

GST/HST Rules to Help Firms Compete Worldwide: Zero-rating of Cross Border Financial Services

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This article outlines an important rule that “zero-rates” a supply of financial services with cross border elements (the Zero-Rated FS Rule) and allows a service provider to recover GST/HST incurred on its related expenses. We examine the Tax Court of Canada’s (TCC’s) decision in *Royal Bank of Canada v The King (RBC)*¹ below, which adopted a broad interpretation of the Zero-Rated FS Rule in the taxpayer’s favour and clarifies the availability of input tax credits (ITCs) related to financial services with cross border elements.

Key Takeaways

- Organizations providing financial services can recover GST/HST on expenses related to many activities with cross border elements.
- Fintech, equipment financing, real estate & private equity funds, and dealers of financial instruments (e.g., debt, equity products) are a few types of businesses or entities that may benefit from the Zero-Rated FS Rule.
- How commercial arrangements are structured can alter the GST/HST implications of a transaction (e.g., granting credit is zero-rated in circumstances where lending money is not).

Background: Zero-rated Supplies of Cross Border Financial Services

Many financial services supplied to a non-resident person are “zero-rated” supplies, meaning that the customer does not pay GST/HST on the supply, and the supplier is eligible for ITCs to recover GST/HST incurred by the supplier on its own related expenses. This rule ensures that GST/HST is not an added cost, and that Canadian financial services providers remain competitive globally with non-Canadian firms with no GST/HST costs or collection obligations.

The Zero-Rated FS Rule has three main requirements:²

1. The supplier must be a “financial institution;”
2. The recipient must be a non-resident of Canada; and
3. No exceptions apply.

Requirement 1: “Financial Institution”

The GST/HST rules capture a broad range of entities as “financial institutions,” which can include:

- Entities acting as traders or dealers of “financial instruments;”
- Entities acting as brokers with respect to financial instruments; such as brokering the purchase or sale of the shares of businesses; and
- Organizations that have more than \$10 million in revenues from certain financial services that represent more than 10% of that entity’s total revenues.

Some unintuitive examples of entities or organizations that may be financial institutions for GST/HST purposes include:

- Equipment financing companies;
- Investment vehicles used to finance real estate, resource, or private equity investments or projects;
- Holding companies holding equity or debt of unrelated entities;
- Investment advisors, dealers and brokers;
- Commercial businesses that provide financial solutions to their customers;
- Fintech companies providing payment processing or remittance services; and
- Cryptocurrency market participants such as cryptocurrency exchanges or traders.

Requirement 2: Non-resident “Recipient”

The “recipient” of a supply is generally the person obligated to pay the supplier under an agreement for a supply.

Requirement 3: No Exceptions Apply

Exceptions to the Zero-Rated FS Rule can be summarized as follows:

- Supplies that “relate to” debts having a certain Canadian nexus (e.g., certain debts arising from deposited funds in Canada or the lending of money that is primarily for use in Canada);
- Supplies that relate to financial instruments purchased by the supplier that are not directly issued to the supplier (e.g., the Zero-Rated FS Rule can apply to a person selling shares directly issued to it from a non-resident corporation, but may not apply to a person selling shares it had instead acquired from another shareholder).

RBC: “Relates to” and Comments on Loans Versus Credit

Cassels

The TCC recently considered the scope of the Zero-Rated FS Rule in the *RBC* decision in the context of the Appellant's credit card line of business. As part of that business, the Appellant charged a transactional interchange fee to non-resident merchants for authorization and payment services on payments using a Canadian customer's credit card (the Foreign Interchange Service).

One issue in dispute was whether the Appellant could rely on the Zero-Rated FS Rule to claim ITCs in relation to the Foreign Interchange Service. The Appellant and Minister disputed whether one of the exceptions to the Zero-Rated FS Rule applied, which excludes a financial service that "relates to a debt that arises from the *lending of money* that is primarily for use in Canada."³ The Minister argued that the Foreign Interchange Service related to such a debt arising from the lending of money, and was therefore excluded from the Zero-Rated FS Rule.

The TCC found that the Foreign Interchange Service did not relate to the lending of money, but rather the granting of credit. This distinction meant that the Zero-Rated FS Rule applied, and the Appellant was not disqualified from claiming ITCs in relation to the Foreign Interchange Service.

The Court determined that when credit is granted, no amount is paid to the debtor in the form of money, and therefore there is no loan. Instead, credit involves a debt being incurred for goods, services, or benefits, with the debt being deferred under an agreement between the parties.⁴ Since there was no loan when credit was granted, the Court concluded that the Foreign Interchange Service did not "relate to" a debt arising from "the lending of money." No exclusions applied, and the Foreign Interchange Service was therefore a zero-rated supply.

The Court also determined that any exceptions to the zero-rating of financial services must be considered in light of the "broad objective" of the Zero-Rated FS Rule to zero-rate all exported financial services.⁵ While the phrase "relate to" may be broadly construed, the policy objective of the zero-rating rule led the Court to apply a narrow interpretation of that term so as not to defeat the policy objective of the rule.⁶

Concluding Remarks

The Court's decision in *RBC* illustrates that the GST/HST rules apply based on how a transaction is structured and legally characterized, which for cross border financial services is affected by concepts like the common law, contractual interpretation, transfer pricing, and international law.

Organizations providing financial services or related services may now be able to unlock ITCs and recover GST/HST paid on inputs if they relate to the provision of a financial service with cross border elements. Additionally, other GST/HST relief may also be available to financial services providers, whether through other available credits or rebates, or through GST/HST-efficient structuring of transactions.

¹ 2024 TCC 125 (*RBC*). We note that the Appellant was ultimately unsuccessful at trial regarding two other issues and has appealed the decision.

² *Excise Tax Act*, RSC 1985, c E-15, Schedule VI, Part IX, s. 1. Note different zero-rated supply rules apply for insurance and precious metals, neither of which are discussed in this article.

³ *RBC* at para 63.

⁴ *RBC* at para 79, citing *Garland v Consumers' Gas Co.*, [1998] 3 SCR 112 at para 35.

⁵ *RBC* at para 69.

⁶ *RBC* at para 76.

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