Docket: 2007-2726(GST)G

BETWEEN:

PRESIDENT'S CHOICE BANK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on January 15, 2009, at Toronto, Ontario.

Before: The Honourable Justice Lucie Lamarre

Appearances:

Counsel for the Appellant:	Al Meghji Sean C. Aylward
Counsel for the Respondent:	Ronald MacPhee

JUDGMENT

The appeal from the assessment made under the *Excise Tax Act* (**ETA**) is allowed, with costs in favour of the appellant, and the assessment under appeal is referred back to the Minister of National Revenue for reconsideration and reassessment taking into account that the audit adjustments for the years ended December 29, 2001 and December 30, 2002 referred to in paragraph 20 of the Partial Agreed Statement of Facts (reproduced at paragraph 3 of the reasons for judgment), are to be cancelled in totality.

With respect to the input tax credits (**ITCs**) claimed by the appellant pursuant to subsection 181(5) of the ETA, the appellant is not entitled to any ITCs with respect to points awarded on President's Choice Financial products and subsequently

redeemed. The appellant is only entitled to ITCs in respect of points awarded on taxable supplies and subsequently redeemed.

Signed at Ottawa, Canada, this 9th day of April 2009.

« Lucie Lamarre »

Lamarre J.

Citation: 2009 TCC 170
Date: 20090409
Docket: 2007-2726(GST)G

BETWEEN:

PRESIDENT'S CHOICE BANK,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Lamarre J.

[1] The assessment under appeal was made pursuant to the *Excise Tax Act* (**ETA**), for the period from December 31, 2000 to December 30, 2002. The appellant (hereinafter also referred to as **PC Bank**) is an indirect wholly owned subsidiary of Loblaw Companies Limited (**Loblaw**) and is licensed to operate as a bank in Canada with full banking powers under the *Bank Act*. Letters patent were issued to PC Bank on November 29, 2000. Prior to November 29, 2000, PC Bank operated pursuant to the *Trust and Loan Companies Act* as President's Choice Financial Trust Company, established on November 30, 1998 (see the introductory paragraph in the notes to the PC Bank audited financial statements for December 31, 2000, December 31, 2001 and December 31, 2002 in Exhibit A-1, Tabs 7, 12 and 13, and the corporate structure by entity in Tab 14). The notes to the financial statements also state that the PC Bank, together with other institutions, offers financial and loyalty products to individuals in Canada.

[2] The issues in the present appeal relate to two agreements entered into on November 1, 1997, between Loblaw and the Canadian Imperial Bank of Commerce (**CIBC**), a Canadian chartered bank, and an amending agreement entered into on January 17, 2001. On October 1, 2000, Loblaw had assigned its rights and obligations under the above-mentioned agreements to the President's Choice

Financial Trust Company, the predecessor to the appellant (see Exhibit A-1, Tabs 1, 2, 5 and 6).

[3] The admitted facts surrounding the execution of those agreements and the issuance of the assessment under appeal ensuing from the execution of the agreements are stated in a Partial Agreed Statement of Facts, filed jointly by the parties and reproduced hereunder:

PARTIAL AGREED STATEMENT OF FACTS

1. The Appellant, President's Choice Bank, is a wholly owned subsidiary of Loblaw Companies Limited (Loblaw).

2. Loblaw is a diversified retailer of groceries and other merchandise operating across Canada.

3. The Canadian Imperial Bank of Commerce (CIBC) is a Canadian chartered bank with its head office in Toronto, Ontario.

Financial Services Agreement

4. Prior to November 1, 1997 Loblaw determined that it wished to provide financial products to its customers because it was not a bank it understood that it could not legally do so.

5. On November 1, 1997, Loblaw executed a Financial Services Agreement (FSA) with CIBC. That agreement included the following provisions:

   i. The parties established a Steering Committee (the "Steering Committee") composed of an equal number of representatives of each of Loblaw and CIBC for the purpose of determining launch times, geographic scope, marketing strategies and overall strategic direction of the President's Choice Financial Offer. All decisions of the Steering Committee were required to be unanimous. The parties intended that the guiding principle of the Steering Committee was to provide direct to the public through electronic means a full range of financial products and services under the President's Choice Financial trade-mark, with discount pricing but quality consistent with non-discounted financial products and services offered by CIBC. In addition the Steering Committee was to be guided by the principle that it was the intention of each party to use all commercially reasonable efforts to ensure that Termination

Thresholds are met. However, nothing therein restricted the discretion of the Steering Committee, and it was not to be obligated to decide any matter in accordance with such guiding principle.

ii. Other than as set out in the FSA, CIBC would be the exclusive provider of financial services under the name "President's Choice Financial", a trade-mark of Loblaw. These financial services included (i) mutual funds sales, (ii) credit products, (iii) securities brokerage, (iv) financial planning, (v) debit cards, (vi) check cards, (vii) bill payment services, (viii) person to person payment services, (ix) ABM services, (x) insurance products relating to credit products and home warranties, and (x) [*sic*] credit cards. The financial services provided by CIBC as described above were each a "financial service" as that term is defined in subsection 123(1) of the ETA.

iii. CIBC, after consultation with Loblaw, would have a broad discretion to establish the attributes of the financial products to be offered, subject to specific restrictions in the agreement providing for no fee banking, and competitive posted interest rates. More specifically, CIBC was to price all PCF Products constituting a deposit or credit product, and mortgages, on an average product portfolio basis (e.g. the average of mortgage rates across all terms, weighted according to balances) at a minimum 45 basis points better than traditional national (or regional, if and when applicable), CIBC branch posted rates.

iv. CIBC was to install banking machines at Loblaw locations, operate a telephone banking facility, and maintain an internet banking site.

v. Loblaw was to design, install and maintain the kiosks at locations to be determined by the Steering Committee.

vi. Each party was to pay its own marketing costs for promoting the PCF brand in their own promotional materials.

vii. A number of program parameters were to be established or changed, as needed, by the Steering Committee.

viii. Either party could terminate the FSA for any reason, upon ninety days written notice.

6. CIBC was obliged to pay to Loblaw, fees calculated by reference to each new account, or other financial products opened, as well as a fee calculated by reference to the average funds and assets under management by CIBC under the PCF program.

Loyalty Program

7. Contemporaneously with the execution of the FSA, Loblaw also entered into a Loyalty Services Agreement (LSA) with CIBC, which in part provided for a loyalty program to be offered to PCF customers or members ("Members"). It was agreed that CIBC would initially administer the Loyalty Program pursuant to the terms and conditions of the LSA. The LSA provided among other things that:

i. The Loyalty Program provided for the award of "Loyalty Points" (or PC Points). The PC Points were issued to the Appellant's customers as a reward for making eligible Loblaw Purchases and Eligible PCF purchases and as part of any other offer made available through the Loyalty Program;

ii. The redemption of the PC Points was available at any participating Loblaw location as well as any other location as agreed to by the FSA Steering Committee. The PC Points could be redeemed, subject to the Loyalty terms and conditions, against the purchase of any eligible products, as defined in the LSA. Loblaw customers (Members) were required to earn a minimum of 20,000 PC Points before the points could be redeemed. Upon accumulating 20,000 PC Points, the Member could redeem the points acquired for the purchase of goods for a fixed value to [*sic*] equal to $20.00. PC Points could be further redeemed in fixed increments of 10,000 points, *e.g.*, 30,000 points could be redeemed for $30.00, 40,000 points could be redeemed for $40.00, etc. A Member could only apply a PC Points redemption to a purchase of goods with a value equal to or greater than the value of the points being redeemed. In other words, a Member could not redeem 30,000 points on the purchase of $20.00 worth of goods.

iii. Loyalty points could also be exchanged for travel with Thomas Cook, a travel service provider, and Famous Player [*sic*] movie coupons; however, during the approximately 24 month period, these options were available to Members, the percentage of PC Points redeemed on Thomas Cook and Famous Players was less than 0.5% of the total PC Points otherwise redeemed on Loblaw merchandise.

iv. CIBC was bound to pay the Appellant $1.00 per every 1000 points issued by it which were redeemed in that month or such other amounts that were agreed to by the Steering Committee; the formula provided for a reduction to reflect the total PC Points issued by CIBC as a proportion of total PC Points issued overall under the program;

v. CIBC was entitled to receive a payment for the cost of administering the Loyalty Program calculated by reference to the points initially issued by Loblaw which were redeemed in any given month.

8. Neither the FSA nor the LSA was intended to create any partnership or joint venture or similar relationship between the Appellant and CIBC.

Amendment of Agreement

9. A letter dated January 17, 2001 (the "Amending Agreement") from Loblaw to CIBC supplemented and amended the FSA and LSA; the amendments dealt with matters such as the issuance of PC Visa Cards and PC insurance by Loblaw in conjunction with someone other than CIBC, the establishment of performance standards and dispute resolution mechanisms.

10. The Amending Agreement contemplated the assignment of the FSA by Loblaw to a new subsidiary trust company and by CIBC to Amicus Bank, a CIBC subsidiary.

11. Pursuant to the Amending Agreement, Loblaw became the administrator of the Loyalty Program and became entitled to receive an amount from CIBC in respect of the administrative costs.

12. The Amending Agreement provided that CIBC would reimburse the Appellant for the Appellant's costs in promoting and marketing PCF Products and the Appellant would reimburse CIBC for CIBC's costs in promoting and marketing Loblaw Sponsored Products.

13. The Amending Agreement provided that the parties would promote, on their respective call centres, the other party's products, and services for reasonable compensation.

Assignment to Appellant

14. On October 1, 2000, as a result of a series of transactions Loblaw assigned both the LSA and the FSA, and their ensuing legal rights and obligations, to the President's Choice Financial Trust Company, the predecessor to the Appellant, PC Bank.

No payment of GST

15. No GST was charged or collected on the fees paid by CIBC to Loblaw or to its successors, including the Appellant, under the FSA, or under the amendments thereto.

16. No GST was charged or collected on the fees paid by CIBC to Loblaw or its successors, including the Appellant, under the LSA or under the amendments thereto.

17. Under the FSA the CIBC paid to the Appellant fees of $12,346,591 in 2001 and $17,793,556 in 2002 for Product Sales and Trailer fees. GST of 7% was assessed under section 165(1) of the ETA for both years.

18. Under the LSA, CIBC paid to the Appellant fees of $13,246,737 in 2001 and $17,774,626 in 2002 for points provided as per their participation in the Loyalty Program. GST of 7% under section 165(1) of the ETA was assessed for both years.

19. Payments were made to the Appellant by CIBC for Administration Costs incurred by the Appellant in administering the Loyalty Program of $1,703,480. GST of 7% under section 165(1) of the ETA was assessed.

20. A summary of the audit adjustments for the years ended 2001/12/29 and 2002/12/30 is as follows:

GST Adjustments	Year Ended 2001-12-29	Year Ended 2002-12-30	Total
Adjustment No. 1 – GST on PCF Products	$ 864,261.00	$1,245,548.00	$2,109,809.00
Adjustment No. 2 – GST on PCF Points (CIBC Portion)	$ 927,271.00	$1,244,223.00	$2,171,494.00

Adjustment No. 3 – GST on Loyalty Admin costs		$ 119,243.00	$ 119,243.00
Total Audit Adjustments	$1,791,532.00	$2,609,014.00	$4,400,546.00
Less Allowable Credits under S.296(2)	$ 382,238.00	$ 293,433.00	$ 675,671.00
	$1,409,294.00	$2,315,581.00	$3,724,875.00
Penalty	$ 445,077.14	$ 538,636.73	$ 983,713.87
Interest	$ 191,131.26	$ 235,234.59	$ 426,365.85
Total Audit Adjustments including penalty and interest	$2,045,502.40	$3,089,452.32	$5,134,954.72

21. The parties hereto agree that this Partial Agreement [*sic*] Statement of Facts does not preclude either party from calling evidence to supplement the facts agreed to herein, it being accepted that such evidence may not contradict the facts agreed.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

[4] Mr. Kevin Lengyell, CA, senior vice-president at PC Bank, testified concerning the context and the application of the above-mentioned agreements.[1] He said that Loblaw had the idea of taking advantage of the constant weekly foot traffic through its doors by offering its customers attractive financial services products. With that in mind, they entered into discussions with a few banking institutions, and ended up negotiating with CIBC regarding a joint offering of financial products under the brand name President's Choice Financial (**PCF**). This culminated in the two agreements signed in November 1997, namely the Financial Services Agreement (**FSA**) and the Loyalty Services Agreement (**LSA**). When PCF was launched, it offered three products: the no-fee bank account, the line of credit account and the mortgage account. The principle behind this was to offer PCF customers, among other things, interest rates lower than CIBC's posted rate. Further, by taking out a PCF mortgage, a client earned points (**PC Points**) that could

[1] At trial, the respondent objected to this testimony at the very outset if its purpose was to enter extrinsic evidence that would recharacterize the terms of the two agreements. Invoking the parol evidence rule, counsel for the respondent argued that the characterization of the appellant's supply under the FSA as taxable or exempt should be done having regard solely to the contracts. I accepted Mr. Lengyell's testimony subject to my ruling later on the admissibility of this testimonial evidence and on the weight, if any, to be given to it. I am now of the opinion that his testimony simply served to explain the functions performed by the appellant in fulfilment of the terms and conditions of the FSA and the LSA, and was not used to subjectively interpret those contracts, as counsel for the respondent feared it would. Besides, the evidence did not reveal that there was any dispute between the appellant and CIBC over terms of the contracts. I therefore conclude that the parol evidence rule has no application in the circumstances of the present case, and I accept without reserve the testimony of Mr. Lengyell.

be redeemed at a Loblaw store. In other words, the idea was to try to align Loblaw's President's Choice brand with an attractive financial product offering. From 2001 to 2003, PCF expanded the range of financial products it offered, to include among others the Interest Plus savings accounts for example.

[5] CIBC's interest in marketing the PCF products at better rates than those offered in its own branches came from the opportunity it saw to grow its own business by creating another channel for acquiring new customers.

[6] For a grocery retailer like Loblaw, in whose business profit margins are very thin, awarding loyalty points can be uneconomic. The idea was for Loblaw to create a loyalty program that would be funded through its success in offering financial services. In other words, the cost of running the loyalty program for Loblaw customers would be underwritten through the financial services business. As for the customers, they would get the benefit of both low interest rates, for example, and PC Points.

[7] When the program was launched in 1997, Loblaw and CIBC both had already assigned employees to work on bringing PCF to market. Loblaw had 10-15 employees assigned to this program. They worked together with a CIBC team on designing and pricing the financial products.

[8] Mr. Lengyell said that the FSA and the LSA are obviously two different agreements, the FSA governing the financial services offered and the LSA governing the loyalty program owned by Loblaw. However, he said that the two agreements work together because they are part and parcel of the same offering. Mr. Lengyell said that Loblaw does not recognize income on the award of loyalty points as Loblaw is reimbursed by CIBC through PC Bank upon redemption of the points issued by the CIBC to PCF customers. As regards the financial services, the compensation received from CIBC is governed by the FSA, which determines the rate at which PC Bank gets paid for participating in the financial services offering: this compensation is income for Loblaw or PC Bank.

[9] Mr. Lengyell explained that, at first, the income generated from the financial services was small because they were starting a new business. They used points as a marketing tool to grow the business. Indeed, in the early years, the value of the points awarded and the amounts received from CIBC relating to those points were almost the same as the amounts received for participating in the financial services offering. However, this has changed over the years.

[10] Mr. Lengyell testified that over the ten-year existence of the business the value of the amounts that PC Bank has received with respect to the financial services has been at least twice the value of the points awards paid by CIBC, and that the gap is continuing to grow. Mr. Lengyell said that PC Bank and CIBC both share the economic benefit of the program and that they work on a formula that determines how those financial rewards are to be split. PC Bank did not charge CIBC any GST with respect to the points because it viewed the loyalty points as being interchangeable with the financial product. PC Bank recognized that CIBC had control over the pricing mechanism. Indeed, CIBC can choose to give the customer a lower rate flat out or to take the rate somewhat lower and make the difference up - which would make the product a PCF product - and use PC Points interchangeably. In Mr. Lengyell's view, PC Points are interchangeable with interest or dollars; they are part of the financial services product.

[11] In cross-examination, Mr. Lengyell said that most of the financial products (but not all of them) were offered by CIBC. PC Bank was acting as an intermediary to bring these products to Loblaw customers. But PC Bank did not want to overemphasize the CIBC name. From Loblaw's perspective, it put itself at risk by associating its brand with CIBC and by working together with CIBC to make sure this business was a success. Indeed, it is in the economic interest of both parties that PCF products meet a high standard of performance. At the same time, PC Bank/Loblaw has to protect its trademark quality and maintain the high standards expected of PCF products. Mr. Lengyell also recognized that PC Bank would not suffer a direct loss in the event of a default on a mortgage, but would suffer an economic loss as its rate of compensation is determined by the amount of funds in each category (mortgages being one category of PCF products listed in the remuneration schedule).

Issues

[12] There are four issues to be resolved as laid out by the parties in their respective memoranda of fact and law. Those issues are the following:

(1) Are the services provided by PC Bank to CIBC under the FSA part of an exempt supply of "arranging for" a financial service, such that GST is not exigible thereon, as per the definition of "financial service" in subsection 123(1) of the ETA, or are these services taxable under subsection 165(1) of the ETA?

(2) Are the supplies provided by PC Bank to CIBC under the LSA part of a single composite supply (together with the FSA) so that such single composite supply is an exempt supply of a financial service, or are these supplies taxable under subsection 165(1) of the ETA?

(3) Is PC Bank entitled to notional input tax credits (**ITCs**) pursuant to subsections 181(2) and 181(5) of the ETA in respect of reimbursements paid to Loblaw on the redemption of PC Points?

(4) Was PC Bank duly diligent in attempting to comply with its obligations under the ETA, such that penalties under section 280 of the ETA should not apply?

I. The services provided by PC Bank to CIBC under the FSA

(i) Legislative Framework

[13] The parties, in their respective memoranda of fact and law, provided an overview of the statutory provisions relied on.

[14] Section 165 of the ETA charged to the recipient of a taxable supply GST at the rate of 7% (the rate applicable during the period at issue) of the value of the consideration for the supply. Subsection 165(1) of the ETA, as applicable herein, provided as follows:

> 165(1) Imposition of goods and services tax – Subject to this Part, every recipient of a taxable supply made in Canada shall pay to Her Majesty in right of Canada tax in respect of the supply calculated at the rate of 7% on the value of the consideration for the supply.

[15] Subsection 221(1) of the ETA imposes on PC Bank an obligation to collect GST in respect of the provision of a "taxable supply". Subsection 221(1) reads as follows:

> 221(1) Collection of tax – Every person who makes a taxable supply shall, as agent of Her Majesty in right of Canada, collect the tax under Division II payable by the recipient in respect of the supply.

[16] The following definitions are found in subsection 123(1) of the ETA:

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

"taxable supply" means a supply that is made in the course of a commercial activity;

"consideration" includes any amount that is payable for a supply by operation of law;

"recipient" of a supply of property or a service means

(*a*) where consideration for the supply is payable under an agreement for the supply, the person who is liable under the agreement to pay that consideration,

(*b*) where paragraph (*a*) does not apply and consideration is payable for the supply, the person who is liable to pay that consideration, and

(*c*) where no consideration is payable for the supply,

(i) in the case of a supply of property by way of sale, the person to whom the property is delivered or made available,

(ii) in the case of a supply of property otherwise than by way of sale, the person to whom possession or use of the property is given or made available, and

(iii) in the case of a supply of a service, the person to whom the service is rendered,

and any reference to a person to whom a supply is made shall be read as a reference to the recipient of the supply;

"commercial activity " of a person means

(*a*) a business carried on by the person . . ., except to the extent to which the business involves the making of exempt supplies by the person,

. . .

"exempt supply" means a supply included in Schedule V.

[17] Part VII of Schedule V of the ETA provides that an exempt supply includes:

1. A supply of a financial service . . ..

[18] "Financial service" is defined in relevant part, as follows in subsection 123(1) of the ETA:

> (*a*) the exchange payment, issue, receipt or transfer of money, whether effected by the exchange of currency, by crediting or debiting accounts or otherwise,
>
> (*b*) the operation or maintenance of a savings, chequing, deposit, loan charge or other account,
>
> (*d*) the issue, granting, allotment, acceptance, endorsement, renewal, processing, variation, transfer of ownership or repayment of a financial instrument,
>
> . . .
>
> (*f*) the payment or receipt of money as dividends (other than patronage dividends), interest, principal, benefits or any similar payment or receipt of money in respect of a financial instrument,
>
> . . .
>
> (*g*) the making of any advance, the granting of any credit or the lending of money,
>
> . . .
>
> (*l*) the agreeing to provide, or the arranging for, a service referred to in any of paragraphs (*a*) to (*i*), . . .
>
> but does not include
>
> . . .
>
> (*t*) a prescribed service.
>
> [Emphasis added.]

[19] Subsection 4(2) of the *Financial Services (GST/HST) Regulations* excludes the provision of administrative services from the definition of "financial service".

> 4(2) Subject to subsection (3), the following services, other than a service described in section 3, 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.

[Emphasis added.]

[20] In summary, under the foregoing provisions of the ETA, making an "exempt supply" does not constitute a "commercial activity", and such a supply does not fall within the definition of a "taxable supply". In the result, an exempt supply is not taxable pursuant to subsection 165(1) of the ETA. The question is whether the services provided by PC Bank to CIBC under the FSA qualify as a financial service so that they would be an exempt supply and thus not taxable under subsection 165(1).

(ii) Appellant's argument

[21] I will reproduce here paragraphs 60, 64 and 65 of the appellant's memorandum of fact and law, which I find reflect the crux of the appellant's argument:

60. It is PC Bank's position that its supply to CIBC involves "arranging for" the provision of financial services by CIBC to its customers and is therefore a financial service pursuant to paragraph (l) of the definition of "financial service" in subsection 123(1) of the ETA. Simply put, PC Bank says that it was being paid by CIBC for the origination, design[,] pricing and strategic deployment of the PCF Product.

. . .

64. In essence, PC Bank undertook to leverage its corporate strength to negotiate better rates, terms and conditions for Loblaw customers from a mainline bank than such customers would have obtained individually. PC Bank's role in ensuring the nature and pricing of the PCF Products is reflected both (i) in the terms of the FSA and, (ii) in the functional role which PC Bank has played since the inception of the PCF product roll-out.

65. The FSA provides that PC Bank shall work with CIBC on the joint Steering Committee to deal with all governance issues and to develop the business strategy for the PCF business. Section 2(a) of the FSA provides that [the] Steering Committee is to be composed of an equal number of representatives from each of Loblaw and CIBC and that all decisions of the Steering Committee must be unanimous. The FSA further provides that PC Bank will consult with CIBC to determine the type of financial products and the

> product attributes to be offered to Loblaw customers e.g., contractual term/terms, fees, interest rates etc. and jointly with CIBC, review and approve all product marketing and advertising materials and all call centre and personal banking representative scripting.

[22] Counsel for the appellant also argues that the administrative position of the Canada Revenue Agency (**CRA**) and the leading Canadian cases support a finding that a broad meaning must be assigned to "arranging for" the supply of a financial service by a financial service supplier to a recipient. The administrative position of the CRA is found in *GST/HST Policy Statement P-239 Meaning of the term "arranging for" as provided in the definition of "financial service"* ("Policy Statement P-239").

[23] In counsel's view, the Attorney General's position at trial that the activities of PC Bank do not constitute "arranging for" a "financial service" contradicts several administrative policies issued by the CRA, including Policy Statement P–239. Policy Statement P–239 reads in part as follows:

> **Elements of an Arranging For Service**
>
> To qualify as a service of "**arranging for**" the supply of a financial service, each of the following elements should be present:
>
> - the intermediary will help either the supplier or the recipient or both, in the supply of a financial service,
>
> - the supplier and/or the recipient count on one or more intermediaries for assistance in the course of a supply of a financial service, and
>
> - the intermediary is directly involved in the process of the provision of a financial service and will therefore, expend the time and effort necessary with the intent to effect a supply of a service described in paragraphs (a) to (i) of the definition of financial service.

[24] In counsel's view, all the elements listed by the CRA in Policy Statement P-239 are present here: (1) PC Bank helps CIBC through the design, pricing, marketing, etc. of savings, chequing and mortgage accounts; (2) CIBC counts on PC Bank for assistance in the course of the supply of PCF products; and (3) PC Bank is directly involved in the process of the provision of PCF products and expends the time and effort necessary with the intent to effect the supply of a financial service.

[25] As for the case law, counsel referred to *State Farm Mutual Auto Insurance Co.* v. *R.*, [2003] G.S.T.C. 35 (TCC). In that case, Bowman A.C.J. (as he then was), held that services performed by the head office of State Farm Insurance in the United States on behalf of its Canadian office, which services involved the design and pricing of insurance policies to be sold by the Canadian office to retail customers, constituted "arranging for" the supply of a financial service. Bowman A.C.J. so ruled notwithstanding the fact that State Farm's head office did not have any role in the sale of any particular contract of insurance to the recipient of that particular financial product. The sale of State Farm insurance policies was done entirely by independent sales agents. (Appellant's memorandum of fact and law, page 17, paragraph 78)

[26] Counsel for the appellant also referred to *Royal Bank* v. *R.*, 2005 TCC 802, [2005] G.S.T.C. 198 (TCC), (referred to in the present reasons as *Royal Bank 2005*)[2], *Promotions D.N.D. Inc.* v. *R.*, [2007] G.S.T.C. 79 (TCC) and *Canadian Medical Protective Assn.*, [2008] G.S.T.C. 88 (TCC).

[27] On the basis of the foregoing, counsel for the appellant concludes that the supply of services made by PC Bank to CIBC under the FSA is an exempt supply of "arranging for" the supply of a "financial service" and that PC Bank is therefore not required to collect and remit GST on that supply.

(iii) Respondent's argument

[28] Counsel for the respondent argues that the services provided by PC Bank to CIBC under the FSA are taxable supplies.

[29] A supply is defined and characterized by asking, what, as a matter of common sense, did the recipient acquire for the money that it paid (*O.A. Brown* v. *Canada*, [1995] G.S.T.C. 40 (TCC)).

[30] Counsel for the respondent submits that the predominant element of the FSA is a supply of facilities, trademarks, advertising and other non-financial services in return for a fee calculated by reference to the funds placed under the management of the CIBC as a result of the FSA. The consideration paid was for intellectual property supplied under the FSA and the appellant's role in the arrangement with CIBC was incidental to its own business, which was the promotion of the PC trademark. In counsel's view, the supply of the services in question by PC Bank does not fall

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[2] Affirmed by the Federal Court of Appeal, 2007 FCA 72.

within paragraphs (*a*) to (*m*) of the definition of "financial service" in subsection 123(1) of the ETA and it does not constitute "arranging for" the making of any of the supplies referred to in that definition. Therefore, the appellant's supply of services under the FSA is a taxable supply pursuant to subsection 165(1) of the ETA.

[31] Counsel for the respondent relies mainly on the case of *Royal Bank of Canada* v. *Her Majesty the Queen*, 2007 TCC 281 (referred to in the present reasons as *Royal Bank 2007*).

(iv) Analysis

[32] In *Royal Bank 2007*, referred to by counsel for the respondent, the Court concluded that everything Canadian Airlines International Ltd. (**CAIL**) did in that case, from being involved in establishing the terms of the credit facility to advertising the program, was for the purpose of promoting the use of the Royal Bank of Canada (**RBC**) credit card by the issuance of points, and that that was what CAIL was paid for: the issuance of points. In other words, CAIL was paid for issuing points and not for its role in setting up the program. If no points were issued, there was no consideration payable.

[33] Accordingly, the Court found that the payments made by the RBC to CAIL were not payments for the supply of a financial service. In so finding, the Court did not ignore the critical role CAIL played in the establishment of the Affinity Card program and the extent of credit use thereby generated for RBC (paragraphs 27 to 29).

[34] I find that the present case is distinguishable from *Royal Bank 2007*. I do not find that PC Bank was paid under the FSA for issuing points or for granting CIBC exclusive use of PC's trademark. That is not what the agreement says. Rather, it reflects Loblaw/PC Bank's desire to promote the no-fee bank account or the low-interest mortgages offered to its customers, just to give examples. Obviously, that agreement was entered into by Loblaw/PC Bank with the intention of maximizing the revenue potential from its own clientele. At the time the FSA was originally entered into between CIBC and Loblaw, the latter could not legally offer attractive financial products of this nature on its own. Loblaw thus had to make an arrangement with a chartered bank. Such an arrangement was advantageous for CIBC as it benefited from the PC trademark by being able to enhance the position of its own financial products. But for PC Bank, the advantage had to involve more than the association of its trademark with CIBC, since, as Mr. Lengyell testified, Loblaw was putting itself at risk through this association. The agreement with CIBC was in fact a necessary

step for Loblaw in order to be able to increase its revenues by offering services other than those relating to its retail grocery business. Evidence of that is the fact that Loblaw, and then PC Bank, received fees that were calculated by reference to each new account opened or other financial products sold, and by reference to the average funds and assets under management by CIBC under the PCF program. Not only was PC Bank paid for its major role in selling attractive financial products to its members, but its fees were directly linked to the profitability of PCF's business. The more of these products that were sold and the more profitable the arrangement was for CIBC as measured by the funds and assets managed by it, the more profitable it was for the appellant as well.

[35] Further evidence of Loblaw's and then PC Bank's direct interaction in the sale of financial products is that Loblaw, in signing the FSA, insisted on the no-fee bank account and the lower, attractive rate of interest on mortgages and on lines of credit. These were non-negotiable aspects of the program with respect to which Loblaw and PC Bank agreed to work together with CIBC, as can be seen from paragraphs 2(a), 2(d) and 3 of the FSA (Exhibit A-1, Tab 1, pp. 6, 7, 11, 12, 13, 17 and 18). A steering committee with equal representation from both parties and whose decisions were required to be unanimous was provided for in the FSA to ensure that CIBC would meet Loblaw's or PC Bank's requirements. Moreover, if those requirements caused a decline in profitability or resulted in the "termination thresholds" (minimum required funds under management per year) not being met, the steering committee had, under certain conditions, the authority to re-evaluate the program, or the FSA could simply be terminated (see paragraph 2(a), clause 2(d)(i)(b) and subparagraph 11(a)(iv) of the FSA, Exhibit A-1, Tab 1, pages 6, 7, 12, 13 and 29).

[36] The present case has more similarities with the English Court of Appeal decision in *Customs & Excise Commissioners* v *Civil Service Motoring Association* ("*CSMA*"), [1998] BVC 21 (C.A.) than with *Royal Bank 2007*. The Automobile Association in *CSMA* negotiated the terms of the credit card facilities being offered to its members. It was involved in designing the credit card arrangement, including such things as the interest rate charged. The English Court of Appeal determined that the compensation paid to the Automobile Association was a commission for its services in making arrangements for the granting of credit. The substantive element of the supply was arranging for favourable special credit terms and benefits to be provided to the Association's members by the financial institution granting the credit. In the present case, Loblaw/PC Bank has negotiated no-fee bank accounts, lower interest rates on mortgages and later on, an Interest Plus savings account for its members. That is equivalent to arranging for favourable special credit terms and benefits to be provided to its customers by CIBC.

[37] In the *Royal Bank 2005* case, in determining whether branch services offered were to be considered as "arranging for" the issuing of mutual fund units, Bowie J. of this Court, said that it was necessary to decide what RBC provided in return for the consideration it received. Bowie J. said at paragraph 15:

> [15] It is necessary to decide what the Appellant provided in return for the consideration it received. The ordinary meaning of the verb "to arrange" is found in the *Canadian Oxford Dictionary* at page 69:
>
> 2. plan or provide for; cause to occur
>
> It is not for me to decide, of course, whether the arrangements between the Appellant and RMFI that I have described conform to the federal and provincial regulatory requirements. I am satisfied, however, that the Appellant did not simply provide personnel services and the use of branch office space to RMFI. The individuals who provided the services to RMFI were at all times employees of the bank, and were not employees of RMFI. The locations in which they worked were premises of the bank, and there is no basis on which I could find that RMFI had the right to occupy any of that space for its own purposes, even temporarily. The service that the Appellant provided to RMFI was that of arranging for the distribution of mutual funds, together with providing ongoing customer service, including responding to customers' inquiries and completing surrender documents for customers when requested to do so. [. . .]

[38] In the present case, Loblaw/PC Bank had 10-15 employees working with CIBC on the terms to be offered on the PCF products. Furthermore, during the years at issue, PC Bank had full banking powers under the *Bank Act*. I am satisfied that the service provided by PC Bank to CIBC was that of arranging for the granting of credit or banking facilities to its members on favourable terms. As was the case with the Automobile Association in *CSMA*, I find that PC Bank was not a passive associate concerned only with promotion and doing no more than allowing access to its list of members. PC Bank did negotiate, did assist in supervision within the steering committee, did express views. The fact that customers of Loblaw benefited was the natural consequence of the negotiation (see *CSMA*, *supra*, page 6). I also agree with counsel for the appellant in response to one argument made by counsel for the respondent, that the fact that PC Bank did not suffer any direct loss from defaults on mortgages is not a concern in determining whether it was "arranging for" the provision of financial services.

[39] Finally, while I concur with Bowie J.'s suggestion in *Royal Bank 2005*, *supra,* at paragraph 16, that CRA policy documents should not be given much weight, I find

that the CRA's argument in the present case goes against its own Policy Statement P–239. Indeed, I find that the appellant helped, assisted and was directly involved in the process of the provision of financial services by CIBC to PCF customers.

[40] As was decided in *CSMA*, I conclude that the arrangement between CIBC and the appellant under the FSA consisted in arranging for the provision of financial services to the appellant's customers and so constituted an exempt supply as being a financial service within the meaning of paragraph (*l*) of the definition of this term in subsection 123(1) of the ETA.

II. <u>The supplies made by PC Bank to CIBC under the LSA</u>

(i) Appellant's argument

[41] Counsel for the appellant argues that the supply of PC Points and points program administration services by Loblaw/PC Bank to CIBC pursuant to the terms of the LSA is part of a single composite supply included with the supply of services under the FSA. In counsel's view, the LSA is entirely intertwined with, and ancillary to, the FSA. It is submitted that the supply of points is an ancillary element which is subsumed in the principal element, namely the financial services, so as to form a single composite supply. That entire single composite supply (inclusive of the supplies made under the LSA) is thus an exempt supply of a financial service.

[42] This is particularly so, in the appellant's view, because the FSA and the LSA are inextricably bound up with each other. An example of this is that a breach of one agreement could serve as a basis for terminating the other (subparagraph 11(a)(iii) of the FSA and subparagraph 15(a)(ii) of the LSA). Furthermore, in order to become a PCF member a customer must agree to be enrolled in the loyalty program. Simply put, a customer cannot waive participation in the loyalty program and remain a PCF member.

[43] From the perspective of the customer, PC Bank and CIBC, the two programs are inextricably linked. PC Points are an integral component of what PCF is offering and the value it is providing and it is one of the key differentiators used to set PCF products apart from other financial products in the marketplace.

[44] Counsel for the appellant relies on the following cases, among others: *O.A. Brown Ltd* v. *The Queen*, *supra*, and *Canada Trustco Mortgage Co.* v. *R.*, [2004] G.S.T.C. 169 (TCC). He concludes that the loyalty program and the points supplied by PC Bank to CIBC under the LSA are an integral part of the services

supplied by PC Bank pursuant to the FSA. It is through the FSA that PC Bank arranges for financial products to be provided by CIBC to PC Bank customers. CIBC in turn awards points to Loblaw customers in respect of these financial products. From the perspective of the parties involved, the FSA and the LSA are integral parts of a composite whole, being the arranging for financial services to be provided to Loblaw customers, which cannot, as a matter of commercial reality, be sensibly separated into separate supplies.

[45] The appellant concedes, however, that if this Court determines that the supply of PC Points and points program administration services by PC Bank to CIBC pursuant to the terms of the LSA is to be regarded as a separate supply and not part of a composite supply made together with the supply of services under the FSA, that supply may be a taxable supply.

(ii) Respondent's argument

[46] The LSA calls for the supply by the appellant of a points reward program in return for a payment to the appellant based on the number of points issued to the CIBC. Under the LSA, a payment was made, initially by Loblaw to CIBC, and then by CIBC to Loblaw/PC Bank, for the cost of administering the loyalty program. In counsel for the respondent's view, the dominant element of the supply is that of intangible personal property, i.e. the points themselves along with the administrative services needed to operate the program. No exemption exists for the supply of points or for the supply of a rewards program or of services for the administration thereof. Thus the supply under the LSA is taxable under section 165 of the ETA.

[47] In the opinion of counsel for the respondent, the appellant's role in the arrangement with CIBC was incidental to its own business, namely the promotion of the PC trademark and the selling of points. Such a conclusion, according to counsel, can be reached through the application of common sense and commercial reality. If this Court were to find that the appellant was providing a single supply of the elements referred to in both the FSA and the LSA, counsel is of the view that that single supply is a taxable supply. As mentioned above, the dominant elements of the supply are, in counsel's view, the facilities and trademark rights and the loyalty program supplied by the appellant. A review of the terms of payment set out in the contracts, as well as the invoices issued between the parties, support this conclusion, argues counsel for the respondent.

[48] In his memorandum of fact and law, counsel also argues that an administrative service is excluded from the definition of "financial service" (pursuant to paragraph

(*t*) of the definition of "financial service" in subsection 123(1) and pursuant to subsection 4(2) of the *Financial Services (GST/HST) Regulations*), and that the single supply, if such there was, would be excluded under those provisions. However, in court, counsel admitted that this argument was weak and did not have much applicability in the present case, other than with regard to the small item for administrative costs under the LSA ($119,243 in the assessment).

(iii) Analysis

[49] Citing abundantly the case of *O.A. Brown Ltd*, *Canada Trustco Mortgage Co.* summarizes well the approach to be taken in determining whether there is one single supply or two distinct supplies. I reproduce here the relevant part of that decision dealing with this matter (paragraphs 16 to 20):

> 16 There is a great deal of jurisprudence on the question of single supply. I can do no better than refer to the leading case decided by Justice Rip, *O.A. Brown Ltd. v. R.*, [1995] G.S.T.C. 40 (T.C.C.). In that case the appellant bought livestock for its customers, not as agent but on its own account. It charged the customers disbursements and a clearing commission in addition to the cost of livestock. The Minister assessed GST on the commission and other disbursements.
>
> 17 Justice Rip said at pages 40-5 to 40-7:
>
>> The GST legislation is of recent vintage in Canada and Canadian courts have not judicially considered what may constitute a single or multiple supply for purpose of GST. The *Value Added Tax* statute in the United Kingdom contains many provisions similar to our GST. In the English cases the issue has been defined as whether the supply in question comprises a compound supply or a multiple supply. A compound supply is a supply where there are a number of constituent elements which, if supplied separately, some would have been taxed and some not. With respect to these types of supplies, it is necessary to determine the quality of the final compound supply for tax purposes regardless of its constituent elements. A multiple supply has been defined as a transaction involving the supply of a number of separable goods or services. Each supply must be considered as an independent supply for tax purposes, the single consideration being apportioned among the separate supplies as appropriate.
>>
>> In deciding this issue, it is first necessary to decide what has been supplied as consideration for the payment made. It is then necessary to consider whether the overall supply comprises one or more than one supply. The test to be distilled from the English

authorities is whether, in substance and reality, the alleged separate supply is an integral part, integrant or component of the overall supply. One must examine the true nature of the transaction to determine the tax consequences. The test was set out by the Value Added Tax Tribunal in the following fashion:

In our opinion, where the parties enter into a transaction involving a supply by one to another, the tax (if any) chargeable thereon falls to be determined by reference to the substance of the transaction, but the substance of the transaction is to be determined by reference to the real character of the arrangements into which the parties have entered.

One factor to be considered is whether or not the alleged separate supply can be realistically omitted from the overall supply. This is not conclusive but is a factor that assists in determining the substance of the transaction. The position has been framed in the following terms:

What should constitute a single supply of services as opposed to two separate supplies, is not laid down in express terms by the value added tax enactments. It would therefore be wrong to attempt to propound a rigid and precise definition lacking statutory authority. One must, it seems to us, merely apply the statutory language, interpreting its terminology, so far as the ordinary meaning of the words allows, with the aim of making the statutory system of value added tax a practical workable system. For this purpose one should look at the degree to which the services alleged to constitute a single supply are interconnected, the extent of their interdependence and intertwining, whether each is an integral part or component of a composite whole. Whether the services are rendered under a single contract, or for a single undivided consideration, are matters to be considered, but for the reasons given above are not conclusive. Taking the nature, content and method of execution of the services, and all the circumstances, into consideration against the background of the value added tax system, particularly its methods of accounting for and payment of tax, if the services are found to be so interdependent and intertwined, so much integral parts or mere components or items of a composite whole, that they cannot sensibly be separated for value added tax purposes into separate supplies of services, then Parliament, in enacting the value added tax system, must be taken to have intended that they should be treated as a single system, otherwise, they should be regarded for value added tax purposes as separate supplies.

> The fact that a separate charge is made for one constituent part of a compound supply does not alter the tax consequences of that element. Whether the tax is charged or not charged is governed by the nature of the supply. In each case it is useful to consider whether it would be possible to purchase each of the various elements separately and still end up with a useful article or service. For if it is not possible then it is a necessary conclusion that the supply is a compound supply which cannot be split up for tax purposes.
>
> This passage was approved by the Federal Court of Appeal in *Hidden Valley Golf Resort Assn. v. R.*, [2000] G.S.T.C. 42 (Fed. C.A.).

> 18 The approach taken by Rip J. in *O.A. Brown Ltd.* did not depend upon the application of the specific provisions of sections 138 or 139. The premise upon which the resolution in *O.A. Brown Ltd.* is based is that a distinction must be drawn between multiple supplies and a single supply.
>
> . . .
>
> 20 For the principle in *O.A. Brown Ltd.* to apply there must be an inextricable interdependency between the two elements so that they are integral parts of a composite whole that cannot, as a matter of commercial reality, be sensibly separated into separate supplies. Whether these criteria are met depends upon a number of factual considerations and these will vary from case to case.
>
> . . .
>
> [Emphasis added.]

[50] In the present case, what is the substance of the transaction between the appellant and CIBC? Can the LSA subsist by itself independently from the FSA?

[51] On the one hand, we have two different agreements, but they were entered into at the same time. The fees received by the appellant pursuant to each agreement are not based on exactly the same factors, but they are in a way interrelated. Under the FSA, the fees are calculated in accordance with the number of accounts opened and the average funds managed by CIBC. Under the LSA, the appellant is reimbursed by CIBC upon redemption of the points issued by the CIBC to PCF customers. On the other hand, the appellant would not have concluded the LSA with CIBC without the FSA. The points issued by CIBC are directly linked to the financial products offered to PCF members. PCF members are automatically eligible for the loyalty program established by Loblaw pursuant to the LSA (subparagraph 2(f)(x) of the FSA and paragraph 2(b) of the LSA).

[52] Mr. Lengyell testified that the FSA was entered into with CIBC, among other reasons, to help finance the costly point system implemented by Loblaw. CIBC reimbursed PC Bank, which then reimbursed Loblaw, only for points issued to PCF members. Without the financial agreement, there would have been no need for CIBC to adhere to the loyalty program. For customers, what made the PCF products attractive was not only the financial benefits gained from a no-fee bank account, the Interest Plus savings account and lower mortgage interest rates, but also the points attached to those PCF products. As a matter of fact, the FSA provides that CIBC may attribute the 45 basis point spread to product or service pricing by reducing fees, changing interest rates or by awarding loyalty points, or a combination thereof (clause 2(d)(i)(b) of the FSA, Exhibit A-1, Tab 1, page 12).

[53] In my view, if we look at the degree to which the supply of PCF products and the supply of points attached to that supply are interconnected, interdependent and intertwined, the conclusion must be that the supplies effected under the FSA and under the LSA are both components of a composite whole. The fact that a separate charge is made for one constituent part of the supply is not conclusive and does not necessarily alter the tax consequences of that one element. As stated by Judge Rip (as he then was), in *O.A. Brown*, *supra*, (at page 40-7), it is useful to consider whether it would be possible to purchase each of the various elements separately. Here the points cannot be issued by CIBC without the PCF products. The two elements are interrelated and, as a matter of commercial reality, could not be sensibly separated into separate supplies (*Canada Trustco Mortgage Co., supra,* at paragraph 20).

[54] As to the respondent's argument that the awarding of points is the dominant element and that the supply of PCF products is only ancillary thereto, I do not accept this proposition. First of all, the revenues resulting from each of the FSA and the LSA during the period at issue were almost the same. Furthermore, if one of the supplies in question is ancillary to the other, I would be inclined to say that the supply made under the loyalty program is ancillary to the supply of PCF products; the points are a means to better enjoy the advantageous financial products. (See *Card Protection Plan Ltd* v *Customs and Excise Comrs*, [1999] All. E.R (EC) 339 Court of Justice (Sixth Chamber) of the European Communities, 25 February 1999, at paragraph 30, referred to by counsel for the appellant).

[55] Indeed, I agree with the appellant that the value of the PC Points earned by Loblaw customers on the purchase of groceries was dwarfed by the value they received from the no-fee banking and favourable savings and lending rates offered by PC Bank. The uncontradicted example given by Mr. Lengyell is self-explanatory. For an average Canadian family spending approximately $600 per month on groceries,

the value of the PC Points earned would be approximately $36 annually. In contrast, the same family with an average mortgage of approximately $300,000 with a one per cent reduction in its mortgage rate over that charged by a standard Canadian bank would enjoy annual savings of $3,000. Clearly, the relative value of the discounted PCF products greatly surpassed the value of the PC Points issued to a PCF customer (see appellant's memorandum of fact and law, page 5, paragraph 25).

[56] With respect to the administration of the loyalty program, for which the appellant received $119,243 during the period at issue, section 5 of the LSA sets out in the following terms the services to be performed thereunder:

> [. . .] the following administrative services and any other services which may from time to time be agreed to by the parties in writing (collectively, the "Administrative Services"):
>
> (a) enrol each PCF Customer as a Member;
>
> (b) attempt to obtain Member Identifying Information from each PCF Customer upon his or her enrolment as a Member;
>
> (c) advise each Member as to the various uses and transfers of Member Identifying Information and Program Information set forth in Section 8 of this Agreement and shall provide a valid opportunity to each such Member to object to such uses or transfers of the Member Identifying Information and Program Information;
>
> (d) record any changes to Member Identifying Information as provided to CIBC from time to time;
>
> (e) on behalf of Loblaw, establish, maintain and operate (including updating on a regular basis) a Points Account for each Member;
>
> (f) provide each Member access to his or her Points Account, free of charge, through PCF automated banking machines, the PCF telephone banking facility and the PCF Internet site;
>
> (g) establish and maintain all controls and procedures which are necessary to protect, enhance and safeguard the integrity and confidentiality of Program Information and Member Identifying Information as

if such Program Information and Member Identifying Information were its own;

(h) make available to Loblaw upon Loblaw's request (which shall be no more frequently than once per week) in electronic format such Member Identifying Information and Program Information that CIBC has collected during that month and Member identification numbers which permit cross-referencing between the identity of Members and SKU Information;

(i) allow each Member to obtain, free of charge, Redemption Certificates from each PCF automated banking machine; and

(j) track, accumulate and report to Loblaw at least once a month the number of Loyalty Points issued to, withdrawn by and / or redeemed by each Member and, in the case of withdrawals, the location of each PCF automated banking machine from which a Redemption Certificate was issued to such Member and the number of Loyalty Points withdrawn by such Member in respect of each Redemption Certificate.

[57] In *Promotions D.N.D. Inc. v. R.*, [2007] G.S.T.C. 79 (TCC), it was decided that the mere distribution and reviewing for completeness of credit card applications constituted a financial service and did not constitute an administrative service as contemplated in the *Financial Services (GST/HST) Regulations*.

[58] In *Royal Bank 2005*, Bowie J. of this Court specifically considered the application of paragraph (*t*) of the definition of "financial service" in subsection 123(1) of the ETA and of section 4 of the *Financial Services (GST/HST) Regulations* as follows, at paragraph 18:

> 18 The Appellant argues that, in any event, the branch services cannot come within the definition of financial service because they are administrative services, and therefore are specifically excluded from the definition by paragraph (*t*) and section 4 of the *Regulation*. This provision has been considered only twice by this Court, and neither case sheds any light on the meaning of the expression "any administrative service" ("les services administratifs"). *The Canadian Oxford Dictionary* (2nd Ed.) gives this definition at page 17:
>
> administrative: concerning or relating to the management of affairs.

> Other dictionaries, both French and English, are no less vague. Clearly this expression is both broad and elastic in meaning, but it seems clear that when read in its context within the statutory scheme of Part IX of the *Act*, and relative to the definition of "financial service" ("service financier") in particular, it is intended to exclude from that definition such ancillary services as data processing, record keeping and the like, but not those activities enumerated specifically in the first part of the definition for inclusion within it, of which arranging for the distribution of securities is certainly one. In my view paragraph (*t*) of the definition and the Regulations have no application in this case.

[59] Department of Finance News Release 90-103 (August 20, 1990), referred to by counsel for the appellant in paragraph 106 of the appellant's memorandum of fact and law, provided the following background information regarding the *Financial Services (GST/HST) Regulations*:

> 106. . . .
>
> **The Definition of a Financial Service**
>
> … Bill C-62 contains provisions for prescribing services as either financial services or as excluded from the financial service definition. These provisions provide the flexibility to address any necessary technical refinement to the definition of a financial service contained in the Bill. The prescribed services will be defined by regulations to be released over the coming weeks. This note outlines the intention and effect of these regulations.
>
> …
>
> B. Third Party Administrative Services
>
> …
>
> However, financial institutions sometimes provide data processing or administrative services in respect of financial services or instruments, but do not provide the underlying financial instrument – the services are provided on a third-party basis by the financial institutions. Examples include debt collection services and administrative-services-only (ASO) provided in respect of health insurance services. Under a broad based sales tax, these types of services should be taxable.
>
> *As a result, services which are purely administrative and provided on a third-party basis will be excluded from the definition of a financial service as a result of a regulation to be issued under paragraph (t) of the definition of a financial service. This regulation will provide that*

> *these services be taxable and will thereby further clarify the application of the tax in this area.*
>
> It is worth noting that this regulation will affect only services that would otherwise be considered to be financial services under paragraphs (a) to (m) of the definition under subsection 123(1). Therefore, this regulation will not affect services that are not captured by these paragraphs and, as a result, would not be financial services in the absence of this regulation.
>
> Services that will be prescribed under paragraph (t) as excluded from the definition of a financial service will, in broad terms, be described as follows:
>
> (a) the service of transferring, collecting or processing information,
>
> (b) an administrative service involving the payment or receipt of dividends, interest, principal, claims, benefits, or any other amount, (other than a service that is solely the transfer of money from one person to another) or,
>
> (c) any other service of an administrative nature.
>
> …
>
> [Emphasis added.]

[60] The services with respect to the administration of the loyalty program, as described in section 5 of the LSA reproduced above, are provided within the framework of that program, under which points are awarded to PCF customers. These services in themselves are not otherwise considered to be financial services under paragraphs (*a*) to (*m*) of the definition in subsection 123(1) of the ETA. However, they are ancillary to the services supplied under the FSA and therefore part of the financial services provided by PC Bank through CIBC. In my view, they do not fit in with what the case law and the Department of Finance News Release describe as being administrative services related to those activities specifically enumerated in the definition of "financial service" in subsection 123(1) of the ETA.

[61] I therefore conclude that the administration of the loyalty program, for which PC Bank was paid $119,243 by CIBC, was part of the consideration received by the appellant in respect of the single exempt supply made under the FSA and the LSA and therefore was not subject to GST.

III. Is PC Bank entitled to notional input tax credit (ITCs) pursuant to 181(2) and 181(5) of the ETA on the PC Points redeemed at Loblaw?

[62] PC Bank submits that, pursuant to subsection 181(5) of the ETA, it is entitled to claim notional input tax credits equal to 7/107 of the amount of "reimbursement" made by it to Loblaw in consideration for Loblaw accepting PC Points as full or partial consideration for products purchased by customers of Loblaw.

[63] It is the respondent's position that PC Bank is not entitled to notional input tax credits equal to 7/107 of the value of PC Points redeemed by it because PC Points do not have a "fixed dollar" value as required by subsection 181(5) of the ETA. Instead, the respondent says, subsection 181(4) of the ETA properly applies to the redemption of PC Points.

(i) Legislative framework

[64] Subsection 181(4) of the ETA provides as follows:

> (4) Acceptance of other coupons – For the purposes of this Part, if a registrant accepts, in full or partial consideration for a supply of property or a service, a coupon that may be exchanged for the property or service or that entitles the recipient of the supply to a reduction of, or a discount on, the price of the property or service and paragraphs (2)(a) to (c) do not apply in respect of the coupon, the value of the consideration for the supply is deemed to be the amount, if any, by which the value of the consideration for the supply as otherwise determined for the purposes of this Part exceeds the discount or exchange value of the coupon.
>
> [Emphasis added.]

[65] Subsection 181(5) of the ETA states the following:

> (5) For the purposes of this Part, where in full or partial consideration for a taxable supply of property or a service, a supplier who is a registrant accepts a coupon that may be exchanged for the property or service or that entitles the recipient of the supply to a reduction of, or a discount on, the price of the property or service and a particular person at any time pays, in the course of a commercial activity of the particular person, an amount to the supplier for the redemption of the coupon, the following rules apply:
>
> (*a*) the amount shall be deemed no to be consideration for a supply;
>
> (*b*) the payment and receipt of the amount shall be deemed not to be a financial service; and

> (*c*) if the supply is not a zero-rated supply and the coupon entitled the recipient to a reduction of the price of the property or service equal to a fixed dollar amount specified in the coupon (in this paragraph referred to as the "coupon value"), the particular person, if a registrant (other than a registrant who is a prescribed registrant for the purposes of subsection 188(5)) at that time, may claim an input tax credit for the reporting period of the particular person that includes that time equal to the tax fraction of the coupon value, unless all or part of that coupon value is an amount of an adjustment, refund or credit to which subsection 232(3) applies.
>
> [Emphasis added.]

(ii) Appellant's argument

[66] Counsel for the appellant argues that subsection 181(5) of the ETA is intended to apply to the redemption of coupons whose value is equal to a "fixed dollar amount" whereas subsection 181(4) is intended to apply to coupons that may be exchanged for a property or service or that entitle the recipient of the supply to a discount on the price of property, that is, coupons whose value is equal to something other than a "fixed dollar amount". Counsel states, by way of example, that subsection 181(5) would apply to a coupon which provided for a $20.00 discount whereas subsection 181(4) would apply to a coupon which offered a percentage discount or to a two-for-one meal voucher. The parties do not dispute that PC Points qualify as coupons for the purposes of section 181 of the ETA. The issue is whether PC Points have a "fixed dollar" value as required by subsection 181(5).

[67] Counsel for the appellant paraphrased subsection 181(5) as follows to show what conditions must be met in order for it to apply:

(a) the "supplier" (i.e., Loblaw) must make taxable supplies and accept a "coupon" in full or partial consideration therefore,

(b) the "recipient" (i.e., the Loblaw customer) is entitled to a discount of a "fixed dollar amount" on the price of the Loblaw supplies,

(c) a "particular person" (i.e., PC Bank) pays, in the course of its commercial activity, an amount to Loblaw for redeeming the PC Points coupon, and

(d) Loblaw's supply (in respect of which the PC Points coupon is redeemed) must not be a zero-rated taxable supply.

[68] According to Mr. Lengyell's testimony, Loblaw calculates the GST on the full sale price, that is, the price before the coupon value is deducted. The customer's receipt indicates that the customer was charged GST on the total amount of the taxable items purchased. According to Mr. Lengyell, the redemption of PC Points entitles the customer to a reduction of the price equal to a fixed dollar amount. For example, if the Loblaw customer redeemed 20 000 points, the customer would receive a $20 discount on the price of the groceries purchased.

[69] Counsel for the appellant argues that the opening words of subsection 181(5) indicate that the time at which the value of a coupon must be ascertained, that is, the "fixed dollar amount", is not at the time of issuance but at the time of redemption of the coupon, i.e. the time at which Loblaw "in . . . consideration for a . . . supply of property . . . accepts a coupon".

[70] Counsel for the appellant further submits that the third condition laid down in subsection 181(5) has also been met. PC Bank pays an amount to Loblaw with respect to the redemption of the PC Points, which it does in the course of its commercial activity. It should be remembered here that the appellant previously argued that the supplies made by PC Bank to CIBC under the LSA (points awards) are exempt supplies which by definition are excluded from the definition of commercial activity in subsection 123(1) of the ETA. However, counsel submits that the PC Points coupons are issued, at least in part, in the course of a commercial activity of PC Bank because that entity is engaged in commercial activities, such as the sale of PC Points to Petro-Canada.

(iii) Respondent's argument

[71] Counsel for the respondent submits that the value of the PC Points was subject to change at any time. According to the documentation provided to the public (Exhibit A-1, Tab 9), Loblaw reserves the right to restrict, suspend or change any aspect of the loyalty program with or without notice and has the right to cancel a person's participation in the program. PC Points are not transferable. In counsel's view, since PC Points may be redeemed only after certain thresholds are met, and because their value may change or the points may be cancelled, it is difficult to argue that the PC Points have a fixed dollar value as argued by the appellant. As a matter of fact, the document setting out the terms and conditions governing PC Points (Exhibit A-1, Tab 9, last page) specifically states that PC Points are not transferable and have no cash value.

[72] Consequently, counsel for the respondent argues, subsection 181(5) has no application. In his view, subsection 181(4) applies such that the points are treated as reducing the consideration paid for a supply rather than as constituting consideration for a supply.

[73] In the alternative, argues counsel for the respondent, if the court finds that the supplies in question are exempt supplies and that the points have a fixed value, the appellant should not be entitled to ITCs under subsection 181(5) because ITCs are only available where the particular person claiming them has redeemed the coupons while in the course of engaging in a commercial activity and the appellant would no longer meet the commercial activity requirement.

(iv) Analysis

[74] In my view, counsel for the appellant is right in his interpretation of subsection 181(5). It is at the time of redemption of the coupon that we have to determine whether that coupon has a fixed dollar value. Subsection 181(5) states that:

> . . . where . . . a supplier . . . accepts a coupon . . . that entitles the recipient of the supply to a reduction of, or a discount on, the price of the property or service and a particular person at any time pays, in the course of a commercial activity of the particular person, an amount to the supplier for the redemption of the coupon, . . .
>
>> (*c*) if . . . the coupon entitled the recipient to a reduction of the price of the property or service equal to a fixed dollar amount specified in the coupon (in this paragraph referred to as the "coupon value"), the particular person . . . may claim an input tax credit . . .

[75] The February 1993 Technical Notes issued by the Department of Finance describe the policy rationale which informs subsection 181(5) of the ETA:

> . . .
>
> Subsection 181(5) also entitles the issuer [PC Bank] of a reimbursable, fixed dollar value coupon to claim an input tax credit equal to 7/107ths of that value when the issuer redeems the coupon from the vendor [Loblaw]. By allowing the issuer an input tax credit, subsection 181(5) ensures that the correct overall net amount of GST is remitted to the government in respect of the supply by the vendor . . .

[76] It can be inferred from these Technical Notes that the fixed dollar value has to be established at the time the issuer (PC Bank) redeems the coupon from the vendor (Loblaw). Even though the respondent is right in saying that the coupon does not

have any cash value when it is issued, this is not what is required by subsection 181(5). What we need to determine is whether a fixed dollar value exists at the time of redemption. There is a cash value at that time: there is a paper coupon or an electronic device showing a fixed dollar amount for the points redeemed; that amount is applied as a discount on the price of groceries purchased and is recorded on the customer's invoice.

[77] However, I am of the view that PC Bank should not be entitled to ITCs on points awarded on PCF products and subsequently redeemed. Indeed, I have decided that the supplies of these PC Points in accordance with the LSA are part of the financial services offered by PC Bank through CIBC and are not subject to GST, as they are exempt supplies. Since they are exempt supplies, PC Bank does not make them in the course of a commercial activity.

[78] For points awarded on taxable supplies, PC Bank should be entitled to ITCs when it pays for the redemption of those points.

IV. Penalties under section 280 of the ETA

[79] Considering the above conclusion, the penalties assessed are not justified.

V. Conclusion

[80] The appeal is allowed, with costs in favour of the appellant, and the assessment under appeal is referred back to the Minister of National Revenue for reconsideration and reassessment taking into account that the audit adjustments for the years ended December 29, 2001 and December 30, 2002 referred to in paragraph 20 of the Partial Agreed Statement of Facts (reproduced at paragraph 3 of the present reasons for judgment) are to be cancelled in totality.

[81] With respect to the ITCs claimed by the appellant pursuant to subsection 181(5) of the ETA, the appellant is not entitled to any ITCs with respect to points awarded on PCF products and subsequently redeemed. The appellant is only entitled to ITCs in respect of points awarded on taxable supplies and subsequently redeemed.

Signed at Ottawa, Canada, this 9th day of April 2009.

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