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Canadian Sales Taxes and the Digital Economy

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On-line Tax Strategies

BITCOINS AND OTHER CRYPTOCURRENCIES: FINANCIAL IMPACTS FOR GST PURPOSES

On May 17, 2019, the Finance Minister for Canada released draft legislation relating to the goods and services tax/harmonized sales tax (GST/HST) with respect to cryptocurrencies and other virtual payment instruments.

Digital currencies are based on a decentralized, peer-to-peer (P2P) network that is not supported by any government or central authority. Additionally, financial institutions generally do not manage or oversee digital currency.[1]

For Canadian tax purposes, including the GST/HST, cryptocurrencies are intangible personal property that cannot be considered as money as they are not legal tender in Canada. In fact, only bank notes issued by the Bank of Canada under the *Bank of Canada Act* and coins issued under the *Royal Canadian Mint Act* are legal tender in Canada.

CRYPTOCURRENCY EXCHANGES: A FINANCIAL SERVICE

Qualifying cryptocurrencies has a GST/HST impact since they would either be considered as transacted in the course of a commercial activity or in the course of an exempt activity.

Under the draft legislation, effective May 18, 2019, the definition of a financial instrument in the *Excise Tax Act* (ETA) is to be amended to include the concept of "virtual payment instrument". As a result, transactions involving such an instrument, whether they be the issue, processing, variation or transfer of ownership will be now considered to be financial services for GST/HST purposes.

The impact of this qualification is considerable, since the provision of financial services is generally an exempt activity that is not undertaken in the course of a commercial activity under the GST/HST system. As a result, financial service suppliers are generally not entitled to input tax credits (ITCs) for expenses incurred in the course of these activities.

FINANCIAL INSTITUTION STATUS

Even if the supply of financial services does not mean that the supplier is considered a financial institution, it should be noted that a person whose principal business is that of a broker, or negotiator of financial instruments, is considered a financial institution for GST/HST purposes.

Accordingly, a person who carries out transactions on a regular basis involving virtual payment instruments could be considered a financial institution. If this is the case, that person would be required to comply with the specific rules applicable to that sector, in particular, those relating to filing ITC returns and claims.

Moreover, certain financial services supplied by a financial institution to a non-resident person could qualify as zero-rated supplies for GST/HST purposes and give entitlement to ITCs. However, there are numerous exceptions to this rule that must be carefully analyzed as they relate to certain financial services supplied by a financial institution to non-residents.[2]

Given the specific context of virtual exchanges and market globalization, the specific rules applicable to transactions with non-residents must be analyzed in detail to determine eligibility for ITCs and the obligation to keep appropriate documentation.

WHAT IS AND IS NOT COVERED

The draft legislation defines a virtual payment instrument as "a digital representation of value that functions as a medium of exchange ... and exists only at a digital address of a publicly distributed ledger". Therefore, it essentially refers to cryptocurrencies such as bitcoins that are defined in a publicly distributed ledger such as blockchain.

The instruments in question are instruments for the general and public market. The following instruments are excluded from the definition:

[1] https://www.canada.ca/en/financial-consumer-agency/services/payment/digital-currency.html

[2] Part IX Schedule VI of Part IX of the *Excise Tax Act*.

- Property that confers an immediate or future right, that is contingent or not, to be exchanged, redeemed as or converted to money, goods or specific services;
- Property that is primarily intended for use within, or as part of, a gaming platform, an affinity or rewards program or a similar platform or program.

The proposed definitions leave room for other exceptions that could potentially be included in regulations. However, there has been no announcement that such a regulation would be implemented.

Tokens: Qualification to be Determined

In light of the proposed new definitions, your activities should be analyzed in detail to determine if tokens used as payments or transacted could be considered "virtual payment instruments" or if they are coupons, gift certificates or other incorporeal movable property for ETA purposes. This determination may have a crucial impact on the tax to be collected and eligibility for ITCs.

Barter exchange rules may also apply, which would result in tax having to be collected in connection with a commercial activity even if there is no cash stream.

PROPOSED EFFECTIVE DATE

Once the proposed measures are adopted, they are deemed to be effective as of May 18, 2019. Agents should therefore immediately analyze the impact of this new definition on the business, both in terms of GST/HST and ITCs.

Your Raymond Chabot Grant Thornton commodity tax consultant can help determine which tax measures apply to your business and can help you undertake the necessary steps to benefit from them. Please do not hesitate to contact us.

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