GST on investment management fees

Moodys Tax
July 6, 2009

By Nicolas F. Baass LL.B., LL.M.(Tax)

The Federal Court of Appeal decision in *Canadian Medical Protective Assn. v. R.* released April 16, 2009 deals with the GST status of investment management fees.

Certain preliminary comments are in order to refresh the minds of those who do not routinely deal with the Excise Tax Act ("ETA"). Pursuant to section 165 of the ETA, the recipient of a "taxable supply" is liable to pay GST in respect of the supply. A taxable supply is a supply made in the course of "commercial activity". Commercial activity excludes the making of exempt supplies which are listed at Schedule V of the ETA. As such, no GST is payable on exempt supplies. Included in Schedule V is the supply of "financial services", as defined by subsection 123(1) of the ETA.

The relevant facts of the case were not in dispute and are relatively straight-forward. The Canadian Medical Protective Association ("CMPA") is a non-profit corporation that provides professional liability protection to doctors in Canada. Amounts received by the CMPA from its members are maintained in a reserve fund pending eventual claims. The CMPA retained the services of investment managers to invest amounts held in the reserve fund. The investment managers had entire discretion as to how they were to invest the funds, which included the purchasing and selling of securities. The investment managers charged CMPA GST on their fees. The CMPA attempted to recover GST paid to the investment managers by applying for rebates, presumably under section 261 of the ETA, claiming that the services rendered by the investment managers were "financial services" and thus GST exempt. The CRA disallowed the CMPA's claim on the basis that the services supplied by the investment managers were primarily for professional investment advice and fund management, thus specifically excluded from the definition of "financial services". As such, the question before the courts was whether the fees paid by the CMPA were exempt as financial services. Justice Bowman of the Tax Court ruled in favour of the taxpayer. The CRA appealed to the Federal Court of Appeal.

In order to fully understand the reasoning in this decision it is essential to be familiar with the definition of "financial service" at subsection 123(1) of the ETA. This definition consists of two parts; paragraphs (a) to (m) of the definition describe the services which are a "financial service" whereas paragraphs (n) to (t) specifically exclude certain services from the definition. In this case the relevant paragraphs were (d), (l) and (p) which read as follows:

(d) the issue, granting, allotment, acceptance, endorsement, renewal, processing, variation, transfer of ownership or repayment of a financial instrument,
(l) the agreeing to provide, or the arranging for, a service referred to in any of paragraph (a) to (i), or
(p) the service of providing advice, other than a service included in this definition because of paragraph (j) or (j.1),

It was the taxpayer's contention that the investment managers were arranging for a service described at

paragraph (d), namely the transfer of ownership of financial instruments and thus fell within the ambit of paragraphs (d) and (l). The Crown argued that the services provided were advisory services and thus fell squarely within the exclusion at paragraph (p).

After examining the activities undertaken by the investment managers, the Court concluded that the services provided were GST exempt pursuant to paragraphs (d) and (l) of the definition of financial service. The Court held that the dominant characteristic of the services provided were research and analysis of the markets, which would be akin to advisory services and thus taxable. However, the Court concluded that the true purpose of the service was to purchase and sell securities and thus was GST exempt. The essence of the Court's decision can be found at paragraphs 63 and 64 and reads as follows:

On the other hand, the research and analysis aspect of the trade will be purposeless if it does not end with a buy or sell order or a "hold" decision. The final order is an essential characteristic of the management of the funds by the investment manager. Otherwise, the investment manager does not manage at all.

I find that, considered as a whole, the services performed by investment managers cannot be divided. It is a mix. They do not provide advice, since there is no one to provide advice to except themselves. The end result of their services is to "cause to occur a transfer of ownership…of a financial instrument." They fall within paragraph 123(1)(d) and (l) of the Act.

The Court stated that the word "arranging" at paragraph (l) could mean "cause to occur", "give instructions" or "make preparation for" and that these terms are broad in nature. In effect, by buying and selling securities the investment managers were arranging for the transfer of ownership of financial instruments and thus qualified for exempt status as a financial instrument.

While this case is a clear win for taxpayers, the specific facts of every case are essential in determining whether a service is a financial service or not. Indeed, there are a number of specific exceptions to the definition of financial service that may apply given a specific set of facts. While not all investment management will fall within the definition of financial service, it is likely that most management services that grant total discretion to an investment manager to buy or sell financial instruments will be exempt of GST.

For those who have made GST payments in error, section 261 of the ETA allows the payer to claim a rebate equivalent to the taxes paid in error. All applications for such a rebate must be filed within two years after the amount was paid. Alternatively, the payer can request a refund from the supplier. Affected persons should consider making a timely rebate application. However, one should also be mindful that the Government may consider amending the ETA to provide clarity on the issue. Stay tuned!