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GST/HST Assessment

Invesco case: Funding services not subject to GST/HST

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(November 8, 2019, 6:10 PM EST) -- In the recent judgment rendered in the *Invesco* case (*SLFI Group v. Canada* 2019 FCA 217), the Federal Court of Appeal ruled that a group of Canadian mutual funds (funds) was not required to self-assess GST/HST on funding services provided by a U.S. entity because these services were exempt financial services, rather than management or administrative services.

Case

The funds were investment vehicles regulated under Canadian securities law. They had no employees and were provided with management and administrative services by a manager in consideration for management fees, plus GST/HST.

The funds offered their investors the option of deferring the broker/dealer commissions charged upon purchasing certain securities, referred to as the "deferred sales charge" (DSC) option. At first, the DSCs were funded by the manager but starting on April 1, 2002, an alternative financing method was put in place through an arrangement (arrangement) with a U.S. subsidiary of Citibank, N.A. (Citibank) that was established for the sole purpose of the arrangement. The arrangement provided for Citibank to fund the DSCs in exchange for fees paid by the funds (fees).

The fees were arrived at by adding two components:

- A fee referred to as the Daily Fee, on which the manager self-assessed GST/HST on behalf of the funds. (This will be addressed in a following article.)
- A fee referred to as the Redemption Fee, on which the manager did not self-assess GST/HST, since the funds construed this fee as an exempt supply.

The minister took the position that the Redemption Fees were taxable and issued GST/HST assessments to certain of the funds.

By virtue of the *Excise Tax Act*, a supply that is a "financial service" is an exempt supply. The supply of "management or administrative service" (or any other service) to an investment plan or any corporation, partnership or trust whose principal activity is the investing of funds, is specifically carved out from the definition of "financial service" if it is made by a provider of management or administrative services. In other words, such supply is not exempt and is thus taxable.

At issue was whether the manager of the funds (which was a provider of management services) delegated its duties to Citibank, with the result that the services were provided on behalf of the

manager and were therefore a taxable supply.

The Tax Court of Canada first determined that the services were a single supply and that their "dominant element" was the daily payment of funding into a trust account, a duty initially incumbent upon the manager that was delegated to Citibank. Therefore, the services qualified as management or administrative services and constituted an imported taxable supply of management services to the funds, resulting in self-assessment obligations by the funds for GST/HST purposes.

Federal Court of Appeal's decision

The Federal Court of Appeal partly allowed the appeal, concluding that the funds were not required to self-assess GST/HST on the fees, because in fact the services did qualify as financial services and were therefore an exempt supply.

On the basis of the evidence adduced at trial, the Federal Court came to the conclusion that the Tax Court made a palpable and overriding error that warranted its intervention, by concluding that the services rendered by Citibank were among those that the manager was required to provide to the funds. According to the Federal Court of Appeal, this was evidenced by the fact that the mutual obligations contained in the arrangement were between Citibank and the funds — and not with the manager.

Having determined that the services were not made further to a delegation of the management duties of the manager, the Federal Court of Appeal further rejected the Crown's argument that Citibank was providing management services.

The Federal Court analyzed the true character of the services on the basis of their dominant element and concluded that the services were financial services provided by third-party financial institutions and that they did not have the usual characteristics of management services. As a result, the appeal was allowed in part on the basis that the services qualified as financial services and the funds did not have to self-assess on the fees.

Takeaway

It is of particular significance that the Federal Court of Appeal confirmed that financing arrangements with a person other than the manager of a mutual fund result in supplies of exempt financial services, given the long-standing policy of the Department of Finance that management fees paid by mutual funds be subject to GST/HST, even if management services include what would otherwise be financial services. For instance, a manager could not invoice his services separately to circumvent this rule.

Legislative amendments might be seen by the tax authorities as a solution to ensure that this type of arrangement entered into with providers other than a manager is carved out of the definition of financial service.

This case illustrates that investment plans and funds administered by a manager may be able to reduce their sales tax burden by entering into separate agreements with a third party in respect of the portion of the services rendered by the manager that qualifies as financial services. Special attention should be given to the nature of the services rendered and to the history and characterization of the legal relationships between the parties.

This is the first of two articles on this judgment. Read part two: Invesco case: Rebate for GST paid in error or notice of objection?

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