



June 27, 2005

Reference Number: IFA 2005-0004
REVISED

XXX

Dear XXX:

Re: XXX

This letter revises and replaces the previous letter issued on XXX.

Thank you for your letter dated XXX, the letter from XXX dated XXX and the emails from XXX dated XXX and XXX, requesting advance rulings on behalf of XXX, with respect to the provisions of the *International Financial Activity Act* (“IFA Act”) and the proposed transactions described below.

FACTS

Our understanding of the relevant facts is as follows:

1. XXX;
2. XXX currently carries on business in Canada principally through its Canadian incorporated and resident company, XXX.

PROPOSED TRANSACTIONS

Our understanding of the proposed transactions is as follows:

1. XXX will be incorporated and resident in Canada for Canadian income tax purposes and will be a member of the XXX. XXX will qualify as a “Canadian corporation” as that term is defined in section 89(1) of the *Income Tax Act (Canada)* (“federal Act”). XXX will not be a securities corporation as defined in section 2(1) of the IFA Act;
.../2

2. XXX will establish, *inter alia*, an international financial business (“IFB”) and will commence operation of activities on or about XXX;
3. XXX will establish a permanent establishment, pursuant to regulation 400(2) of the federal Act, in British Columbia from which it will carry on, *inter alia*, its proposed IFB. XXX will be liable to income tax pursuant to section 2(1) of the federal Act and section 2(2) of the Income Tax Act. XXX taxation year-end will be XXX;
4. XXX will engage in credit risk management and collection of outstanding customer trade accounts receivable owing by residents and non-residents of Canada to the XXX;
5. XXX will on an ongoing basis purchase trade receivables owing by residents and non-residents of Canada outright from the XXX and without recourse to those companies, relieving the operating companies of bad debt risk and collection work;
6. XXX may have some accounts receivable balances collected that have not been purchased from the seller, but which are managed by XXX for a fee;
7. XXX employees will perform ongoing analysis of the credit and collections portfolio, price the purchase of receivables, establish and review customer credit lines, make collection calls, work with customers and collection agencies, and manage currency exposures;
8. XXX may outsource the financial reporting, recording, and cash management functions to the XXX for a fee for service. XXX will maintain its own bank accounts. XXX will continually keep its capital invested in outstanding receivables, such that whenever collected cash is remitted to XXX, new receivables from a XXX will be purchased, with the exception of cash distributed in the form of a dividend;
9. The determination of the discount to be applied to the purchase of receivables will be based on the risk associated with the selling company’s portfolio, prevailing interest rates, loss history, and other factors. The discount rate received by XXX with respect to its factoring activities will be equivalent to an arm’s length amount, as required by section 20(2) of the IFA Act;
10. XXX will be exposed to foreign currency risks during the normal course of its factoring activities as the accounts receivable owed to it by non-residents will be denominated primarily in foreign currency and XXX functional currency will be the Canadian dollar.

XXX intends to hedge against a majority of the risks through the use of forward contracts to be entered into with XXX. Forward contracts will only be used if they have an underlying corresponding position or planned transaction arising from the operating business or cash position of XXX.

The forward contracts held by XXX would not be held for the purpose of trading or speculation. The risk management policy of XXX will be to enter into rolling hedges to mitigate any foreign currency gains or losses on the portfolio of receivables held in its factoring activities.

11. XXX proposes to ensure that there is a high degree of correlation between the Canadian dollar-equivalent change in value of the portfolio of foreign currency-denominated receivables attributable to changes in foreign exchange rates and the change in value of the forward contracts entered into to mitigate the foreign currency risk. XXX intends to match the dollar value of the portfolio of receivables with the outstanding notional amount of the forward contracts outstanding at any point in time. This will be accomplished by forward contracts that will match the anticipated liquidation date of the receivables XXX. However, it may not be possible to manage the currency exchange risks on a dollar for dollar and term for term basis in every circumstance. Certain high value receivables may be hedged with a specific forward contract while the general portfolio of receivables would be hedged as a group. Each month the forward contracts would be closed out and new contracts would be entered into that match the dollar value of the portfolio of receivables which are denominated in a foreign currency. As a result of these economic hedging activities, XXX anticipates that any gains or losses on the forward contracts would substantially offset any foreign exchange fluctuations from its portfolio of receivables. Therefore, the net income from XXX factoring activities would consist primarily of the discounts earned on the factored receivables less any associated collection expenses, including hedging costs.

RULINGS REQUESTED

You have requested our rulings, with respect to the proposed transactions described above, as to whether:

1. The proposed factoring activities with non-residents of Canada satisfy the definition of “international financial business” in section 1 of the IFA Act. In particular, XXX proposed factoring activities constitute a “business” and qualify as part of an “active business” as required in the definitions of the IFA Act;
2. The proposed factoring activities satisfy the international financial activity specified in section 2(2)(o) of the IFA Act or specified at section 2(2)(t) of the IFA Act and regulation 4(9) of the International Financial Activity Regulation (“IFA Regulation”);

3. XXX factoring income will not be considered “interest revenue” for the purposes of the definition of “adjusted interest” in section 19(1) of the IFA Act; and
4. The gain or losses incurred by XXX with respect to the settlement of the foreign currency forward contracts that are directly associated with the proposed factoring activities will be considered part of IFB income, as defined in section 19(1) of the IFA Act.

ANALYSIS AND LEGISLATION

For the purposes of the IFA Act, an “international financial business” is a business carried on by a corporation through a fixed place of business in British Columbia as part of an active business of the corporation, and in respect of which the corporation carries on “international financial activities”. Income derived from international financial activities may be eligible for the tax refund under the IFA Act even if the corporation carries on non-qualifying activities. For these purposes, “active business” and “business” have the same meaning as under section 248(1) of the federal Act and “international financial activities” has the meaning as provided in section 2 of the IFA Act.

For the purposes of the federal Act, “active income” has been interpreted to include income from a non-arm’s length factoring arrangement on terms comparable to those between arm’s length parties, carried out on a regular and ongoing basis. We agree with this interpretation for purposes of applying the IFA Act.

Section 2 of the IFA Act lists the activities that qualify as international financial activities for the purposes of the Act, including, in section 2(2)(o), collecting trade accounts that are receivable from a non-resident person and have been bought outright from the seller and without recourse to the seller (commonly known as factoring).

For the purposes of section 2(2)(o) of the IFA Act, trade accounts receivable may be purchased from a resident or non-resident, on an arm’s length or non-arm’s length basis, so long as the ultimate obligation to pay the debts which have been purchased rests with the non-resident person.

Section 2(2)(t) of the IFA Act and IFA Regulation 4(9) provide that collecting trade accounts receivable from a non-resident person that is conducted exclusively for non-resident persons and from which the corporation earns fee or commission income is an international financial activity.

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 for that part of the taxation year that the corporation was a registered corporation.

For the purposes of the adjusted interest formula, contained in section 19(1) of the IFA Act, it is our view that if factoring income is treated as interest for purposes of the federal Act, it will also be characterized as interest for the purposes of section 19.

Section 20 provides that in determining IFB income, transactions between related parties and affiliated corporations must be valued at fair market value. If the transaction is not at fair market value the Commissioner may set the transaction price to reflect fair market value.

RULINGS GIVEN

Please note advance rulings are intended to enable taxpayers to decide on a particular course of action.

Provided that our understanding of the relevant facts and the proposed transactions as set out above is correct and complete and the proposed transactions are carried out as described above, our rulings are as follows:

1. The proposed factoring activities with non-residents of Canada satisfy the definition of “international financial business” in section 1 of the IFA Act. In particular, XXX proposed factoring activities constitute a “business” and qualify as part of an “active business” as required in the definitions of the IFA Act;
2. Subject to section 20 of the IFA Act, the proposed factoring activities satisfy the international financial activity specified in section 2(2)(o) of the IFA Act. Only the collection of trade accounts receivable from a non-resident person that is conducted exclusively for non-resident persons and from which the corporation earns fee or commission income will qualify as international financial activities under section 2(2)(t) of the IFA Act and IFA Regulation 4(9);
3. Only the amounts included in XXX IFB income, that are characterized as interest for the purposes of the federal Act, will be treated as interest revenue (or expense, as the case may be) for the purposes of the adjusted interest formula in section 19(1) of the IFA Act;
4. To the extent that there is a high degree of correlation between the change in value of the portfolio of receivables attributable to changes in forward exchange fluctuations that qualify under ruling number 2 above and the change in value of the forward contracts, the gain or losses incurred by XXX with respect to the settlement of those forward contracts that are included in income or loss for the purposes of Subdivision b of Division B of Part I of the federal Act will be considered part of IFB income, as defined in section 19(1) of the IFA Act.

This advance ruling ceases to be valid if the law on which it is based is subsequently changed as a result of a court decision or if the legislation on which the ruling is based is subsequently amended. The branch is not responsible for updating this advice if there are changes to the law after the date of this letter.

Yours truly,

Jeffrey S. Krasnick
A/Director
Provincial-Federal Management Issues
Income Taxation Branch