THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

May 3, 2010

The Honourable James Rajotte, Chair
Standing Committee on Finance
Sixth Floor, 131 Queen Street
House of Commons
Ottawa ON K1A 0A6

Dear Mr. Rajotte,

Re: Bill C-9, *Jobs and Economic Growth Act*
Amendments to definition of "financial service" in *Excise Tax Act* and Amendments to the *Canadian Environmental Assessment Act*

We are writing on behalf of the National Commodity Tax, Customs and Trade Section of the Canadian Bar Association (the CBA Commodity Tax Section) to raise concerns about proposed changes to the definition of "financial service" in Bill C-9, and the National Environmental, Energy and Resources Law Section (the CBA Environmental Law Section), to raise concerns about significant amendments to the *Canadian Environmental Assessment Act* (CEAA).

The CBA is a national association representing 37,000 jurists, including lawyers, notaries, professors of law and law students across Canada. The Association's mandate includes improvement in the law and in the administration of justice. The CBA Commodity Tax Section comprises experts in all aspects of law relating to commodity tax, including the Goods and Services Tax/Harmonized Sales Tax. The CBA Environmental Law Section addresses matters of legal reform relating to the environment, energy and natural resources, and its members include Canadian lawyers specializing in this area of law.

Definition of "financial service" in *Excise Tax Act*

The CBA Commodity Tax Section has serious concerns with certain GST amendments in clause 55 of Bill C-9, the *Jobs and Economic Growth Act*, relating to one of the most complex areas of the GST, involving a range of financial services.

The Government has departed from historic practice by tabling these tax measures in Parliament without consulting on the proposals in draft legislative form, despite concerns communicated to the Department of Finance by industry members and the professional tax community in the short period since the proposals were announced on December 14, 2009. The CBA Commodity Tax Section is of the view that these GST measures, as currently drafted, are so seriously flawed that they should be struck from Bill C-9, to allow for the necessary consultations and for government and industry to work together to arrive at more satisfactory resolutions of the complex issues involved.

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Amendment will create uncertainty

The Minister of Finance has stated that the substantive amendments in clause 55 of Bill C-9 narrowing the definition of a "financial service" for GST purposes are for clarification purposes only. [1] As financial services generally are GST-exempt, the anticipated effect of the amendments is that many service providers who are not charging GST on a range of fees or commissions for services related to financial transactions will be required to do so.

The existing definition of a "financial service" for GST purposes encompasses transactions such as granting or obtaining an insurance policy, credit card or loan, or selling or investing in such things as stocks, bonds or mutual funds. The definition further provides that the service of "arranging for" these transactions is in itself a financial service. A stock brokerage service is a good example. The purchase of a publicly-traded stock by an investor might involve the intermediate service of a broker who places the investor's order with the stock exchange. The sale and purchase of the security constitutes a "financial service" and, based on the application of the existing GST law, so too does the stock broker's service of arranging for that purchase. A similar intermediate service is provided by mortgage brokers, insurance agents and investment managers or advisers.

The proposed amendments attempt to address the issues arising from the fact that there may be a variety of intermediate services provided (whether by a single or several suppliers) in a process that may culminate in a financial transaction. For example, as part of its package of services to a regular client, a stock broker might research emerging market opportunities and inform the client before carrying out the client's purchase and sale decisions. An insurance broker might research its customer's needs to determine if off-the-shelf insurance products are suitable or if the broker needs to design a product before arranging for the purchase of a specific insurance policy for the customer. The amendments are intended to exclude from the definition of an exempt financial service intermediate services that are preparatory to, or that facilitate, an underlying financial transaction.

The December 14, 2009 announcement of these GST measures stated that they are intended to address "recent court decisions which may have created uncertainty" and to reaffirm "the longstanding policy intent".

Far from creating uncertainty, the case law has been remarkably consistent and clear when interpreting what constitutes a financial service. Since 2003, a body of case law has emerged that establishes the relevant principles and serves as a reliable guide to the application of the GST in this area.

Further, the case law is consistent with the Canada Revenue Agency's longstanding Policy Statement on the meaning of a financial service (P-239). P-239 sets out CRA's administrative interpretations by way of examples. To illustrate the effect of the proposed amendments, CRA replicated six examples from P-239 in a Notice issued in February 2010[2]. In every example reconsidered in which P-239 concluded that the subject service constituted an exempt financial service, CRA determined that the service would be taxable under the proposed amendments. According to the CRA's own interpretations, the proposed amendments do not reaffirm the longstanding policy.

The proposed amendments also raise new doubts about the treatment of other specific fees not addressed in P-239, including investment management fees charged to individual investors and mutual fund servicing fees (commonly known as "trailer fees"). These fees are understood to be GST-

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1 Minister of Finance press release March 26, 2010 can be found at http://www.fin.gc.ca/n10/10-024-eng.asp, retrieved April 6, 2010.

2 CRA GST/HST Notice 250, February 2010 can be found at http://www.cra-arc.gc.ca/E/pub/gi/notice250/notice250-e.pdf, retrieved April 7, 2010.

exempt, both as a matter of policy and industry practice. However, it is not clear that they will remain exempt under the proposed amendments.

On March 26, 2010, in response to feedback from the financial services sector, Finance Minister Flaherty issued a statement that the proposed amendments are designed to confirm a longstanding policy and that CRA would be "reviewing and updating" its February Notice. CRA's re-examination of its initial interpretations of the amendments highlights the uncertainty for service providers who face the prospect of paying additional tax, with interest and penalties, if they did not correctly interpret the proposed amendments.

The CBA Commodity Tax Section's view is that there are serious problems with the proposed amendments. We question whether the proposed legislation will achieve Finance Canada's aims or have unintended effects. If passed in their present form, the amendments are likely to cause uncertainty as to the proper application of the law, and as much or more litigation in this difficult area of the GST.

The initial indication from CRA on how it will administer the new rules suggests that where, for a single fee, a supplier provides a mix of a financial service and other services that are preparatory to, or facilitate, the provision of that financial service, the supplier will be expected to rely on an existing "mixed-supply" rule under the GST legislation. Under that rule, the supplier may treat the entire bundle of services as a GST-exempt financial service if more than 50% of the fee is attributable to the financial service element. This approach will be extremely difficult to apply, if not unworkable, for many suppliers.

In the case of securities brokers, for example, each broker would have to document, seemingly on a trade-by-trade basis, each of the activities surrounding a trade to determine if the activity qualifies as a financial service or one of the excluded preparatory or facilitation services. This determination could depend on such factors as whether the client simply called the broker to request that the trade be made, or whether the client asked the broker to research alternative options before making the trade. Neither the Department of Finance's December announcement nor CRA's February Notice provide guidance on how this apparent legislative approach is expected to operate in practice.

Retroactive Application

The coming-into-force provision of clause 55 will result in retroactive application of the amendments to supplies occurring before the December 14, 2009 announcement. A special rule in subclause 55(6) would override the normal statutory limitation on reassessing suppliers to give effect to these amendments in cases where the normal reassessment period has either already expired, or would otherwise expire within a year of enactment of Bill C-9. This use of retroactivity and unprecedented powers of reassessment beyond the normal statutory limits is unwarranted and in conflict with longstanding Department of Finance policies.

In 1995, the Department of Finance, in response to a request from the House of Commons Standing Committee on Public Accounts, produced guidelines to govern the use of retroactive application of amendments in the tax law context. The Department of Finance emphasized that tax changes should be retroactive only in extraordinary circumstances, and retroactive changes should be consistent with longstanding and well-understood government policy. In the view of the CBA Commodity Tax Section, the proposed amendments do not fulfill either of these fundamental principles.

As for consistency with clear policy, these GST amendments appear to run counter to the longstanding government policy as stated in CRA Policy Statements and Department of Finance technical notes and papers.

The proposed retroactive application of the GST amendments is particularly egregious given the government's unreasonably long delay in taking this legislative action. Several of the issues addressed in these GST amendments first surfaced in rebate claims filed in mid-1998; as such, it is difficult to conceive of how the circumstances could reasonably be characterized as extraordinary when it has taken over 11 years to address them. Following 2008 Tax Court of Canada decisions that certain investment management services were exempt, investors in similar situations began demanding that their investment managers comply with the case law and stop charging tax on management fees. Managers, however, generally understood that the Department of Finance and CRA disagreed with these decisions and that retroactive amendments likely were forthcoming. Many managers continued to follow CRA's instructions and charge GST on their services in anticipation of forthcoming amendments. This resulted in some investors launching class action law suits against investment managers for continuing to collect tax, contrary to the emerging body of jurisprudence.

The proposed amendments will generally not apply to services supplied under a particular agreement with a customer if the supplier did not charge any tax under the agreement. This means that an investment manager that followed CRA instructions and not the courts is now to be penalized for doing so, by not being eligible for grandfathering.

The CBA Commodity Tax Section urges the striking of clause 55 from Bill C-9 to allow for broad industry consultations on the proposed amendments. The Government acknowledged the need for consultations when the Minister of Finance invited stakeholders to provide input to CRA in its review of its February Notice relating to the proposed amendments. Consultations are essential to arriving at sustainable solutions for government, industry and consumers. Any consequential amendments should be made on a prospective basis, only after consultations have taken place.

Amendments to the *Canadian Environmental Assessment Act*

Part 20 proposes significant amendments to the *Canadian Environmental Assessment Act* (CEAA). In our view, those provisions should be struck from Bill C-9, contained in a stand-alone Bill and subject to informed and focused public consultation and consideration by Parliament.

The CEAA is important legislation designed to prevent the degradation of the environment as well as achieve sustainable development. The Standing Committee on Environment and Sustainable Development is scheduled to conduct a full review of the CEAA pursuant to section 72 of that Act later this year. A Bill containing the amendments in Part 20 could and should be part of that full Parliamentary review.

We believe that a budget implementation bill is not an appropriate legislative vehicle for addressing material changes to the CEAA. As a matter of public confidence, it will not be subject to the debate on the details that is required and warranted. Informed and experienced monitors of the legislative process would not anticipate material changes to the CEAA to be included in an omnibus budget bill. Including such changes in such a bill may mean that Canadians will not have the benefit of Parliamentary debate on the details of the proposed changes to the CEAA, and will lose the opportunity to provide important feedback.

A Parliamentary review should be done by MPs with particular expertise and interest in environmental issues. Proposals include key amendments to the CEAA, such as permitting the Minister of the Environment to determine the scope of an environmental assessment review (overturning a recent Supreme Court of Canada decision[3]) and expanding the duties of the Canadian Environmental Assessment Agency. In our view, that review is more appropriately placed

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3 *MiningWatch Canada v. Canada (Fisheries and Oceans),* 2010 SCC 2.

in the Standing Committee on Environment and Sustainable Development, rather than the Standing Committee on Finance.

The issues at stake are important, and justify the degree of focused public consultation and debate that attends to an ordinary Bill, subject to detailed and expert review by Parliament.

Thank you for considering the views of the CBA National Commodity Tax, Customs and Trade and the CBA National Environmental, Energy and Resources Law Sections.

Yours very truly,

(Original signed by Danielle Lussier for Dalton J. Albrecht and James L. Thistle)

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