

Tax Court of Canada: Denial of ITCs on costs to administer cardholder rewards program

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On June 27, 2023, the Tax Court of Canada (TCC) released its decision in *Amex Bank of Canada v His Majesty the King*,¹ dismissing the taxpayer's appeal against assessments by the Canada Revenue Agency (the CRA). The TCC upheld the CRA's denial of input tax credits (ITCs) for goods and services tax / harmonized sales tax (GST/HST) relating to the administration of a cardholder rewards program. In particular, the TCC ruled that the components of the rewards program constituted a single compound supply, with the predominant element being a supply of exempt financial services pursuant to the *Excise Tax Act* (the ETA).

What you need to know

- Where a transaction consists of several elements, the accepted approach is to determine whether there is a single supply or multiple supplies. This is relevant where the underlying components would have a different GST/HST treatment if supplied separately. If elements together constitute a single supply, the GST/HST status of the supply (i.e., taxable or exempt) is determined by the GST/HST status of the predominant element in the supply.
- All the elements and components of Taxpayer's cardholder loyalty program form a single compound supply of exempt financial services to the cardholder, the predominant element of which is the extension of credit.
- As a result, the Taxpayer is not entitled to claim ITCs for expenses incurred in connection with the administration and operation of its cardholder loyalty program, because the expenses are not incurred in the course of a commercial activity.

Background

Amex Bank of Canada (Amex or the Taxpayer) issued a variety of credit cards (Amex Cards) to eligible individuals (the Cardholders). By acquiring a card from Amex, Cardholders were qualified to participate in Amex's loyalty program, referred to as the "Membership Rewards Program" (the MRP). Cardholders participating in the MRP (Members) could accumulate a certain number of points based on the dollar amounts charged to a card (the **Points**). Amex's largest revenue sources included interest

income, transaction charges and discount revenue earned from the credit/charge card operations. The discount revenue Amex earned had a direct correlation to the money spent by a Cardholder using an Amex Card.

In exchange for Members redeeming all or a portion of their Points, Amex offered various rewards such as airline tickets, hotel chain loyalty points and travel certificates, along with tangible products such as watches, luggage and electronics (the Rewards). Amex purchased the Rewards from third-party suppliers (the Participants). In making the MRP available to Members, Amex paid GST/HST in two primary instances: on the Participant's supply of goods and services used as the Rewards; and on the overhead costs, such as system maintenance, in respect of which Amex self-assessed GST/HST under Division IV of the ETA (the MRP Expenses).

Amex was assessed for its reporting periods between 2002 and 2012, whereby the CRA denied \$13.97 million dollars of ITCs relating to the MRP Expenses. The CRA took the position that the MRP Expenses formed part of a "single compound supply", with the predominant element of such supply being an exempt financial service provided to Cardholders. Amex argued that it made "multiple supplies" and the GST/HST incurred on the MRP Expenses related to the provision of taxable supplies, separate from the exempt supplies it made to Cardholders.

Single supply vs multiple supplies

The TCC provided a brief overview of ITCs before characterizing Amex's supply of the MRP, noting that a GST/HST registrant can only claim ITCs where expenses are incurred as inputs for consumption, use or supply by the registrant in carrying out its commercial activity. The definition of "commercial activity" excludes exempt supplies, meaning ITCs cannot be claimed on such supplies. For purposes of the ETA, many "financial services" constitute exempt supplies.

Because the MRP consisted of several components, the TCC applied the well-established "compound supply test" to determine whether the MRP Expenses were incurred by virtue of a single supply or multiple supplies. The test is twofold: (1) all components of the single compound supply must be identified; and (2) the "predominant" component must be determined.

On the first step, the TCC reiterated the widely accepted principle that a single compound supply will exist where each component is so intertwined and interdependent such that they are integral to the overall supply. Some components of the MRP were, in and of themselves, a supply of exempt financial services by Amex – in particular:

- the transactions entered into between Amex and merchants, as the merchants are entitled to payment from Amex when a Cardholder make purchases using an Amex Card; and
- in conjunction with merchants accepting the Amex Cards, Amex's extension of credit to Cardholders.

According to the TCC, the balance of components were directly linked to Amex's above-noted supply of exempt financial services, such as the Members' ability to redeem the Points in exchange for the Rewards. As such, all of the components of the MRP were

integrated and intertwined to the extent that they formed part of the overall supply – being a single compound supply of exempt financial services.

On the second step, the TCC was required to take into account the perspective of the recipient of the MRP – i.e. the Members. Largely based on its prior assessment of each component of the MRP, the TCC established that the predominant supply was the extension of credit by Amex to the Members.

The free supply rule

Amex also contended that the Rewards should be subject to the “free supply rule” contemplated by subsection 141.01(4) the ETA. Amex’s position was that this subsection should apply as Members do not provide consideration for the Rewards and the purpose of the MRP was to promote the goods and services offered by Participants. If applicable, the Rewards would be characterized as a taxable supply, allowing Amex to claim ITCs in respect of the MRP Expenses.

The TCC disagreed on both the consideration and purpose requirements, noting that Amex essentially had a “redemption liability” associated with the Points. When the Points were redeemed and Amex supplied a Reward, the satisfaction of such liability constituted consideration for the Reward. With respect to the purpose requirement, the TCC notably declared that Amex carried out the marketing and promotional efforts for its own purpose.

In the result, the TCC concluded that Amex was not entitled to claim ITCs for GST/HST paid in connection with the MRP Expenses.

Takeaways

The TCC’s decision in *Amex Bank of Bank* is consistent with recent case law. The opinion of the Court’s remains that a financial institution is not entitled to claim ITCs for GST/HST relating to a loyalty program where such inputs are used to carry out a financial services business.

To this end, businesses that offer exempt financial services as part of their product or service offering should, on an ongoing basis, ensure that claims for ITCs are solely restricted to inputs acquired for taxable supplies under the ETA. If the inputs are determined to be incurred in the course of single composite supply, the predominant element of which is an exempt financial service, there is an increased likelihood that the CRA will deny the ITCs on the basis that the expenses were not incurred in the course of a commercial activity.

If you have questions about the TCC’s decision and its effect on ITCs claimed with respect to exempt financial services, reach out to your BLG lawyer, the authors of this piece, or a member of BLG’s Tax Group.

¹ *Amex Bank of Canada v His Majesty the King*, 2023 TCC 93.

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