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Ms. Susan Eastman, Manager, Financial Services Unit
Canada Revenue Agency
Excise and GST/HST Rulings Directorate
Financial Institutions and Real Property Division
320 Queen Street
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Ottawa Ontario K1A 0L5

Dear Ms. Eastman:

RE: RITS 187184 - GST/HST Interpretation March 2022: Application of GST/HST to mutual fund trailing commissions in the mutual fund industry: Where the dealer is not the same person that facilitated the initial sale of shares or units of a fund.

We are writing further to our March 8th, 2023 meeting with the GST/HST Rulings Directorate on the GST/HST status of trailing commissions that are paid by the manager of a mutual fund to licensed mutual fund dealers as discussed in GST/HST Interpretation No. 187184 (the "**2022 Interpretation**") and in particular regarding GST/HST applicable where the Dealer is not the same person that facilitated the initial sale of shares or units of a fund. In this respect, as requested by the Canada Revenue Agency (the "**CRA**"), we are writing to provide the CRA with facts and reasons which support our view that trailing commissions that are paid by a mutual fund manager to dealers are exempt from GST/HST in the "exceptional circumstance" that is referenced in the 2022 Interpretation where "a dealer is not the same person that facilitated the initial sale of shares or units in the fund but receives a trailing commission in respect of those shares or units".

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Supplemental Facts to those referenced in the 2022 Interpretation

The "Statement of Facts" referenced in the 2022 Interpretation provide a fairly concise and accurate summary of the relevant facts as they relate to dealers that receive commissions where the dealer is not the same person that facilitated the initial sale of shares or units of a fund. With respect to the Series A units and the obligation of the "Manager" to pay trailing commissions to the "Dealer", we believe that the following additional facts are relevant:

1. As a result of a Dealer having arranged for the sale and issuance of units in a mutual fund (referred to herein as the "**Original Dealer**"), the Manager is obligated to pay a trailing commission with respect to each and every outstanding Series A Unit for so long as those units remain outstanding.

2. The particular Dealer that is entitled to receive the trailing commission from the Manager in respect of the units is, pursuant to the Prospectus, the dealer on record for the particular unitholder (referred to herein as "**Dealer of Record**").

3. The obligation of the Manager to pay trailing commissions to the Dealer of Record is not contingent on the quality or quantity of services provided to a unitholder or the manager and for that matter is not contingent on the Original Dealer or the Dealer of Record providing any services to the unitholder or the Manager.

4. The Dealer of Record may not be the same person that facilitated the initial sale of shares or units of a fund (i.e., may not be Original Dealer) for various reasons including:

   (i) The Original Dealer may have transferred its book of business, including the right to receive the trailing commissions from the Manager in respect of units that the Original Dealer facilitated the sale of to its unitholder clients to the Dealer of Record; or

   (ii) The unitholder client may have decided to terminate its relationship with the Original Dealer and has appointed a new Dealer as their Dealer of Record which, pursuant to the Prospectus, results in the Dealer of Record obtaining the right to receive the trailing commissions in respect of the units that the Original Dealer facilitated the sale of to the unitholder client and the Original Dealer ceasing to have any right to receive trailing commissions.

5. It should be noted that notwithstanding that the Dealer of Record may be different in certain circumstances, the salesperson/agent that was involved with the original sale of the mutual fund units may have remained the same.

Trailing Commissions Paid to a Subsequent Dealer of Record Should be Treated as Exempt

We submit that trailing commissions paid to a subsequent dealer of record should be treated as exempt. This is consistent with the dominant element of the supply remaining the arranging for the issue, renewal, variation, transfer of ownership and repayment (redemption) of units of a fund. The main reason that the manager makes payment of the trailing commission is the issuance (and later redemption) of the units.

Jurisprudence has established that, for GST/HST purposes, a supply should be characterized from the point of view of the recipient of the supply and the "end result" of the supply. For example, in *Applewood Holdings,*[1] the Tax Court confirmed that the "predominant element" of the supply should be determined based on the "end result" of the service from the recipient's perspective, with the Tax Court stating as follows:

> [31] It is simply unconvincing that in evaluating a retail dealer agreement whose underlying rationale is the sale of Insurance Products to a consumer by appointing the Appellant as a dealer "to promote, offer for sale and sell" the Insurance Products of Walkaway, that somehow the predominant element of the agreement is other than the sale of the Insurance Products, but the ancillary obligations of the seller to the higher tier supplier. I find that any objective analyses of the Dealer Agreement would lead to the conclusion the main purpose of the contract is to sell insurance not provide expert advice, personnel or commercial efficacy. As CJ Rossiter opined in *Canadian Imperial Bank of Commerce*, <u>one can look to the end result of the services provided to determine the predominant element of the services</u>…
>
> [32] <u>It is therefore quite clear that the "purchaser" whose perspective one must objectively look through is the consumer of the end supply that is the subject matter of the transaction</u>. In our case, that is the car buyer who buys the insurance product and he would clearly and objectively know he was buying insurance, not the expertise or training, or

[1] *Applewood Holdings Inc. v. The Queen* 2018 TCC 231

> commercial efficacy or profitability of the Dealer or its staff as the predominant elements of the transaction, notwithstanding that such services, if provided, may have an ancillary role to play in his decision making process; if he was even aware of their existence. There is simply no merit to the Respondent's argument that the services or duties under the Dealer Agreement that may be said to be owed to Walkaway from the Appellant constitute the predominant element of the services to be provided under the Dealer Agreement, neither when analysing the terms of such agreement nor when conducting a functional analyses of the Appellant's acts in performing its Insurance Product retailer duties. [emphasis added]

When considering the GST/HST status of the trailing commissions from the Manager's perspective and the "end result" of the services that the Manager received, the Manager is paying the trailing commissions as consideration for distribution services that were performed by the Original Dealer. Characterizing the payment of the commissions as consideration for a financial service is buttressed by the fact that the Manager is not receiving any other supply from the Original Dealer or the Dealer of Record as the Manager's obligation to pay the commission is tied solely and directly to the issuance of the units to the investor. This appears to be consistent with the CRA's position outlined in the 2022 Interpretation wherein it states the following under the heading "Supplies of services made by a manager to a fund":

> "**The essential character of the supply made to the manager** under the dealer agreement **would be the distribution of the fund's shares or unit**. This would be the **service that the manager is essentially paying for**"
>
> [emphasis added]

We also believe that the Tax Court's conclusion in *Zomaron*[2] provides some additional support for treating the trailing commissions as being exempt from GST/HST. In *Zomaron*, the Tax Court concluded that referral fees that were payable by a payment processor to Zomaron Inc. ("**Zomaron**") were exempt from GST/HST as the intermediary, by delivering fully negotiated applications from merchants wanting to acquire payment processing services, was "arranging for" the exempt financial services that were ultimately provided by a payment processor. Zomaron did not have authority to bind the payment processors to provide payment processing services and for each payment processing transaction that was provided by the payment processor to the "referred" merchants, Zomaron was paid a separate referral fee. The court concluded that Zomaron was "arranging for" the Acquirer's payment processing services as it brought the parties together by delivering "fully negotiated merchants" and caused to occur the Acquirer's acceptance of merchants. Accordingly, the court concluded that the referral fees that were being regularly paid to Zomaron were exempt from GST/HST even though Zomaron was not involved in each of the ongoing payment processing transactions.

For similar reasons, we believe that the Manager's payment of trailing commissions continues to represent to it consideration for the exempt financial services that it received from the Original Dealer when the units of the mutual fund were issued to the investors and to arrange for the redemption of the relevant securities at the time the unitholder disposes of them. From the perspective of the Manager, the fact that the Manager may be paying the commissions to another person that acquired the right to receive the payment (i.e., the Dealer of Record) does not change the nature of the supply that it is compensating for.

All that is happening from the perspective of the Manager, is that the Original Dealer's right to receive money from the Manager has been transferred to the Dealer of Record. The transfer of a right to be paid money, in and of itself, constitutes the supply of a financial service and, even to the extent the right to the trailing commissions could be considered not to be a right to be paid money because they could be considered contingent, then the supply of the right should, in any event,be deemed to be non-taxable pursuant to deeming rules in paragraph 141.1(1)(b) of the Excise Tax Act.

[2] *Zomaron Inc. v. The Queen*, 2020 TCC 35

In similar situations involving the sale of a right to be paid money (whether contingent or not), we note that the CRA has also concluded that the payments made to the person that acquires the right to be paid money is not required to collect GST/HST when it receives the payments as the payment now being made to the person that acquired the right, does not represent [fresh] consideration for a taxable supply. For example, in GST/HST Ruling No. 167225 dated May 10, 2019, the CRA reasoned that an investor who purchases a royalty interest equal to a percentage of the revenue that is earned by a business is not required to collect GST/HST on the royalty payments that it receives as the person acquiring the right to receive the payment is not making a taxable supply to the person making the payment, as follows:

> When Company #1 pays the instalments and Royalty Fee #1 to the Investors pursuant to the right that the Investors have acquired, we do not consider the Investors to be making a taxable supply in exchange for these payments of money. Accordingly, the instalments and Royalty Fee #1 are not subject to GST/HST.
>
> [emphasis added]

Applying this same reasoning, the Dealer of Record that receives the trailing commission from the Manager by virtue of having obtained the right to receive the trailing commissions from the Original Dealer, should also be relieved from having to collect GST/HST as it is not making a taxable supply to the Manager in exchange for the payment. Rather, the sole reason the Dealer of Record receives the trailing commission is that it acquired a right to be paid money that the Original Dealer previously owned. In this respect, a new supply has not been created by virtue of the Dealer of Record, as opposed to the Original Dealer, receiving the trailing commissions. Furthermore, to the extent that the Dealer of Record acquires the right to receive the trailing commission, the payment of the trailing commission to the Dealer of Record is not contingent on the Dealer of Record providing any additional on-going services to the investor. In this respect, the Dealer of Record will receive the trailing commission even if no additional time is spent servicing an investor's account.

Furthermore, from the perspective of the Manager, the essential character of the supply has not changed when the trailing commission is paid to the Dealer of Record, as opposed to the Original Dealer.

In situations wherein the "right to be paid money" is transferred from the Original Dealer to the Dealer of Record, we submit that a new supply has not been made. The principles that form our view on a new supply not being created appear to be consistent with the CRA's view on "whether a supply" has been made. As noted in the Pacific Region Topical Research Paper TRP-11, "Supply for the Purposes of the Excise Tax Act", the CRA outlined key indicators to determine whether a supply has been made. In this respect, the CRA noted that the key indicators in determining whether a supply has been made includes, *inter alia*, the following:

(i) Indicator 5: to "make a supply", a person must do something;

(ii) Indicator 8: a supply cannot be made by more than one person;

(iii) Indicator 10: a transaction does not necessarily give rise to a supply;

(iv) Indicator 12: a transaction that is a supply to one person may not be a supply to another person.

Based on the foregoing indicators, we submit that a supply has not been made for the following reasons:

- The dominant supply is the original sale of the units and in that regard, the Dealer of Record is not required by the Manager to do anything to earn the trailing commission;
- the supply of fund distribution services was between the Manager and the Original Dealer and in this respect, a new supply has not been created as a result of the transfer of the "right to be paid money" (i.e., a supply is not made by more than one person);
- the transaction by which the subsequent Dealer of Record becomes entitled to the trailing commission involving the transfer of money does not give rise to a supply; and

- the transaction that is a supply between the Manager and Original Dealer, does not result in a supply between the Manager and the Dealer of Record.

Interpretation Requested

Based on the facts and reasons provided herein, we kindly request that the CRA revise the 2022 Interpretation by removing the reference to "exceptional circumstances" and that the statement in bold in the following paragraph should be added:

> As indicated above, a dealer would normally be responsible for the distribution of shares or units of a fund under a dealer agreement with a manager who relies on these agreements for the distribution of units or shares of the funds that it manages. The essential character of the supply made to the manager under the dealer agreement would be the distribution of the fund's shares or units. This would be the service that the manager is essentially paying for. Any other services provided would be ancillary to this purpose. Thus, the supply by the dealer to the manager would be arranging for a financial service i.e., the sale of shares or units of mutual funds. **[As the only supply that is received by the manager is the financial service that was performed by the dealer, the commissions that are payable by the manager in relation to the supply are exempt from GST/HST].** An upfront commission under this agreement is consideration for a financial service and GST/HST would not apply. Further, where **the manager is required to pay a** dealer ongoing amounts as a trailing commission **(including situations where the dealer receiving the commission was not the original dealer that arranged for the issuance of the units)**, this amount would ordinarily be viewed as additional consideration for the supply of the financial service of arranging for the sale of shares or units. This is on the basis that the trailing commission is not consideration for a separate supply from the dealer to the manager. In these circumstances, GST/HST would not apply to the payment of the trailing commission by the manager to the dealer.

We thank you for your cooperation in respect of this matter. Should you require any additional information, please call the undersigned to discuss any questions or concerns you may have.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

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