KPMG LLP
777 Dunsmuir Street
Vancouver BC
V7Y 1K3
Telephone (604) 691-3000
Fax ((604) 691-3031
www.kpmg.ca

Private and Confidential
Mr. Colin Hansen
President & CEO
Advantage BC
Suite 3093, Three Bentall Centre
595 Burrard Street, PO Box 49067
Vancouver, BC V7X 1C4

January 2, 2019

Dear Mr. Hansen:

AdvantageBC International Business Centre ("**Advantage BC**") has requested us to provide an analysis of the scope of certain provisions of the *International Business Activity Act* (British Columbia) (the "**IBAA**")[1] in light of the experience of some Advantage BC members ("**Members**") in dealing with audits by the British Columbia Ministry of Finance (the "**Ministry**") of Members' claims under the IBAA.

Our views expressed herein take into account the applicable provisions and judicial and administrative interpretations of the IBAA. Our views do not otherwise take into account or anticipate any changes in law or practice, by way of judicial, governmental or legislative action or interpretation. These authorities are subject to change, retroactively and/or prospectively, and any such changes could affect our views. Unless you specifically request otherwise, we will not update our advice to take any such changes into account.

In accordance with the terms of our engagement, our views expressed herein are general in nature, to assist Members in seeking more specific advice and assistance for themselves in light of their own specific circumstances; accordingly, while we address certain hypothetical cases, this memorandum is not intended to constitute tax or other

[1] SBC 2004, c.49, as amended. The name of this statute was changed to "*International Financial Activity Act*" by SBC 2010, c.18, s.35. However, to conform to common usage in the industry, we have retained the former reference. All statutory references herein are to the provisions of the IBAA unless otherwise indicated.

advice to any particular Member or other person. As such, we specifically disclaim any responsibility to any person other than Advantage BC in respect of our views expressed herein.

Executive Summary

The essence of the IBAA, in very general terms and subject to the more detailed discussion herein, is to provide a rebate or refund of some or all of BC income taxes paid in respect of international business activities undertaken in British Columbia. A key criterion for qualification for the benefits available under the IBAA is that the business in question be carried on by the member "through a fixed place of business in British Columbia".

This memorandum provides an analysis of this statutory language as may be relevant in the context of Members' dealings with the Ministry in the context of an audit or otherwise. In summary, our views are as follows.

(1) The modern tax jurisprudence, as well as the views of the Canada Revenue Agency in relation thereto, make it clear that the threshold for a taxpayer "carrying on business" in a particular jurisdiction is relatively low, and is to be determined with regard to all relevant factors. Thus, no one factor (*e.g.*, place of contract approval) is determinative of where a taxpayer is carrying on business.

(2) The structure and text of the IBAA, as well as comparable provisions of other taxing statutes, support the foregoing view, and indicate that the income of a Member from an "international financial business" is to be allocated among the different jurisdictions (specifically, British Columbia and elsewhere) in which that business is carried on.

(3) The reference to a "qualifying financial business carried on … **through** a fixed place of business in British Columbia" itself contemplates that the business in question need not be carried on **entirely** at that fixed place of business.

(4) The provisions of the IBAA (quoted below) specifically contemplate the allocation of international financial business between British Columbia and elsewhere. The relatively complex formula calculations would not have been required had the BC Legislature intended that the international financial business in issue be carried on entirely in British Columbia.

(5) Had the Legislature intended that the international financial business in issue be carried on entirely in British Columbia, it would have taken a much simpler approach to drafting the IBAA. Specifically, rather than the reference to a "qualifying financial business carried on … **through** a fixed place of business in

British Columbia", the Legislature could have referred to a "qualifying financial business carried on … **solely in** a fixed place of business in British Columbia".

(6) The notion that the international financial business in issue be required to be carried on entirely in British Columbia could produce results which would clearly be inappropriate having regard to the policy objectives of the IBAA, and indeed could rise to the absurd. In an extreme case, if such an approach were followed, then an international financial business of a Member would be disqualified from the benefit if the IBAA if its entire business were carried on in British Columbia except for the procurement of forms used in the business through an office of the Member situated in Ontario. This is clearly not the intention of the IBAA.

In light of all of the foregoing summarized above and discussed in greater detail herein, in our view an "all or nothing" approach to the IBAA which required **all** of the business to be carried on in British Columbia is not supported by the statutory language, the relevant context and the purpose of the BC Legislature in enacting the statute.

Statutory Framework

The relevant provisions of the IBAA include in particular the definition of "international financial business" ("**IFB**") and the provisions relating to the determination of the amount of the tax credit available under the IBAA, which are reproduced here in relevant part for convenience.

1 "**international financial business**" means,

(a) in relation to a corporation other than a foreign bank[2], a business

(i) that is a qualifying financial business carried on by the corporation through a fixed place of business in British Columbia, and

(ii) all the activities of which are international financial activities …

17 A corporation that was a registered corporation at any time in a taxation year may claim a tax refund for the taxation year not exceeding the amount calculated by the following formula:

tax refund = eligible proportion x net tax payable

where

[2] In accordance with your instructions, we have herein omitted any further references to provisions applicable only to foreign banks.

eligible proportion = the corporation's eligible proportion of income for the taxation year as determined under section 18 or 18.1, whichever is applicable;

net tax payable = the corporation's net tax payable for the taxation year as determined under section 19.1.[3]

18(1) Subject to subsection (2), the eligible proportion of income for a taxation year for a corporation … is the lesser of one and the proportion calculated by the following formula:

$$\textbf{eligible proportion} = \frac{\text{total adjusted IB income}}{\left\{\text{adjusted income} \times \frac{\text{BC taxable income}}{\text{federal taxable income}}\right\}}$$

where

adjusted income = the total of

(a) the corporation's income as determined under section 3 of the federal Act for the taxation year, and

(b) any amount added to the corporation's taxable income under section 110.5 of the federal Act for the taxation year,

less any amounts the corporation deducted under sections 111(1)(b), 112, 113 and 138(6) of the federal Act for the taxation year;

BC taxable income = the corporation's taxable income earned in the year in British Columbia, as defined in section 13.3 *[definitions — corporation income tax]* of the [British Columbia] *Income Tax Act*[4], for the taxation year;

federal taxable income = the corporation's taxable income, as defined in [sub]section 248(1) of the federal Act, for the taxation year;

total adjusted IB income = the corporation's total adjusted IB income for the taxation year, as determined under section 19, 19.01 or 19.02, whichever is applicable.

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[3] Section 17.1, which addresses patents, is omitted here in anticipation that the facts relating to exploitation of patents by a member will be relatively unique.

[4] *Income Tax Act* (British Columbia), RSBC 1996, c.215, as amended ("**BCITA**").

19 …

adjusted IB income = IB income – (foreign dividends + inducements)

where

IB income = …

(a) the income or loss, as determined under Subdivision b of Division B of Part I of the federal Act, of the international financial business as if the business's only income for the taxation year was from international financial activities …[5]

In accordance with your instructions, we have assumed for purposes of this memorandum that the relevant business of a particular Member satisfies the "qualifying financial business" criterion (and that all of the relevant activities satisfy the "international financial activities" criterion) referenced in the IFB definition. As such, to constitute an IFB, the remaining criterion is that the business of a Member corporation be "carried on by the corporation through a fixed place of business in British Columbia".

The IBAA provides no definition of the term "fixed place of business". As such, in our view the term should be interpreted taking into account the ordinary commercial meaning of the words and the meaning of the same or similar terms as used in statutes having similar subject matter, such as the *Income Tax Act* (Canada) (the "**Federal ITA**"). In that regard, Regulation 400(2) under the Federal ITA defines "permanent establishment" to mean (in part) a "fixed place of business"; subsection 1(1) of the IBAA then incorporates this definition of permanent establishment by reference.

While particular cases may raise complexities of interpretation, for purposes of this memorandum we anticipate that the existence of a permanent establishment in a particular case will be clear.

Overview of Possible Member Positions

We understand that, in the context of audits of Members, the Ministry may have taken positions which would deny the availability of the IBAA refund in cases in which something less than all of the Member's relevant activities take place outside British Columbia; or (b) transactions entered into by the Member are largely undertaken or arranged in British Columbia but are subject to some level of approval by persons situated outside British Columbia. In both cases, in our view the essence of the issue is whether (a) the IBAA imposes an "all or nothing" test, requiring all of a Member's

[5] The deductions of foreign dividends and inducements do not bear on this part of the analysis, and are omitted. The full text of the provision is reproduced in Appendix A.

relevant activities to be undertaken in British Columbia, or (b) the statute contemplates the possibility of a mix of activities which take place partly within and partly outside British Columbia[6], requiring a determination of the portion of the Member's income which is, for IBAA purposes, allocable to British Columbia such that the BC provincial income tax attributable to those activities and thereby entitled to relief. In this memorandum, we address possible lines of argument which might be taken by Members in response to an all or nothing approach by the Minister.

(It is also possible that the Ministry could take audit positions which would seek to reduce the amount of "total adjusted IB income" (as defined in the IBAA and discussed herein) which would be based on allocations of income as among different fixed places of business of the Member in and outside British Columbia. If the dispute were as to allocation of IB income among different fixed places of business of a particular member, a more nuanced argument would require closer consideration of particular Member facts and detailed principles of income allocation. Exploration of these nuanced arguments is beyond the scope of this memorandum.)

Construction of IBAA Provisions

In analyzing the operative provisions of the IBAA, the meaning of those provisions is to be interpreted in accordance with the following statement of the Supreme Court of Canada.

> The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.[7]

The following addresses arguments which might be formulated based upon the text, context and purpose of those provisions.

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[6] Activities which might take place within or outside British Columbia could include (for example): (i) initial contact or ongoing relationship maintenance with transaction customer/client/counterparty (collectively, a "**Counterparty**"); (ii) "back room" supporting activities (e.g., technical or computational support, market research); (iii) related business activities for/with same Counterparty.

[7] *Canada Trustco Mortgage Co v R*, 2005 SCC 54, at paragraph 10.

In our view, the fundamental generic issues to be discussed here are the following.

- What is required for an otherwise qualifying activity of a Member to be carried on "through a fixed place of business in British Columbia"?
- What principles should govern the determination of "IB income" for purposes of the IBAA?

As observed above, as the second issue will be highly factual depending upon a Member's particular circumstances, in this memorandum we will address only the first issue.

Carrying on business

It is important to first note that the threshold for "carrying on business" in a particular place is quite low – a minimal level of business activity (including administrative or supporting activity) is sufficient to constitute the carrying on of business in a particular place. Under the jurisprudence as it now stands, criteria such as physical presence, location of decision-making activities, location of entering into contracts and physical location of goods or customers may all be of relevance to this first-level determination. However, none of these criteria are *necessary* requirements to be carrying on business. In our view, therefore, a taxpayer may be considered to be carrying on an IFB in British Columbia even if the activities carried out in British Columbia are quite modest and ancillary. While some of the older jurisprudence attached comparatively mechanical rules to the determination of the location of a business, modern cases have taken a more nuanced approach to such determinations, with the place of final approval being only one factor (albeit an important one) in determining the place of completion of a contract.

For example, if a taxpayer were engaged in buying and selling widgets through transactions completed between sales staff physically situated in offices in British Columbia, maintained stocks of widgets only in British Columbia, and primarily targeted customers physically located in British Columbia, but that taxpayer had an office located in Ontario where employees undertook online market research the results of which it provided to the sales personnel located in British Columbia, and it maintained an accounting office located in Alberta where it maintained its accounting records and made modest sales to customers located in Alberta, in our view that taxpayer would likely be regarded as carrying on business in all three provinces.

The jurisprudence is very clear that a business may be carried on in more than one location (or country). For example, in *Loeck v R*, [8] a resident of Germany acquired certain real estate properties in Canada, which he subsequently disposed of for profit. Notwithstanding that the activities of the taxpayer in Canada were relatively modest, the

[8] [1982] CTC 64, 78 DTC 6368 (FCA).

Court held that the taxpayer was also carrying on business in Canada. Similar issues have been considered in a number of other cases[9].

It appears that Canada Revenue Agency ("**CRA**") takes a similar view; in CRA document #9312986 dated May 31, 1993, the criteria referenced by CRA makes clear their view that a taxpayer may be found to be carrying on business in more than one jurisdiction, and that activities carried on in a particular jurisdiction may constitute the carrying on of a business even if its activities are merely ancillary or supportive of the overall business. These factors have been considered by CRA more recently in *Income Tax Folio S5-F2-C1 – Foreign Tax Credit,* where again CRA makes it clear that in appropriate circumstances a business may be carried on in more than one jurisdiction [emphasis added].

> *1.53* While a determination of **the place where a particular business (or a part of the business) is carried on** (that is, the location of the source of the business income—see the comments starting at ¶1.48) necessarily depends upon all the relevant facts, such place is generally the place where the operations in substance, or profit generating activities, take place. For the following particular types of business, the following factors (among others) should be given consideration:
>
> • development and sale of real or immovable property—the place where the property is situated;
>
> • merchandise trading—the place where the sales are habitually completed, but other factors, such as the location of the stock, the place of payment or the place of manufacture, are considered relevant in particular situations;
>
> • transportation or shipping—the place of completion of the contract for carriage, and the places of shipment, transit and receipt;
>
> • trading in intangible property, or for civil law incorporeal property (for example, stocks and bonds)—the place where the purchase or sale decisions are normally made;
>
> • money lending—the place where the loan arrangement is in substance completed;
>
> • personal or movable property rentals—the place where the property available for rental is normally located;
>
> • real or immovable property rentals—the place where the property is situated; and

[9] See for example *Cragg v MNR*, [1952] Exch CR 40; *Tara Exploration and Development Company Limited* v *MNR*, [1970] CTC 557, 70 DTC 6370; *Masri v MNR*, [1973] CTC 448 (FCTD); *Guest v MNR*, [1985] 1 CTC 2241 (TCC).

- service—the place where the services are performed.

1.54 Other factors which are also relevant, but generally given less weight than the factors listed above include, but are not limited to:

- the place where the contract for the sale of property or the provision of services is formed or entered into;
- the place where payment is received;
- the place where assets of the business are located; and
- the intent of the taxpayer to do business in the particular jurisdiction.

1.55 In the case of a single business comprised of more than one of the above-mentioned activities, each activity is considered separately for purposes of **determining in which country or countries the business is carried on** (this situation should not be confused with the situation in which the taxpayer has separate businesses—see *Interpretation Bulletin IT-206R, Separate businesses*). If, however, one activity of a business is clearly incidental to a predominant one, the incidental activity is not considered when determining in which country or countries the business is carried on. For example, if a vendor of machinery provides customers with an engineer to supervise the installation of the machinery, this service would generally be considered to be incidental to the activity of selling the machinery; however, this type of service could in some cases be considered to be a significant activity on its own, depending on the machinery being sold, the nature of the installation service, and the terms of the contract with the customer.

1.56 **If a business is carried on in more than one country, a reasonable proportion of the net income from the business must be allocated to each country.** For this purpose, see the comments in ¶*1.80*–1.88 regarding the determination of net income from a source or sources in a particular foreign country.

…

1.83 Income from sources in a foreign country is computed under the rules given in sections 3 and 4 of the Act, subject to the additional rules contained in subparagraphs 126(1)(b)(i) or 126(2.1)(a)(i), as the case may be. **Where profits or losses arise from multiple jurisdictions they should be allocated between jurisdictions in a manner that reflects the contribution of the activities in each jurisdiction** that gave rise to those profits or losses, which may not necessarily be the way tax legislation of the foreign jurisdiction allocates the income. …

Carried on through a fixed place of business

The facts referenced above may also be relevant to determinations of (a) whether a taxpayer has a "permanent establishment" in a particular place, and (b) how much income should be allocated to such permanent establishment for purposes of the Federal ITA and various Canadian provincial taxing statutes (such as the BCITA) and, where applicable, any bilateral income tax conventions to which Canada is a party.

As noted above, to constitute an IFB, a fundamental qualitative requirement is that the business of the Member be "carried on by the corporation through a fixed place of business in British Columbia". The meaning of "fixed place of business" is relatively well-developed in the Canadian tax jurisprudence. While its application will depend upon the facts of a particular Member's situation, for purposes of the general discussion herein, we assume for purposes of this memorandum that a particular Member will have a physical presence in British Columbia, and that there will be some connection (specific to the facts) between such Member's physical presence and the asserted IFB. Further, consistent with the discussion of "carrying on business" in the preceding section, that fixed place of business may be, but need not be, the point of "physical" contact or interaction between the Member and a given Counterparty.

Textual analysis

In our view, the words "carried on … through a fixed place of business", and most significantly the word "through", are likely to be central to some of these cases. In the absence of a statutory definition of the word, a textual analysis of this word would look to its "ordinary meaning". A helpful source is the *Oxford Dictionary* (online edition), which provides (in part) the following.[10]

1. Moving in one side and out of the other side of (an opening, channel, or location)
   as preposition 'stepping boldly through the doorway'
   as adverb 'as soon as we opened the gate they came streaming through'
   …
2. Continuing in time towards completion of (a process or period)
   as preposition 'the goal came midway through the second half'
   as adverb 'to struggle through until pay day'
   2.1 So as to complete (a particular stage or trial) successfully.
   as preposition 'she had come through her sternest test'

[10] https://en.oxforddictionaries.com/definition/through, retrieved 2018-11-05.

as adverb 'I will struggle through alone rather than ask for help'

2.2 From beginning to end of (an experience or activity, typically a tedious or stressful one)

as preposition 'we sat through some very boring speeches', 'she's been through a bad time'

as adverb 'Karl will see you through, Ingrid'

…

5. *preposition* By means of (a process or intermediate stage)
'dioxins get into mothers' milk through contaminated food'

5.1 By means of (an intermediary or agent)
'seeking justice through the proper channels'

It is apparent from these textual interpretations of the word "through" that the word imports a thing (in 1 above) or event (in 2 and 5 above) which is *a part of* a sequence or series of things or events – it is *not* the entirety of the sequence or series, and it need not be either the beginning or the ending thing or event.

In the case of the IBAA, in our view the term "through" should similarly be understood to indicate that the IFB must have a BC fixed presence, but that it is not required that the entire business activity take place in British Columbia or that it either begin or end in British Columbia.

Contextual analysis

In our view, the IFB definition (and the use of the word "through" therein) must be considered in light of the provisions of the IBAA reproduced above. As discussed in greater detail below, the definition of "eligible proportion" reflects the ratio of "adjusted IB income" of a Member to "BC adjusted income" of the Member. This formula essentially answers the question "How much of that portion of the Member's worldwide income that is allocable to British Columbia is included in adjusted IB income"?[11]

While it is somewhat different in form, the computation contemplated by the "eligible proportion" definition may be read in light of alternative formulations which parallel provisions found elsewhere in Canadian taxing statutes. All of those provisions reflect a

[11] In our view, the limitation in subsection 18(1), which requires that the "eligible proportion" be "the lesser of one and" the amount computed under the formula, also reflects our understanding. But for this limitation, the computed "eligible proportion" would be greater than 1 if "total adjusted IB income" is greater than BC adjusted income. The clearest example of this arising is where the Member has positive income from an IFB but losses from other sources.

recognition that a taxpayer may carry on business in more than one location (permanent establishment or fixed place of business), and that it is therefore necessary to establish a method to allocate income among those different locations. In the case of the IBAA, this method is the computation of "eligible proportion" described below.

If it had been the intention of the BC legislature to restrict entitlement to the benefit of the IBAA only to cases where the Member carried on the IFB activity *solely* in British Columbia, the complex formula allocation rule would not have been required. Rather, if that had been the legislative intent, the IFB definition could have simply required that the Member's business had been "a qualifying financial business carried on by the corporation ***solely*** through a fixed place of business in British Columbia". As this approach was not taken, in our view a strained reading that in effect inserts that word should not stand.

Purposive analysis

It is clear that the IBAA was enacted with a view to attracting certain types of business activities to British Columbia, including activities which would generate incremental employment and other economic activity in the province. While there is no requirement of incremental employment in British Columbia, this objective is clearly supported by the IBAA provisions which provide individual tax relief to such employees. This objective is clearly satisfied as long as some portion of the otherwise qualifying business activities are undertaken in British Columbia, irrespective of whether activities undertaken in the province are at the beginning, middle or end of the chain of transactions which constitute that business. There is simply no indication in the IBAA that the incentive to economic activity is to be restricted to activities in one particular part of such a transaction chain.

Allocation of income already provided for in definitions

In our view, an analysis of the IBAA which entirely excludes from the benefit of the statute businesses which have material (or even essential) components executed outside British Columbia (such as those referred to immediately above) is contrary to the text, context and purpose of the IBAA provisions. For example, in our view a business involving international financial transactions which are largely managed by personnel situated in British Columbia must be regarded as "carried on through a fixed place of business in British Columbia" even where the transactions are subject to final approval of personnel situated outside Canada. Conversely, in our view, international financial transactions are "carried on through a fixed place of business in British Columbia" where a business relationship with a Counterparty is created and maintained by personnel situated in a fixed place of business in British Columbia even if the particular financial transactions are implemented using computing resources operated on computer hardware situated outside British Columbia.

This does not mean that the entirety of the income of the Member from these businesses would be allocable to British Columbia and entitled to the benefit of the IBAA. It is still the case that the statutory allocation rules (*i.e.*, the determination of "eligible proportion" and underlying definitions and computations noted above) apply to establish the amount which is allocated to British Columbia and entitled to the benefit of the IBAA. However, those limitations are already incorporated in the statute, and should not be overlaid by an all-or-nothing requirement founded on the "fixed place of business" provision.

Textual analysis

This branch of the analysis is very similar to that undertaken in respect of the words "though a fixed place of business" above. Specifically, there is no indication in the language of the IBAA that a given business is to be disqualified from the benefit of the statute where any particular part of that business is carried on through (or in) a fixed place of business outside British Columbia. To the contrary, the text of the statute makes it clear that the amount of refund available under the IBAA is determined by an *allocation* of IB income to British Columbia, not by a *qualitative inclusion/exclusion* of a particular business activity of a Member.

An understanding of the operation of this formula is of assistance in understanding the structure of the tax relief under the IBAA. This in turn indicates that an "all or nothing" approach is contrary to the intended scheme of the IBAA.

The relief is provided in the form of a refund rather than an exemption for structural reasons; as such, the refund is determined in section 17 by multiplying the amount of BC income tax payable by the Member (after taking into account the portion of its overall income allocable to BC and applying the BC corporate income tax rate) by the "eligible proportion". The latter number determines what portion of the Member's BC income tax is attributable (on a formula basis) to the IFB that is carried on by the Member through a fixed place of business in British Columbia.

The following describes the mechanics of computation of the credit available under the IBAA to reduce BC provincial income tax. The structure of this computation is relevant in understanding the statutory scheme underlying this credit, by which certain of our views expressed herein are supported and from which certain of our views expressed herein are derived.

- Determine the amount of the Member's "adjusted income". This is essentially the Member's worldwide taxable income (determined under the *Income Tax Act* (Canada) (the "**Federal ITA**")) excluding certain deductions for losses carried forward and dividends received.

- Compute the **proportion of the Member's worldwide taxable income**, determined under the Federal ITA, which is **attributable to British Columbia** for purposes of the Federal ITA (the "**Federal ITA BC proportion**"). In this computation, no distinction is drawn between IB income and other income. Under the applicable provisions of the Federal ITA (and essentially incorporated in the *Income Tax Act* (British Columbia) ("**BCITA**")), this allocation is by a formula which takes into account gross revenues and salaries and wages[12]

- attributable to permanent establishments of the taxpayer (i.e., the Member) in British Columbia and elsewhere. This determination appears as follows in the definition of "eligible proportion" above.

$$\frac{\text{BC taxable income}}{\text{federal taxable income}}$$

- Multiply the Member's worldwide adjusted income (from all sources) by the Federal ITA BC proportion determined above, to determine **the amount of the Member's adjusted income (from all sources) which is allocable to British Columbia** (herein, "**BC adjusted income**"). (This amount is referred to in the applicable Ministry forms as "British Columbia adjusted income"[13].) This determination appears as follows in the definition of "eligible proportion" above.

$$\left\{\text{adjusted income} \times \frac{\text{BC taxable income}}{\text{federal taxable income}}\right\}$$

- Determine the amount of the Member's "IB income" and "adjusted IB income". The amount of "IB income" is essentially **the Member's income from its IFB** as determined under the Federal ITA. The amount of "adjusted IB income" is equal to adjusted income less certain amounts not relevant to this analysis, and the Member's total adjusted IB income is simply the total of all amounts which are adjusted IB income if the member carries on more than one IFB. This amount is essentially the income of the Member derived from international financial businesses as if the Member's only income for the taxation year was from international financial activities carried on by the Member through a BC permanent establishment or fixed place of business.

[12] The basis of allocation for financial institutions is different, instead based on loans and deposits.
[13] See Ministry form FIN 578, "IBA Tax Refund of a Corporation".

- Divide the Member's total adjusted IB income by the Member's adjusted income (from all sources) which is allocable to British Columbia. The result is a ratio which should reflect the proportion which the Member's IB income allocable to BC (by virtue of being carried on through a BC fixed place of business (permanent establishment) is of the Member's income from all relevant sources which is allocable to BC under applicable federal rules. This ratio is the "eligible proportion", reflected in the formula which follows, and is intended to determine the proportion of the Member's BC provincial income tax otherwise payable which is attributable to its IFB.

$$\{\text{adjusted income} \times \frac{\text{total adjusted IB income}}{\text{BC taxable income}}\}$$
$$\{\qquad\qquad\qquad \text{federal taxable income}\ \}$$

It is important to note a subtlety inherent in this statutory analysis. As described above, the denominator in this computation represents the portion of the Member's BC provincial income tax otherwise payable which is allocable to its IFB. In order for "eligible proportion" to represent the portion of the Member's BC provincial income tax otherwise payable which is attributable to its IFB, as stated above, the numerator in the computation (being the Member's adjusted IB income) **must already be that income which is earned in (and thus reasonably allocable to) British Columbia**[14]. Thus, the IBAA contains a mechanic which requires the determination of the portion of a Member's IFB income which is earned in British Columbia.

While there are a number of adjustments, as can be seem in Appendix A and in the detailed provisions of the IBAA, "total adjusted IB income" is essentially the income or loss, as determined under Subdivision b of Division B of Part I of the Federal ITA, of the international financial business as if the business's only income for the taxation year was from international financial activities.

If these rules were intended to create an all-or-nothing test, then it would have been unnecessary to structure these computations in a manner which envisions an allocation of earnings from the IFB between British Columbia and elsewhere. Rather, if the IFB were by definition carried on solely in British Columbia, as would be the case with an all-or-

[14] It appears that the numerator "total adjusted IB income" must be only the portion of IB income allocable to the BC permanent establishment – otherwise the ratio would be comparing the Member's worldwide IB income to the Member's portion of overall income allocable to BC, which does not appear to generate a result which would be reflective of the statutory policy or purpose.

nothing approach, then the formula would not have contemplated an allocation of that income among jurisdictions.

Contextual and purposive analysis

If the intention of the BC Legislature had been to restrict the availability of the IBAA refund where some portions of the IB activities are undertaken outside British Columbia, it could have modelled the rules in the IBAA on those in Part IV of the Regulations under the federal Act. In that Regulation, the basic rule is that income of a corporation is allocated among permanent establishments based on gross revenues and salaries and wages allocable among those permanent establishments. Special rules are then provided in subsections 402(4) and following of the Regulation in particular cases where, in the view of Parliament, it is appropriate to reallocate such amounts.[15] If it had been the intention of the BC Legislature to override normal principles and reallocate IB income outside British Columbia, it would have enacted rules comparable to those override rules found in the federal Regulation.

Does any portion of activity outside BC eliminate all income from refund entitlement?

In our view, an interpretation of the IBAA that in effect eliminates any entitlement to benefits where any part of the IB activity is undertaken outside British Columbia is not supported by a textual, contextual or purposive analysis.

Textual and contextual analysis

The operative provisions of the IBAA and the computation of tax refund thereunder are discussed in detail above. As is evident, that computation requires a number of determinations in order to finally reach the amount of income which is to be entitled to the benefit of the IBAA. If the objective of the legislature had been to require the entire IFB of a member to be carried on in British Columbia, there are several simpler approaches to the statutory formulation which could have been used. For example:

- Subparagraph (a)(i) of the IFB definition could have been formulated even more explicitly as "that is a qualifying financial business carried on by the corporation *solely in* a fixed place of business in British Columbia, and".

[15] For example, paragraph 402(4)(g) of the Regulation states: "where gross revenue is derived from services rendered in the particular province or country [in which the corporation has a permanent establishment], the gross revenue shall be attributed to the permanent establishment in the province or country".

- The complex formulas could have been omitted, and the term "tax refund" could have been defined as simply "total adjusted IB income multiplied by British Columbia provincial corporate tax rate".

Purposive analysis

As already observed above, it is clear that the IBAA was enacted with a view to attracting certain types of business activities to British Columbia which would generate incremental employment and other economic activity in the province. The purpose of the IBAA was clearly to generate incremental economic activity. Such incrementalism would be less likely to occur if prospective members were placed in an "all or nothing" position, where the benefit of the statute would be unavailable unless the member were able to transfer its entire IB activity to British Columbia. In the case of a prospective Member with more extensive and integrated operations across Canada (and elsewhere), it would likely be impracticable as a business matter to establish or move IB activities into British Columbia where those activities depend upon others which must remain outside the province as a part of broader integrated business operations.

OECD positions

In the context of the OECD's "Base Erosion and Profit Shifting" ("**BEPS**") initiatives[16], work has been undertaken to address concerns as to so-called "tax avoidance" by international businesses in a number of areas, which work bears upon the principles underlying the allocation of income contemplated by IBAA.

The most interesting and potentially relevant work by the OECD in this area is that under the heading "Aligning Transfer Pricing Outcomes with Value Creation"[17]. While a discussion of the principles arising from this very extensive work is far beyond the scope of this general analysis, and its application would require detailed appreciation of a particular Member's facts, the fundamental tenet of these works is that transfer pricing should be undertaken in a manner that aligns income allocation with "value creation". In our view, these now well-accepted principles should be addressed by or incorporated in proposed assessments or determinations in the IBAA audit context. In our view, an analysis which takes into account these principles of transfer pricing is essential to the determination of total adjusted IB income for purposes of the IBAA. While the detailed application of these principles will be very sensitive to the facts and circumstances of a particular Member, in our view it is at least clear that the transfer pricing approach to

[16] See http://www.oecd.org/ctp/beps.htm (link confirmed 2018-11-06).

[17] Referred to as "Actions 8 – 10. See the various links under this Action heading at http://www.oecd.org/tax/beps/beps-actions.htm (link confirmed 2018-11-06).

allocation of income based upon situs of value creation would be equally applicable in the context of the IBAA. Again, this approach would require an allocation of income between British Columbia and elsewhere, and would reject an all-or-nothing approach.

The OECD BEPS work has also resulted in tax policy papers entitled "Addressing the Tax Challenges of the Digital Economy"[18] and "Preventing the Artificial Avoidance of Permanent Establishment Status"[19]. Both of these may have bearing upon the same determination of total adjusted IB income, depending upon the facts of a particular member's activities. However, it should be noted that these aspects of the OECD BEPS work remain "in progress", and as such will require ongoing updating.

We trust you will find the foregoing of assistance to you and your Members. Should you have any questions or require further assistance, please feel free to contact me.

Yours very truly,

Mark Meredith
Partner, KPMG Canada
Vancouver

[18] Referred to as "Action 1". See the Interim Report at http://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-interim-report-9789264293083-en.htm (link confirmed 2018-11-06).
[19] Referred to as "Action 7". See the Discussion Draft at http://www.oecd.org/tax/transfer-pricing/oecd-releases-beps-discussion-drafts-on-attribution-of-profits-to-permanent-establishments-and-transactional-profit-splits.htm (link confirmed 2018-11-06).