

## DON'T MAKE A PAPER AIRPLANE OUT OF THE GST/HST LETTER YOU RECEIVE FROM CRA

It is always wise to pay careful attention to form letters that are sent by the CRA, and particular attention should be paid to the GST/HST form letter you may receive in the mail in the next few weeks. The reason that you may receive such a letter is that the CRA is attempting to confirm that your business is a financial institution based on information included in your business' income tax returns.

### 1. What is the issue and why should you care about being a financial institution?

Sources of revenue earned by your business could cause your business to become subject to GST/HST reporting and compliance rules applicable to financial institutions. This could mean an increased tax and compliance burden for your business.

In particular, your business may be required to file a GST 111 form entitled "Financial Institution GST/HST Annual Information Return", or be subject to significant penalties for non-compliance.

In addition, the CRA imposes very strict input tax credits ("ITCs") eligibility requirements on financial institutions. This could reduce or eliminate the ITCs your business can claim and require you to begin segregating invoices received from your

suppliers between those related to your taxable operations and those related to your tax exempt financial operations; and allocating the tax you pay to the two types of operations.

### 2. Who should care?

As it is the amount of financial revenues that your business earns that may trigger the application of these rules, it is difficult to identify any particular type of business that could be at risk of being caught. Therefore, if your business **earned over \$1M in financial revenue** (as described below) in your last fiscal year, you should ensure that you are not caught by these rules.

Note that municipal entities, universities and colleges, hospitals, charities and certain non-profit organizations are excluded from these rules.

**3. There are two tests that could potentially cause your business to be a financial institution and be subject to the application of these reporting rules.**

**A. The first test creates a higher threshold with more expansive sources of income.**

Your business will be considered to be a financial institution if gross financial income reported in its last fiscal year from:

- interest,
- dividends, and
- separate fees or charges for financial services,

**exceeds both \$10 million and 10 per cent of your gross business income.**

*For example, the following may be required to be included as financial revenue:*

- *A guarantee or an indemnity in respect of a loan or other financial instrument; and*
- *Entering into certain derivative contracts, assigning such a contract, and payments received from a counterparty to such a contract.*

Note: this is a gross income test. Therefore, to the extent that your business has offsetting costs, they are not taken into consideration when calculating financial revenue.

**B. The second test has a lower threshold, but the sources of income inclusions are restricted.**

Your business will be considered to be a financial institution if gross financial income reported in its last fiscal year from:

- interest and separate fees or charges in respect of a credit card or charge card your business issued, and
- interest and separate fees or charges your business received for making an advance, lending money, or granting credit,

**exceeds \$1 million.**

*For example, the following may be required to be included as financial revenue:*

- *The acceptance of a conditional sales agreement would be considered the granting of credit and any interest or fee received in respect of entering into the agreement would be included in both tests.*
- *The allowance of an interest-free period between the billing date for an account receivable and the date on which payment is due would not be considered the granting of credit and there is no requirement to impute an interest amount and include it in this test.*

Note that interest and dividends received from a related corporation are excluded from financial income under both tests.

#### 4. WHAT IS THE SOLUTION?

Call BLG: we can help determine if your business qualifies as a financial institution, file the GST 111 return, minimize the loss of ITCs and ease your administrative burden.

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