> He also pointed out that there was no requirement in the GST law that there be stamping of wafers or bars, or that the wafers, ingots<sup>39</sup> or bars be transferable to meet the legislative definition of financial instrument.<sup>40</sup>

Counsel for the respondent pointed out that the GST is designed to apply to all goods and services, unless specifically exempted. All such exemptions must be read restrictively and be readily identifiable.<sup>41</sup> The respondent also referred to *Unwin v Hanson*<sup>42</sup> to assert that the technical meaning of the terms should be used because the provisions at issue deal with a specific trade or business.<sup>43</sup>

The Court agreed with the respondent that the terms are technical as used in the financial industry and the technical meaning, not the dictionary meaning, should be used. The exemption is for investment quality gold, not just pieces of pure gold cut off a larger bar.<sup>44</sup> The Court concluded that the appellant did not meet their onus of showing that the gold at issue was a financial instrument, hence the appeal was dismissed.<sup>45</sup>

The Court went on to say that clearly the appellant had provided a good or service that should attract GST, unless it could be shown on a balance of probabilities that the good or service was exempt. The exemption at issue would be financial services. To meet this burden, the gold sale would have to be the sale of a precious metal as defined by the legislation. The Court noted that it is the service of selling the gold, not the gold itself, that is exempt.<sup>46</sup>

The Court concluded that it was more reasonable to apply the technical meaning of the terms “bar”, “ingot” and “wafer” than to apply the common dictionary meaning because the terms arise in the restrictive confines of the financial instruments provisions.<sup>47</sup> It added that to apply the common meaning of the terms would lead to absurd results.<sup>48</sup> Further, when the

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<sup>38</sup> Ibid at para 37, quoting *Unwin v Hanson* [1891] QB 115 (Eng CA).

<sup>39</sup> Ibid at para 39.

<sup>40</sup> Ibid at para 40.

<sup>41</sup> Ibid at para 48.

<sup>42</sup> [1891] QB 115 (Eng CA).

<sup>43</sup> Ibid at para 51.

<sup>44</sup> Ibid at para 52.

<sup>45</sup> Ibid at para 61.

<sup>46</sup> Ibid at para 66.

<sup>47</sup> Ibid at para 71.

<sup>48</sup> Ibid at para 75.

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appellant cut pieces off the gold bars they had purchased, those bars were no longer financial instruments and neither were the pieces cut off.<sup>49</sup>

This case provides some insights into the meaning of the term precious metal, in the context of the definition of financial service. The inclusion of terms “bar, ingot and wafer” in the definition of precious metal was pivotal to the conclusion of the Court. The Court concluded that since there was not only a reference to purity level but to the form in which the metal should take, it meant that the metal must be in one of those recognised forms to be an exempt financial instrument. It is interesting to note that, in Australia, under the definition of “precious metal” only the purity level is prescribed. If the gold, silver or platinum are of the required level of purity they can be in any form and be characterised as a “precious metal” for the purposes of the GST.<sup>50</sup>

***Skylink Voyages Inc v Canada* [1999] GSTC 119 TCC (General Procedure) Interest and credit card fees.**

The appellant was a wholesale travel agency. It acted as an intermediary between the airlines and the retail travel agencies. The appellant was assessed for GST in relation to collection charges, credit card sales and cancellation charges associated with cancelled airline reservations.<sup>51</sup> The appellant argued that the collection charges were an exempt financial service and that the cancellation fees related to travel outside Canada and the USA and thus was zero-rated.<sup>52</sup> This latter argument was abandoned in favour of an assertion that no service had been rendered in relation to the cancellation, thus there was no basis for the assessment of GST.<sup>53</sup>

The appellant acted on requests by retail travel agents for overseas air bookings. If the appellant found the appropriate flight it would make a 10 day reservation and notify the retail agency.<sup>54</sup> Where the booking was suitable to the client, the traveller was asked to pay the ticket price. The payments are generally made by credit card. Sometimes, however, the credit card of the client is not one with which the retail agency has an agreement. In these instances, the appellant acted as an intermediary by accepting the credit card directly from the client.<sup>55</sup> The collection charge accompanying these

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<sup>49</sup> Ibid at para 78.

<sup>50</sup> A New Tax System (Goods and Services Tax) Act 1999, Div 195.

<sup>51</sup> *Skylink Voyages Inc v Canada* [1999] GSTC 119 (TCC General Procedure) para 1.

<sup>52</sup> As the Canadian GST is destination based, exports are zero-rated and imports are taxed on entry to the country.

<sup>53</sup> Ibid at para 2.

<sup>54</sup> Ibid at para 3.

<sup>55</sup> Ibid at para 4.

transactions is a flat rate of \$15. It was asserted that this merely represented an average of 2.2-3% charged by the credit card operators and that no profits were made from this operation.<sup>56</sup>

The appellant stated that there were instances where it was unable to collect on the credit card transactions that they processed. In these instances the appellant absorbed the loss.<sup>57</sup>

If the passenger decided to cancel their reservation the retail agency is liable to pay a cancellation fee to the appellant. If the ticket has already been issued, the cancellation fee is paid directly to the airline.<sup>58</sup>

The Court first dealt with the assessment of cancellation charges. The Court rejected the argument that no service was rendered by the appellant and therefore no GST was payable. The Court noted that, even when no ticket was issued, the appellant had provided the service of searching databases and finding the flight appropriate to the needs of the retail client.<sup>59</sup> The Court also rejected the argument that the fee was akin to a penalty under the traffic laws and therefore not the provision of services.<sup>60</sup>

The more complex question was the treatment of the collection charges under the GST. The appellant argued that the collection charges were payments for a financial service and therefore exempt from the GST.<sup>61</sup>

The Court then dealt with the appellant's argument that they did not charge GST on collection fees because they were providing a financial service. The most likely part of the definition of financial service was the "arranging for a service provided pursuant to the terms and conditions of an agreement relating to payments of amounts for which a credit card voucher was issued".<sup>62</sup> The Court considered at some length whether the collection service fell within any of the exclusions in the definition of financial service. These exclusions were aimed at excluding administrative services related to financial services but not financial services in themselves.<sup>63</sup> The Court gave the example that collection by a bank for amounts lent would be a financial service but collection by a third party would be taxable.<sup>64</sup> The Court concluded that the service provided by the appellant was not one of the

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<sup>56</sup> Ibid at para 6.

<sup>57</sup> Ibid at para 7.

<sup>58</sup> Ibid at para 8.

<sup>59</sup> Ibid at para 12.

<sup>60</sup> Ibid at para 13.

<sup>61</sup> Ibid at para 15.

<sup>62</sup> Ibid at para 31. Quoting from Excise Tax Act at s 123(l) and (i).

<sup>63</sup> Ibid at para 32.

<sup>64</sup> Ibid at para 36.

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prescribed exceptions under the definition of “financial service”.<sup>65</sup> The appellant was not excepted from the definition of financial service because they were “a person at risk” as described by the Regulations.<sup>66</sup> The Court then concluded that the collection services were financial services (arranging for a credit card service) under the GST law and therefore it was not necessary for the appellant to collect GST in relation to those fees.

### **On-Guard Self-Storage Ltd v Canada [1996] GSTC 9 TCC (informal procedure) Late payment penalty**

The issue in the following case was to determine the GST treatment of the difference between the discounted rental price and the full rental price to those who were charged the higher amount.

The appellant was the owner of a large number of self-storage facilities. Under the rental contract, they would provide a prompt payment discount for those who paid by a certain date.<sup>67</sup> Most renters did pay promptly and received the benefit of the discount. Those who did not pay by the due date were subject to aggressive collection proceedings almost immediately.<sup>68</sup> The appellant calculated the GST payable in relation to the discounted price of the rental, whether the rental discount was applied or not.

Originally, the prompt payment discount was characterised as a late payment penalty. It was felt that for customer relations’ purposes it would make more sense to call the amount a prompt payment discount.<sup>69</sup> The Court was of the view that the prompt payment discount was in fact a late payment penalty. The amount was to compensate the appellant for costs incurred in relation to collecting fees that were not paid on a prompt basis. The Court pointed out that the amount that represented rent was the “discounted” amount, regardless of how it was characterised in the rental contract. That it was important to consider the legal reality rather than the characterisation purely based on what the contract says.<sup>70</sup>

The Court agreed with the submission of the appellant that the late fee was a financial service.<sup>71</sup> The Court pointed to a GST Memorandum that stated that a late payment fee is a financial service as it related to an overdue account.<sup>72</sup>

<sup>65</sup> Ibid at para 41. Quoting from Excise Tax Act at s 123(l) s i.

<sup>66</sup> Ibid at para 40.

<sup>67</sup> *On-Guard Self-Storage v Canada* [1996] GSTC 9 TCC (Informal Procedure), para 5.

<sup>68</sup> Ibid at para 12.

<sup>69</sup> Ibid at para 11.

<sup>70</sup> Ibid at para 13.

<sup>71</sup> Ibid at para 14.

<sup>72</sup> Ibid at para 18. Quoting GST Memorandum Series, ch 17.1 at para 7.

The Court concluded that it was reasonable to characterise the amounts paid by the tenant as an account for the purposes of the definition of financial service. Further, the Court concluded that the late fee was consideration for services that the appellants provided to the account. This made the supply of one of the financial services thus exempt from GST and therefore no GST was payable on these amounts.<sup>73</sup> The matter was then appealed to the Federal Court of Appeal.

***On-Guard Self-Storage Ltd v Canada* [1996] GSTC 88 FCA Late payment penalty**

The main issue before the Court of Appeal was whether the trial judge erred by finding that the “prompt payment discount” was in fact a late payment penalty and that the penalty amount was not assessable for GST purposes.

Linden JA speaking for the Court disagreed with the analysis of the trial judge. He was of the view that the agreement provided for a two tiered pricing system, not a credit account. He further found that the \$10 represented a fee in relation to collecting money on this account. Since no evidence was given by the taxpayer to support the taxpayer’s assertion that the fee represented payment for the costs of collection on the rental account, there was no support for the taxpayer’s position.<sup>74</sup>

The appeal court then noted that Parliament exempted as financial services late payment penalties and prompt payment discounts in relation to “tangible personal property or services”. In contrast, the exemption did not apply to the fees related to the leasing of storage facilities, which is a supply of real property subject to GST.<sup>75</sup>

The Court of Appeal then, in detail, rejected the trial judge’s analysis of the characterisation of the \$10 late fee. The trial judge concluded that the amount was a late payment charge in relation to a financial services overdue account. The Court of Appeal pointed out that this analysis does not recognise that the higher amount paid is arbitrarily set and does not relate to the cost of provision of credit for the overdue period. The Court of Appeal concluded that the monthly rent without the prompt payment discount is no different than the monthly charge less the prompt payment discount. The differential rates charged represented a higher fee to encourage renters to pay in a timely manner.<sup>76</sup> The Court of Appeal allowed the tax administration’s application for judicial review.

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<sup>73</sup> Ibid at para 21.

<sup>74</sup> *On-Guard Self-Storage v Canada* [1996] GSTC 88 FCA para 7 per Linden JA.

<sup>75</sup> Ibid at para 9.

<sup>76</sup> Ibid at para 10.

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This appeal decision is interesting because it reined back the rather broad view of what should be considered a financial service and late fees in relation to a financial services account. The Court of Appeal was clearly right in their analysis that the contract here is a contract for the supply of real property and not a financial services account. On a related procedural point, the trial decision on informal procedure was reviewable on the standard of correctness, not reasonableness. In other words, if the decision of the trial court was not correct on a point of law, that would be sufficient for the trial decision to be overturned.

### WHAT IS THE SIGNIFICANCE OF THESE DECISIONS?

These decisions cover a wide range of issues in the calculation of the GST for financial instruments and transactions. Much of the controversy attached to the court treatment of financial transactions for GST purposes has to do with the treatment of financial transactions under the GST law.

In most of these cases, the taxpayer had refrained from collecting GST from persons with whom they were doing business. In most instances, the taxpayer made the argument that they did not collect GST because they were of the view that what they were doing was engaging in financial activity. These dealings were not subject to GST.

There are important issues to consider in both Canada and Australia. Is there a strong justification for the exclusion of financial transactions from the operation of the GST (in Canada or Australia)? The burden is on the government to meet its obligations to make programs continue and flourish. Of course, one of the problems with this analysis is to consider whether the government maintains any serious ongoing amount of government assistance. Governments throughout the developed world are relinquishing their traditional roles as providers of government services. This trend makes it much more difficult for governments to argue that they should be providing more assistance than they are now.

The taxing of financial services is complex. For example, the taxation of interest creates real problems for working out a means of taxation. For instance, interest represents the real cost of capital (the value of the money or other asset that is being lent); the existing and forecast rate of inflation, as well the cost of financial intermediation.<sup>77</sup> Financial intermediation as the rationale for not taxing financial transactions is not a very sound basis. Clearly, the financial institutions are able to afford to pay the GST on those transactions, or pass those taxes on to the customer in the appropriate

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<sup>77</sup> Tait A, *Value Added Taxation* (1989 International Monetary Fund, Washington DC) at 93.

circumstances. The question, then, is what methodology of tax should be employed?

Satya Poddar of Canada has written extensively on possible methodologies for taxing financial transactions. His theories are very complex and provide theoretically a fairly accurate basis for taxing financial transactions.<sup>78</sup>

Israel is one of the few countries that taxes financial intermediation and the financial sector generally. The tax began in 1976 as part of the VAT and was renamed in 1979 as a separate tax. This permits Israel to collect VAT from financial institutions on financial intermediation and other financial services. In Israel, the base for GST taxation is an addition base that includes wages, salaries and profits of the financial institution. Even if the methodology is not perfect, it is still an effective means of seeking to tax financial services for GST.<sup>79</sup>

The use of GST taxation on financial services as in Israel reduces distortion, improves equity and increases revenue to the tax administration.<sup>80</sup> Israel is a glaring exception to the world powers in the taxation or otherwise of financial transactions. The other nations that do not charge VAT tend not to charge an alternate tax to make up the revenue lost to the tax base.<sup>81</sup>

The problem that remains for nations that would like to apply VAT to the financial sector is that something needs to be done about financial services that are provided from overseas (or threatened to be taken overseas to avoid the tax). This is one of those vexed questions of how to maintain the integrity of the tax system while at the same time applying the law in a manner that is seen to be appropriate (leaving aside the lack of similar view from other nations).<sup>82</sup>

Although the author's view is that financial transactions not be excluded from the operation of the GST law, this is the almost exclusive position of nations. If there were some commonality of charging GST/VAT on financial transactions, either by the Israeli method or by some other method, there would be considerably less discord in the application of the GST/VAT in the affected nations.

<sup>78</sup> See generally, Poddar & English, *Taxation of Financial Services Under a Value-Added Tax: Applying the Cash-Flow Approach* (1997) 50 Nat Tax J 89.

<sup>79</sup> Ibid.

<sup>80</sup> Tait, above n 77 at 95.

<sup>81</sup> Ibid at 99.

<sup>82</sup> Ibid at 100.

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What follows is the definition of the term “financial service” for the purposes of the Canadian GST law.

## **APPENDIX**

### **Section 123, definition of “financial service”**

“financial service” means:

- (a) the exchange, payment, issue, receipt or transfer of money, whether effected by the exchange of currency, by crediting or debiting accounts or otherwise;
- (b) the operation or maintenance of a savings, chequing, deposit, loan, charge or other account;
- (c) the lending or borrowing of a financial instrument;
- (d) the issue, granting, allotment, acceptance, endorsement, renewal, processing, variation, transfer of ownership or repayment of a financial instrument;
- (e) the provision, variation, release or receipt of a guarantee, an acceptance or an indemnity in respect of a financial instrument;
- (f) the payment or receipt of money as dividends (other than patronage dividends), interest, principal, benefits or any similar payment or receipt of money in respect of a financial instrument;
- (f.1) the payment or receipt of an amount in full or partial satisfaction of a claim arising under an insurance policy;
- (g) the making of any advance, the granting of any credit or the lending of money;
- (h) the underwriting of a financial instrument;
- (i) any service provided pursuant to the terms and conditions of any agreement relating to payments of amounts for which a credit card voucher or charge card voucher has been issued;
- (j) the service of investigating and recommending the compensation in satisfaction of a claim where
  - (i) the claim is made under a marine insurance policy; or

- (ii) the claim is made under an insurance policy that is not in the nature of accident and sickness or life insurance and
    - (A) the service is supplied by an insurer or by a person who is licensed under the laws of a province to provide such a service; or
    - (B) the service is supplied to an insurer or a group of insurers by a person who would be required to be so licensed but for the fact that the person is relieved from that requirement under the laws of a province;
  - (j.1) the service of providing an insurer or a person who supplies a service referred to in paragraph (j) with an appraisal of the damage caused to property, or in the case of a loss of property, the value of the property, where the supplier of the appraisal inspects the property, or in the case of a loss of the property, the last-known place where the property was situated before the loss;
  - (k) any supply deemed by subsection 150(1) or section 158 to be a supply of a financial service;
  - (l) the agreeing to provide, or the arranging for, a service referred to in any of paragraphs (a) to (i); or
  - (m) a prescribed service;
- but does not include:
- (n) the payment or receipt of money as consideration for the supply of property other than a financial instrument or of a service other than a financial service;
  - (o) the payment or receipt of money in settlement of a claim (other than a claim under an insurance policy) under a warranty, guarantee or similar arrangement in respect of property other than a financial instrument or a service other than a financial service;
  - (p) the service of providing advice, other than a service included in this definition because of paragraph (j) or (j.1);
  - (q) the provision, to a corporation, partnership or trust the principal activity of which is the investing of funds, of:
    - (i) a management or administrative service, or

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- (ii) any other service (other than a prescribed service), where the supplier is a person who provides management or administrative services to the corporation, partnership or trust;
- (r) a professional service provided by an accountant, actuary, lawyer or notary in the course of a professional practice;
- (r.1) the arranging for the transfer of ownership of shares of a cooperative housing corporation;
- (s) any service the supply of which is deemed under this Part to be a taxable supply; or
- (t) a prescribed service.