



July 30, 2009

Reference number: IFA 2009-0002

XXX

Dear XXX:

Re: Deposits and Loans

Thank you for your email dated XXX, requesting a technical interpretation with respect to the provisions of the *International Financial Activity Act* (“IFA Act”) in relation to certain proposed activities of XXX. We apologize for the delay in responding.

FACTS

Our understanding of the facts is as follows:

1. XXX, a savings institution¹, proposes to purchase debt instruments that:
 - are to be issued by a G7 non-resident unaffiliated bank and will be unconditionally guaranteed by the resident bank’s G7 government;
 - are usually fixed or floating rate notes issued in local currency or US dollars for 3 year terms;
 - qualify as liquid assets, and are to be classified as “Loans to Banks” in XXX’s financial statements.

¹ Savings institution as defined in the *Interpretation Act* means

- (a) a bank,
- (b) a credit union,
- (c) an extra-provincial trust corporation authorized to carry on deposit business under the *Financial Institutions Act*,
- (d) a corporation that is a subsidiary of a bank and is a loan company to which the *Trust and Loan Companies Act* (Canada) applies, or
- (e) the B.C. Community Financial Services Corporation established under the *Community Financial Services Act*;

2. XXX requests:

- confirmation that the debt instruments will qualify as “making loans in any currency to a non-resident person” under the IFA Act, and
- clarification concerning non-resident deposits and loans activities.

ACT AND REGULATION

An “international financial business” (IFB) is defined under section 1 of the IFA Act as follows:

“international financial business”, in relation to a corporation, means a business

- (a) that is a qualifying business carried on by the corporation through a fixed place of business in British Columbia, and
- (b) all the activities of which are international financial activities;

To be a “qualifying business”, a corporation will have to satisfy one of the following criteria establishing a substantial British Columbia presence:

- the corporation carries on an active business;²
- the corporation carries on a separate business within a corporation that carries on an active business where that separate business earns income principally from property (such as treasury activities), other than from property used in or incident to the active business, or
- the corporation is affiliated with another corporation that carries on an active business, the corporation pays at least \$300,000 in annual salary and wages to employees employed in the active conduct of the corporation’s qualifying business and the corporation has “capital employed in BC”³ of at least \$10 million.

The IFA Act defines “business” as having the same meaning as under section 248(1) of the *Income Tax Act* (Canada) (federal Act), except it does not include an adventure or concern in the nature of trade. To qualify as an international financial business, “all the activities” of the “business” must be “international financial activities”. For this purpose, “international financial activities” has the meaning as provided in section 2 of the IFA Act.

² For this purpose, active business has the same meaning as under section 248(1) of the *Income Tax Act* (Canada).

³ Defined to mean an amount equal to the total capital stock of the corporation multiplied by the corporation’s BC taxable income for the year divided by the Corporation’s federal taxable income for the year.

Section 2 of the IFA Act lists the activities related to deposits and loans that qualify as international financial activities including:

- section 2(2)(a) accepting deposits in any currency from a non-resident person, or in respect of a prescribed business from a person carrying on the business;
- section 2(2)(b) making deposits in any currency with a non-resident person, or in respect of a prescribed business with a person carrying on the business;
- section 2(2)(c) making loans in any currency to a non-resident person or in respect of a prescribed business to a person carrying on the business, and
- section 2(2)(d) borrowing in any currency from a non-resident person or in respect of a prescribed business to a person carrying on the business.

Section 4(1) of the IFA Regulation reads as follows:

- “For the purposes of section 2(2)(a) to (d) of the Act, the following are prescribed businesses:
 - (a) an international financial business of any other registered corporation;
 - (b) an international banking centre business designated under section 33.1(3) of the federal Act;
 - (c) an international finance centre as defined in an Act Respecting International Financial Centres (Quebec).

Section 19(1) of the IFA Act defines IFB income as the income or loss, as determined under Subdivision b of Division B of Part I of the federal Act, of the international financial business as if the business’s income for the taxation year was only from international financial activities other than patent activities for that part of the taxation year that the corporation was a registered corporation. Any allocation method chosen to comply with the IFA Act should be reasonable in the circumstances and should substantiate the amount claimed.

INTERPRETATION

It is the Ministry’s position that for the purposes of sections 2(2)(a) to (d) of the IFA Act, the terms “accepting deposits” or “making deposits” and “making loans” or “borrowing” have the same meaning as those terms are used to describe the traditional borrowing and lending activities of banks and other financial institutions, whether domestic or international. Banks borrow money by accepting funds deposited on current accounts, by accepting term deposits, and by issuing debt instruments such as banknotes and bonds.

Banks lend money by making advances to customers on current accounts, by making installment loans, and by investing in marketable debt instruments and other forms of money lending. Income is generated from the spread between interest earned on lending activities and any costs related to the source of those funds.

Accepting deposits under section 2(2)(a) of the IFA Act provides for funds deposited from non-residents as a qualifying international financial activity. It is the Ministry's position that this activity would only be carried on by a savings institution that is authorized to accept deposits. It is understood that this activity would not generate income but may incur a cost for the use of the funds that have been accepted for deposit.

Making loans to non-residents under section 2(2)(b), or making deposits with non-residents under section 2(2)(c), of the IFA Act would include an IFB, as first lender, acquiring an investment such as a certificate of deposit or debt instrument directly from a non-resident. This activity would generate interest income for the IFB.

Finally, borrowing from non-residents under section 2(2)(d) would include an IFB, as first borrower, issuing debt instruments such as banknotes and bonds directly to a non-resident. There would be a cost to the IFB for the borrowing of funds.

While it is not necessary to track the source of the funds, all costs related to the source of the funds, whether received from residents or non-residents, must be deducted in determining the IFB income for purposes of section 19(1) of the IFA Act.

It is the Ministry's view that a non-resident G7 government would qualify as a non-resident person for purposes of the IFA Act, should the G7 Government be required to guarantee the debt instruments in question. As long as there is a direct debtor-creditor and borrower-lender relationship, respectively, between the IFB and the debtor/borrower, the debt instruments that were initially issued by the non-resident banks and purchased by the IFB would be considered to be loans to a non-resident.

Where the debt instrument becomes tradable and is, or has been, traded in the secondary market, it is considered to be a debt security. It is the Ministry's view that these types of securities are obligations, but they are not loans for the purposes of the IFA Act.

Corporations may routinely buy and/or sell debt securities such as treasury bills, banker's acceptances, bonds, certificate of deposits and commercial paper with non-residents on a secondary market as part of their normal treasury function operations. For an IFB that is a securities corporation as defined in section 1 of the IFA Act, the income earned on transactions with a non-resident involving debt securities bought and sold on a secondary market either as principal or agent, may qualify for inclusion under sections of the Act. The definition of "securities corporation" includes a savings institution.

We trust that the above comments are of assistance. This letter is not a ruling and consequently is not binding on the Ministry of Finance.

Yours truly,

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Ministry of Finance