GST Memoranda Series

17.1 Definition of "Financial Instrument"

Overview	This section explains the components of the definition of "financial instrument" as it relates to the provision of financial services under the Goods and Services Tax (GST).

Disclaimer

Note

This section of Chapter 17 supersedes GST Memorandum 700-2, *Definition of "Financial Instrument"*.

General

1. The definition of financial instrument is relevant for the definition of financial service. Financial service generally involves a transaction relating to a financial instrument or money.

Financial services

2. Supplies of financial services are exempt under Part VII of Schedule V unless they are specifically listed as zero-rated under Part IX of Schedule VI. Fees charged for services relating to financial instrument transactions are exempt where these transactions fall within the definition of financial service found in subsection 123(1). Detailed information on what constitutes a financial service will be available in Section 17.2, *Definition of "Financial Service*" of this chapter.

Definition of financial instrument
ss 123(1)

3. A financial instrument means:

(a) a debt security;

(b) an equity security;

(c) an insurance policy;

(d) an interest in a partnership or trust or any right in respect of such interest,

(e) a precious metal;

(f) an option or a contract for the future supply of a commodity, where the option or contract is traded on a recognized commodity exchange,

(g) a prescribed instrument;

(h) a guarantee, an acceptance or an indemnity in respect of anything described in paragraph (a), (b), (d), (e) or (g); or

(i) an option or a contract for the future supply of money or anything described in any of paragraphs (a) to (h).

Components of financial instrument

4. The following paragraphs explain the components of a financial instrument.

Debt security

Definition
ss 123(1)

5. Debt security means a right to be paid money and includes a deposit of money, but does not include a lease, licence or similar arrangement for the use of, or the right to use, property other than a financial instrument.

Right to be paid money

6. Financial obligations representing a right to be paid money are by definition a debt security for GST purposes. Debt security generally includes a deposit of money, debentures, unsecured notes, convertible notes, mortgages, treasury bills, bonds, etc. It also includes book debts and accounts receivable.

Late payment charges

7. A late payment charge occurs where a supplier of property or services charges the recipient (customer) an additional amount if payment for the supply is not made within the time required on the invoice. The late payment is a financial service as it relates to the operation of an overdue account.

Exclusions

8. The payment of money relating to leases, licences or similar arrangements, or the right to use property other than a financial instrument, is specifically excluded from the definition of debt security and therefore such payment is not in respect of a financial instrument. For example, the leasing of commercial property is treated as a supply of that property, and not a debt security, for GST purposes pursuant to subsection 136(1). Similarly, an automobile lease payment although partially comprised of a financing component is a taxable supply.

Equity security

Definition
ss 123(1)

9. Equity security means a share of the capital stock of a corporation or any interest in or right to such a share.

10. A share of capital stock in a corporation representing ownership or an interest in or right, claim or title to such a share is, for GST purposes, a financial instrument.

Insurance policies

Definition
ss 123(1)

11. For GST purposes, an insurance policy means:

(a) a policy or contract of insurance that is issued by an issuer, including

(i) reinsurance policies,

(ii) annuity contracts,

(iii) segregated funds contracts; and

(b) contracts relating to accident, sickness or dental insurance.

Definition of insurer
ss 123(1)

12. Insurer means a person who is licensed or otherwise authorized under the laws of Canada or a province to carry on in Canada an insurance business or under the laws of another jurisdiction to carry on in that other jurisdiction an insurance business.

13. Generally, an insurance policy is a contract whereby one person undertakes to indemnify another against loss, damage or liability arising from an unknown or contingent event, and applies only to some contingency or act which may occur only in the future. It is an agreement by which one party, for a consideration, promises to pay money or its equivalent, or to perform an act valuable to the other party upon destruction, loss, or injury of something in which the other party has an insurable interest. An insurance policy includes life, property and casualty policies issued by a person specifically licensed or authorized under the laws of Canada, a province, or another jurisdiction to carry on an insurance business. This definition includes reinsurance policies, annuity contracts, segregated fund contracts, and different types of life insurance contracts.

Exclusions - warranty contracts

14. The definition of insurance policy, however, excludes warranties in respect of the quality, fitness or performance of tangible property where the warranty is supplied to a person who acquires the property otherwise than for resale, whether or not they are provided by an insurer.

Exclusions - self insurance arrangements

15. Insurance services provided by non-licensed persons are also excluded from the definition of insurance policy except in the case of accident, sickness or dental insurance as described in paragraphs 16 and 17 of this section.

Health insurance contracts

16. Health insurance contracts, such as accident, sickness or dental insurance pertain to reimbursement for eligible medical, hospital, nursing, dental and certain other health-related expenses. These contracts cover payment for the cost of specified dental services, loss of earnings, and accidental death or dismemberment and are included in the definition of an insurance policy whether or not provided by an insurer.

Supplementary health insurance

17. Contracts or policies issued by certain organizations providing supplementary health insurance in Canada licensed under the *Prepaid Hospital and Medical Act* such as Blue Cross as well as certain corporations or associations providing accident and sickness policy benefits to their employees under self-insurance plans administered by a third party, are also included in the definition of an insurance policy.

Interest in a partnership or trust

Terms

18. A partnership is created where two or more persons enter into a relationship to carry on business for profit. A trust is a fiduciary relationship imposed by contract or by law with respect to property or money held by one person for the benefit of one or more persons. Both a partnership and a trust are treated as separate persons under the Act.

19. Any interest or any right in respect of an interest in a partnership or trust is a financial instrument. This interest or right represents a right, claim, title, or legal share of an investment in a partnership or trust and not in the underlying assets of a partnership or a trust.

Precious metals

Definition
ss 123(1)

20. Any supply of a precious metal meeting the purity requirements of a precious metal as it is defined in subsection 123(1) and in the form of a bar, ingot, coin or wafer is a financial instrument and generally exempt. Metals of this quality are normally investment-related and are usually bought and sold on international exchanges which establish world-wide precious metal prices.

21. The sale or purchase of metal, in the course of a commercial activity, not complying with the defined requirements is not regarded as a supply of a financial instrument, but as a supply of property. Generally, the following supplies are taxable at the general rate of 7% where the sale of gold, silver or platinum in bar, ingot, coin or wafer form with a purity level of less than 99.5% for gold and platinum, or less than 99.9% for silver is taxable. Also, the sale of gold, silver, or platinum at the defined purity levels, but not as a bar, ingot, coin or wafer (e.g., in granular form), is taxable.

Refiner

22. A refiner of precious metals is any person who in the regular course of business converts or refines gold, silver or platinum, regardless of the degree of purity.

23. A supply of precious metals, as defined in paragraph 20 of this section, made by the refiner thereof or by the person on whose behalf the precious metals were refined is a zero-rated financial service. Accordingly, the first sale of newly refined precious metal by the refiner or its owner is zero-rated. All subsequent supplies of a precious metal are exempt.

24. Where a refining or a manufacturing fee is charged by a refiner of precious metals to the owner of the precious metals, this fee is taxable. However, where it is standard practice for a refiner to charge a separate premium fee when selling its own precious metal that is over and above the intrinsic precious metal value of the product, this fee is considered part of the selling price and, therefore, would take on the tax status of the sale of the precious metal.

Non-precious metals

25. Carat gold, sterling silver or platinum in jewellery or chattel form are examples of metals that do not meet the purity and form requirements established under subsection 123(1) and are, therefore, not considered to be precious metals. Supplies of these goods are taxable unless otherwise zero-rated in Schedule VI or exempted under Schedule V.

Supplies to non-residents

26. Precious metals supplied by a financial institution to a non-resident person are zero-rated.

Imports

27. Precious metals are prescribed by the *Non-Taxable Imported Goods (GST) Regulations* as being non-taxable imports under section 8 of Schedule VII.

Options or contracts traded on recognized commodity exchanges

Financial instruments

28. A commodity option or commodity future contract is a financial instrument for GST purposes when traded on a recognized commodity exchange, such as the Winnipeg Commodity Exchange.

Options

29. An option for the future supply of a commodity includes a right, but not an obligation, to buy or sell a commodity at a specified price on a stipulated future date. The option buyer pays a premium to the dealer for this right, in addition to the usual commission. The supply of a commodity option where sold on a recognized future exchange is a financial service provided under paragraph (d) of the definition of financial service in subsection 123(1). However, the taxable status of the underlying commodity, if the option is exercised, is either taxable or exempt depending on the nature of the supply.

Futures contract

30. A futures contract is an agreement to buy a specific amount of a commodity at a particular price on a stipulated future date. Contrary to a commodity option, a futures contract obligates the buyer to purchase the underlying commodity and the seller to sell it, unless the contract is sold to another before the exercise date. The supply of a futures contract where sold on a recognized futures exchange is a financial service provided under paragraph (d) of the definition of financial service in subsection 123(1). However, the taxable status of the underlying commodity when the exercise date becomes due is either taxable or exempt depending on the nature of the supply.

Prescribed instruments

31. Paragraph (g) of the definition of financial instrument provides for additional categories of financial instruments. To date, no regulations have been promulgated.

Guarantees, acceptances or indemnities

Guarantee

32. A guarantee includes an undertaking by a person to pay money or perform obligations with respect to a financial instrument provided under paragraphs (a), (b), (d), (e), and (g), should the person primarily liable for the payment of a debt or obligation fail to execute that person's responsibility. For example, a guarantee bond is considered to be a financial instrument. A guarantee bond is a guarantee wherein the principal and interest may be guaranteed by a party other than the issuer. This situation may arise in parent-subsidiary relationships where bonds issued by a subsidiary are guaranteed by the parent.

Acceptance

33. An acceptance in respect of paragraphs (a), (b), (d) and (g) of the definition of financial instrument will include a formal indication by a person of its acceptance or guarantee that a financial instrument will be paid (e.g., Banker's Acceptance). An acceptance agreement is created, for example, when the drawee of a financial instrument writes "accepted" and a designated date of payment on the instrument and the drawee is responsible for payment at maturity.

Indemnity

34. An indemnity in respect of paragraphs (a), (b), (d) and (g) of the definition of financial instrument refers to a collateral contract or agreement by which one person engages to indemnify another against an anticipated loss. It is an undertaking to be liable to pay money or perform an obligation in respect of the financial instrument (e.g., indemnity bond).

35. Guarantees, acceptances or indemnities pertaining to financial instruments defined in paragraphs (a), (b), (d), (e) or (g) of the definition of financial instrument are also defined to be themselves financial instruments for GST purposes. Therefore, financial services relating to these guarantees, acceptances or indemnities will generally be exempt.

Options and contracts

Options

36. An option for the future supply of money or a financial instrument described in paragraphs (a) to (h) of the definition of financial instrument refers to a right, but not an obligation, to buy or sell money or a financial instrument at a specified price on a stipulated future date.

Contract

37. A contract for the future supply of money or a financial instrument described in paragraphs (a) to (h) of the statutory definition of financial instrument refers to an agreement to buy or sell the above at a stipulated future date. For example, a future contract to purchase or sell US dollars at a specified price on a stipulated future date is a financial instrument.