



July 4, 2005

Reference Number: IFA 2005-0006

XXX

Dear XXX:

Re: XXX

Thank you for your letter dated XXX and subsequent email dated 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. I regret the delay in responding.

FACTS

Our understanding of the relevant facts is as follows:

1. XXX is a corporation incorporated in XXX. The company’s principal office is located in XXX and the company is listed for trading on the XXX.
2. XXX is an indirect wholly-owned subsidiary of XXX.
3. XXX customers are primarily non-residents of Canada and are not affiliated with XXX.

PROPOSED TRANSACTIONS

Our understanding of the proposed transactions is as follows:

1. XXX will incorporate a new wholly-owned subsidiary (“Newco”), with nominal share capital, under the *Canada Business Corporation Act*.
2. From the time of incorporation and onward, Newco will be a taxable Canadian corporation as defined in section 89(1) of the *Income Tax Act (Canada)* (“federal Act”).

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3. XXX will borrow, through existing bank lines (or use cash on hand), sufficient funds to capitalize Newco, receiving common shares of Newco with a stated capital equal to the subscription price of the shares received. The expectation is that this amount will be approximately equal to the average accounts receivable balance from non-Canadian customers of XXX and its relevant affiliates.
4. Newco will lease office space and hire employees in order to carry out factoring activities in British Columbia.
5. Newco will have an office located in XXX, British Columbia, that will constitute a permanent establishment in British Columbia as defined in section 400(2) of the Income Tax Regulations (Canada).
6. XXX, and possibly its affiliates, will offer to sell to Newco their accounts receivable due from non-resident customers and/or non-resident related parties (the "Vendors") at terms comparable to those between arm's length parties. These purchases will be carried out on a regular and ongoing basis in the ordinary course of Newco's factoring activities. Newco will be under no obligation to purchase any accounts receivable. It is the intention of Newco and the Vendors that these transfers be a true sale of receivables from the Vendors to Newco and the Vendors and Newco do not intend the transfer to be, or for any purpose to be characterized as, a loan from Newco to the Vendors. If Newco decides to purchase any accounts receivable, it will be purchased at a predetermined discount to the face value of the accounts receivable.
7. The predetermined discount rate will be determined pursuant to a transfer pricing study that will comply with the requirements of section 247 of the federal Act and Canada Revenue Agency (CRA)'s Information Circular 87-2R and should fall within an acceptable arm's length transfer price range. Newco will have in place contemporaneous documentation which supports this arm's length discount rate.
8. Newco will assume all credit and foreign exchange risk on a non-recourse basis in respect of purchased accounts receivable and will be responsible for collections.
9. As Newco derives cashflow from the collection of trade receivables, it will use these funds to buy additional trade receivables. Newco will not derive significant interest income from the temporary investment of surplus cash.
10. The proposed factoring transactions between Newco and XXX (and its affiliates if applicable) will be legally effective and Newco will in fact assume real risks and obligations associated with the accounts receivable.

RULINGS REQUESTED

In your letter of XXX and subsequent email dated XXX you have requested our rulings with respect to the proposed transactions described above as to whether:

1. The business of Newco described in the proposed transactions will qualify as an international financial business, as defined under section 1 of the IFA Act;
2. Newco will meet the requirements to apply to register with the commissioner, as set out in section 9 of the IFA Act;
3. The factoring activity discussed in the proposed transactions will be regarded as an international financial activity as defined in section 2 of the IFA Act;
4. Transfer pricing documentation, prepared in accordance with section 247 of the federal Act will be considered consistent with the requirements of section 20 of the IFA Act;
5. Income derived from the factoring activities of Newco described in the proposed transactions will, subject to adjustment under section 20 of the IFA Act, be IFB income, as defined in subsection 19(1) of the IFA Act; and
6. IFB income from the proposed factoring activity will not be treated as interest income, for the purposes of the adjusted interest formula 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 IFA Act, including, in section 2(2)(o), collecting trade accounts that are receivable from a non-resident person and have been bought outright from a 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 9 of the IFA Act sets out the qualifications required to apply to register a corporation. The corporation must be incorporated in Canada and must not have been continued, amalgamated or transferred out of Canada. It must have a permanent establishment in British Columbia as defined in section 400 (2) of the Income Tax Regulations (Canada), and it must not be exempt from income tax under section 27 of the *Income Tax Act* (British Columbia). It is our view that incorporation under the *Canada Business Corporations Act* meets the criteria of being incorporated in Canada.

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.

It is our view that documentation required by section 247(4) of the federal Act will be accepted for the purposes of applying section 20 of the IFA Act to non-arm's length transactions between residents and non-residents of Canada where that documentation has been accepted and agreed to by the CRA.

RULINGS GIVEN

Please note that 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. Newco's proposed factoring activities with non-residents of Canada as described in the proposed transactions will qualify as an international financial business, as defined under section 1 of the IFA Act;
2. Newco will meet the requirements to apply to the commissioner for registration as set out in section 9 of the IFA Act.;
3. The factoring activities of Newco described in the proposed transactions, with respect to accounts receivable from non-resident persons that have been bought outright and without recourse, will be international financial activities as defined in section 2(2)(o) of the IFA Act;
4. Documentation required by section 247 of the federal Act will be accepted for the purposes of applying section 20 of the IFA Act to non-arm's length transactions between residents and non-residents of Canada where that documentation has been accepted and agreed to by the CRA.
5. Income derived from the factoring activities of Newco that are international financial activities for the purposes of the IFA Act, subject to section 20 of the IFA Act, will be IFB income of Newco, as defined in subsection 19(1) of the IFA Act; and
6. Only the amounts included in Newco's IFB income, that are characterized as interest for the purposes of the federal Act, will be treated as interest revenue (or interest expense, as the case may be) for the purposes of the adjusted interest formula 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.

Yours truly,

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