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# Tax Alert – Canada

## Federal budget: Changes to the definition of “financial service” under the *Excise Tax Act*

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 28 March 2023, Canada’s Deputy Prime Minister and Minister of Finance, Chrystia Freeland, tabled the 2023 federal budget. The budget proposed a significant GST/HST amendment to the definition of *financial service* in the *Excise Tax Act* (ETA) by introducing paragraph (r.6) in the exclusionary paragraphs (Proposed amendment) of the definition. Paragraph (r.6) operates to exclude the supply of certain services rendered by a “payment card network operator” from the definition of a “financial service,” resulting in such services being considered as a taxable supply and therefore subject to the GST/HST.

This Proposed amendment impacts financial institutions (i.e., card issuers, payment acquirers, banks and other financial institutions) that acquire certain services (i.e., payment card authorization and clearing/settlement services) from payment card network operators. Accordingly, these entities can expect to face significant administrative and financial burden resulting from the proposal, especially given that the rules could apply retroactively.

The Proposed amendment is significant for the industry particularly in light of a recent decision of the Federal Court of Appeal confirming such fees to be exempt financial services. The Federal Court of Appeal overturned a decision of the Tax Court of Canada and concluded that the service provided by a credit card operator to a Canadian bank was a GST/HST exempt supply, rather than a taxable administrative service.

As a result of this decision, many taxpayers have attempted to recover the tax that was previously paid by filing for a rebate of tax paid in error, as well as amended returns. Many of the rebates have been refunded by the Canada Revenue Agency. These taxpayers will have to consider the implications of the Proposed amendment, including whether there is an obligation to repay the refunds received.

The coming-into-force provisions extend the limitation period for the minister to assess taxpayers for “any amounts payable or remittable” in respect of a supply of a service referred to in proposed paragraph (r.6). This provision allows the minister to assess on or before the later of:

- ▶ The day that is one year after the day on which the Proposed amendment receives Royal Assent; and
- ▶ The last day of the period that is otherwise allowed under section 298 of the ETA for the minister to assess or reassess the taxpayer.

Given the broad nature of the language in the coming-into-force provisions, it appears that all open years may be potentially assessed subject to the one-year time limit.

## Proposed amendment

A supply of a financial service is exempt from GST/HST under Schedule V, Part VII, section 1 of the ETA.

“Financial service” is defined under subsection 123(1) of the ETA. The definition comprises inclusionary paragraphs (a) to (m) followed by exclusionary paragraphs (n) to (t). The characterization of a particular supply within these paragraphs determines the taxability of that particular supply.

Proposed exclusionary paragraph (r.6) describes a service (other than a prescribed service) that is supplied by a *payment card network operator* in respect of a *payment card network*, and that is (referred to herein as the Services):

- (i) A service in respect of the authorization of a transaction in respect of money, an account, a credit card voucher, a charge card voucher or a financial instrument;
- (ii) A clearing or settlement service in respect of money, an account, a credit card voucher, a charge card voucher or a financial instrument; or
- (iii) A service provided in conjunction with a service referred to in subparagraph (i) or (ii).

*Payment card network* and *payment card network operator* are defined terms under section 3 of the *Payment Card Networks Act*.<sup>1</sup>

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<sup>1</sup> *Payment Card Networks Act* (S.C. 2010, c. 12, s. 1834).

*Payment card network* is defined as “an electronic payment system... used to accept, transmit or process transactions made by payment card for money, goods or services and to transfer information and funds among issuers, acquirers, merchants and payment card users.”

*Payment card network operator* is defined as “an entity that operates or manages a payment card network, including by establishing standards and procedures for the acceptance, transmission or processing of payment transactions and by facilitating the electronic transfer of information and funds.”

The Proposed amendment will apply to Services for which any consideration becomes due, or is paid without having become due, **after** 28 March 2023 (i.e., budget day).

In addition, the Proposed amendment will apply with respect to consideration for the supply that became due, or was paid, on or before 28 March 2023, except where the following two conditions were both met (retroactive exclusions):

- (a) The supplier did not, on or before 28 March 2023, charge, collect or remit any amount as or on account of tax under Part IX of the ETA in respect of the supply; and
- (b) The supplier did not, on or before 28 March 2023, charge, collect or remit any amount as or on account of tax under Part IX of the ETA in respect of **any other supply** that is made under the agreement and that includes the provision of the service referred to in paragraph (r.6).

Furthermore, it should be noted that the retroactive exclusions do not include “Division IV” amounts (i.e., amounts subject to self-assessment under Division IV of the ETA). As a result, amounts invoiced by non-resident payment card network operators may be subject to self-assessment.

## **Next steps**

The Proposed amendment is a significant change to the GST/HST treatment of certain services that are rendered by payment card network operators in respect of payment card networks.

Given the potential retroactive implications of the Proposed amendment, taxpayers should consider:

- (i) The implications of previously filed rebates of tax paid in error and amended GST/HST return to recover/eliminate the GST/HST/QST;
- (ii) The implications of not previously self-assessing GST/HST (or paying the corresponding QST under the “special attribution method” formula) on certain amounts that were invoiced by payment card network operators;
- (iii) Whether additional system and administrative changes need to be implemented; and
- (iv) Potential pricing implications, given the added GST/HST/QST costs.

## Learn more

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