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**TAX EXECUTIVES INSTITUTE, INC.**

**LIAISON MEETING QUESTIONS**

**Submitted to**

**CANADA REVENUE AGENCY**

**and**

**THE DEPARTMENT OF FINANCE**

**DECEMBER 5- 6, 2017**

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Tax Executives Institute, Inc. ("TEI") welcomes the opportunity to present the following questions on Canadian commodity tax issues for discussion with representatives of the Canada Revenue Agency ("CRA") and the Department of Finance ("Finance") during the scheduled December 5 – 6, 2017 liaison meetings. Please contact David Card, Chair of TEI's Canadian Commodity Tax Committee, at (403) 699-1463 or David.Card@enbridge.com if you have any questions about the agenda.

## 1. Sales of Oil and Gas Resource Properties (CRA and Finance)

*Background*

When oil and gas resource properties ("Assets") are sold, there is typically a time lag between the effective date and closing date of the contract. This delay could be several months due to the complexity involved in completing transactions for active producing assets.

In general, legal title and ownership to the Assets during this interim period reside with the vendor, which continues to operate the Assets, whereas entitlement to the revenues and the responsibility for the expenses are transferred to the purchaser as of the effective date.

The sale agreement would typically stipulate that, until the closing date, the vendor will maintain the Assets in a proper and prudent manner, in accordance with generally accepted oil and gas industry practices, and in material compliance with all applicable laws.

The sale agreement would also outline the parties' reconciliation procedures during this interim period to arrive at a final adjusted purchase price for the Assets ("Adjustments"). Any resulting payment by one party to another does not constitute a taxable supply for GST/HST purposes. There is no invoice issued, but rather an accounting adjustment that simply increases or decreases the sale price, with one party issuing a settlement payment.

Furthermore, it is common practice within the oil and gas industry to treat such Adjustments (increases or decreases) as a sale price adjustment to the Petroleum and Natural Gas ("PNG") rights, the supply of which are not subject to GST/HST under section 162 of the *Excise Tax Act* ("ETA").

***Hypothetical***

Company A ("Vendor") is selling oil and gas assets located within Alberta to Company B ("Purchaser") using the typical 80%-20% purchase price allocation that assigns values between mineral rights (80%) and tangible assets (20%). The effective date of the contract is July 1, 2016 and closing date is September 1, 2016.

| | |
|---|---|
| PNG Right | $80,000,000 |
| Tangibles | $20,000,000 |
| Misc. Interest | $100 |
| Total Purchase Price | $100,000,100 |

On the closing date, 5% GST/HST will be charged to the Purchaser on the value of tangibles and miscellaneous interest.

The final statement of adjustments prepared on October 1, 2017 (for the period July 1, 2016 to September 1, 2016) is as follows:

| | | |
|---|---|---|
| **Revenues:** | | $100,000 |
| | | |
| **Expenses:** | | |
| Royalty | $20,000 | |

| | | |
|---|---|---|
| Property Taxes | $15,000 | |
| Operating Costs and Expenses | $170,000 | |
| Environmental Taxes | $5,000 | |
| Rentals – Mineral | $50,000 | |
| Rentals – Surface | $1,000 | |
| **Total Expenses** | | $ 261,000 |
| | | |
| **Due to Vendor** | | ($ 161,000) |

*Question to CRA and Finance*

A. Please confirm that the Vendor does not need to charge the Purchaser GST/HST on the total expenses of $261,000. If GST/HST is determined to apply to all or a part of the above amount, please explain why.

*Questions to CRA*

The industry's general practice is to allocate 80% of the sale price for producing resource property to the PNG rights and 20% to the tangible properties. CRA has allowed this 80-20% allocation in the past.

However, the terms of any sale agreement normally reflect the particular transaction agreed to by the parties, the circumstances surrounding the agreement, and the sale price allocation. The industry thus may deviate from this allocation if necessary to obtain a more representative allocation. For example, it might use a 90-10% or 95-5% ratio for the sale of resource properties comprised primarily of shut-in wells that have minimal tangible properties.

B. What is CRA's position on the typical 80-20% sale price allocation for resource properties?

C. What standards will CRA use to evaluate a deviation in the event the parties to a transaction determine the typical 80-20% sales price allocation is inappropriate?

D. What type of supporting documentation would CRA rely upon to determine whether a non-typical sale price allocation is appropriate?

**2. Audit Assessments Based on Auditor Requested Rulings (CRA Only)**

What is the assessment protocol when an auditor has requested a ruling from CRA's headquarters? Is it appropriate for an auditor to issue an audit proposal and/or the final audit assessment before CRA's headquarters has issued the ruling?

**3. Drop Shipments (CRA Only)**

The rules relating to drop shipment transactions recently changed. Registrants are required to create their own drop shipment certificates or pay GST/HST consultants to do so, and such certificates inadvertently may not meet all the required criteria. Would CRA consider creating a standardized drop shipment certificate(s) that reflect the new rules?

**4. Emission Allowances (CRA and Finance)**

Quebec linked its Cap and Trade program ("C&T") with California on January 1, 2014. The C&T program provides for the resale of emission allowances between parties that have registered for the C&T program and have been assigned a Compliance Instrument Tracking System Service ("CITSS") account. The CITSS account is a closed electronic inventory system, as only persons registered under the C&T system are assigned accounts.

Emission units originate at auction and are issued by the jurisdiction holding the auction (i.e., California or Quebec) and placed into the CITSS account. Offset credits that stem from emission reductions in sectors not caught by the C&T system add to the emission allowances available. Both emission units and offset credits (collectively, "Emission Allowances") may be used by a market participant to settle its obligations under the C&T system.

The rules surrounding the transfer of Emission Allowances for Quebec and California are fully harmonized. Since the Emission Allowances are only created in electronic form in the CITSS and currently only originate in either Québec or California, they are fully fungible. All transfers occur within the CITSS and the same transfer rules apply to all participants, whatever the jurisdiction.

It is our understanding that CRA and Finance consider Emission Allowances to be intangible personal property ("IPP") for purposes of the ETA. Subparagraph

142(1)(c)(i) of the ETA deems the place of supply of IPP to be in Canada where "the property may be used in whole or in part in Canada." Further, section 10.1 of Part V of Schedule VI to the ETA ("Section 10.1") zero-rates the supply of IPP to a non-resident that is not registered for GST/HST purposes ("NRNR") unless one of paragraphs (a)-(e) of Section 10.1 apply.

*Questions for CRA and Finance*

A. Please confirm Emission Allowances originating from outside of Canada are subject to GST/HST when sold between two non-residents that are both registered for GST/HST purposes.?

B. Please confirm the sale of Emission Allowances to a NRNR is considered a zero-rated supply pursuant to Section 10.1.

C. Ontario will link its C&T program with California and Quebec on January 1, 2018. Will the sale of Emission Allowances be subject to GST/ HST at 13% or will it be subject to GST/ HST based in the mailing address of the purchaser, pursuant to paragraph 8(b) in Division 2 of the New Harmonized Valued-Added Tax System Regulation, Part 1 (unless the supply is zero-rated pursuant to Section 10.1)?

D. Suppose a non-resident has a refinery in California for which it has compliance obligations under the C&T. It also has a natural gas business in Western Canada that requires it be registered for GST/HST purposes. The two distinct business units are separate divisions of the same legal entity but operate independently.

   Will the non-resident registered for GST/HST purposes in Canada for commercial activity unrelated to the refinery business in California be required to charge or pay GST/HST on the supply of Emission Allowances to another GST/HST registrant?

E. Please provide an interpretation of Section 10.1's phrase "may be used in Canada" in the context of Emission Allowances that are traded under the C&T.

F. Please advise how, in a market-based economy, the fees are going to meet the requirements of the Carbon Backstop Model.

**5. New Entity Verification Process (CRA Only)**

CRA has a new process for New Entity Verification, where CRA agents will call the director listed on a registration form to verify the new entity's information and confirm that the director is aware of the registration request.

CRA will have access to the director's information listed on the applicable business number application and will be able to associate it to other information in its database, such as the director's personal phone number. CRA could thus call a director using its home phone number by matching the SIN of the director; this is a concern for directors of large corporations.

A. Would CRA consider not calling a director on their personal home number for New Entity Verifications?

B. What is CRA's New Entity Verification policy in situations where the director's personal information is not in CRA's database, for example, if the director is a non-resident of Canada?

**6. Change to Partnership Rules (CRA and Finance)**

On September 8, 2017, Finance proposed to add subsection 272.1(8) to the ETA. The proposed subsection applies to the provision of any management or administrative service (as defined in subsection 123(1) of the ETA) to an "investment limited partnership" ("ILP") (as proposed to be defined in subsection 123(1) of the ETA, and set out below) by a "general partner" ("GP") of the ILP.

Proposed Subsection 272.1(8) would deem the provision of any management or administrative service to an ILP by a GP not to be done by the GP as a member of the ILP. It would further deem the supply of the services to have been done other than in the course of the ILP's activities. The result would be that subsection 272.1(3), rather than subsection 273(1), of the ETA would apply and the GP would be considered to make a taxable supply to the ILP.

An ILP is a limited partnership whose primary purpose is to invest funds in property consisting primarily of financial instruments that meet the criteria set out under either paragraph (a) or (b) of the proposed definition to be added to subsection 123(1) of the ETA.

The condition in paragraph (a) of the definition would be met if the limited partnership is represented or promoted as a hedge fund, ILP, mutual fund, private equity fund, venture capital fund, or other similar collective investment vehicle.

The condition in paragraph (a) would also be met if the limited partnership forms part of an arrangement or structure that is represented or promoted as a hedge fund, ILP, mutual fund, private equity fund, venture capital fund, or similar collective investment vehicle. For example, this could include limited partnerships in tiered investment fund structures such as master-feeder funds or fund-of-funds.

The condition in paragraph (b) of the proposed definition would be met if listed financial institutions (as described in paragraph 149(1)(a) of the ETA) hold interests representing at least 50% of the total value of all the interests in the limited partnership. This structure is intended to include, for example, a limited partnership that is otherwise not included in paragraph (a) of the definition that is an investment vehicle for, or a funding medium for investing on behalf of, listed financial institutions.

***Question for CRA and Finance:***

A. Please confirm that partnership distributions would be included in the broad definition of "consideration." If so, how will the distribution be allocated between the deemed consideration payable for the services and other distributions not deemed to be consideration?

***Questions for CRA only***

B. Please provide your position with respect to consideration payable prior to September 8, 2017.

C. Please confirm that the comments in the Policy Statement P-244 would still apply to situations not involving ILPs.

## 7. Partnership Versus Corporations (Finance Only)

During the November 2016 liaison meetings, TEI articulated the differences afforded to corporations and partnerships under the ETA. Finance requested

that TEI identify sections of the ETA where such treatment differs. Exhibit A is provided for your reference.

TEI acknowledges that Finance does not dictate which type of entity people choose when setting up a business structure and acknowledges that these differences must be accounted for when making such decisions. However, TEI requests that Finance consider legislation that would reduce some of the inconsistencies.

For example, where a partnership dissolves, subsection 272.1(6) of the ETA allows the partnership's GST/HST account to remain open until it is requested to be closed. This rule was presumably implemented to allow the business affairs of the partnership to wind down. Without specific provisions from Finance, we see many administrative concerns:

- Continued filing of GST/HST returns up to four years; likely nil returns, but possibly not.
- Dissolved partnerships within a large corporate structure need to remain open to claim input tax credits (ITCs) based on audits within the corporate group, including the dissolved partnership itself.
- Bank accounts may be closed; it is unclear how refunds would be cashed.

*Questions for Finance*

A. Has Finance considered allowing the managing partner elect to become the operator of the dissolved partnership, similar to the joint venture rules?

B. Alternatively, could ITCs be included into the managing partner's returns?

## 8. Pension Plan Rebates (Finance Only)

Pursuant to subsection 261.01(3) of the ETA, a pension entity must file an application for rebate within two years of the last day of a claim period. Alternatively, if the pension entity is a registrant, the rebate claim must be made within two years of the date on which the pension entity was required to have filed a return for the related claim period.

Certain participating employers are required to determine and remit GST/HST relating to deemed supplies of employer resources to pension entities as required

under section 172.1 of the ETA. In certain cases, the pension entity is eligible to claim a pension entity rebate in respect of the deemed tax paid.

Considering a registrant employer may be reassessed for the deemed taxes owing for up to four years after the latter of the actual return filing or due date, and the complexity of the legislation surrounding selected listed financial institutions including certain pension entities, it seems reasonable that a pension entity should be entitled to a four-year window to claim the pension entity rebate.

*Questions for Finance*

A. Please provide Finance's rationale for limiting a pension entity's opportunity to claim a pension rebate to two years, and address whether Finance would consider extending this limitation period to four years.

B. Please comment on why a pension entity is not able to refile or amend an incorrect pension rebate claim, similar to a GST/HST return.

**9. Waivers (CRA Only)**

CRA's Registrant Bill of Rights states the following:

> "You can expect us to provide you with complete, accurate, and timely information in plain language explaining the laws and policies that apply to your situation."
>
> "Our enquiries agents have extensive training and reference tools that let them respond quickly and accurately to your questions and provide you with the highest quality of service."
>
> "Service standards are the basis of our performance management system and represent our public commitment to the level of service you can expect from us under normal circumstances."
>
> "We set targets for achieving each service standard based on operational realities and infrastructure, available resources, historical performance, degree of complexity of the work, and Canadians' expectations."

Numerous examples have been provided to TEI indicating that when waivers have been signed by the registrants, the motivation to complete rulings or audits may wane.

*Question for CRA*

Is there a "service standard" determining how long CRA can delay finalizing an assessment when a waiver has been signed by the registrant?

**10. Company Director Updates/Access and Maintain Company Information (CRA Only)**

Due to the challenging economic climate, directors are changing companies more than in the past and are working for competitor companies. In many cases, such directors still have direct access to their previous company's CRA accounts and confidential banking information. Companies are sending their updated list of directors to CRA; however, it appears that the updates are not being input into the CRA system in a timely manner or sometimes not at all.

Registrants need an effective process to protect their financial information. TEI acknowledges that CRA's resources are limited.

*Questions for CRA*

A. Would CRA consider providing a special access to the registrant's appointed "Delegation of Authority" person, to allow that person to make the appropriate changes to directors directly in CRA's systems?

B. Does CRA have any other recommendations or solutions?

**11. Dedicated CRA Person for Large Case File Registrants (CRA Only)**

Please provide an update with respect to CRA's use of dedicated large case file managers.

**12. My Business Account Education (CRA Only)**

My Business Account ("MBA") is an excellent tool to allow a registrant to be independent from CRA for administrative purposes. CRA has been making upgrades on a regular basis to keep up with registrants' improvement requests.

However, there are still many registrants and large and small business auditors who do not use MBA efficiently because they do not know how to use all the functions.

*Questions for CRA*

A. When will CRA be providing updated training to registrants and TSO staff? We believe this training would reduce the communication burden on CRA.

B. Has CRA considered expanding MBA to allow for online filing of GST/HST elections such as the section 156 and 167 elections, among others? If so, please provide details and the expected time frame.

## 13. Update Regarding Changes to Joint Venture Election (Finance Only)

In 2014, the Federal Government announced its intention to consult with stakeholders on measures allowing more joint venture participants to make the joint venture election as part of the Federal Government's Economic Action Plan. The Federal Government confirmed its intent to proceed with previously announced tax and related measures relating to the GST/HST joint venture election in its 2015 Budget 2015.

*Question for Finance*

Please provide an update regarding when these measures will be announced and implemented.

## 14. Update Regarding Out-of-Pocket Costs Publication (CRA Only)

At previous TEI-CRA liaison meetings, CRA indicated that it would be preparing a GST/HST publication with respect to the application of GST/HST to out-of-pocket costs incurred by a supplier that are reimbursed by its customers.

*Question for CRA*

Please provide an update regarding the status of CRA's out-of-pocket costs publication.

## 15. GST111 Form – Financial Institution GST/HST Annual Information Return (Finance Only)

Under paragraph 149(1)(c) of the ETA, if the previous year income from money-lending and credit-granting exceeds $1 million per year, the person is deemed to be a financial institution.

Section 273.2 of the ETA requires financial institutions with over $1 million in revenues to file GST111 - Financial Institution GST/HST Annual Information Return.

Subsection 149(4.02) of the ETA, added in the 2016 Budget (first bill) and effective for taxation years that begin after March 21, 2016, provides that interest on a deposit of money is excluded from the calculation of interest for paragraph 149(1)(c) of the ETA if the deposit is "received or held by the other person in the usual course of its deposit-taking business" and the other person is one of the following:

(i) A bank,

(ii) A credit union,

(iii) A trust company (technically, "a corporation authorized under the laws of Canada or a province to carry on the business of offering to the public its services as a trustee"), or

(iv) A corporation authorized under the laws of Canada or a province to accept deposits from the public and that carries on the business of lending money on the security of real property or investing in indebtedness on the security of mortgages or hypothecs on real property.

Subsections 149(4.02) and (4.03) of the ETA, added by the 2016 budget (first bill) and effective for taxation years that begin after March 21, 2016, provide that the sums to be considered under paragraph 149(1)(c) exclude short term sums (364 days or less). In other words, if the payee is obligated, or may by demand become obligated, to repay the money on or before the 364th day after the day on which the deposit of money is made, these sums are excluded from the calculation of the $1 million threshold. On the other hand, subsection 149(4.03) of the ETA provides for cases where a sum may seem like a short-term sum but has, for example, a clause allowing an extension of the term, in which case these sums would still be included in the $1 million threshold.

We understand that CRA/Finance intended to eliminate the obligation to file the GST111 form for persons qualified as financial institutions under the *de minimis* rule of paragraph 149(1)(c) of the ETA if the principal activities of such person is to make taxable supplies and the reason that person qualified as a financial institution under the *de minimis* rule was due to the receipt of interest on cash flow required for their commercial activities. However, we note that large businesses may easily exceed this $1 million threshold or may have term deposits that may be extended for more than 364 days, and therefore, would still be required to file the GST111 form.

***Questions for Finance***

A. Would Finance consider increasing the $1 million threshold amount?

B. Would Finance consider eliminating the restriction provided in subsection 149(4.03) of the ETA if the principal activities of such person is to make taxable supplies and the reason it qualifies as a financial institution under the *de minimis* rule is only because the $1 million threshold has been reached or because the investment was for more than 364 days?

**16. GST111 Form – Financial Institution GST/HST Annual Information Return (CRA Only)**

TEI's members have had a variety of experiences relating to the filing of GST111 – Financial Institution GST/HST Annual Information Returns.

***Example 1:***

An entity filed the GST111 form for the last three years as required by section 273.2 of the ETA. The entity received a letter from CRA stating "We have received your GST111 Financial Institution GST/HST Annual Information Return for the reporting period from January 1, 2016 to December 31, 2016, but since the account is not registered to file a GST111 Financial Institution GST/HST Annual Information Return, we cannot process your return. If you want to register the account, please call…."

The entity called CRA and learned none of its GST111 forms from the last three years had been processed. The CRA agent requested the entity to re-send the three past years of GST111 forms if the entity wanted those returns to be processed.

*Example 2:*

Another entity that filed the GST111 forms received a call from a CRA agent to confirm CRA received its GST111 form but wanted to confirm if it would like to be coded as "financial institution;" otherwise, CRA would reject its GST111 form.

*Questions for CRA*

A. Please comment on the above examples.

B. Please indicate what entities should do to help ensure the appropriate actions are taken.

## 17. Qualifying Environmental Trusts (Finance Only)

*Background*

Provincial and territorial environmental regulations commonly impose security requirements for reclamation obligations on registrants engaged in mining and other activities to ensure sufficient financial resources are available for reclamation and remediation of lands, water, and property affected by the registrants' activities. To pay for these reclamation costs, registrants must post financial security in the forms of cash, bonds, or other forms acceptable to the province or territory. These amounts may be very large, often in the billions of dollars, and are generally due in the near future.

The *Income Tax Act* ("ITA") provides a qualifying environmental trust ("QET") regime for funding future reclamation costs of certain large-scale reclamation obligations, including for mines and pipelines.

Under the ITA, a QET is a trust maintained for the sole purpose of funding the reclamation of a qualifying site in Canada. It is an arm's length trust to which companies operating certain sites, such as mines and waste disposal sites, are required to make contributions that pre-fund site reclamation costs. However, this sole purpose use of a QET vehicle to meet requirements of provincial and territorial environmental regulators adversely affects the recovery of GST/HST paid on funding costs.

A QET is not permitted to engage in any activities outside of its funding mandate and, therefore, does not have commercial activities in its own right, as defined

within the ETA. As such, a QET is not permitted to register for GST/HST and is unable to recover any GST/HST payable on costs incurred. However, without the mandatory use of a QET, such activities related to funding for future reclamation would be considered to be in respect of the commercial activities of operating companies exclusively involved in the making of taxable supplies, and any GST/HST payable by those companies on funding costs (such as investment management fees) would be available as ITCs under subsection 169(1) of the ETA.

QETs typically incur significant taxable costs for the services of the trustee and investment management services. As a non-registrant that is not considered to be involved in commercial activities, all GST/HST payable by the QET are not recoverable in the hands of the QET but would otherwise give rise to an ITC if incurred by the contributing operating company.

*Question for Finance*

Would Finance consider amending the legislation to deem the funding activities of the QET an extension of the commercial activities engaged in by the contributor and to permit registration of the QET under subsection 240(3) of the ETA, thus allowing the QET's ITCs under subsection 169(1)?

## 18. Amended Returns (CRA Only)

*Hypothetical*

- Two closely related companies (Registrant A and Registrant B) are registered for GST/HST purposes. Registrant A claims $4,000,000 of GST/HST under a return filed on April 30, 2013 with respect to the March 2013 period.
- For reasons unrelated to the claim of ITCs included in the March 2013 return, Registrant A amends its March 2013 return on August 1, 2016.
- As a result of this amended return, CRA now has four years from August 1, 2016 to audit Registrant A's amended return based on the rules found under section 298(1) of the ETA.

- An audit of Registrant A is initiated on May 1, 2017. On September 1, 2017, the auditor issues an assessment of $100,000 relating to ITCs claimed by Registrant A on the basis the recipient was Registrant B.

- However, because the denied ITCs relate to the March 2013 period, Registrant B is unable to claim the $100,000 of ITCs denied to Registrant A in the course of an audit.

*Question for CRA*

Would CRA consider an administrative position that would allow that other closely related registrants to claim the ITC beyond the four-year ITC limitation period?

We note that such administrative easement could be limited to situations where the denied ITC resulted only because CRA had an extended period to assess due to an amended return and because the closely related company was unable to claim the ITC due to the expired four-year ITC limitation period.

This approach would be very similar to section 225(4) of the ETA, where a recipient that is invoiced by a supplier for taxes not previously charged by the supplier within the normal four-year period may still be allowed to make such claim if the supplier’s claim for unpaid taxes arises from an assessment of the supplier. Section 225(4) was enacted to ensure that a recipient charged for taxes outside the normal four-year period, as a result of CRA assessing the supplier, would be given the opportunity to claim back an ITC for the payment of such late taxes.

## 19. Agency and Elections (CRA)

*Hypothetical*

A GST/HST registered company (“Aco”) enters into an agency agreement with a non-registered, non-resident company (“Bco”), which then enters into a second agency agreement with a registrant (“Cco”) to bill on behalf of Aco; Cco would still be expected to charge taxes on behalf of Aco.

Aco is bound by the actions of the Bco under their agency agreement, which may include entering into the agreement with the Cco.

- Aco, a GST/HST registrant, retains the service of an agent (Bco) to advise Aco on how to increase sales in Canada.
- Bco is not registered for GST/HST purposes as it is a non-resident.
- Bco then enters into a billing agency with Cco to bill on behalf of Aco.
- The agency between Bco and Cco has been disclosed to Aco.
- The agency between Aco and Bco has been disclosed to Cco.
- Cco also operates a business for which it files its own GST/HST returns.
- Aco and Cco agree that the taxes collected on behalf of Aco should be remitted in Cco's monthly returns
- Aco and Cco file an election under section 177 of the ETA.
- Cco will now include the GST/HST it collects on behalf of Aco in its GST/HST return.

***Question for CRA***

Should Aco and Cco be filing an election under section 177 of the ETA even though no direct agency agreement exists between the two parties?

## 20. Section 232 - Credit Adjustments (CRA Only)

GST/HST Memorandum Series Chapter 12 provides CRA's position on refunds, adjustments, or credits set out in section 232 of the ETA.

It is common for a recipient to request an adjustment following the issuance of an invoice. A literal reading of paragraph 8 of the memorandum would suggest that such request on the part of the recipient would be an "action" that would render inapplicable the various provisions found under section 232.

It is unclear as to what type of action on the part of the recipient CRA has in mind under this Memorandum.

***Question for CRA***

Given that section 232 does not contain such a restriction, please indicate what actions by a recipient would give rise to a refusal from CRA to accept a reduction in consideration.

## 21. Section 156 Election (CRA Only)

Since January 1, 2016, a registrant is required to update its section 156 election (electronically or in writing) whenever changes are required.

Where a registrant is part of a group that includes many closely related members (e.g., 30 members) and the registrant is entitled to file such election on behalf of all members, one election form can be used by listing all parties that are subject to this election. The online form then requires the registrant to indicate all the legal names of the parties making this election.

Where additional members are to be added to the existing election, a new election must be filed containing all names of the closely related members of the group. Likewise, where one existing member of the election is to be removed, a new election containing the name of the remaining members must be filed. A new election must be filed rather than an amendment for the particular additional member.

### *Question for CRA*

Would CRA consider a process that would enable registrants to simply add or delete the name of a new closely related member?

## 22. Recharging Production Taxes (CRA Only)

### *Hypothetical #1*

Production/excise taxes are imposed on a bulk producer of goods ("Bulkco"). These taxes must be charged to the contract packager ("Packco") that renders a packaging service to Bulkco. Bulkco makes no other charge for the bulk goods delivered to Packco, as Bulkco continues to hold title to the goods during and after packaging. Packco is entitled to recover the production taxes passed onto it by claiming a refund/deduction/credit on the returns it files for these same production taxes. If Bulkco did not pass on the cost of the production taxes incurred, double payment of production taxes on the goods would result because

both Bulkco and Packco need to remit with the flow of goods. Both Bulkco and Packco are GST/HST registered and utilize only their Canadian production facilities (i.e. no international movements of goods are involved) in this operation.

*Questions for CRA*

A. Is the charge made by Bulkco to Packco for the production/excise taxes considered a supply on which GST/HST applies?

*Hypothetical #2*

Packco incurs production taxes on the bulk goods packaged for Bulkco. In accordance with the terms of the written agreement between Bulkco and Packco for packaging services, Bulkco is required to pay Packco a fee for each unit of Bulkco's goods packaged. Under the services agreement, Bulkco is also liable to pay or reimburse Packco for any production taxes imposed on Packco arising from its packaging of Bulkco's goods. Note, Bulkco is not entitled to recover these production taxes.

*Question for CRA*

B. Is the separate charge made by Packco to Bulkco in respect of the production taxes incurred, regarded as part of the consideration payable by Bulkco for the packaging service being provided by Packco and as such, subject to GST/HST?

## 23. Draft GST/ HST Technical Information Bulletin B-103, Harmonized Sales Tax – Place of Supply Rules for Determining Whether a Supply is Made in a Province (CRA only)

Please provide an update regarding the status of the final version of Draft GST/ HST Technical Information Bulletin B-103, Harmonized Sales Tax – Place of Supply Rules for Determining Whether a Supply is Made in a Province.

## 24. Pre-Payment for Potential GST/HST Assessment (CRA Only)

*Hypothetical*

- Following a GST/HST audit for the years from 2014 to 2016, a registrant is assessed for GST/HST over claimed;
- Most of the errors were due to incorrect manual input when processing payable invoices and sales invoices (e.g. incorrect selection of expense codes, jurisdictions, etc.);
- To minimize potential interest and penalties applicable on the next audit assessment for the future years, the registrant wants to make a "payment" for the potential GST/HST over-claimed during 2017;
- The registrant estimates GST/HST over-claimed during 2017 based on the yearly average amount assessed (i.e., the estimate is not related to specific transactions).

*Questions for CRA*

A. Can the registrant make an adjustment on its GST/HST return for the month of December 2017, by reducing its ITC?

B. If yes, could the "payment" also be used to reduce a future GST/HST assessment for GST/HST not collected?

C. Is there another way for the registrant to make a "payment" for the year 2017?

**25. Collection and Enforcement Activities (CRA Only)**

A TEI member was recently informed by a CRA agent that it is not possible for CRA to release amounts that were automatically set-off – for example, reducing a GST/HST or FET refund to pay an income tax assessment, even if the assessment is under appeal and the taxpayer paid 50% of the tax assessed under section 225.1(7) of the ITA. The CRA agent also indicated that there is a team at CRA reviewing the compensation issues.

Furthermore, several TEI members have experienced set-offs between their tax accounts that occurred on the same day the assessments were issued or on the day their GST/HST tax returns were filed.

Tax accounts set-offs by CRA increase taxpayers' administrative burdens and create important cash flow issues.

***Questions for CRA***

A. Please provide more information regarding current initiatives with respect to compensation between taxpayer's tax accounts.

B. Would CRA be interested in consulting with TEI to identify the issues and potential solutions to these issues?

## Exhibit A - Summary of Differential Tax Treatment for Partnerships and Corporations Under the *Excise Tax Act*

During the November 2016 liaison meetings between Tax Executives Institute (TEI) and the Canada Department of Finance and the Canada Revenue Agency, TEI raised concerns regarding the manner partnerships are treated relative to corporations under the *Excise Tax Act* (ETA) (see Questions 13-15 of that submission).

The federal officials requested a comprehensive list of other challenges that arise for partnerships under the ETA. Below are some examples where partnerships are treated less favourably than corporations despite that a partnership is treated as a "person" under the Act.

### 1. Registration

- **S. 240(3) –** Registration is permitted where a corporation intends to own or will acquire shares of corporation engaged in commercial activities. No such voluntary registration is allowed in the context of a partnership. The resulting treatment, combined with the differential treatment in s. 186, renders a partnership that intends to acquire shares of a corporation engaged in commercial activities ineligible to voluntarily register in order to claim ITCs related to that acquisition.

### 2. Frequency of returns

- **S. 272 –** When a corporate registrant is wound up into a corporation, the corporation is deemed to be the same corporation for the purposes of determining the threshold for time period for filing returns under s. 249. No similar provision exists for a successor of a partnership. The result is that a successor corporation will take on the same filing period as its predecessor, whereas a successor to a partnership will need to determine its threshold amount for its fiscal year to determine the appropriate filing period.

### 3. Financial Institutions

- **S. 149(4) –** Interest or dividends from a related corporation are excluded from calculating the threshold amounts for the financial revenue tests in paragraphs 149(1)(b) and (c) to determine whether a registrant is a *de minimis* financial

institution. No similar exclusion exists for interest or dividends received from related trusts and/or partnerships. S. 149(4) thus deems certain partnerships to be financial institutions when corporations having the same attributes would not be treated as such. Deemed financial institutions are required to file the *GST111 - Financial Institution GST/HST Annual Information Return* (GST 111), which requires a tremendous amount of time and resources to prepare. The result would be that a partnership would be required to allocate input tax credits under s. 141.02 whereas a corporation having the same attributes would continue to claim input tax credits without such allocation.

- **S. 150 –** The financial institutions election to exempt supplies between members of a closely related group applies to corporations and not to trusts and/or partnerships. Therefore, supplies between financial institutions and related partnerships are subject to GST/HST and the listed financial institution would incur unrecoverable GST/HST.

4. **Input tax credits**

- **S. 181.1 –** A successor corporation is eligible to claim ITCs for manufacturer' rebates as s.181.1 is prescribed, however a successor to a partnership will not be eligible to claim ITCs if the partnership was the registrant that made the original supply.
- **S. 186(1) –** ITCs are available to a parent corporation if inputs are for consumption or use in relation to shares of capital stock or debt of a related corporation. ITCs are not similarly available to trusts and/or partnerships, for example, if a partnership is a holding partnership or the holding company holds partnership units.
- **S. 186(2) –** ITCs are available to a corporation where tax is paid on fees in relation to the acquisition of shares in corporations engaged in commercial activities. As a result, a partnership taking over a corporation and a corporation taking over a partnership cannot benefit from ITCs on takeover costs.
- **S. 186(3) –** The extension of ITCs under s.186(1) to multi-tiered corporate structures is also not available if a partnership is included in the structure.

5. **Closely Related Group Election under Section 156**

- **S. 156 –** Although a partnership is a "person" under the ETA, one must look to the partners to determine the residency of the partnership for eligibility under s. 156 even if a partnership has a permanent establishment in Canada. In contrast, a corporation that has a permanent establishment in Canada is deemed a resident for s. 156 regardless of where its shareholders reside. Thus, partnerships must clear an additional hurdle to make an election under s. 156 to relieve the collection of GST/HST on goods and services sold between related parties.

6. **Wind-ups**
    - **S. 272 (also affects s. 141.02(5)) –** A successor corporation in a wind-up is deemed to be the predecessor corporation and may claim ITCs attributable to the predecessor following a wind up. In contrast, upon dissolution and de-registration, the partner(s) loses the eligibility to claim ITCs (i.e., s. 272.1(6)), even if the ITCs relate back to the period when the partnership was in commercial activity.
    - **S. 272.1(7) –** A rollover is only allowed when a new partnership is created; it is not allowed for the transformation of partnership into a corporation. As a result, the transfer of the assets from a partnership to a new corporation would occur at fair market value, creating potentially significant cash flow issues unless s. 167 or s. 156 relieves such tax.
    - **S. 272.1(4) –** The dissolution of a partnership by operation of law occurs when one partner acquires all the partnership units and a supply of the partnership property is deemed to occur from the partnership to the partner at fair market value under s. 272.1(4).
        - In the case where the partners are corporations and closely related, a transfer of property is taxable at fair market value under s. 272.1(4) unless the parties can rely on s. 167 (which requires an agreement to supply partnership property even though it occurs by operation of law) or a s. 156 election in place between the partners and partnership. In the absence of the ability to rely on either s. 167 or s. 156 for such a transfer, the transfer could create a significant cash flow for what is, in effect, a corporate reorganization. Consider a partnership with $2B in assets, which are all held in Ontario. The partner would be required to pay $260M in HST if neither s. 167 nor s. 156 is applicable to such a transfer.

- o In such a case, could the Department of Finance consider implementing a rollover provision such that no tax would apply in such a corporate reorganization amongst a corporate group?

7. **Bad debts**
   - **S. 272 –** Section 272 provides that on a wind-up of a registrant corporation into another corporation, the successor corporation is deemed to be the same corporation as the predecessor registrant for the purposes of claiming bad debts under s. 231. Thus, the successor corporation can claim the bad debt deduction for a supply made by the predecessor corporation. No similar provision exists in s. 272.1 that would allow a partner of a wound-up partnership or a successor corporation to the partnership to claim the bad debt deduction where the partnership made the original supply.

8. **Credit Notes**
   - **S. 232 –** Section 232 allows a supplier that charged tax to a person to subsequently credit tax to a recipient where the tax was charged in error (s. 232(1)) or the consideration is reduced (s. 232(2)). As s. 232 is prescribed, a successor corporation is deemed to be the supplier such that the successor can issue the credit note and tax adjustment under s. 232(3). However, if a credit is provided by a successor to a partnership when the partnership made the supply, the successor cannot claim the tax adjustment and a partnership (even if continued under s. 272.1(6)) could not claim the credit given that the dissolved partnership could no longer legally pay the credit.

9. **Miscellaneous**
   - **S. 134 –** Section 134 deems a transfer and retransfer of a security interest not to be a supply, and therefore not subject to GST/HST. For corporations, s. 134 is prescribed such that a successor corporation is deemed the same as a predecessor corporation so a retransfer to a successor corporation is not a supply. This would not however be the case for a successor of a partnership, and such transfers and retransfers will be subject to tax.
   - **S. 224 –** Under s. 224, a successor corporation can maintain an action for tax against a recipient for a supply provided by a predecessor corporation.

However, while partners are liable for tax under s. 272.1(5) post wind-up, neither the partners nor the other successor of a partnership are eligible to maintain actions for tax against the recipient.