TAX EXECUTIVES INSTITUTE, INC.

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Ms. Michelle Lee
Executive Director, Consumer Taxation Programs Branch
Mr. Richard Purnell
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British Columbia Ministry of Finance
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Via Email: michelle.lee@gov.bc.ca and richard.purnell@gov.bc.ca

Re: Pre-Budget Submission – Provincial Sales Tax Matters

Dear Ms. Lee and Mr. Purnell:

Each year, members of Tax Executives Institute, Inc.'s ("TEI") Canadian Commodity Tax Committee (the "Committee") meet in Victoria, British Columbia ("BC") with representatives from the BC Ministry of Finance ("the Ministry") Taxation Programs and Tax Policy branches. At these meetings, Committee and Ministry representatives discuss administrative and technical issues relating to British Columbia's *Provincial Sales Tax Act* ("PSTA"), *Motor Fuel Tax Act* ("MFTA"), and *Carbon Tax Act* ("CTA"). Following the meetings, the Committee typically prepares a written submission with recommendations for proposed changes to these taxes. This year's submission focuses on BC's Provincial Sales Tax ("PST") only.

The comments and recommendations in this letter are not listed in order of importance. TEI welcomes the opportunity to meet with the Ministry to discuss these recommendations further.

About Tax Executives Institute, Inc.

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 57 chapters in Europe, North and South America, and Asia, including four chapters in Canada. As the preeminent association of in-house tax professionals worldwide, TEI has a significant

interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 individual members represent over 2,800 of the leading companies in the world. Approximately 15 percent of TEI's members are resident in Canada and many of our non-Canadian members' companies do business in Canada.

Delivery Charges

In March 2018, BC amended *PST Bulletin 302 - Delivery Charges* to provide that PST applies to delivery charges incurred at or before title to the goods passes to the purchaser. This was a significant change to the previous version of *PST Bulletin 302*, which indicated PST did not apply to delivery charges if the goods were purchased from a BC supplier and title to the goods passed at the seller's premises.

When this change was issued, the Consumer Taxation Branch ("CTB") clarified the changes were effective on April 1, 2013. The CTB claimed the retroactive application of the change was necessary because the definition of "purchase price" in section 10 of the PSTA did not support the previous version of *PST Bulletin 302*.

On March 20, 2018, the Ministry issued a Remission Regulation 48/2018 ("the Remission"). The Remission provides:

> *"Authorization is given for the remission of a penalty under section 203 (1) of the Act imposed on a collector who has not levied tax on the portion of the purchase price of tangible personal property that is a delivery charge, if (a) the sale occurred on or after April 1, 2013 and on or before March 31, 2018, and (b) under the sale, title to the tangible personal property passed, or is to pass, to the purchaser at premises of the collector that are in British Columbia."*

The Remission thus eliminated the CTB's ability to assess for non-collection of PST on delivery charges prior to April 1, 2018, essentially making the related March 2018 changes to *PST Bulletin 302* effective on that date.

Sellers with delivery vehicles are now at a competitive disadvantage when compared with common carriers. In short, 7% PST now applies to most delivery charges when goods are delivered by a vehicle owned and operated by the seller, while no PST is payable if a common carrier is used for the delivery and paid for by the customer.

The competitive disadvantage for sellers with delivery vehicles was partially corrected on July 16, 2018, when Order in Council No. 308 (the "OIC") was approved. The OIC added a new exemption to the PST Exemption and Refund Regulation (the "Regulation") for charges to deliver "aggregate," which is defined as "*quarry material and fill ordinarily used in the construction and maintenance of civil and structural projects*." The new PST exemption for aggregate is available if the purchaser has the option to pick up the aggregate, use a common carrier, or acquire delivery services from the seller of the aggregate.

TEI recommends that the Ministry further amend the Regulation to expand the exemption to include deliveries of all commercial and consumer goods. The taxing provisions in the PSTA should provide a level playing field for all businesses that own and operate delivery vehicles.

Production Machinery & Equipment Exemption

Manufacturers, mine operators, and oil and gas producers can acquire production machinery and equipment ("PM&E") on a PST-exempt basis if the PM&E is used "primarily and directly" in a manufacturing, processing, or mining activity, and such machinery or equipment is "obtained for use primarily at the qualifying part of the manufacturing site." Part 5 of the Regulation sets forth a detailed set of rules that must be met to qualify for the PM&E exemption. These rules are difficult to interpret and often result in assessments based upon differences of opinion between taxpayers and PST auditors.

A. Integrated Plant Theory

TEI recommends that the Ministry amend Part 5 of the Regulation to conform the base for the PM&E exemption to principles of the "integrated plant theory." Under the integrated plant theory, all machinery and apparatus at a manufacturing site that are integral or essential to the overall manufacturing process are deemed to be used "directly" in the manufacturing process, regardless of whether the PM&E themselves altered the form, qualities, or properties of the goods produced. This theory reflects the reality that modern manufacturing facilities operate on an integrated basis.

For example, a manufacturer may use a central compressor to control machinery and conveyor systems, and for the onsite maintenance facility. Under the current PM&E rules, one could argue the compressor is not used directly in the production process. In contrast, if the PM&E exemption followed the integrated plant theory, the compressor would clearly qualify for the exemption. Similarly, the current PM&E definition for "qualifying part" of the manufacturing site, which restricts the exemption to PM&E located on parts of the manufacturing site where certain processes are performed, could exclude PM&E that would otherwise qualify for the exemption if the PM&E rules followed the integrated plant theory.

B. Definition of "Manufacture"

TEI also recommends that the Ministry broaden the definition of "manufacture" to include processes that increase value rather than just processes that result in a substantial change in form and substance. Section 90 of the Regulation defines "manufacture" as:

> *"(a) to fabricate or manufacture tangible personal property to create a new product that is substantially different from the material or tangible personal property from which the new product was made, or*
>
> *(b) to process tangible personal property by performing a series of operations or complex operation that results in a substantial change in the form or other physical or chemical characteristics of the tangible personal property,*

but does not include performing a non-qualifying activity…."

Under the current definition of "manufacture," the PM&E exemption may not be available for a facility that further processes existing TPP, such as re-sawing and/or re-planing dimension lumber, cutting stone to make countertops and tiles, liquefying or freezing industrial gases, or final assembly of components manufactured elsewhere. These processes may not result in a finished product that is substantially different from the original material they were made from even though the value of the finished product is significantly higher than the original material.

Software as a Service and Cloud-Based Computing

As time passes, traditional services are increasingly offered via platforms designed for use on a handheld device (referred to as an "APP") or "web-based services" available over the internet using a handheld device, tablet, or personal computer. Also, taxpayers are increasingly relying on "cloud-based computing" rather than traditional computing models that rely upon computer servers and operating software located on-site.

The challenge with these modern computer processes is that many of the names and acronyms assigned to the process are jargon rather than defined words or terms with consistent meanings. In fact, if several tax or computer specialists were asked to explain the meaning of software as a service ("SaaS") or "cloud-based computing," it is very likely that more than one explanation would emerge. The continual evolution of this field makes it even more difficult to precisely define these terms.

These differing views on what constitutes SaaS, cloud-based computing, and other online services create uncertainty and risk for taxpayers who sell and/or acquire these products and services, as well as inconsistent results when PST auditors reach different conclusions on what is taxable or not taxable for PST purposes.

TEI offers the following suggestions to guide how the PST applies to these services:

A. Right to Access Software is Not a Right to Use Software

Many APPs and web-based services are nothing more than a modern way to deliver services traditionally handled using paper-based processes or in-person contact with the service provider. For example, if a financial institution provides a free APP to its customers to transfer money from one bank account to another, rather than requiring the use of a cheque or an in-person transfer request, and a transaction fee is charged for the transfer made via the APP, PST should not apply. The APP enables the customer to access the banking platform to request the transfer and the transaction fee is a bank charge; the customer does not receive a separate right to use software. A similar outcome should occur for other non-taxable services such as web-based surveys, web-based training and testing, and web-based payroll processing. A fee for these services should not be treated as a payment for the right to use software when the customer merely obtains the ability to transfer data or other information to or from the service provider.

B. PST Should Only Apply Once to Software that is Part of a Taxable Web-Based Service

In certain instances, PST is payable by the purchaser on the right to use software that is part of a web-based service. When the same software license is also used to perform a web-based service, there is no mechanism in the PSTA or the Regulation to recover a portion of the PST paid on the software now taxable through the web-based service. For example, if a payroll service provider acquires the right to use software for processing internal payroll transactions and preparing tax forms for its own staff, and the software is also used for paper-based systems available to third party customers, PST will be payable only once on the software license. However, if the same payroll service provider grants web-based access to its customers so they can directly input time entries and run reports, this access could be deemed a taxable right to use software, and PST would be applied twice to the same software license. The payroll service provider who collects PST on the taxable web-based service should be able to recover a portion of the PST paid on the initial software license.

C. Bundling Rules Should Provide More Flexibility to Purchasers of Cloud-Based Computing

The bundling rules in section 24 of the PSTA leave the purchaser at the mercy of software vendors. Cloud-based computing often includes the use of computer hardware, data storage, and software, among other things. Some or all of these items may be located outside BC and the vendor may not be registered for PST. When this occurs, the purchaser is required to self-assess PST. The bundling rules should allow the vendor, or the purchaser for self-assessment purposes, to confidently allocate the purchase price of cloud-based computing between the taxable component and the non-taxable component of bundled purchases.

Leases of Real Property Including Affixed Machinery

Under the PSTA, a lease of real property is not subject to PST. However, when "Affixed Machinery," as defined in the PSTA, is included in a real property lease, there is an obligation for the lessor to collect PST on the FMV of the Affixed Machinery unless an exemption applies.

PST Bulletin 503 – Affixed Machinery provides examples of Affixed Machinery, including: automatic teller machines built into the wall of a bank building or shopping mall, liquor/draft beer dispensers that are affixed to a cabinet, or counter in a bar. Other examples of Affixed Machinery are cranes that run on rails and materials handling apparatus permanently installed in real property.

The requirement to collect PST on Affixed Machinery is explained in *PST Bulletin 315 - Rentals and Leases of Goods*, which states:

> *"As a lessor, if you lease taxable goods and real property together for a single price, generally, you must charge PST on the fair market value of the lease for the taxable goods.*

> *For example, you lease taxable restaurant equipment together with a non-taxable commercial lease of real property. You must charge PST on the fair market value of the lease for the taxable restaurant equipment."*

For real property that is leased, PST is generally payable on building materials used to construct the improvements; PST is not payable on the lease. PST is generally payable on the lease of Affixed Machinery, so the opposite should occur – the materials and apparatus that become Affixed Machinery on installation should qualify for a PST exemption when acquired.

While an exemption is available in certain cases, it has very limited application. The exemption for the purchase of Affixed Machinery is addressed in *PST Bulletin 315*, which states:

> *"You are exempt from PST on affixed machinery you purchase or lease solely for resale or leasing to other persons. For example, you are exempt if you purchase or lease real property in which affixed machinery is already installed for the sole purpose of reselling or leasing to other persons.*
>
> *To claim these exemptions, give the supplier or service provider your PST number or, if you are not registered, a Certificate of Exemption – General (FIN 490)."*

This exemption is only available if a person (in this case, the "Lessor") acquires real property that includes Affixed Machinery for purposes of re-leasing the property. However, this exemption is further limited by subsection 142 (3) of the PSTA, which states:

> *"The exemption…does not apply to a person if the person is granting to other persons a right to use the tangible personal property under an agreement in which*
>
> *(a) the right to use the tangible personal property is not the main purpose of the agreement, and*
>
> *(b) a separate price is not specified for the right to use the tangible personal property."*

The lease of Affixed Machinery is seldom the main purpose of a real property lease; moreover, it is unlikely that a lease of real property would state a separate price for the portion attributable to Affixed Machinery. When a real property lease includes a nominal amount of Affixed Machinery for a single price, the PST exemption for the purchase of the Affixed Machinery is not available.

Further, a PST exemption is not available for the materials and apparatus where the Lessor hires a contractor to construct a building for lease, and the contractor or sub-contractor installs materials and apparatus that will become Affixed Machinery on installation. In such cases, the PST becomes a cost to the contractor or subcontractor that is included in the price payable by the Lessor, and the Lessor must then collect PST from the lessee on the FMV of the real property lease payment attributable to the Affixed Machinery.

The contractor or subcontractor who installs materials and apparatus that become Affixed Machinery on installation do not qualify for a PST exemption based on sub-paragraph (a) (viii) of the PSTA definition for "use," and paragraph (l) of the PSTA definition for "sale" as follows:

> *"[U]se…includes…the consumption, employment or utilization of tangible personal property for the purposes of fulfilling a contract for the supply and installation of affixed machinery or improvements to real property."*
>
> *"[S]ale… does not include…the provision of tangible personal property by a contractor for the purposes of fulfilling a contract under which the contractor is required to supply and affix, or install, affixed machinery or improvements to real property."*

Moreover, the PSTA does not include a provision that would allow for a refund of PST paid by the contractor or subcontractor on materials and apparatus that become Affixed Machinery on installation.

TEI recommends that the Ministry amend the exemption provisions in the PSTA and/or the Regulation or add a refund provision ensuring PST is not imposed on materials and apparatus that become Affixed Machinery on installation and are then leased as part of a real property lease.

Partnership as a Person for PST Purposes

Under the PSTA, partnerships can register as collectors for PST purposes but are not treated as separate legal persons for purposes of owning partnership property. Instead, each partner is treated as if it owns a fractional interest in all the partnership's property. This places responsibility on the partners to collect or pay PST on property utilized by the partnership when an interest in the partnership is purchased or sold. In contrast, there is no requirement to account for PST on property owned by the corporation when shares in a corporation are purchased or sold.

TEI recommends that the Ministry amend the PSTA and its regulations to treat partnerships as persons for PST purposes, including, among other things, the ability to sell/purchase a partnership interest without triggering a PST liability related to the partner's proportionate share of underlying partnership property, and the ability to use exemptions for transactions within a closely-related group. Such treatment would be consistent with the treatment of partnerships under the *Excise Tax Act* and other jurisdictions, such as Saskatchewan, Manitoba, and states in the United States of America.

Exports – Customers Shipping Property Using Their Own Conveyance

The Regulation provides a point-of-sale exemption for exported TPP but only if the TPP is shipped by the seller or common carrier to a location outside of BC.

For operational reasons, such as the physical attributes of the item being shipped, the location and capacity of available conveyances, and project requirements, a "Business" operating outside of BC may choose to ship TPP it acquired in BC using its own conveyance.

If the purchaser (in this case, the "Business") uses its own conveyance to export TPP from BC, it must pay the PST to the seller and claim a refund directly from the Ministry under section 158 of the PSTA, via a refund provision specific to TPP exported for business use. The refund process is time consuming for the Ministry and the Business, and essentially taxes exports if the Business is not aware of the refund process. BC-based retailers and wholesalers who sell TPP for export would be more competitive if fewer tax compliance burdens were imposed on the Business who exports TPP using their own conveyances.

By comparison, the *Excise Tax Act* eliminates the requirement to pay GST/HST on TPP exported using the Business' own conveyance. Section 1 of Part V of Schedule VI to the *Excise Tax Act* provides a zero-rating on the supply of TPP exported by a Business if the seller maintains "evidence" of the export of property. Such "evidence" typically includes customs clearance certificates, waybills, movements of dangerous goods tickets, carrier invoices, contracts of sale, purchase orders, and invoices. This zero-rating provision is not available for sales to purchasers that are consumers, thus limiting the zero-rating to exports for business use.

The decision regarding how to transport TPP should be based on operational and environmental concerns only; exporting property using the Business' own conveyance should not create an additional tax and/or compliance burden. TEI thus recommends that the Ministry amend the Regulation to mirror the *Excise Tax Act*'s zero-rated export provision.

Pollution Prevention and Control

Section 99 of the Regulation exempts machinery and equipment used substantially and directly in the prevention, measurement, treatment, or reduction of pollution. This exemption is only available if the pollutants are attributable to the manufacture of TPP or the extraction or processing of petroleum, natural gas, or minerals. The exemption is further limited to taxpayers that are manufacturers, oil or gas producers, or mine operators. There is no PST exemption for similar machinery and equipment acquired for use in other industries, such as transport, warehousing, retail, or farming, even though they operate under similar codes and rules intended to protect the environment. Also, no PST exemption is available for consumables used to clean up pollutants after a spill has occurred.

TEI recommends that the Ministry amend the PST exemption for pollution prevention and control equipment to make it available to all taxpayers who acquire these items for business use. TEI also recommends that the Ministry expand the PST exemption to include consumables used to clean-up after an environmental spill has occurred.

Reusable Containers – Used in Multiple Jurisdictions

Returnable recyclable packaging containers ("RRPs") including, but not limited to, pallets, reels, barrels, drums, cylinders, skids, and boxes, are used by many businesses for internal shipments and/or shipments to customers. Using RRPs makes excellent commercial and environmental sense: packaging is minimized, costs are reduced, and the product is protected from shipping damage.

RRPs are filled, loaded, and shipped locally or to other jurisdictions. The location and movement of RRPs are typically not tracked by the owner due to the substantial administrative costs. The common business practice to control RRPs is to indicate their ownership by prominently marking the business name and logo on the RRPs, allowing them to be returned to the owner.

PST is payable on the purchase or import of RRPs into BC, while packaging that is not returnable is generally exempt from PST. Further, RRPs used in multiple jurisdictions, including BC, are subject to PST.

TEI recommends that the Ministry amend the Regulation to exempt RPPs from PST, comparable to the PST relief afforded to non-reusable packaging.

Legal Services

The application of PST to legal services is based on the location of the service provider and its client. If the legal service provider and client both reside in BC, PST is payable on all legal services under subsection 126 (1) of the PSTA, regardless of the jurisdiction to which the services relate. In contrast, when a BC-based client acquires legal services from a service provider located outside of BC, the fees are taxable under subsection 127 (1) and an exemption is available for legal services that relate to a jurisdiction other than BC. A similar outcome is achieved by subsection 126 (2), whereby a non-resident of BC is only required to pay PST on legal services that relate to BC.

These rules inadvertently encourage businesses with national operations to use legal service providers located outside of BC or to use service providers outside of BC to provide legal services for matters that relate to a jurisdiction other than BC. The selection of a legal services provider should be based on their skills and experience, not on the PST status of the legal fees. Moreover, PST should not be payable on legal services acquired in BC that relate to a jurisdiction other than BC. The payment of PST on the purchase of legal services in BC for matters outside that jurisdiction can create double taxation if the jurisdiction to which the services relate also imposes sales tax on the legal services.

For example, if a business with operations in BC and Saskatchewan acquires legal services relating to Saskatchewan from a BC-based service provider, the service will be subject to tax in both BC and Saskatchewan. In contrast, an exemption is available in Saskatchewan for legal

services provided in Saskatchewan that relate to BC, resulting in tax applying only once to the service.

TEI recommends that the Ministry add a new provision to the PSTA or the Regulation to exempt PST on BC-based businesses obtaining legal services provided in BC that relate to a jurisdiction other than BC.

* * *

TEI welcomes the opportunity to meet with Ministry staff to discuss these comments and other issues relating to the administration of the PSTA, MFTA, and CTA to ensure that the system operates in a practical, effective, and efficient manner for the benefit of the Ministry and taxpayers.

TEI's comments were prepared under the aegis of TEI's Canadian Commodity Tax Committee, whose chair is Chantal Groulx and whose legal staff liaison is Pilar Mata. Should you have questions about our recommendations, please call Ms. Groulx at (514) 399-7877 or email her at chantal.groulx@cn.ca.

Respectfully submitted,

Tax Executives Institute

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