FINANCIAL INSTITUTIONS
GST MEMORANDUM 700-2: DEFINITION OF "FINANCIAL INSTRUMENT"

Ottawa, November 28, 1991

Obsolete: Replaced by Section 17.1 of Chapter 17 of the GST Memoranda Series.

This memorandum does not replace the law found in the *Excise Tax Act* and its Regulations. It is provided for your reference. As it may not completely address your particular operation, you may wish to refer to the Act or appropriate Regulation or contact any Revenue Canada Excise/GST office for additional information.

This memorandum may reflect amendments proposed to the *Excise Tax Act* by Notices of Ways and Means Motion tabled on December 18, 1990, March 27, 1991, June 24, 1991 and November 5, 1991. The federal government announced its intention to introduce certain amendments to the *Excise Tax Act* to effect these changes which were outlined by the Minister of Finance in press releases on the mentioned dates. [Where proposed changes affect information contained in this memorandum, the information is enclosed in square brackets.] At the time of publication, Parliament has not enacted these proposed amendments. Any commentary in this memorandum should not be taken as a statement by the Department that such amendments will in fact be enacted into law in their current form.

This memorandum describes the components of the definition of the term **financial instrument** as it relates to the provision of financial services under the Goods and Services Tax (GST).

LEGISLATIVE AND OTHER REFERENCES

Excise Tax Act - sections 123, 138 and 139; Schedule VI, Part IX

Non-Taxable Imported Goods (GST) Regulations

Financial Services (GST) Regulations

Notices of Ways and Means Motion tabled on December 18, 1990 and March 27, 1991

INTERPRETATIONS

The following definitions have either been taken from the *Excise Tax Act* as amended by S.C. 1990, c. 45 (Bill C-62) or represent departmental interpretations of terms relevant to the administration of that Act.

"Act" means the *Excise Tax Act*;

"Canada"

(a) Canada includes:

(i) the sea bed and subsoil of the submarine areas adjacent to the coasts of Canada in respect of which the Government of Canada or of a province may grant a right, licence or privilege to explore for or exploit any minerals; and

(ii) the seas and airspace above the submarine areas referred to in paragraph (i) in respect of any activities carried on in connection with the exploration for or exploitation of minerals;

(b) in respect of imports, Canada has the meaning assigned by the *Customs Act*;

"consideration" may be money, a thing, a service, forbearance in the exercise of a right or anything else which induces the supplier to make the supply. Where consideration is monetary, the amount of money will be used to calculate the tax. Where the consideration is non-monetary, the fair market value of the consideration at the time the supply was made will be used to calculate the tax;

"exempt supply" means a supply included in Schedule V to the Act;

"fair market value" of property or a service supplied to a person means the fair market value of the property or service without reference to any tax excluded by section 154 of the Act from the consideration for the supply;

"financial institution", at any time, means a person who is at that time a financial institution under section 149 of the Act;

"input tax credit" means a credit claimable by a registrant for the Goods and Services Tax paid or payable by the registrant in respect of the acquisition or importation of any property or service for consumption, use or supply in the course of a commercial activities of the registrant;

"Minister" means the Minister of National Revenue;

"money" includes any currency, cheque, promissory note, letter of credit, draft, traveller's cheque, bill of exchange, postal note, money order, postal remittance and other similar instrument, whether Canadian or foreign, but does not include currency the fair market value of which exceeds its stated value as legal tender in the country of issuance or currency that is supplied or held for its numismatic value;

"property" means any property, whether real or personal, movable or immovable, tangible or intangible, corporeal or incorporeal, and includes a right or interest of any kind, a share and a chose in action, but does not include money;

"registrant" means a person who is registered under section 241, or who is required to apply to be registered under section 240 of the Act;

"supply" means, subject to sections 133 and 134 of the Act, the provision of property or a service in any manner, including sale, transfer, barter, exchange, licence, rental, lease, gift or disposition;

"tax" means the Goods and Services Tax payable under Part IX of the Act; and

"zero-rated supply" means a supply included in Schedule VI to the Act.

GENERAL

1. The definition of **financial instrument** is relevant for the definition of "financial service" as defined in subsection 123(1) of the Act since a financial service is generally defined as an activity involving a financial instrument.

2. Pursuant to Part VII of Schedule V to the Act, supplies of financial services are exempt for purposes of the GST unless they are specifically listed as zero-rated under Part IX of Schedule VI to the Act. Fees charged for services relating to financial instrument transactions are exempt where these transactions fall within the definition of financial service under subsection 123(1) of the Act.

3. Subsection 123(1) of the Act defines a "financial service" to mean:

> "(a) the exchange, payment, issue, receipt or transfer of money, whether effected by the exchange of currency, by crediting or debiting accounts or otherwise,
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> (b) the operation or maintenance of a savings, chequing, deposit, loan, charge or other account,
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> (c) the lending or borrowing of a financial instrument,
>
> (d) the issue, granting, allotment, acceptance, endorsement, renewal, processing, variation, transfer of ownership or repayment of a financial instrument,
>
> (e) the provision, variation, release or receipt of a guarantee, an acceptance or an indemnity in respect of a financial instrument,
>
> (f) the payment or receipt of dividends (other than dividends in kind and patronage dividends), interest, principal, claims, benefits or any other amount in respect of a financial instrument,
>
> (g) the making of any advance, the granting of any credit or the lending of money,
>
> (h) the underwriting of a financial instrument,
>
> (i) any service provided pursuant to the terms and conditions of any agreement relating to payments of amounts for which a credit card voucher or charge card voucher has been issued,
>
> (j) the service of investigating and recommending the compensation in satisfaction of a claim arising under an insurance policy provided by an insurer or by a person licensed under the laws of a province to carry on such services [**NOTE:** Pursuant to the Ways and Means Motion introduced by the Minister of Finance on December 18, 1990, it is proposed that the above licensing requirement will not apply to marine claims adjustment services. In addition, pursuant to the Ways and Means Motion introduced by the Minister of Finance on March 27, 1991, paragraph (j) of the definition of financial services will be amended to include the service of providing an estimate of the value of physical damage to property where that service is sold to any insurer or adjuster who uses the estimate in the course of settling a property and casualty insurance claim],
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> (k) any supply deemed by subsection 150(1) or section 158 of the Act to be a supply of a financial service,
>
> (l) the agreeing to provide, or the arranging for, a service referred to in any paragraphs (a) to (i), or
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> (m) a prescribed service,
>
> The following is a prescribed service under paragraph (m):
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> > Any service in relation to the clearing and settlement of cheques and other payment items under the national payments system of the Canadian Payments Association that is supplied by the Association or any of its members.
>
> but does not include
>
> (n) the payment or receipt of money as consideration for the supply of property other than a financial instrument or of a service other than a financial service,
>
> (o) the payment or receipt of money in settlement of a claim (other than a claim under an insurance policy) under a warranty, guarantee or similar arrangement in respect of property other than a financial instrument or a service other than a financial service,
>
> (p) the service of providing advice other than a service included in this definition by reason of paragraph (j),
>
> (q) the provision of management or administrative services to a corporation, partnership or trust the principal activity of which is the investing of funds on behalf of shareholders, members or other persons,
>
> (r) a professional service provided by an accountant, actuary, lawyer or notary in the course of a professional practice,

(s) any service the supply of which is deemed under Part IX of the Act to be a taxable supply, or

(t) a prescribed service;

For the purposes of paragraph (t):

(1) "instrument" means money, an account, a credit card voucher, a charge card voucher or a financial instrument;

"person at risk", in respect of an instrument in relation to which a service referred to in subsection (2) is provided, means a person who is financially at risk by virtue of the acquisition, ownership, or issuance by that person of the instrument or of a guarantee, an acceptance or an indemnity in respect of that instrument.

(2) Subject to subsection (3) below, the following services are prescribed for the purposes of paragraph (t) of the definition "financial service" in subsection 123(1) of the Act;

(a) the transfer, collection or processing of information, and

(b) any administrative service, including an administrative service in relation to the payment or receipt of dividends, interest, principal, claims, benefits or other amounts, other than solely the making of the payment or the taking of the receipt.

(3) A service referred to in subsection (2) above is not a prescribed service for the purposes of paragraph (t) of the definition "financial service" in subsection 123(1) of the Act where the service is supplied with respect to an instrument by:

(a) a person at risk,

(b) a person that is closely related to a person at risk, where the recipient of the service is not the person at risk or another person closely related to the person at risk, or

(c) an agent, salesperson or broker who transfers ownership of the instrument for a person at risk or a person closely related to the person at risk.

4. GST MEMORANDUM 700-1, **DEFINITION OF "FINANCIAL SERVICES"**, contains more detailed information pertaining to what constitutes a financial service.

5. A **financial instrument** is defined in subsection 123(1) of the Act to mean:

(a) a debt security,

(b) an equity security,

(c) an insurance policy,

(d) an interest in a partnership or trust or any right in respect of such interest,

(e) a precious metal,

(f) an option or a contract for the future supply of a commodity, where the option or contract is traded on a recognized commodity exchange,

(g) a prescribed instrument,

(h) a guarantee, an acceptance or an indemnity in respect of anything described in paragraph (a), (b), (d), (e) or (g), or

(i) an option or a contract for the future supply of money or anything described in any of paragraphs (a) to (h).

6. Financial services which are exempt pursuant to Part VII of Schedule V to the Act are exempt regardless of whether they are supplied by financial institutions or other businesses.

7. Financial institutions may claim input tax credits for goods and services acquired or imported for consumption, use or supply to provide taxable supplies. They may not claim input tax credits for goods and services acquired or imported to provide exempt financial services.

8. However, where a person that is not a financial institution supplies financial services, an input tax credit may be claimed in respect of the provision of these financial services to the extent they relate directly to the person's commercial activity.

9. The supply of a financial service is exempt except where it is specifically zero-rated by virtue of its inclusion under Part IX of Schedule VI to the Act. In addition, a supply of a financial service to non-residents is zero-rated only when this supply is provided by a financial institution with the exception of precious metals where the supply is made by the refiner thereof or by the person on whose behalf the precious metals were refined. A registrant is entitled to claim input tax credits in respect of tax paid on goods and services acquired or imported for use in the provision of zero-rated financial services.

10. Financial institutions are generally involved in making both taxable and exempt supplies. It is therefore necessary that financial institutions determine the intended use of their taxable purchases so that they may allocate these taxable inputs between taxable and exempt supplies. Only the portion of tax paid on these inputs to provide taxable supplies may be claimed as an input tax credit. Additional information on input tax credits for financial institutions is available in the **GST GUIDE FOR PROVIDERS OF FINANCIAL INSTITUTIONS (ALLOCATION OF INPUT TAX CREDITS)**.

DEFINITION OF "FINANCIAL INSTRUMENT"

11. The following paragraphs will explain the components of a "financial instrument".

Debt Security

12. A "financial instrument" means

"(a) a debt security"

13. Subsection 123(1) of the Act defines a "debt security" as "a right to be paid money and includes a deposit of money, but does not include a lease, licence or similar arrangement for the use of, or the right to use, property other than a financial instrument;".

14. Paragraph 13 of this memorandum provides that a 'right to be paid money' is a debt security and in turn a financial instrument. Revenues for services listed in the definition of "financial services" in subsection 123(1) of the Act relating to debt securities would be tax exempt. For example, a vendor would have a right to be paid money in respect of accounts receivable. The accounts receivable would be debt securities and financial instruments for purposes of the GST. The purchasing of these accounts would be tax exempt as provided under paragraph (d) of the definition of "financial services".

15. Debt securities include debentures, unsecured notes, convertible notes, mortgages, book debts, accounts receivable, treasury bills, bonds, etc.

16. The definition of a "debt security" also includes a deposit of money.

17. The payment of money relating to leases, licences or similar arrangements, or the right to use property other than a financial instrument, is specifically excluded from the definition of debt security and therefore such payment is not in respect of a financial instrument. For example, the leasing of commercial property is treated as a supply of that property, and not a debt security, for purposes of the GST.

18. The payment of interest or a flat fee charged for late payment where a person fails to make lease payments at a specific time is a financial service and, therefore, exempt from GST as the outstanding lease debt is a 'right to be paid money' and, therefore, a financial instrument as defined in subsection 123(1) of the Act. The actual amount owing on the lease would still, however, include GST since the nature of the lease payment is still taxable irrespective of the fact that the payment has not been made at the appropriate time.

Equity Security

19. A "financial instrument" means:

"(b) an equity security"

20. Subsection 123(1) of the Act defines an "equity security" to mean "a share of the capital stock of a corporation or any interest in or right to such a share;".

21. Paragraph (b) of the definition of financial instrument provides that a share of capital stock in a corporation representing ownership or an interest in or right, claim or title to such a share is, for purposes of the GST, a financial instrument.

Insurance Policies

22. A "financial instrument" means

"(c) an insurance policy"

23. Subsection 123(1) of the Act defines "insurance policy" as

"(a) a policy or contract of insurance that is issued by an insurer, including

(i) a policy of reinsurance issued by an insurer;

(ii) an annuity contract issued by an insurer, or a contract issued by an insurer that would be an annuity contract except that the payments under the contract

(A) are payable on a periodic basis at intervals that are longer or shorter than one year, or

(B) vary in amount depending on the value of a specified group of assets or on changes in interest rates, and

(iii) a contract issued by an insurer all or part of the insurer's reserves for which vary in amount depending on the value of a specified group of assets, and

(b) a policy or contract in the nature of accident, sickness or dental insurance, whether the policy is issued, or the contract is entered into, by an insurer;".

24. An insurance policy is a contract whereby one person undertakes to indemnify another against loss, damage or liability arising from an unknown or contingent event, and is applicable only to some contingency or act to occur in the future. It is an agreement by which one party, for a consideration, promises to pay money or its equivalent, or to perform an act valuable to the other party upon destruction, loss, or injury of something in which the other party has an insurable interest.

25. An insurance policy includes life, property and casualty policies issued by a person specifically licensed or authorized under the laws of Canada, a province, or another jurisdiction to carry on an insurance business. This definition includes reinsurance policies, annuity contracts, segregated fund contracts, different types of life insurance contracts as well as accident, sickness, or dental insurance. [It should be noted that the definition of an insurance policy will be amended as per a Ways and Means Motion of December 18, 1990 to exclude

contracts for the service, maintenance or warranty of tangible personal property entered into after December 31, 1990. Therefore, such contracts even if issued by licensed insurers for warranting or insuring tangible personal property sold after January 1, 1991 are taxable. To further clarify the application of the amendment, the Ways and Means Motion of March 27, 1991, announced that a policy or contract of insurance between an insurer and a person other than the owner or user of the property continues to be exempt.]

26. However, insurance services provided by **non-licensed** persons are excluded from exempt status except in the case of accident, sickness, or dental insurance.

27. Health insurance contracts, such as accident, sickness or dental insurance pertain to reimbursement for eligible medical, hospital, nursing, dental and certain other health-related expenses. These contracts cover payment for the cost of specified dental services, loss of earnings, and accidental death or dismemberment and are included in the definition of an insurance policy **whether or not provided by an insurer.**

28. Similarly, contracts or policies issued by certain organizations providing supplementary health insurance in Canada licensed under the *Prepaid Hospital and Medical Act*, such as Blue Cross, as well as certain corporations or associations providing accident and sickness policy benefits to their employees under self-insurance plans administered by a third party, are also included in the definition of an insurance policy. Therefore, services related to these contracts or policies are financial services and hence are exempt from the GST.

29. For additional information on exempt health care services, refer to GST MEMORANDUM 300-4-2, **HEALTH CARE SERVICES**.

Interest in a Partnership or Trust

30. A "financial instrument" means

> "(d) an interest in a partnership or trust or any right in respect of such an interest,"

31. A partnership is created where two or more persons enter into a relationship to carry on business for profit. A trust is a fiduciary relationship imposed by contract or by law with respect to property or money held by one person for the benefit of one or more persons. Both a partnership and a trust are treated as separate persons under the Act.

32. Any interest or any right in respect of an interest in a partnership or trust is a financial instrument. This interest or right represents a right, claim, title, or legal share of an investment in a partnership or trust and not in the underlying assets of a partnership or a trust.

Precious Metals

33. A "financial instrument" means

> "(e) a precious metal,"

34. Subsection 123(1) of the Act defines "precious metal" to mean

> "a bar, ingot, coin or wafer that is composed of gold, silver or platinum and is refined to a purity level of at least
>
> (a) 99.5% in the case of gold and platinum, and
>
> (b) 99.9% in the case of silver;".

35. Any supply of a precious metal meeting the above-noted purity requirements and in the form of a bar, ingot, coin or wafer is a financial instrument and generally exempt from GST. Metals of this quality are normally investment-related and are usually bought and sold on international exchanges which establish world-wide precious metal prices.

36. The sale or purchase of metal, in the course of a commercial activity, not complying with the prescribed purity level and form is regarded as a sale of property and is therefore subject to the GST. For example, the sale of gold, silver or platinum in bar, ingot, coin or wafer form with a purity level of less than 99.5 per cent for gold and platinum or less than 99.9 per cent for silver is taxable at seven per cent. Also, the sale of gold, silver, or platinum at the prescribed purity levels but in a form other than a bar, ingot, coin or wafer (e.g., in granular form) is taxable at seven per cent.

37. A refiner of precious metals is any person who in the regular course of business converts or refines gold, silver or platinum, regardless of the degree of purity.

38. Pursuant to section 3 of Part IX of Schedule VI to the Act, a supply of a financial service that is the supply of precious metals where the supply is made by the refiner thereof or by the person on whose behalf the precious metals were refined is a zero-rated supply. Accordingly, the first sale of newly refined precious metal by the refiner or its owner is zero-rated. All subsequent supplies of a precious metal are exempt from GST unless the precious metal is converted into another precious metal form and sold by the refiner or by the person on whose behalf the precious metals were refined.

39. Where a supply of precious metals qualifies for zero-rated treatment, the refiner or the person on whose behalf the metal has been refined can claim input tax credits for the GST paid on purchases relating to the supply of the precious metals.

40. Where a refining or a manufacturing fee is charged by a refiner of precious metals to the owner of the precious metals, this fee is taxable at seven per cent. However, where it is standard practice for a refiner to charge a separate premium fee when selling its own precious metal that is over and above the intrinsic precious metal value of the product, this fee is considered part of the selling price and, therefore, would take on the tax status of the sale of the precious metal.

41. Carat gold, sterling silver or platinum in jewellery or chattel form are examples of metals that do not meet the purity and form requirements established under subsection 123(1) of the Act and are, therefore, not considered to be precious metals. Supplies of these goods are taxable at a rate of seven per cent unless otherwise zero-rated in Schedule VI or exempted under Schedule V to the Act.

42. Supplies of precious metals to non-residents will be zero-rated in the situations as follows:

> (a) under section 1 of Part IX of Schedule VI to the Act where the supply is made by a financial institution to a non-resident, and
>
> (b) under section 3 of Part IX of Schedule VI to the Act where the supply is made by the refiner thereof or by the person on whose behalf the precious metals were refined.

43. Precious metals are prescribed by the Non-taxable Imported Goods (GST) Regulations as being non-taxable imports under section 8 of Schedule VII to the Act.

Options or Contracts Traded on Recognized Commodity Exchanges

44. A "financial instrument" means

> "(f) an option or a contract for the future supply of a commodity, where the option or contract is traded on a recognized commodity exchange,".

45. A commodity option or commodity future contract is a financial instrument for purposes of the GST when traded on a recognized commodity exchange, such as the Winnipeg Commodity Exchange. Financial services provided with respect to this financial instrument are exempt.

46. An option for the future supply of a commodity includes a right, but not an obligation, to buy or sell a commodity at a specified price on a stipulated future date. The option buyer pays a premium to the dealer for this right, in addition to the usual commission. The supply of a commodity option where sold on a recognized future exchange is a financial service provided under paragraph (d) of the definition of "financial service" in subsection 123(1) of the Act. However, the taxable status of the underlying commodity, if the option is exercised, is either taxable or exempt depending on the nature of the supply.

47. A futures contract is an agreement to buy a specific amount of a commodity at a particular price on a stipulated future date. Contrary to a commodity option, a futures contract obligates the buyer to purchase the underlying commodity and the seller to sell it, unless the contract is sold to another before the exercise date. The supply of a futures contract where sold on a recognized futures exchange is a financial service provided under paragraph (d) of the definition of "financial service" in subsection 123(1) of the Act. However, the taxable status of the underlying commodity when the exercise date becomes due is either taxable or exempt depending on the nature of the supply. Further, a futures contract or option may be exempt, even where it is not traded on a recognized exchange, pursuant to paragraph (i) of the definition of financial instrument in subsection 123(1) of the Act if it does not entail any supply other than money.

Prescribed Instruments

48. A "financial instrument" means

> "(g) a prescribed instrument,".

49. Paragraph (g) of the definition of "financial instrument", mentioned above, provides for additional categories of financial instruments. To date, no regulations have been promulgated.

Guarantees, Acceptances or Indemnities

50. A "financial instrument" means

> "(h) a guarantee, acceptance or an indemnity in respect of anything described in paragraph (a), (b), (d), (e) or (g)," of the definition of financial instrument in subsection 123(1) of the Act.

51. A guarantee includes an undertaking by a person to pay money or perform obligations with respect to a financial instrument provided under paragraphs (a), (b), (d), (e), and (g), should the person primarily liable for the payment of a debt or obligation fail to execute that person's responsibility. For example, a guarantee bond is considered to be a financial instrument. A guarantee bond is a guarantee wherein the principal and interest may be guaranteed by a party other than the issuer. This situation may arise in parent-subsidiary relationships where bonds issued by a subsidiary are guaranteed by the parent.

52. An acceptance, in respect of paragraphs (a), (b), (d) and (g) of the definition of "financial instrument" under the Act will include a formal indication by a person of its acceptance or guarantee that a financial instrument will be paid (e.g., Banker's Acceptance). An acceptance agreement is created, for example, when the drawee of a financial instrument writes "accepted" and a designated date of payment on the instrument and the drawee is responsible for payment at maturity.

53. An indemnity in respect of paragraphs (a), (b), (d) and (g) of the definition of "financial instrument" refers to a collateral contract or agreement by which one person engages to indemnify another against an anticipated loss. It is an undertaking to be liable to pay money or perform an obligation in respect of the financial instrument (e.g., indemnity bond).

54. Guarantees, acceptances or indemnities pertaining to financial instruments defined in paragraphs (a), (b), (d), (e) or (g) of the definition of financial instrument in subsection 123(1) of the Act are also defined to be themselves financial instruments for GST purposes. Therefore, financial services relating to these guarantees, acceptances or indemnities will generally be exempt from GST.

Options and Contracts

55. A "financial instrument" means

> "(i) an option or a contract for the future supply of money or anything described in any paragraphs (a) to (h)" of the definition of "financial instrument" in subsection 123(1) of the Act.

56. An option for the future supply of money or a financial instrument described in paragraphs (a) to (h) of the definition of "financial instrument" refers to a right, but not an obligation, to buy or sell money or a financial instrument at a specified price on a stipulated future date. Since it is a financial instrument, financial services supplied with respect to this instrument will be exempt from GST.

57. A contract for the future supply of money or a financial instrument described in paragraphs (a) to (h) of the statutory definition of "financial instrument" refers to an agreement to buy or sell the above at a particular or a stipulated future date. For example, a future contract to purchase or sell US dollars at a specified price on a stipulated future date is a financial instrument. Generally, financial services provided with respect to this instrument will be exempt from GST.

REFERENCES — 700-2

OFFICE OF RESPONSIBILITY:
Policy and Legislation

LEGISLATIVE REFERENCES:
Excise Tax Act

HEADQUARTERS FILE:
N/A

SUPERSEDES GST MEMORANDUM:
N/A

OTHER REFERENCES:
N/A