



November 18, 2009

Reference number: IFA 2009-0004

XXX

Dear XXX:

Re: *International Financial Activity Act*

Thank you for your letter dated XXX, requesting a technical interpretation with respect to the provisions of the *International Financial Activity Act* ("IFA Act"). The issues outlined in your letter were further discussed in our meeting of XXX.

The technical interpretation requests relate to the five hypothetical fact patterns outlined in your letter, subject to amendments arising from our phone conversation in XXX.

FACTS

The request letter sets out five separate fact patterns, labelled patterns "A" through "E". A number of facts common to all scenarios are restated below. The terms 'Parent Co' and 'IFA Co' are used generally herein in place of "A Co", "B Co", etc. and "A IFC Co", "B IFC Co", etc., respectively, which were used in the request letter for each of the five fact patterns "A" through "E". Facts unique to a particular fact pattern are then highlighted for the analysis of each separate fact pattern. Our understanding of the common facts is as follows:

1. Parent Co is resident in Canada for income tax purposes, is an active business, and has multiple non-resident affiliated corporations and branch offices.
2. In all of the fact patterns except for "C", Parent Co incorporates IFA Co in Canada as a wholly owned subsidiary to conduct the treasury and/or lending operations at issue. In fact pattern "C", Parent Co creates a division to conduct the treasury and/or lending operations at issue.
3. IFA Co (or the division in fact pattern "C") will operate exclusively from a permanent establishment in British Columbia, will be registered, and otherwise meet the requirements under the IFA Act.
4. Except where indicated, IFA Co will perform certain treasury operation services ("other treasury activities") for the non-resident affiliates, including:

Ministry of Finance

Revenue Programs Division
Income Taxation Branch

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- raising (by borrowing short or long term) and placement of capital within the group, or investing proceeds in short term investments;
 - managing bank transfers, utilization of cash and foreign exchange position;
 - conducting research, and
 - providing advice on credit risk, tax and accounting issues.
5. In each fact pattern except for “D”, IFA Co will make one long-term loan to a non-resident affiliate. In fact pattern “D”, IFA Co will make 10 long term loans to non-resident affiliates.

Fact Pattern A

In addition to the common facts above, the following facts are relevant for fact pattern A:

6. IFA Co will act as global treasury manager for the corporate group. All domestic treasury activities will be done within Parent Co.
7. IFA Co employs more than five full time employees.
8. IFA Co’s principal source of income is interest from the long term financing loan.

Fact Pattern B

In addition to the common facts above, the following facts are relevant for fact pattern B:

6. IFA Co will act as global treasury manager for the corporate group. All domestic treasury activities will be done within Parent Co.
7. IFA Co is capitalized with equity of \$10 million¹ and pays its employees in excess of \$300,000.
8. IFA Co does not employ more than five full time employees.
9. IFA Co’s principal source of income is interest from the long term financing loan.

Fact Pattern C

In addition to the common facts above, the following facts are relevant for fact pattern C:

6. Parent Co will operate exclusively from a permanent establishment in British Columbia, will be registered and otherwise meet the requirements under the IFA Act.

Fact Pattern D

In addition to the common facts above, the following facts are relevant for fact pattern D:

6. IFA Co is capitalized with equity of \$50 million and debt of \$50 million and pays its employees in excess of \$300,000.
7. IFA Co does not employ more than five employees.
8. IFA Co is involved solely in the provision of loans to its global affiliates, which includes monitoring the capital needs of the corporate group, managing foreign exchange for the 10 loans denominated in a foreign currency and handling all of the compliance requirements of a separate legal entity such as reviewing tax issues and monitoring legal, accounting and tax matters.

¹ Fact pattern B included \$5 million in debt and \$5 million in equity. It was agreed at the XXX meeting that this fact should be read as \$10 million in equity only.

9. Except as stated herein, IFA Co does not perform the other treasury activities described in 4 above.

Fact Pattern E

In addition to the common facts above, the following facts are relevant for fact pattern E:

6. IFA Co is capitalized with equity of \$100 million and pays its employees aggregate salaries of \$300,000.
7. IFA Co does not employ more than five employees. IFA Co is involved solely in the provision of loans to its global affiliates, which includes monitoring the capital needs of the corporate group, monitoring foreign exchange exposure for the loan and handling all of the compliance requirements of a separate legal entity such as reviewing tax issues and monitoring legal, accounting and tax matters.
8. Except as stated herein, IFA Co does not perform the other treasury activities described in 4 above.

LEGISLATION

For the purposes of the IFA Act, an “international financial business” 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 business²;
- 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.

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

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 Corporations federal taxable income for the year.

The IFA Act defines “business” as having the same meaning as under section 248(1) of the *Income Tax Act* (Canada) (the “federal Act”), except it excludes 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.

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 IFB 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, and
- the income or loss, if a corporation is not a securities corporation, incurred by the IFB in the taxation year due to currency fluctuations, from a prescribed foreign currency agreement which is incident to the underlying international financial activity. The prescribed foreign currency agreement must provide for the purchase, sale or exchange of foreign currency and must reasonably be considered to have been made to reduce the risk of currency fluctuations related to the underlying international financial activity.⁴

INTERPRETATION

For all fact patterns presented, you have requested our interpretation as to whether the long-term financing of affiliated non-resident corporations is a part of the international financial business carried on by the IFA Co (or division of Parent Co) at issue.

Section 2 of the IFA Act lists the activities that qualify as international financial activities, and includes, in section 2(2)(c), the making of loans in any currency to a non-resident person. While making a loan to a non-resident person qualifies as an international financial activity, it is a question of fact whether the proposed long term loan or loans to be made to non-resident affiliates will qualify as a business carried on by the IFA Co (or division of Parent Co) as required under the definition of international financial business in the IFA Act.

In fact scenarios “A” and “B” you are suggesting that the IFA Cos are carrying on one active business and each function is an international financial activity. You are suggesting that the lending activity is just one activity within an active treasury business.

⁴ This part of the definition of IFB income ensures that for a corporation that is not a securities corporation, the income or loss from an international financial activity and any related hedging transaction are treated in the same manner. In determining IFB income, any allocation method chosen to comply with the IFA Act should be reasonable in the circumstances and should substantiate the amount claimed.

In fact scenario “C” you make a number of alternative suggestions. First you suggest the treasury functions of the division are incident to or pertain to Parent Co’s active business and the lending activity would be one of those treasury functions. In the alternative you are suggesting that the making of the loan is simply part of the active business of Parent Co. In the further alternative you suggest that if these functions are not part of the active business, then the treasury functions constitute a separate business and the lending activity is part of those treasury functions. In short, you are suggesting the lending activity is part of a treasury business all of the activities of which constitute international financial activities for IFA Act purposes.

In fact scenarios “D” and “E” you suggest the companies are involved “solely” in providing loans, but you suggest there are other loan related activities being carried on that lead to the conclusion that these companies are carrying on a “business”.

It is our view that the provision of the loans at issue is simply a means of capitalizing the affiliated corporations. They are not businesses in and of themselves and they are not connected to or integral to any treasury businesses. Further, we are of the view that the making of 10 loans in the case of fact scenario “D” is still a means of capitalizing the affiliated corporations and does not constitute a separate business.

Further, we are of the view that the lending activities alone do not constitute the “carrying on” of a separate business.⁵ To be “carrying on” a business for this purpose, there must be a continuity and regularity of lending activity and multiplicity and variety of transactions⁶.

Further, the courts have held that the nature of the activities involved in the capitalizing of subsidiaries leads one to conclude that they do not constitute the carrying on of a business.

In *Charter Industries Limited v. The Queen* (75 DTC 270), the court held that the company was not in the business of lending money as it did not lend money to the general public, only to non-arm’s length parties within the corporate group. In order to constitute a business activity, the lending activities would have to reflect the normal business activities of a lending company. In the facts at issue in *Charter Industries Limited*, the function of the lending companies were to arrange the flow of funds within an affiliated group for financing purposes so as to avoid the need to borrow from outside sources. These loan activities did not reflect the normal activities of companies in the business of lending money.

In order for the loan activities at issue to constitute an “international financial business” for IFA Act purposes, there would have to be a minimum level of activity and appropriate operational characteristics to demonstrate the “carrying on” of a business. The lending

⁵ *Muttart Industries Ltd. v. MNR*, 86 DTC 1301 at 1305 (TCC).

⁶ *Smith v. Anderson* (1880), 15 Ch. D. 247 (CA) at 277-278. See also *Noak v. MNR*, 53 DTC 1212 (SCC), and *Tara Exploration and Development Co. Ltd. v. MNR*, 70 DTC 6370 (Ex. Ct.)

operations of the companies at issue, in our view, do not constitute the “carrying on” of a business for the purpose of the IFA Act.

You have suggested that the proposed lending of money by IFA Co (or division of Parent Co) to affiliated corporations may qualify on the basis that IFA Co would be in the business of making investments in order to earn business income. The earning of interest income from the loans is not determinative of whether or not the company’s lending activity constitutes the carrying on of an investment business. It is the cumulative effect of all of the facts that must be considered. As we have discussed above, we are of the view that in order to be “carrying on” any business, there must be a continuity and regularity of lending activity and multiplicity and variety of transactions. It is our view that the purpose of making the proposed loans to the affiliated corporations is not to earn business income, but to provide a means of capitalizing the related corporations. They are separate and distinct capital investment activities of IFA Co (or division of Parent Co) and do not constitute the carrying on of a business, investment or otherwise, for IFA Act purposes.⁷

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,

Jeffrey S. Krasnick, CA
Director
Income Tax Advisory and Intergovernmental Relations
Ministry of Finance

⁷*Jackson Promotions Ltd. v. MNR*, [1985] 1 CTC 2151, 85 DTC 145 at 2155, 148 (TCC).