Noteworthy 2020 GST/HST developments for the Financial Services Industry

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Despite a year that included court closures and a CRA shutdown, there were a number of noteworthy and interesting decisions from the Tax Court of Canada (the TCC) and Federal Court of Appeal (FCA) with respect to Goods and Services Tax/Harmonized Sales Tax (GST/HST) that affect various stakeholders in the financial services industry. Here are four of the key judgments.

Payment from a GST/HST debtor to a Secured Creditor deemed to be held in trust for the CRA in priority to Secured Creditor: *Toronto-Dominion Bank v. Canada, (TD Bank)*[1].

In *TD Bank*, TD granted a mortgage and secured home equity line of credit (HELOC) to a customer that, unbeknownst to TD, was also a GST/HST debtor in relation to operating as a sole proprietor of a landscaping business.

After having repaid the mortgage and HELOC, the CRA issued a demand letter to TD and later, commenced a legal action to collect the proceeds received by TD from the repayment of the mortgage and HELOC. The CRA asserted a deemed trust over the funds pursuant to section 222 of the *Excise Tax Act*. Section 222 grants the Minister priority over all other secured creditors with limited exceptions. The CRA was successful before the Federal Court and FCA, which confirmed that the amounts collected by the GST/HST debtor were held by him in trust for the Crown in priority to secured creditors.

The FCA's judgment confirmed that the deemed trust operates without any notice or triggering event, and without providing any sort of due diligence or *bona fide* purchaser defence to the prudent creditor. Many secured creditors have now revisited their lending practices and/or arranged for updated insurance coverage to protect against the CRA's super priority. For more details and commentary on the *TD Bank* judgment, see BLG's previous *TD Bank* commentary.

Merchant payment processing services were a GST/HST exempt supply of "arranging for" financial services and not a taxable administrative or marketing service: *Zomaron Inc. v. The Queen* (*Zomaron*)[2]:

The *Zomaron* judgment considered what activities constitute "arranging for" financial services. *Zomaron* involved a complex relationship between credit card payment processors, merchants, and merchant service providers. While the relationships were complex, the judgment itself offers practical guidance for all intermediaries in the financial services industry that may not fit within traditional "broker" or "agent" type roles.

A service of "arranging for" financial services generally involves facilitating the connection between a financial services provider and their customer. Arranging for financial services is an exempt supply where no GST/HST is charged but such services often risk being characterized as services that are administration, marketing, or promotional, which are generally taxable supplies.

In *Zomaron*, the TCC held that the appellant was a financial intermediary that facilitated credit and debit card payment processing services between merchants that were required in order for a payment processor to render those services. After a thorough analysis, the TCC concluded that Zomaron's activities were an exempt supply of "arranging for" financial services.

For more details and commentary on *Zomaron*, see BLG's previous *Zomaron* commentary.

Employer disallowed ITCs for employee healthcare expenses rendered under its employer-funded healthcare benefit plan: *Westcoast Energy Inc. v The Queen* (*Westcoast*).[3]

Westcoast considers whether an employer may claim an input tax credit (ITC) in respect of a payment or reimbursement of the GST/HST payable on healthcare services like acupuncture, massage or homeopathy provided under an employer-funded healthcare benefit plan.

This is the first case to interpret s. 175 of the ETA, a provision that allows a business to claim ITCs for GST/HST that an employee incurs "in relation to" the business's commercial activities (and where the business reimburses that GST/HST expense). The general rule is that a business can only claim ITCs to offset GST/HST that the business itself incurs (*i.e.,* it is the "recipient" of the expense for use in its commercial activities).

Westcoast provides useful guidance to employers with respect to the interpretation of s. 175 to claim ITCs for employee expenses, as well as the restrictions in s. 170(1)(b). The TCC decision also underscores the importance of determining the "recipient" of a service, a defined term in the ETA that carries significant importance in the application of GST/HST.

Westcoast has appealed to the FCA. BLG will continue to monitor this case and will provide further commentary on it early this year.

Cross-border truck fleet insurer denied ITCs for expenses related to U.S. claims because its trucks not ordinarily situated outside of Canada; Court outlines test to apportion insurance risk inside and outside of Canada: *Northbridge Commercial Insurance Corporation v. The Queen* (*Northbridge*).[4]

In *Northbridge,* the appellant supplied fleet insurance to trucking companies operating in Canada and the U.S. The CRA disallowed the appellant's claim for ITCs to recover a portion of the GST/HST it paid on expenses related to its insurance products. Those ITC claims related to coverage for risks that the appellant asserted where in the U.S.

While a supply of an insurance policy is generally an exempt supply, s. 2 of Part IX of Schedule VI of the *Excise Tax Act* will zero-rate an insurance policy "to the extent that" the policy relates to risks that are "ordinarily situated outside of Canada."[5] To the extent that a supply is zero-rated, the supplier may claim ITCs to recover GST/HST paid to make the supply (*i.e.,* GST/HST paid on providing insurance coverage for risks ordinarily outside of Canada).

The appellant, Northbridge, claimed ITCs on inputs related to its insurance products on the basis that its insurance coverage partially related to risks ordinarily situated outside of Canada (*i.e*., the U.S.) and therefore was partially zero-rated. The appellant relied on the fact that historically 33.3 per cent of its insurance payouts were in respect of perils that arose in the United States.[6]

Northbridge appealed to the Tax Court of Canada to allow for the ITCs on the basis that it related to risks ordinarily situated outside of Canada.

TCC dismissed the appeal and concluded that the zero-rating rule at issue (s. 2, Part IX, Sch. VI of the ETA) turned on where the object of the insurance policy was ordinarily situated and not where perils historically arose. The appellant relied on where insurance claims historically arose to determine the share of insurance coverage incurred outside of Canada versus inside of Canada, and the TCC disagreed with this apportionment methodology. Instead, the TCC ruled that the proper analysis in the case of fleet insurance requires a separate apportionment between exempt and zero-rating treatment for each policy, on a vehicle-by-vehicle basis, using factors such as the location where each vehicle was registered and maintained, and the proportionate kilometres driven by each vehicle in and outside of Canada.

Northbridge is an important case for Canadian insurers that provide risk coverage both in Canada and abroad. The TCC provided guidance on the documentation and process to follow in determining the portion of insurance coverage that relates to risks ordinarily in Canada and outside of Canada. Insurers should revisit their processes to ensure that ITC claims (historical and on a go - forward basis) satisfy the guidelines set by the TCC.

[1] 2020 CAF 80.

[2] 2020 TCC 35.

[3] 2020 TCC 116.

[4] 2020 TCC 132.

[5] ETA, Schedule VI, Part IX, s. 2(d).

[6] 2020 TCC 132 at para. 71.

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