

---

**TAX EXECUTIVES INSTITUTE, INC.**

**EXCISE TAX QUESTIONS**

**Submitted to**

**CANADA REVENUE AGENCY  
and  
THE DEPARTMENT OF FINANCE**

**DECEMBER 6-7, 2011**

---

Tax Executives Institute, Inc. welcomes the opportunity to present the following questions on Canadian commodity tax issues, which will be discussed with representatives of Canada Revenue Agency and the Department of Finance during TEI's December 6-7, 2011, liaison meetings. If you have any questions about the agenda, please do not hesitate to call David V. Daubaras, TEI's Vice President for Canadian Affairs, at 905.858.5309 (or david.daubaras@ge.com), or Kim N. Berjian, Chair of TEI's Canadian Commodity Tax Committee, at 403.233.5480 (or kim.n.berjian@conocophillips.com).<sup>1</sup>

**TECHNICAL QUESTIONS**

**1. Provincial Matters and the Harmonized Sales Tax**

Earlier this year, residents of British Columbia approved a referendum to repeal the Harmonized Sales Tax (HST) and reinstate the Provincial Sales Tax (PST). On August 26, 2011, the British Columbia Ministry of Finance published its Action Plan to Re-implement PST. The Action Plan notes that the process of transitioning back to the PST will require much effort and a minimum of 18 months to achieve. In contrast, Quebec agreed on September 30 to make changes to the Quebec Sales Tax (QST) to harmonize it with the federal Goods and Services Tax (GST).

---

<sup>1</sup> Unless otherwise noted, topics are for discussion at the meetings with both CRA and the Department of Finance. Questions for CRA requesting a written response are noted.

a. *HST and British Columbia.* Please provide an update on the timetable, transitional rules, and any other legislative or administrative changes that will be required to rescind the HST in British Columbia?

b. *QST and GST.* Please provide any available details concerning the agreement announced on September 30, 2011, with the province of Quebec to harmonize the QST with the GST?

c. *Other Provinces (Finance Only).* Is Finance negotiating with other provinces to replace their provincial sales taxes with the HST?

## **2. Recaptured Input Tax Credits (RITCs)**

As a temporary measure beginning July 1, 2010, and effective through June 30, 2018, large businesses and certain financial institutions (other than selected listed financial institutions) are required to recapture input tax credits for the provincial part of the HST paid or payable on specified property and services in British Columbia and Ontario. Although the HST has been repealed in British Columbia, it remains in effect while the province develops transitional rules for a return to the PST.

a. *Audit Issues (CRA Only).* The rules for reporting RITCs can be difficult to apply in practice. Please provide an update on the compliance issues being discovered upon audit of returns that include RITCs?

b. *TEI Submission (Finance Only).* Reporting RITCs pursuant to the time frames required in the current regulations is not possible, and the inability to comply exposes businesses to significant penalties and increased administrative costs. On March 7, 2011, the Institute submitted a letter urging Finance to amend paragraph 30(d) of the New Harmonized Value-added Tax System Regulations, No. 2 to permit reporting RITCs either (1) within 90 days of the invoice date; or (2) in the period in which it is accounted for unless there has been a deliberate or undue delay in the reporting. Could Finance provide an update on this issue?

c. *Reimbursed Expenses – Generally.* Many common business arrangements require customers to reimburse suppliers for certain expenses. The GST/HST treatment of those transactions remains unclear in certain situations. Consider the following example:

Company A provides taxable services to Company B. Compensation for these services is determined, in part, by the expenses incurred by Company A in providing them. The expenses are not incurred by Company A as agent of Company B nor are the supplies to which the expenses relate re-supplied by Company A to Company B; the reimbursement of expenses is simply part of the formula for determining the consideration payable for the overall services provided. Some of the reimbursed expenses are subject to the RITC mechanism.

Please confirm that it is Company A and not Company B that is required to account for the RITCs on these expenses. Would the answer change if some of the expenses to be reimbursed by Company B consist of meals and entertainment expenses incurred by Company A that are identified as such on Company A's invoices to Company B?

d. *Reimbursed Expenses – Start-up Costs.* The treatment of reimbursed costs also remains unclear where one company incurs start-up costs attributable to a related company which consist at least partly of taxable supplies. Consider the following example:

Company A forms a new subsidiary – Company B. Prior to making its first taxable supply, Company B obtains its GST/HST registration number and begins setting up its general ledger, computer systems, purchasing and sales departments and modules, etc. Company A provides support to Company B and incurs expenses for which it is entitled to be reimbursed by Company B as start-up costs. Some of these expenses may be legal fees relating to the incorporation of Company B but others are operational in nature (*e.g.*, telecommunications services subject to RITCs, purchases and/or leases of passenger vehicles and gasoline to operate these vehicles, meals and entertainment expenses incurred by Company A's employees working on the project to establish Company B that are subsequently reimbursed by Company A). Company A issues invoices to Company B that clearly identify the nature of these expenses.

Which of the two companies, if any, is subject to the RITC rules respecting the aforementioned expenses originally incurred by Company A and re-charged by Company A to Company B?

### **3. Input Tax Credits – Section 180 Pass Through ITCs and Services** (Finance Only)

Unregistered nonresidents must pay HST/GST on certain imports of goods into Canada. These nonresidents are generally not entitled to an input tax credit for those taxes. The *Excise Tax Act* provides relief in certain situations. Specifically, section 180 of the *Excise Tax Act* deems a person to have paid tax in respect of a supply of property equal to the tax under *Excise Tax Act* Division III or subsection 179(1) in respect of the importation of goods. This deeming provision provides a mechanism to pass through a tax amount paid by one party that is unable to meet the input tax credit conditions to another party who will be in a position to recover the tax paid. This works very well when a nonresident vendor supplies goods but provides no relief when the vendor is a service provider.

Consider the following example:

A U.S. moving company (US MoveCo) has a contract with a multinational firm (MNCo) engaged exclusively in commercial activities to handle all of MNCo's employee moves. US MoveCo subcontracts with a Canadian moving company (Canadian MoveCo) to handle the Canadian moves for MNCo's Canadian subsidiaries (also engaged exclusively in commercial activities and registered for GST/HST). US MoveCo (a U.S. resident corporation not registered for GST/HST) is invoiced by Canadian MoveCo (Canadian resident, registered moving company) for moving charges plus GST/HST as the services were provided in Canada. US MoveCo then invoices the full value of charges to MNCo's Canadian subsidiaries – including the GST/HST that US MoveCo was charged by Canadian MoveCo and unable to claim as an input tax credit. US MoveCo has no ability to transfer to MNCo's Canadian subsidiaries the GST/HST paid by US MoveCo to Canadian MoveCo for recovery by MNCo's Canadian subsidiaries as an input tax credit since section 180 applies only to goods, and the drop shipment rules of section 179 are not applicable. This results in GST/HST being unrecoverable merely because the underlying supply is a service rather than a good.

Will Finance consider extending equitable treatment to the supply of services?

#### **4. Input Tax Credits – Imported Goods**

Incoterms 2010 created two new Incoterms and related rules (DAT – Delivered at Terminal and DAP – Delivered at Place) to replace previous Incoterms 2000 DAF, DES, DEQ, and DDU. Under the two new Incoterms, delivery occurs at a named place of destination.

The official explanation describing the use of the Incoterm DAP requires the seller to clear the goods for export, where applicable. However, the seller has no obligation to clear the goods for import, pay any import duty, or carry out any import customs formalities.

Consider the following example:

A GST/HST registered party (Seller) sells standard rated taxable goods to a GST/HST registered customer (Purchaser) using the Incoterm DAP Hamilton, Ontario. Purchaser is acquiring the goods for consumption, use, or supply exclusively in its commercial activities and meets all of the other conditions to claim a full input tax credit of the GST/HST paid with respect to its acquisition of the goods. The goods are sourced in the U.S. and will be imported into Canada. The agreement calls for Purchaser to be the importer of record.

Please confirm that for purposes of the *Excise Tax Act*:

- (i) For GST/HST purposes, the supply from Seller to Purchaser is considered a supply made in Canada and thus Seller is required to charge and collect *Excise Tax Act* Division II tax at a rate of 13% on its invoice to Purchaser.
- (ii) Purchaser will be able to claim a full input tax credit for the 13% Division II HST paid on Seller's invoice (assuming standard documentation requirements are met).
- (iii) Purchaser, who is the importer, will pay *Excise Tax Act* Division III tax at a rate of 5% of the value of the goods being imported on its importation of the goods into Canada.
- (iv) Purchaser, who is the importer, and who has paid 5% GST on the value of the imported goods will be able to claim a full input tax credit for the Division III tax paid on importation (assuming standard documentation requirements are met). Note: Reference GST/HST Policy Statement P-125R, Example #10.
- (v) If Purchaser is not able to claim an input tax credit for the 5% *Excise Tax Act* Division III GST paid on importation per (iv) above, can Purchaser seek reimbursement of the 5% GST from Seller entitling Seller to recover the 5% *Excise Tax Act* Division III tax as an input tax credit (assuming standard documentation requirements are met)?

## **5. Drop-shipment Rules and Commingled Petroleum Products**

Historically, CRA has interpreted the drop shipment rules of section 179 of the *Excise Tax Act* to exclude situations where there is commingling of the goods such as oil or gas in a pipeline. This position is based on physical possession of identifiable tangible personal property transferring between parties, as opposed to merely acquiring physical possession of an equivalent quantity of like property.

In the *Tenaska Marketing Canada* case,<sup>2</sup> the Federal Court of Canada ruled that section 144.01 of the *Excise Tax Act*<sup>3</sup> applies to natural gas even though it is commingled with other natural gas in the pipeline.

In light of this decision, can a person use the deeming provisions of section 179 of the *Excise Tax Act* if there is commingling of the goods?

---

<sup>2</sup> *Tenaska Marketing Canada v. Canada*, 2006 FC 583, [2006] 4 F.C.R. D-40.

<sup>3</sup> Section 144.01 deems a continuous transmission commodity (e.g., oil, gas, or electricity) not to be exported when transported outside Canada in the course of a shipment originating in Canada and ultimately delivered in Canada.

**6. Documentary Requirements for Procurement Cards**  
(Finance Only)

In June 2005, CRA issued GST/HST Notice 199: *Procurement cards – Documentary requirements for claiming input tax credits*. The purpose of that notice was to set-out the conditions that must be met in order for CRA to exempt a registrant from meeting the input tax credit (ITC) documentation requirements on procurement card transactions. The complexity and compliance requirements in GST/HST Notice 199 were discussed at TEI meetings with Finance in December 2005 and 2006, and a working group was established to develop an acceptable alternative to GST/HST Notice 199. The working group developed a draft proposal that would incorporate the documentation requirements for procurement card transactions into the *Excise Tax Act*. When Ontario announced it would harmonize with the GST, Finance re-assigned staff to work on that initiative and the procurement card project was put on hold. Because there is merit in developing an alternative approach to GST/HST Notice 199, TEI recommends that the procurement card project be re-started.

- (i) How many registrants have received an approval to use the procedure set-out in GST/HST Notice 199?
- (ii) Would Finance consider re-starting the procurement card project and commit staff accordingly?
- (iii) Given that some work has been done on this project already, would Finance agree to a fast-track approach with the goal being a formal announcement on proposed changes by June 30, 2012?

**7. Rates for Reimbursements of Automobile Expenses**

a. *Automobile Expenses (Finance Only)*. For 2011, will Finance revise the reasonable per-kilometre allowance rates for the deductibility of automobile expenses reimbursed to employees? The reimbursement rates used by registrants affects the amount of GST/HST that they may recover. These rates have remained unchanged since 2008 yet fuel and insurance costs have been escalating.

b. *Factor for Motor Vehicle Allowance (CRA and Finance)*. At last year's TEI-CRA liaison meeting, we were informed that CRA and Finance, in consultation with the governments of Ontario and British Columbia, were "in the process of determining an administrative factor that GST/HST registrants may use in determining what portion of an ITC for a motor vehicle allowance would be subject to recapture." Please provide an update on these consultations.

## 8. Financial Services

a. *Pension Plans.* What additional changes are being considered to simplify the current rules for pension plans and other investment plans?

- (i) Would Finance/CRA consider modifying the legislation/administrative practice to confirm that deemed supplies will only exist in situations where an operation or process is being carried out “in house,” and not in situations where only a portion of a full-time equivalent headcount is utilized to support the pension plan?
- (ii) Would Finance/CRA clarify through the legislation or in an administrative publication whether it is acceptable to calculate the amount of a deemed supply using fully-burdened internal costs (as opposed to market rates)?
- (iii) Would Finance consider amending the rules so that no deemed supply would exist when an actual supply of services was made by the employer, and GST/HST charged on that supply?
- (iv) Would Finance/CRA consider recognizing the pension plan as the recipient of services where they were contracted for by the employer as administrator for the operation of the pension plan and paid for by the pension plan so long as no input tax credits were taken by the employer?
- (v) Would Finance consider exempting pension plans from the selected listed financial institution (SLFI) requirements where less than 10 percent of the members are outside of a single participating province?

b. *Master Trusts.* The new rules for pension entities have the effect of deeming all GST/HST on pension related expenses incurred by employers participating in a pension plan to have been paid by the relevant pension entity. The pension entity is also entitled to claim a rebate equal to 33% of the GST/HST it has actually paid, as well as the GST/HST deemed to have been paid under section 172.1 of the *Excise Tax Act* during the claim period. Master trusts are not eligible for the GST/HST rebate for pension entities.

Master trusts add complications to the deemed supply and SLFI rules. Generally, master trusts are set up when one employer is sponsoring more than one pension plan. The participating plans (pension trusts) hold units in the master trust. The master trust agreement provides for the collective investment and reinvestment of the assets of the participating trusts. Investment management fees are usually charged as a single amount. The master trust will allocate between pension trusts based on percentage holdings.

Unless stipulated in the master trust agreement that investment management fees are payable by the individual pension trusts, generally the fees should be viewed as a supply to the master trust. There is no deemed supply by the employer.

- (i) For GST/HST purposes, does the employer make a supply to the master trust (no deemed supply) or to each pension trust (deemed supply)?
- (ii) Please confirm that there would be no deemed supplies under section 172.1 by the employer to the master trust in circumstances described in the above scenario.

c. *Financial Institution GST/HST Annual Information Returns.* What changes are being contemplated to help alleviate the complexity of certain information requirements currently found within the Annual Information Return?

- (i) Would Finance consider relieving *de minimis* financial institutions of this annual obligation to complete the returns?
- (ii) Is consideration being given to incorporating the Annual Information Return into a SLFI's annual GST/HST Return to avoid burdensome duplicative reporting?
- (iii) Would it be possible to exclude the reporting of items which have already been reported to the CRA or Canada Border Services Agency (CBSA) through another return or process?
- (iv) How will industry be able to participate and provide input and feedback to develop improvements to this return?

d. *Taxation of Financial Services (Finance Only).* Could Finance please provide an update on the review of the GST/HST treatment of financial services that was announced in early 2010?

- (i) Will Finance consider implementing a regime that would include the taxation of financial services, including expanding the tax base to include both fee and margin-based services?
- (ii) Would the zero-rating of supplies made to businesses be considered?
- (iii) How will industry be able to participate in this review and provide input and feedback?



**9. Calculation of Threshold for Purposes of *De Minimis* Financial Institutions (Finance Only)**

A common large business group structure is a parent company with wholly- or majority-owned operating subsidiaries. Typically, the parent issues all the external debt and other financing, and is the named insured party on the group insurance policies. The parent also acts as “banker” to the group, and invests in short-term commercial paper and similar instruments the surplus cash that is concentrated from operating subsidiary bank accounts on a daily basis (often referred to as a “cash sweep” arrangement). Other than an administrative service fee to the subsidiaries and charges for interest on loans to related corporations, the parent typically makes no supplies. Paragraph 149(1)(c) of the *Excise Tax Act* makes the parent company a *de minimis* financial institution where the short-term third-party interest income of the parent in the preceding tax year exceeds \$1 million on an annual basis.

Will Finance consider amending paragraph 149(1)(c) of the *Excise Tax Act* to exclude from the \$1 million annual limit interest income that is earned by the parent company of a group of closely-related corporations from the investment of short-term surplus funds, where those funds are generated through the commercial activities of the operating corporations of the group?

**10. Place of Supply – Goods – Unknown Destination at Time of Invoicing**

Please consider the following scenario involving place of supply rules when the destination of a good is unknown at the time of the sale:

A Quebec-based manufacturer (Supplier), registered for GST and QST, accepts an order from a customer (ManitobaCo) whose head office is located in Manitoba and from which the purchase order is issued. Supplier will address and send any invoices to the Manitoba location of ManitobaCo for payment.

The order consists of two pieces of equipment (*e.g.*, lathes) each worth \$500,000 not including any Canadian sales tax or other taxes. Supplier agrees to deliver the equipment to ManitobaCo’s site – *i.e.*, Supplier will engage a freight carrier to take the goods from Supplier’s plant in Quebec to the ManitobaCo site; Supplier will pay the freight carrier; and such freight cost has been factored into the \$500,000 unit selling price.

ManitobaCo is in the process of building two manufacturing facilities – one in British Columbia and the other in Ontario.

At the time of the order, ManitobaCo does not know whether both lathes will be shipped to Ontario or British Columbia, or one lathe will be shipped to each facility. The uncertainty of the destination of the shipment results in part from the fact that the Supplier’s date of completion of manufacturing of the lathes is not guaranteed and

ManitobaCo does not have a definitive date upon which each new site will be prepared to accept delivery of the lathes.

If both ManitobaCo sites are not available when the lathes are ready for shipment, the lathes will be stored either at Supplier's plant in Quebec, at one of ManitobaCo's sites outside Ontario and British Columbia, or a third party storage facility. If the third-party storage facility option is used, the supply of the storage service will be acquired by ManitobaCo and paid for directly by ManitobaCo to the storage service facility provider.

The terms of payment between Supplier and ManitobaCo are 100% due and payable upon receipt of the order.

Supplier issues an invoice to ManitobaCo for \$1 million with a billed to address of Manitoba.

- (i) What Canadian sales tax applies on Supplier's invoice for \$1,000,000 to ManitobaCo?
- (ii) When ManitobaCo subsequently advises Supplier where to ship the two lathes (*e.g.*, one unit to British Columbia and one unit to Ontario), is there a requirement for Supplier to issue a subsequent invoice to ManitobaCo for any Canadian sales taxes only and if so what would be the correct Canadian sales tax(es) to invoice?

## **11. Place of Supply – Personal Services**

a. *Training Courses Provided to an Unregistered Nonresident.* A GST/HST registered company is in the business of providing management training courses to individuals. (Assume that the supply of these courses does not qualify for zero-rating under section 18 of Part V of Schedule VI to the *Excise Tax Act*.) The company usually invoices the employers of the individuals and these employers can be located anywhere in the world.

The company provides the training courses at one of its three premises in Canada – Montreal, Toronto, and Vancouver. The individual participants travel to one of these training sites where the course is presented in a classroom setting.

Please confirm that for purposes of the *Excise Tax Act*:

- (i) The provision of a management training course at a physical location in Canada is a supply of a service.
- (ii) The above service is a “personal service” since the service is performed in Canada in the presence of the individual to whom the service is rendered.

- (iii) In the case of a management training course where the participant physically attends the course in Montreal, Toronto, or Vancouver, the supply of the training course is subject to the GST (and QST); the Ontario HST; and the British Columbia HST respectively.
- (iv) If the company is invoicing a U.S. resident corporation not registered for GST/HST because one of its employees has come to Canada to take the course in Toronto, the Ontario HST is applicable on the invoice since the supply is not a zero-rated supply, in particular as it does not meet the conditions in section 7 of Part V of Schedule VI to the *Excise Tax Act*.

b. *Training Courses Delivered Online.* A GST/HST registered company is in the business of providing management training courses to individuals. (Assume that the supply of these courses does not qualify for zero-rating under section 18 of Part V of Schedule VI to the *Excise Tax Act*.) The company usually invoices the employers of the individuals and these employers can be located anywhere in the world.

The courses are delivered entirely on-line and all of the software and other telecommunications requirements for the course are hosted on one of three identical servers located at three sites in Canada – Montreal, Toronto, and Vancouver.

The individual participants sign up on-line for the course. These participants usually provide their name and their company's billing information including the company's address they are associated with. (Sometimes payment for the course is made by credit card.) Once approved, the participant then goes on-line and completes the course. The course does not include any interactive component with a "live" moderator / presenter linked into the training session.

Please confirm that for purposes of the *Excise Tax Act*:

- (i) Whether the provision of the on-line training course described above is considered to be a supply of a service or a supply of intangible personal property (IPP)?
- (ii) If the on-line course is a supply of a service, please confirm that the service would **not** be a "personal service" since the service is **not** performed in the presence of the individual to whom the service is rendered.
- (iii) If the on-line course is a supply of a service, would the place of supply of the service be based on the geographical address provided by the participant when registering on-line? (This address may be within or outside Canada.)

- (iv) In the alternative, if the supply of the on-line course is considered to be a supply of IPP, would the place of supply be based on the geographical address provided by the participant when registering on-line? (This address may be within Canada or outside Canada.)
- (v) If the company is invoicing a U.S. resident corporation that is not registered for GST/HST because one of its employees is taking the on-line course from a location outside Canada, and provides the U.S. address of its employer when completing the registration, what Canadian sales tax applies, if any?
- (vi) Would the responses provided in questions (i) to (v) above change if the on-line course was fully interactive and the training was being delivered by a “live” presenter / moderator who the participant could communicate with on-line while taking the course? Would the physical location of the “live” presenter have any relevance in determining the tax consequences?
- (vii) Given the evolution of technology in the area of on-line training and the expansion of the features and capabilities in delivering courses to participants on-line, have Finance/CRA developed principles in this field and are there factors which are viewed as determinative when contemplating the nature of the supply?

## **12. Point of Sale Rebates (CRA Only)**

The *Excise Tax Act* provides an exemption for sales of goods and services made on reserve to First Nations peoples (referred to as Status Indians, Indian Bands and councils of an Indian band living off-reserve in Ontario). Goods and services purchased off reserve are also exempt if they are delivered to a reserve by the registrant. The provinces that have not harmonized their tax systems apply similar exemptions for purposes of their provincial sales taxes. To be eligible for this exemption, First Nations peoples must supply sellers with documentation that proves their status and that shows delivery will occur on reserve. CRA accepts a Certificate of Indian Status card as proof of exempt status, but that documentation does not identify whether the individual lives on or off reserve.

CRA does not provide a centralized database registrants can use to check whether an address provided by a First Nations person is on reserve. The only tool available to sellers for making a determination of eligibility for the exemption is the INAC website (<http://www.ainc-inac.gc.ca/index-eng.asp>), which lists the name of reserves throughout Canada with a postal code. This web site was not established for GST/HST purposes, however, and is a limited tool because the postal code listed on the website is not necessarily the only one that would cover the reserve. TEI recommends that, if the status card is produced and its number noted, that should be sufficient for purposes of the

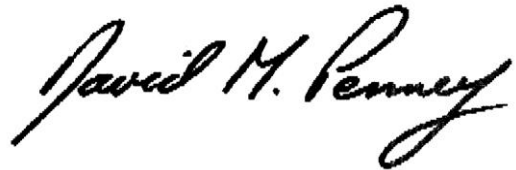
exemption (at least until CRA creates a tool with accurate information registrants can access to verify delivery on reserve).

**CONCLUSION**

Tax Executives Institute appreciates this opportunity to present its comments and questions for discussion. We look forward to meeting and discussing our views with you on December 6-7, 2011.

**TAX EXECUTIVES INSTITUTE, INC.**

Respectively submitted,

A handwritten signature in black ink that reads "David M. Penney". The signature is written in a cursive, flowing style.

David M. Penney  
*International President*