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TAX EXECUTIVES INSTITUTE, INC.

EXCISE TAX QUESTIONS

Submitted to

CANADA REVENUE AGENCY

DECEMBER 8, 2009

Tax Executives Institute, Inc. welcomes the opportunity to present the following questions on Canadian Commodity Tax issues, which will be discussed with representatives of the Canada Revenue Agency during TEI's December 8, 2009, liaison meeting. If you have any questions about the agenda, please do not hesitate to contact Sherrie Ann Pollock, TEI's Vice President for Canadian Affairs, at 416.955.7373, sherrieann.pollock@rbcdexia.com; or Diana M. Spagnuolo, Chair of TEI's Canadian Commodity Tax Committee, at 403.237.2948, diana.m.spagnuolo@esso.ca.

TECHNICAL QUESTIONS

1. FORM GST111

A. *Update.* TEI members recently submitted the Form GST111, *Financial Institution GST/HST Annual Information Schedule*. In September, several changes to the form were announced. During the liaison meeting, please provide an overview of the reasons for the changes.

B. *Misdirected Requests to File Form.* Several TEI members — who do not work for companies that qualify as financial institutions under subsection 149(1) of the Excise Tax Act (ETA) — have received letters requesting them to file the Form GST111, apparently based on the inclusion of interest and dividend income on their income tax returns. The reporting of such income from a closely related corporation, however, is not included in the calculation under paragraphs 149(1)(b) and (c), which determines whether a registrant qualifies as a financial institution. Responding to

these requests is time consuming; indeed, some members report receiving multiple inquiries or inquiries in subsequent years, even after demonstrating they were not required to file.

During the liaison meeting, we request an update on this program, including how it can be modified to avoid future requests to file the form. In the interim, CRA should suspend requesting the information.

2. STANDARDIZED ACCOUNTING

The standardized accounting initiative — under which the federal government is harmonizing various accounting, interest, and penalty provisions administered by CRA — has significantly increased the transfer of funds among taxpayer accounts. The result is a substantial administrative burden on both taxpayers and government agents as they try to unravel the trail and rationale behind the transfers.

The burden is borne by taxpayers large and small. Large taxpayers have many accounts, often maintained by different areas within a business. Small taxpayers, while perhaps not dealing with the same number of accounts, still face the burden of identifying the cause of the transfers with limited resources.

Revenu Québec has also implemented a revenue accounting system that facilitates the offsetting of overpayments of one tax against unpaid liabilities for other taxes, but the agency notifies the taxpayer of any deficiencies in filing and identifies the provision that the taxpayer has failed to comply with. This type of notification permits the taxpayer to rectify the error or explain why the proposed offset is wrong (for example, because the identified returns have in fact been filed but not yet processed).

Implementing a similar process to notify taxpayers of the contemplated transfers and the reasons for them would save considerable time for both taxpayers and the government.

A. Is CRA considering any enhancements to improve the process, including ensuring there is an audit trail to permit the tracing of the movement of funds and the reasons for that movement?

B. TEI recommends that CRA adopt the following policy:

   (i) If a large file case manager is assigned to an account, all transfers should be approved in advance by that manager, permitting the manager and taxpayer to discuss the problem and ensure that the transfer is correct.

(ii) If a large file case manager is not assigned to a taxpayer's account, a written notification should be sent to the taxpayer, explaining the transfer under consideration. The transfer would not be made until 30 days after notification.

3. EXTENSION OF LIMITATION PERIOD FOR CLAIMING ITCS: SECTION 225(4)(C)

ETA section 225(4)(c) requires the supplier to disclose in writing to the registered customer that the Minister has assessed the supplier, and the customer must pay the tax prior to claiming any input tax credit (ITC). This requirement is difficult to comply with when the taxpayer has made a voluntary disclosure because there are frequently delays in issuing assessments after a voluntary disclosure and the taxpayer may not invoice the GST to the party who should have been charged until after the assessment is issued.

A. Where there has been a prolonged delay in issuing the assessment, is CRA granting any leniency concerning when the taxpayer may issue the invoice without negatively affecting the ability of the purchaser to claim their ITCs?

B Will CRA consider proposing that the Department of Finance make any changes to this section to accommodate the current voluntary disclosure process?

C. Is CRA considering any changes to its voluntary disclosure program?

4. HARMONIZATION

TEI supports the decisions of the Provinces of Ontario and British Columbia to harmonize their provincial sales taxes (PST) with the federal goods and services tax (GST), but continues to believe that financial services should be zero-rated. During the transitional period, however, invoices issued by suppliers will likely not identify the right name of the tax to be charged, although the amount of the taxes charged under these invoices will be correct. For example, many suppliers may incorrectly invoice the five-percent GST and eight-percent Ontario PST on tangible personal property shipped after June 30, 2010, rather than charging the thirteen-percent Ontario HST. A similar issue may occur in respect of services billed before July 1, 2010, but performed after that date, which would subject them to the new harmonized tax.

Since the amount of collected taxes will remain the same, companies' accounts payable departments will likely be unable to identify that the wrong taxes were charged, though these errors may be detectable after a review of the invoices issued and taxes paid.

TEI recommends that, during a reasonable transition period (say, 6 months), CRA permit recipients who have paid the proper amount of taxes to treat the PST invoiced as the provincial component of the HST and claim an ITC in respect of that amount. The failure to permit an ITC in these circumstances would create a heavy administrative burden for taxpayers, who would first request the supplier to cancel the original invoice, obtain a new invoice with the provincial component of the HST identified, and only then claim an ITC. This process could take months and may be impossible in some cases where a supplier refuses to reissue an invoice or no longer exists. This seems a harsh result, especially since the taxpayer has not received any advantage.

5. GST Registration Process: Follow-Up

During its 2008 liaison meeting with CRA, TEI requested information on CRA's business registration services, noting that it is often easier to register a sole proprietorship for GST purposes than it is to obtain a GST number for a corporation or a trust. In response CRA said that it was "examining options for the development of a national inventory system for tracking all correspondence received in [Taxpayer Services Offices] TSOs, which should improve tracking of all correspondence being processed in TSOs."

TEI members continue to experience difficulties in having registrations completed on a timely basis. During our liaison meeting, please provide an update on this initiative.

6. Emission Credits

What is the tax treatment of the buying, selling, and trading of emission credits for GST purposes? Please confirm that payments into Alberta's Climate Change and Emissions Management Fund to purchase Fund Credits are exempt from GST.

7. Waiver of Interest and Penalties

ETA section 281.1 grants the Minister authority to waive or cancel penalty and interest payable by a person under section 280. GST Memorandum 16.3.1, *Reduction of Penalty and Interest in Wash Transaction Situations*, provides that, in a wash transaction, CRA will consider waiving or cancelling the portion of the penalty and interest in excess of four percent of the tax not properly collected by

the supplier if certain conditions are met.[1] Paragraph 11(b) of that memorandum requires that, among other conditions, the supplier must not have been previously assessed for the same mistake and must have "a satisfactory history of voluntary compliance."

What is CRA's rationale for this restriction? Because there is no revenue loss to the government in these transactions, TEI recommends that CRA apply the four-percent wash to all business-to-business (B2B) transactions. Are updates to GST Memorandum 16.3.1 contemplated in the near future?

8. DROP SHIPMENT CERTIFICATE: SALE BY NON-RESIDENT

A U.S. company not registered for GST and not resident in Canada, Company (A), sells goods to GST-registered Company (B), who subsequently sells the goods to GST-registered Company (D), and the contract provides for the goods to be shipped to Company (D)'s premises in Canada. Legal delivery of the sale by Company (A) to Company (B) occurs after GST-registered Company (C) supplies a commercial service to Company (A), and the finished goods are shipped directly from Company (C) to Company (D) in Canada. Note that Company (B) never takes physical possession of the goods.

Questions:

A. Can Company (B) issue a drop shipment certificate to Company (C), to enable Company (C) not to charge GST on the services performed for Company (A). If not, is Company (D) able to issue the referenced certificate, or is Company (A) liable to pay unrecoverable GST to Company (C)?

B. If Company (B) did issue a certificate under Section 179(2) and Company (C) accepted the certificate in good faith and doesn't charge GST on the supply of services to Company (A), does Company (C) possess the required documentation to relieve it from charging GST to Company (A)?

C. If Company (C) cannot accept a drop shipment certificate in good faith and GST applies, what option(s) does Company (A) have to recover the GST paid?

TEI Comment:

CRA has provided feedback and reference to CRA Memorandum 3.3.1; specifically paragraphs 25 and 71, and examples 6 and 11. TEI agrees:

[1] A "wash transaction" occurs when a taxable supply is made and the supplier has not remitted an amount of net tax by virtue of not having correctly charged and collected the tax from the recipient who is a registrant who would have been entitled to claim a full ITC if the tax had been correctly applied.

A. that a drop shipment cannot be issued by any registrant in the question above;

B. that a drop shipment certificate (if issued and accepted by Co. C) would not absolve Co. C of liability for tax under the ETA; and

C. that the supply of a commercial service by Co. C is a deemed 'supply' as per section 179(1); *i.e.*, GST applies on the full value of the goods being sold by Co. A to Co. B (refer to 3.3.1, example 6).

Supplemental Question:

The essence of the original question is that a commercial service was performed by Co. C. to Co. A, no drop shipment certificate could be used in the referenced four party transaction and GST applies.

CRA has provided the rationale for recovery of GST paid by Co. A by using the section 180 provision. This results in practical business issues and we are requesting confirmation that the following statements apply based on the fact pattern given above:

A. Co. C is required to charge GST to Co. A on the full value of the goods that are deemed to have been supplied, ie., GST on the selling price of the goods sold by Co.A to Co. B, inclusive of the commercial service performed by Co. C to Co A.

B. Co. A can seek reimbursement of the full GST it paid to Co. C, by invoicing Co. B. and referencing Section 180 [Section 180(b) sets forth the critical point that Co.A "has paid tax in respect of a supply of the property deemed under Section 179(1) to have been made by a registrant."].

C. Co. B is entitled to claim a full ITC for the GST amount invoiced.

9. INSURANCE PREMIUM TAX

TEI has been working with CRA on updating the administrative policy with respect to the Insurance Premium Tax. The next return is due on April 30 and the industry will require time to implement any changes. Please provide a summary of the proposed changes, including when they will be issued.

10. JOINT VENTURE ELECTION

Under the GST system, a joint venture (JV) is different from a partnership because the JV is not included in the definition of a "person" and thus cannot register and account for the GST in its own right.

ETA section 273 provides for a simplified remittance and compliance process for JVs. Under this provision, a joint election can be made by the JV participants to elect one party as the JV "operator," who accounts for the GST collected by the JV and claims the ITCs in relation to the expenses incurred by the JV.

Under the Joint Venture (GST/HST) Regulations, the JV election may generally be made for certain prescribed activities, including activities relating to the construction of real property (including feasibility studies, design work, development activities and the tendering of bids where undertaken in the furtherance of a JV for the construction of real property). In addition, CRA has administratively accepted numerous activities for the JV election, including the maintenance of roads.

One commentator provides —

> In practice, virtually any legitimate joint venture activity would be permitted by CRA, as long as there is no tax loss involved (*i.e.*, the joint venture election is not used to reduce the total GST that would be remitted to the government). Given that the alternative to the election is to have numerous individual participants account for their respective share of the GST and input tax credits separately, the CRA's tolerance in this area is almost a necessity.[2]

TEI agrees that CRA's flexibility in this area is vitally important.

A. Businesses often perform feasibility studies before major construction projects are launched. For example, some governments may require consortiums to provide such studies before moving forward with major road, bridge, and infrastructure projects. Please confirm that these studies qualify for the JV election.

B. Issues have arisen in respect of JVs that rehabilitate, repair, and maintain bridges. Under CRA's administrative guidelines, the maintenance of roads is a qualifying activity. Please confirm that the rehabilitation, repair, and maintenance of bridges also qualify.

C. ETA section 273(1)(c) provides that, where supplies are made by the JV operator to the JV, they are deemed not to be taxable supplies, provided that certain conditions are met, and thus no GST applies. On the other hand, where supplies are made to the JV by the other JV participants, GST must be collected. Please confirm that this interpretation is correct.

[2] David Sherman, *Analysis: What Is a Joint Venture?*, TAXNETPRO (Carswell, 2002-11-15).

CONCLUSION

Tax Executives Institute appreciates this opportunity to present its comments and questions for discussion. We look forward to meeting with you and discussing our views during our December 8, 2009, meeting.

TAX EXECUTIVES INSTITUTE, INC.

Respectively submitted,

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Drop Shipment Example