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2023 TEI Canadian Commodity Tax Committee Liaison Meeting with Department of Finance Questions

1. 2023 Update on Proposed Expansion of Joint Venture Election in Subsection 273(1)

As the Department of Finance may be aware, TEI members have had a keen interest in the proposals to expand the prescribed activities for the joint venture election in subsection 273(1) of the *Excise Tax Act* (Canada) (ETA) since announced in the 2014 Federal Budget. Further, the 2022 addition of a new prescribed activity to the *Joint Venture (GST/HST) Regulations* has prompted other industries to seek specific activities to be prescribed.

***Question to Finance*:**

Could the Department provide a further update on the status of such amendments from its update at the 2022 TEI liaison meetings?

2. Joint Venture Election – Preliminary Activities

Given the very restrictive application by the Canada Revenue Agency ("CRA") and Revenue Québec ("RQ") of activities already provided for in the *Joint Venture (GST/HST) Regulations*, it has prompted certain industries to seek that those already prescribed be clarified. The following is an industry specific request:

Currently, paragraph 3(1)(a) of the *Joint Ventures (GST/HST) Regulations* provides that:

> 3. (1) Subject to subsection (2), for the purposes of subsection 273(1) of the Act, the following activities are prescribed activities:
>
> (a) the construction of real property, **including feasibility studies, design work, development activities and the tendering of bids,**

> **where undertaken in furtherance of a joint venture for the construction of real property**; (emphasis added)

This paragraph is interpreted by RQ (which consulted the CRA to answer the question) in a very restrictive manner, as evidenced by two recent questions answered to the liaison committees with RQ[1], namely that to summarize:

> Where the joint venture has been formed to carry out pre-construction activities of real property, such as feasibility studies, design work, development activities and the tendering of bids but does not have the mandate for the construction work of the real property, for example, it may be because these will be carried out subsequently by another joint venture, RQ and CRA are of the opinion that this joint venture is not eligible for the election, even if the preliminary activities of the joint venture (feasibility studies, design work, development activities and the tendering of bids) are all undertaken in furtherance of the construction of a real property, that is to say that the purpose of feasibility studies, design work, development activities and the tendering of bids undertaken by the joint venture all have the ultimate goal of constructing a real property.

Indeed, the response from RQ to the various questions is to the effect that participants in a joint venture cannot avail themselves of the election if they participate in a joint venture which is devoted only to preliminary activities to the construction of real property, but without being involved in the phase relating to the construction work of a real property. Thus, RQ and CRA are of the opinion that the construction work of the real property must absolutely be part of the same contract as the preliminary activities so that the election can be made, otherwise, all preliminary activities to construction, even if clearly described in subsection 3(1) of the Regulations, are not eligible.

However, participants in a joint venture who carry out both the feasibility studies/design work/ development activities/the tendering of bids of a

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[1] Comité de d'échange ICF/Revenu Québec/Ministère des finances du Québec, 2 novembre 2018, question 13 et Comité de liaison de l'Ordre des comptables professionnels agréés du Québec et Revenu Québec, 15 juin 2023, question 9. [SEE APPENDIX BELOW]

construction project and who are then involved in the construction work phase of this same project can take advantage of the election during the entire project.

The divergence in the tax treatment of these two situations presented above is irreconcilable with today's reality in terms of calls for public tenders and demonstrates the need to clarify the prescribed activities, and additionally appears to TEI to be an unfair result.

In the sector of large infrastructure projects, before moving forward with large construction costs, feasibility studies, design works and tenders must be carried out well in advance and distinctly of the start of construction work. Furthermore, currently, public bodies which award infrastructure contracts wish and even sometimes require that the preliminary services be provided by joint ventures or groups not constituting a legal entity, even requiring in certain cases joint ventures between different professional firms with different expertise. Construction work will also often take place well after the feasibility studies and design work and might not ultimately take place for various reasons, economic or otherwise.

***Question to Finance*:**

If the Department of Finance does not plan to shortly expand the election of prescribed activities to all commercial activities, as announced in 2014, could the Department of Finance comment on whether it would be willing to recommend broadening subsection 3(1) of the *Joint Ventures (GST/HST) Regulation* to include any preliminary activities to the construction of a real property or clarify the wording so that feasibility studies, design work, development activities and the tendering of bids are eligible activities when they are undertaken in furtherance of the construction of a real property even if the joint venture is not involved in the construction.

3. Joint Venture Election – Expansion for Greenhouse Gas Activities

The following is an industry specific request for expansion of the joint venture election. Currently, members of the energy industry are undertaking initiatives to meet the Government of Canada's target of net zero greenhouse gas (GHG) emissions by 2050 through collaborative arrangements such as research and development and carbon capture projects. These arrangements can take the form

of joint ventures that consist of cost-sharing agreements where all participants are engaged exclusively in commercial activities. Many of the activities carried out by these joint ventures are not listed as a prescribed activity under the *Joint Venture (GST/HST) Regulations* prescribed under subsection 273 of the ETA, including the recently proposed draft amendment to the regulations released in August 2022. Broadening the applicability of the election to all commercial activities, and in particular cost sharing arrangements, with the objective of meeting net zero GHG emission targets, would enable joint venture participants to optimize cash flow and simplify GST/HST compliance obligations.

***Question to Finance*:**

Could the Department comment on whether it would be willing to recommend the addition of activities in the GHG emission industry to be added as a prescribed activity?

4. Joint Venture Election – Inclusion of Co-venturer's Supplies

Where a joint venture qualifies to file a joint venture election under section 273 of the *Excise Tax Act* (Canada), paragraph 273(1)(c) only provides that supplies made by the operator to co-venturers (i.e., non-operators) are deemed not to be supplies. However, in certain cost sharing arrangements, co-venturers may acquire inputs on account of the joint venture, however any amounts paid by the operator to reimburse the co-venturer would be treated as consideration for a taxable supply. As a result, a co-venturer would still be required to account for GST/HST on these supplies to the operator. Although these payments are made in respect of joint venture activities, they are treated as payment for taxable supplies made to the operator outside of the scope of the election. Ideally, the purpose of an election is to ease the compliance burden for all participants, but the election in its current form only deems supplies made by the operator to not be supplies pursuant to subsection 273(1)(c), thus removing the requirement for the operator to collect GST/HST from a non-operator, but not vice versa.

***Question to Finance*:**

To simplify the GST/HST accounting and optimize cash flow for all joint venture participants, and particularly for cost sharing agreements where resources and knowledge are contributed by co-venturers, particularly under GHG emission

reduction initiatives discussed in question 3 above, would the Department consider recommending legislative amendments to subsection 273(1) to deem supplies made by a co-venturer to an operator in respect of joint venture activities not to be a supply when a valid joint venture election is in effect?

5. Licensing of Wholesalers under the Federal Excise Tax on Fuel

To become a licensed wholesaler under the Federal Excise Tax on fuel (FET), the Canada Revenue Agency has required the entity to have at least 50% of its sales exempt from the FET over the previous three months. However, there is no explicit definition of an exempt sale in Part III of the Excise Tax Act (Canada) (ETA). The CRA administratively defines exempt sales to be sales of Schedule 1 petroleum products to licensed wholesalers and sales by the entity where title transfers outside of Canada.

This interpretation made more sense when the ETA imposed a sales tax under paragraph 50(1.1)(c) of Part VI on Schedule II.1 petroleum products. However, with the introduction of the GST, the Consumption or Sales Tax levied under Part VI is not imposed on goods that were delivered after December 31, 1990, subject to the transitional provisions of section 118. This includes the sales tax levied under Schedule II.1. Conceivably, the only valid licensed wholesalers are those who were licensed prior to 1991 (with the result that there cannot be any new licensed wholesalers created after that date). This is because subsection 55(1) refers to sales exempt from the sales tax and not the excise tax under Part III. In 2023, there are no longer any sales subject to Part VI. As a result, there should be no new licensees under subsection 55(1).

Section 64 in conjunction with the *General Excise and Sales Tax Regulations* allows persons who pay excise tax to become licensed. Under subsection 23(1), the tax is payable by manufacturers and importers. This means that importers may be eligible to become licensed as a wholesaler. Even if we assume that a case can be made that section 55(1) would allow an importer to become licensed, there are no exempt sales that an unlicensed person could make.

Various subsections of section 23 refer to sales of manufacturers and licensed wholesalers on which Part III tax is not payable. Subsection 23(6) allows a licensed wholesaler to purchase Schedule 1 goods without the payment of taxes. Subsection 23(7) allows a manufacturer to purchase goods without the payment

of excise tax if they will become part of an excisable good. Subsection 23(8) allows an exemption like subsection 23(6). However, there is no provision in the legislation that allows an unlicensed person to exempt sales to the licensed entities in the section 23 exemptions. The unlicensed person would always be required to purchase products on which the excise tax has already been paid.

Conceivably, CRA's administrative provision is based on the ability of an unlicensed distributor obtaining a refund. FET paid on export sales could be refunded under section 68.1 while FET paid sales to licensed wholesalers could be refunded under section 68.2. However, there are other provisions that would allow a refund/drawback to be paid to the unlicensed distributor who purchased tax-in product.

Question to Finance:

Would the Department of Finance consider recommending an amendment to the ETA to provide a legislative basis for the licensing of wholesalers that reflect current industry practices?

6. Retroactive Legislation in Response to "Adverse" Court Decisions

Budget Implementation Act, 2023, No. 1 amended the of definition of "financial service" in subsection 123(1) of the *Excise Tax Act* (Canada) in respect of payment card clearing services. The in-force provisions effectively meant the amendments were generally effective back the introduction of GST in 1991. Additionally, the in-force provisions override the assessment limitation periods in s. 298 allowing the Canada Revenue Agency to effectively audit on this issue back to 1991 for one year from the date of Royal Assent.

The Department's position is that these amendments were merely clarifying in nature and needed to override a 2021 Federal Court of Appeal decision that was "adverse" to the Department's interpretation of the existing law.

TEI is dedicated to the development of sound tax policy, compliance with and uniform enforcement of tax laws, and minimization of administration and compliance costs to the mutual benefit of government and taxpayers. TEI is committed to fostering a tax system that works—one that is administrable and with which taxpayers can comply in a cost-efficient manner. Retroactive (and

retrospective) tax legislation can hamper these goals, and TEI is generally not supportive of retroactive or retrospective tax legislation.

However, putting aside the issues that were much debated relating to this amendment during the Parliamentary progress of Bill C-47, TEI members are very concerned about the future use of retroactive legislation to override future court decisions that the Department deems "adverse". As a result, the prospect of retroactive legislation potentially overriding a court decision will now need to be a factor that taxpayers need to weigh in their decision to litigate future GST/HST disputes.

TEI members would appreciate some direction from the Department so that they can make informed decisions on whether to litigate GST/HST issues in the future.

Questions to Finance:

(a) Could the Department of Finance provide insight into what factors it considers in whether a court decision is "adverse" to the Department's intent?

(b) Further, could the Department comment on what factors it will consider in the future for introducing retroactive GST/HST legislation?

7. Partnership Dissolutions under Income Tax Act s. 98(3)

It is common to dissolve a partnership on a tax-deferred basis under subsection 98(3) of the *Income Tax Act* (Canada) ("ITA") by transferring an undivided interest in the partnership property to the partners in proportion to their partnership interest. The tax deferral under ITA s. 98(3) applies even when the partners are not closely related entities.

When a partnership dissolution under ITA s. 98(3) is contemplated as part of a reorganization of a closely related corporate group, a disconnect with partnership provisions of the *Excise Tax Act* (Canada) ("ETA") is highlighted. Subsection 272.1(4) of the ETA deems a transfer of partnership property from a partnership to a partner to occur at fair market value. Given each partner is

receiving an undivided interest in the property, an election under ETA s. 167 is not available to mitigate the tax on the partnership dissolution.

Additionally, it would appear that any GST/HST that would be applicable under ETA s. 272.1(4) cannot be mitigated either by a 156 election nor input tax credits, creating unrecoverable tax on such a transfer. GST/HST Interpretation 11585-13D (August 11, 2000) confirms that if an amalgamation of the partners is undertaken after the partnership dissolution, the partners would not be eligible for ITCs on the ETA s. 272.1(4) transfer of the partnership property as the partners would not be receiving the property for use in their commercial activity (as ETA s. 271(c) deems property transferred on amalgamation to not be a supply).

Further, the GST/HST on such a transfer of partnership property would be not allowed to be mitigated under a 156 election as paragraph 156(2.1)(b) of the ETA excludes transfers where the recipient (i.e. partner) is not receiving the property for use exclusively in its commercial activities (since the subsequent amalgamation is not a supply of the property as above).

As a result, if a partnership dissolution occurs under ITA s. 98(3), any taxable property transferred to the partners appears to be subject to GST/HST on the fair market value of the property and such GST/HST would be unrecoverable, even if the partners were engaged exclusively in commercial activity.

Question to Finance:

Could the Department of Finance consider recommending an amendment to section 272.1 or section 156 to allow transfers of partnership property to partners that are part of a closely related group without the tax being unrecoverable – either by allowing an input tax credit or deeming the transfers to not be a supply under section 156?

8. Emission allowances issued by a Regulator

CRA published its views on the phrase "**issued or created by, or on behalf of, a government or an international organization (a "regulator") or by a body established by, or an agency of, a regulator"** from the definition of an "emission allowance" in Excise and GST/HST News No. 113.

In this document CRA stated that:

- "Generally, the CRA does not consider **instruments** (emphasis added) that are created by a person and simply validated by an employee of a regulator (or a body established by, or an agency of, a regulator) to be an emission allowance" and

- "For an instrument to meet the criterion in subparagraph (a)(i) of the definition of emission allowance, the instrument must be issued or created by, or on behalf of, a regulator or by a body established by, or an agency of, a regulator. For example, where the applicable legislation governing these instruments states that the instrument is issued or created by a designated or appointed employee (such as a director) of a regulator".

The criteria attempt to define who is creating the instrument. It appears that CRA is equating the actions that are carried out by an industry participant that qualify and allow for an instrument to be awarded with the creation of the instrument. The definition only looks to who creates the instrument and not the actions that allow for its creation. An example of this is the Part III credits under the BC low carbon fuel standard. The Part III fuel supplier does not technically have the authority to create an instrument. However, they may be awarded Part III credits if they sell fuel with a lower intensity than other fuels in the class. The fuel supplier performs the actions that earn them credits but they do not create the instrument. A fuel supplier must submit an application (i.e. request) to the Regulator for credit validation and the credit is only created once validated. Without the intervention of the Regulator, the actions carried out by a fuel supplier do not technically result in the issuance of an instrument that can be traded. Therefore, it cannot be said that the action of selling lower carbon intensity fuel results in the creation of an instrument.

We understand that the ETA requires an instrument to be created by an entity with the ability to create legislation or rules that can bind the general population or a person that is operating on behalf of the entity. This would preclude private organizations that create an environmental credit such as airline carbon offsets from "creating emission allowances". However, TEI believes that the BC credits are created by the BC government and not the Part III fuel supplier.

The issues with CRA's reliance on the governing legislation stating that the Regulator "issues" the instrument is shown by the discrepancy that results in the treatment of Alberta offset credits and BC Part III agreement credits. The instruments under both schemes are earned by a project organizer who completes activities approved by the applicable provincial Regulator. The legislation governing the Part III agreement credits states that the Regulator "issues" the credit. However, under the Alberta legislation the emissions reduction is verified by a third-party assurance provider based on standards established by Alberta and then serialized by an agency working with Alberta. The third-party assurance provider is qualified to verify emission reductions based on criteria established by Alberta. Without this verification and subsequent serialization, the credits may not be traded. However, the CRA's interpretation results in totally different outcomes in BC than Alberta for conceivably the same actions. It is our belief that the organizer's actions only earn the instrument. The instrument itself is created by the Regulator (or by a third party on behalf of a Regulator in the context of Alberta) when it is validated, issued, or serialized.

Question to Finance:

TEI has requested numerous times to work with the Department of Finance to draft legislation to correct this unintended discrepancy that impacts Alberta's offset program. While some work has been done, there has been no change and the issue continues to create confusion and commercial liability for companies that are complying with emissions legislation. Finance has been hesitant up to this point to deem Alberta offsets to be "emissions allowances" as they do not want an extended list. Please deem Alberta Offsets to be "emissions allowances" to fix the one major issue at the present time.

APPENDIX – ADDITIONAL MATERIAL FOR QUESTION 2

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