



Canadian Automobile Dealers Association
Corporation des Associations de Détaillants d'Automobiles

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Canadian Automobile Dealers Association Pre-Budget Submission 2014

Presented to: House of Commons Standing Committee on Finance
Presented by: Canadian Automobile Dealers Association
Date: August 6, 2014

... At the Wheel

Overview

The Canadian Automobile Dealers Association (CADA) is the national association for franchised automobile dealerships that sell new cars and trucks. CADA deals with national issues that affect the well-being of franchised automobile and truck dealers. The association also advocates dealer views and concerns to Parliament, federal agencies, the courts, the public and Canada's automobile manufacturers.

We represent over 3,000 active small and medium-size businesses. Our members employ over 160,000 Canadians in every province, city, town, village and hamlet in the country. The House of Commons Finance Committee's request for input on federal spending priorities comes at a critical juncture for our economy.

Improving Canada's Tax and Regulatory Regime

Ever since the establishment of the GST more than two decades ago, financial services have been exempt from the sales tax. This exemption recognizes the vital role that such services play in the economy and in the prosperity of Canadians.

Financial services are not only provided by banks. Many retail players offer financial services to assist their customers. Car dealers are one such retail group, providing and arranging for billions of dollars of financial services to Canadian consumers every year. Since the establishment of the GST in the early 1990s, income earned by automobile dealers through the provision of financial services has been exempt from GST and HST. Dealers arranging for financing for their customers through automotive manufacturer captive finance arms or other financial institutions have historically been exempt – like other providers of financial services – from sales tax.

In 2009 the federal government signaled its intent to change some of the details surrounding the definition of financial services for the exemption in the Income Tax Act, specifically what constitutes "arranging for" a financial service. At that time, a wide array of financial institutions that deal with automobile dealerships investigated the definition as it pertains to the retail automotive sector. They concluded that a "typical dealer transaction" constituted "arranging for" a financial service as per the Act and as such its exemption from sales tax was appropriate. Despite this conclusion, soon after, the government started making changes to its interpretation of arranging for financial services, and automobile dealers in various regions of Canada started facing audits and often significant and retroactive assessments for finance income.

Typical Dealer Transactions

Because the vast majority of automobile dealers' customers require financing for new vehicle purchases, dealers are very active in helping their customers obtain this financing. Dealers' finance and insurance (F&I) offices are vital components of dealer business models. They help customers obtain financing by acting as financial consultants within the dealership. They explain finance terms, rates, options, and products for customers. They provide and assist in completing necessary paper work and they help ensure their customers choose a financial product that is appropriate for them. In short,

automobile dealership staff is very actively involved in helping their customers obtain the financing they require to purchase a vehicle.

For example, in a typical transaction for an installment sales contract, (i) the Dealer meets with the customer and explains the process and the nature of an installment sales contract; (ii) the Dealer outlines the likelihood of successfully assisting the customer to obtain credit and the anticipated available terms of credit given the customer's credit history; (iii) the Dealer verifies the customer's identity; (iv) working with the customer, the Dealer completes a credit application and obtains the customer's consent to obtain a credit bureau report and proceed with the application; (v) the Dealer submits the credit application and consent to the financial institution; (vi) if the credit application is acceptable to the financial institution, the Dealer ensures the vehicle being financed is free and clear of liens or encumbrances, (vii) if the credit application is acceptable to the financial institution, the Dealer enters into an installment sales contract with the customer using the financial institution's preapproved form; (viii) after entering into an installment sales contract, the Dealer assigns the contract to the financial institution in consideration for an amount which generally equals the unpaid portion of the purchase price of the vehicle.

Throughout this process there is no direct contact between the customer and the financial institution. The Dealer is held liable under the Conditional Sales Agreement for failing to carry out any of the above activities, most notably the failure to ensure the vehicle is free and clear of liens or encumbrances.

“Arranging for” Financial Services

The meaning of “arranging for” in paragraph (l) of the definition of financial service has been given a broad interpretation by the courts. The effect is to set a very low threshold which is required to be met in order for a service to be considered to be “arranging for”.

In *Royal Bank of Canada v. The Queen*¹, Royal Mutual Funds Inc. (RMFI), a wholly owned subsidiary of the Royal Bank of Canada (RBC) and the manager of a number of mutual fund trusts ("the funds"), provided management and administrative services to the funds, including “arranging for” the transfer and distribution of units of the funds ("the fund units"). RBC had, in turn, provided "branch services" (use of RBC employees, premises, etc.) to RMFI, to enable RMFI to "arrange for" the transfer of fund units. The issue before the Court was whether the branch services provided by RBC were a "financial service" or merely an input thereto. The court adopted the *Canadian Oxford Dictionary* meaning of “to arrange” which was to “plan or provide for; cause to occur”. The court found that the major element of the branch services provided by RBC was the very service that RMFI had contracted to supply to the funds, namely, distributing or arranging for the distribution of the fund units. On that basis, the court found that the branch services constituted an exempt supply of "arranging for" the distribution of fund units.

*Les Promotions DND Inc. v. The Queen*² involved an appellant who solicited credit card applications for financial organizations and retailers. In particular, the appellant's activities were: (i) using its

¹ 2005 TCC 802; aff'd. 2007 FCA 72.

² 2006 TCC 63.

employees to distribute applications for credit cards in a specific location; (ii) placing certain employees in shopping centres in order to promote the acquisition of a particular credit card; (iii) having the potential client complete the credit card application form handed to him or her by the Appellant; and (iv) forwarding the completed form to the Appellant's client. The Appellant had no further involvement with the potential client.

Believing the activities to be taxable, the appellant charged GST and claimed input tax credits. The Crown argued that the activities were contemplated by paragraph (l) of the definition of "financial services" and were exempt. The Court focused on the concept of "intermediary" in reaching its decision. It stated that the appellant was an intermediary in the process bringing the credit card applicants together with the credit card company and, therefore, that the appellant was making an exempt supply pursuant to paragraph (l) of arranging for a "financial service".

The combined effect of *Promotions DND* and *Royal Bank* was to expand the previously understood interpretation of "arranging for" to include, for instance, mere soliciting and marketing efforts and what were effectively administrative services.

This broad interpretation of "arranging for" is highlighted by Justice Woods in *Global Cash Access (Canada) Inc. v. The Queen* [add cite] where she stated: "The term "arranging for" in this context has been broadly interpreted as "plan or provide for; cause to occur: [*Royal Bank*] ... A broad interpretation is also supported by the administrative policy of the Canada Revenue Agency".

Similarly, in the 2007 decision in *Royal Bank v. the Queen*³ (which for clarity is a different decision involving different facts from the *Royal Bank* decision referenced above), the Court reiterated the fact that there is a broad meaning to "arranging for":

To support a broad interpretation of the language "arranging for", the Appellant relies on the ordinary meaning of the word "arrange" and on *Promotions D.N.D. Inc.* which accepted a fairly minimal threshold as to what would constitute "arranging for" the granting of credit.

...

... I agree with the Appellant's argument that *Promotions D.N.D. Inc.* supports a broad interpretation of the phrase "arranging for"

Thus, the case law unequivocally establishes a broad meaning to the term "arranging for".

Recommendation

Canadian businesses rely on a tax and regulatory regime that is predictable, fair, transparent, and consistent. While most would accept the need to change tax laws as circumstances dictate on an ongoing basis, the notion of retroactive tax hikes is a troubling and ominous one. That CRA sees fit to retroactively reinterpret such a vital piece of tax law for Canadian business is not conducive to the kind of business climate we need to foster in Canada.

³ 2007 G.T.C. 999-108 (TCC)

Therefore the Canadian Automobile Dealers Association recommends that the Canada Revenue Agency continue to treat automobile dealer finance income as sales tax exempt as it historically has, and that it not establish the precedent for retroactive tax increases on Canadian small businesses. Automobile Dealers arranging for financial services for their customers have always been exempt from sales tax in such transactions and should continue to be so, in the interest of a tax and regulatory regime that is fair and transparent and conducive to economic growth and job creation.

As this recommendation is merely a request for a continuation of historical practices and tax interpretations, it will involve zero fiscal cost to the federal government.