Message

From: Anthony Martinello [/O=EXCHANGELABS/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/CN=3FB7D76317B34780B15D96309B995C31-ANTHONY MAR]
Sent: 2017-06-19 9:28:09 AM
To: Jeannette Briggs [/o=ExchangeLabs/ou=Exchange Administrative Group (FYDIBOHF23SPDLT)/cn=Recipients/cn=148095610f7242f48a5a9da24b1a8a87-Jeannette B]
Subject: FW: Impact to IESO -

fyi

From: Susan Nicholson
Sent: June 19, 2017 8:57 AM
To: Anderson, Rhonda E
Cc: Anthony Martinello; Kim Marshall
Subject: RE: Impact to IESO -

Hi Rhonda. Thank you for the document below.

Just a quick clarification with respect to IESO revenues (I believe this will alter some of the facts below).

The IESO had revenues from core operations, smart metering and market sanctions in 2016 of $221.5 million (included in our audited financial statements). The number below of $180 million may have been just for core operations before interest and other revenue.

The revenues and expenses of the Market are $17.2 billion. These are not included in the audited financial statements of the IESO as they are considered to be the financial transactions of market participants with the IESO-administered markets. Accordingly and as previously mentioned the IESO and the Market are established with two separate HST numbers with CRA.

Thanks, Susan

From: Anderson, Rhonda E [mailto:rhondaanderson@kpmg.ca]
Sent: June 16, 2017 7:43 AM
To: Susan Nicholson
Cc: Anthony Martinello; Kim Marshall
Subject: Impact to IESO -

Hi Susan

Our understanding of the facts to date, **not having seen or reviewed any agreements,** is as follows. I've described it in layman's terms as I understand it. Please review this preliminary memo for accuracy of understanding of the facts. If there are corrections to understanding of the facts, please let me know.

Nature of Transaction

1. IESO will sell the "right to a future income stream of revenue" ("IP" and the "investment asset") to the OPG Trust. This "right" relates to the variance between the cost to produce electricity and the price it will be sold to consumers in the Province of Ontario under the Fair Hydro Plan. Under the Fair Hydro Plan, each month the LDCs will short pay the IESO because of home owners Fair Hydro rates. There will essentially be a 25% shortfall between the cost of the electricity and the price or revenue generated on the sale. This "variance" has to be balanced and paid somehow and IESO will sell

the right to this income stream to a financing entity, where it will be used as a debt security to borrow the money to cover this variance.

2. The IESO has the right to set the price or rates at which electricity will be sold – under provincial legislation (The *Electricity Act*). The IESO will sell the right to the future income stream of the differential or variance, to a financing entity (the OPG Trust) and the value of the investment asset (ie., right to the future income stream for that 25% variance in that particular month) will be used by the OPG Trust as IP collateral and a source of revenue – to cover the 25% variance.

3. IESO will borrow from OFA to pay the electricity generators their full amounts due. This is expected to be approx. $200million/month. Presumably there will be interest on this debt.

4. The right to a future income stream will be sold by IESO to the financing entity, the OPG Trust. On a monthly basis the OPG Trust will acquire an interest in the investment asset by paying $200million/month to the IESO and in turn, IESO will repay the OFA debt.

5. In addition, the OPG Trust will incur interest costs, labour and third party costs . The interest is to be paid by the IESO during the first 4-5 years. As we understand it, the IESO will borrow the money to cover the interest cost, and make a **cash advance or short term loan to the OPG Trust, so it can pay this cost**. The OPG Trust will also charge labour costs it has incurred to IESO. Third Party costs will similarly be charged to IESO. After the five year period the OPG Trust will realize revenue on the IP acquired, as a result of the charge to electricity bills sent to consumers or ratepayers via the clean energy adjustment rate. The interest, and other costs are assumed to be $1million/month. The IESO will borrow $1million from OFA to make a cash advance, or short term loan to the OPG Trust, to pay the OPG Trust's monthly interest and other costs. According to Anthony, the $1million will go into the IESO's variance FH account. The OPG Trust can purchase the $1million variance account balance each month as an asset similar to above, and the IESO will repay the OFA debt.

6. Any amounts not purchased by OPG Trust, and that remain in the IESO's variance account, will become a regulatory asset for the IESO (separate from OPG's asset). The IESO will have the ability to ask OEB to charge a separate rate (in addition to the clean energy adjustment rate above) for the IESO to be reimbursed for the IESO variance amount balances. Once funds are collected, the IESO will repay OFA debt.

7. Notwithstanding the $1m will be posted to the IESO's FH account, and be considered a "asset", at some point when purchase or payment is realized, IESO will realize interest revenue which would increase over time as this transaction will repeat itself every month for the five years period.
8. The question is would the interest income as a consequence of the above, be sufficient to cause IESO to become a de minimis financial institution under s.149(1)(c).

Findings

Nature of the Supply made by IESO (For Purposes of the Excise Tax Act, (the "ETA")

1. The investment asset IESO is selling, or the "right to the future income stream" is a supply of intangible property at law, but would be characterized as a financial service for GST/HST purposes: the sale of a "financial instrument" as that term is defined in the ETA (i.e., a debt security, or the right to be paid money), which is exempt under paragraph (d) of the definition of "financial service" in subsection 123(1) of the ETA. IESO should not charge, collect and remit any amount of GST/HST on this supply to the OPG Trust.

Having identified the supply being made by IESO as a financial instrument it is also necessary to consider what impact making such supplies could have on IESO's with regards to being a financial institution for GST/HST purposes.

IESO is not, in our view, a financial institution under section 149(1)(a) of the ETA as they do not meet any of the conditions laid out in (i) through (xi).

2. Whether the IESO would be considered a financial institution under sections 149(1)(b) of the ETA would depend on whether the IESO's total financial revenue will exceed the 10% threshold outlined in the legislation. IESO's total revenue from its commercial activities is $1.7B per year **[NTD: can we confirm – the P&L I've seen for them in previous years when we were doing the returns was more like $180M in gross revenue, and the Gross revenue on the GST111 was around $340M]**. With the current information the calculation would utilize the $12 (estimate) million per year of interest income as financial revenue and when considered in comparison to total annual revenues for IESO of $1.7 billion it would fall well below the 10% threshold and lead to the IESO not being considered a financial institution under section 149(1)(b). However, if there were any **other amounts of financial revenue that the IESO receives** this would need to be factored into the calculation as well and could result in a different determination. We are aware of the interest income IESO generates from investing on a very short-term basis (less than a month. However, provided the total is less than 10%, s.149(1)(b) will not apply.

The $200M monthly sale of the interest in the investment asses (the right to the income stream) while a financial service, will not have to be included in the calculations for purposes of paragraph 149(1)(b), since "financial revenue" is defined in that paragraph to only include **interest, dividends or "separate fees or charges from a financial service"**. The CRA has determined that the proceeds from the sale of a financial instrument like accounts receivables does not fall within the meaning of "separate fee or charge for a financial service."

3. Whether the IESO will be considered a financial institution under sections 149(1)(c) of the ETA depends on the total interest income amount the IESO will generate and whether or not it exceeds the $**1million** threshold outlined in this section of the ETA. A person is a de minimis FI under paragraph 149(1)(c) insofar as it receives $1M or more in interest income in the year from unrelated parties, subject to recent amendments regarding the exclusion of investments of a short term nature.

The facts indicate that total interest income could exceed the $1M threshold, (given the already exiting short-term investments) outlined in section 149(1)(c) <u>and as a result the IESO will be considered a de minimis financial institution for GST/HST purposes.</u> While some short-term loans are excluded from the $1M interest income threshold in paragraph 149(1)(c) as a result of amendments announced in the 2016 Federal Budget, the exclusion only applies to interest earned from deposits with banks, credit unions, trust companies and other regulated deposit-taking financial institutions – <u>the interest from the OPG Trust would not qualify for the exclusion.</u>

Impact on IESO's ITC's
Currently IESO is entitled to claim all of the GST/HST paid in respect of its costs as ITC's. While the IESO would still to be eligible to claim **all of their ITC's related to their taxable activity** (e.g., electricity market operations) they likely would have to establish an allocation methodology for shared expenses (e.g., overhead) and may have some direct expenses related to the exempt activity that would result in no ITC's being available for the tax expense specific to those direct inputs (e.g., legal fees related to the transactions with OPG Trust). Further work would be required to devise an allocation methodology that **minimizes the unrecoverable HST** incurred by the IESO – however I believe the impact on IESO's ITC's may be negligible based on the current facts. However, to the extent there would be an amount of unrecoverable HST, it would presumably have to be recovered from utilities and ratepayers The GST111 would again be required – based on the facts today. .

Qualifying as a de minimis financial institution for GST/HST purposes would also result in the IESO once again being required to file GST111 Annual Information Returns with the CRA.

Susan – I am available to meet next week if this is required or necessary.

-----Original Message-----
From: Susan Nicholson [mailto:susan.nicholson@ieso.ca]
Sent: Thursday, June 15, 2017 8:37 AM
To: Anderson, Rhonda E <rhondaanderson@kpmg.ca>
Cc: Susan Nicholson <susan.nicholson@ieso.ca>; Picard, Michel <mpicard@kpmg.ca>; Kim Marshall <Kim.Marshall@ieso.ca>
Subject: FW: DIminimis FI
Importance: High

Hi Rhonda, hope all is well there. The Fair Hydro conversations are continuing and we are meeting on Monday with OPG to get language sorted out with respect to the interest liability.

*As discussed on Monday, it would be very helpful if you could send me a "**one-pager**" that lists:*

1. ***The** definition for the di minimis rules and*
2. *how the interest components of the Fair Hydro Plan may be interrupted against those rules and lastly*
3. *the potential consequences/risks, such as loss of ITCs.*

I believe that having this information available will help ensure that the wording from the lawyers does not lead to any unintended consequences with respect to the Excise Tax Act.

Thanks, Susan.

-----Original Message-----
From: ANTHONY-HOKORORO Gail -FIN & C CTRL [mailto:gail.anthony.hokororo@opg.com]
Sent: June 14, 2017 4:35 PM
To: Susan Nicholson

Cc: SHAH Ameet -FIN & C CTRL
Subject: DIminimis FI
Importance: High

Hi Susan,

We want to get some context around the IESO's concern if you must report the interest obligation. You indicated that the IESO total market obligation is approximately $17B annually. If the annual interest obligation recorded by the IESO re the Fair Hydro Plan arrangement is >$10M annually, and the IESO becomes a di minimis FI, the IESO should still be able to claim ITCs in respect of all its other commercial activities. It will only be restricted with respect to claiming ITCs on expenses related to the Fair Hydro Plan.

The payment of the funding rebate amounts by the IESO to the OPG financing entity is not subject to HST. The unrecoverable HST (included in the funding rebates) that becomes a part of the regulatory asset cannot be claimed as ITCs by the IESO, regardless of the IESO's status as a di minimis FI or not.

Have I over looked any other expenses where the ITCs would be trapped? We would appreciate your response.

Regards,

Gail Anthony-Hokororo
Senior Manager, Taxation
Phone (416) 592-1964
Fax (416) 592-4949

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