TAX EXECUTIVES INSTITUTE, INC.

EXCISE TAX QUESTIONS

Submitted to

CANADA REVENUE AGENCY
and
THE DEPARTMENT OF FINANCE

DECEMBER 3-4, 2013

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 3-4, 2013, liaison meetings. If you have any questions about the agenda, please do not hesitate to call Shiraz Nazerali, TEI's Vice President for Canadian Affairs, at 403.213.8125 (or Shiraz.Nazerali@dvn.com), or Robert Smith, Chair of TEI's Canadian Commodity Tax Committee, at 514.832.8198 (or robert.smith@mckesson.ca).[1]

TECHNICAL QUESTIONS

1. Provincial Matters and the Harmonized Sales Tax

Since our liaison meetings last year, there have been several changes to Harmonized Sales Tax (HST) measures in British Columbia, Quebec, and Prince Edward Island that significantly affect businesses with operations there. We welcome a discussion on the following related issues with the Department of Finance (Finance) and Canada Revenue Agency (CRA).

a. *Revocation of HST in British Columbia*. Please provide CRA's and Finance's views on the revocation of the HST in British Columbia including any issues which you consider worthy of our focus.

[1] Unless otherwise noted, topics are for discussion at the meetings with both CRA and the Department of

b. *Enhanced Harmonization of QST*. Please provide CRA's and Finance's views on the enhanced harmonization of the Quebec Sales Tax including any issues which you consider worthy of our focus.

c. *Introduction of HST in PEI*. Please provide CRA's and Finance's views on the introduction of the HST in Prince Edward Island including any issues which you consider worthy of our focus.

d. *Reduction of HST in Nova Scotia*. Please provide CRA's and Finance's views on the status of the announced reduction of HST in Nova Scotia to 14% effective July 1, 2014. The measure was introduced by the NDP government that was subsequently voted out of power in October 2013, and the newly elected Liberal government in Nova Scotia has stated that the HST reduction will occur only if the province has a surplus that would offset the loss of revenue resulting from the rate reduction.

2. Returned Goods
(CRA Only)

Section 232 of the *Excise Tax Act* (ETA) permits a supplier to refund, adjust, or credit GST/HST when a supplier has collected or charged an excess amount of tax or when the consideration for a supply is reduced after GST/HST has been charged or collected in respect of a supply. GST/HST Memoranda Series 12.2, *Refund, Adjustment, or Credit of the GST/HST under Section 232 of the* Excise Tax Act, provides additional guidance on the application of this rule. Specifically, paragraph 10 of that publication reads as follows:

> "A reduction in consideration is not considered to have occurred if the goods are sold back to the original supplier. To be considered a reduction of consideration, it must be evident that the goods are being returned to the supplier rather than being sold to the supplier."

Despite this explanation, it remains difficult in some situations to distinguish between a return of goods and a sale of goods back to the supplier. For purposes of the following questions, please consider the following example: A supplier and a recipient have entered into a supply and purchase agreement pursuant to which the recipient has purchased goods from the supplier and legal title to the goods has transferred to the recipient.

a. *Time Interval Before Return to the Supplier*. Does CRA impose a time limit from the date of original sale after which goods cannot qualify as returned but will be treated as sold back to the supplier?

b. *Price Change Since Original Sale*. Does CRA require that returned goods be credited at the original sales price in order for a transfer back to the supplier to be treated as a return of goods and not as goods being sold back to the supplier (*e.g.*, where

the supplier and recipient agree that the market value of goods initially sold at $100 per unit has decreased by 10%, and supplier refunds only $90 per unit)?

3. Demurrage and Layover Fees

(CRA Only)

Under section 162.1 of the ETA, an amount paid as or on account of demurrage is deemed not to be consideration for a supply, and therefore not subject to GST/HST. Paragraph 52 of GST/HST Memoranda Series 28.2, *Freight Transportation Services* provides further guidance:

> "Any demurrage fees and any penalty paid by one railway corporation to another railway corporation for delay in returning railway rolling stock are deemed not to be consideration for a supply. They are therefore not taxable. Demurrage fees are amounts that a shipper pays a carrier for the detention of a ship, freight car or other cargo conveyance during loading or unloading beyond the scheduled time of departure."

While this language provides helpful guidance, the application of section 162.1 to some layover charges remains unclear. For example, assume a carrier and a shipper enter into a freight transportation service agreement (that does not include a charter component for the carrier's truck and trailer) for the carrier to provide a taxable domestic freight transportation service. The agreement allows the carrier to add a layover charge if the cargo being shipped is not ready at the agreed time of delivery of the goods to the carrier.

In some instances, the carrier's invoice for the freight transportation service will label this layover charge as a demurrage fee. Given that it is related to a supply of a taxable domestic freight transportation service, it is unclear whether the layover charge in this instance would be relieved of GST/HST by virtue of section 162.1. We invite CRA to provide its view on the treatment of the demurrage rules to layover fees such as the one described in our example.

4. Transitional Rules for GST/HST Rate Changes

Over the last 10 years there have been several changes to the GST/HST and PST landscape. On July 1, 2006 the GST rate dropped from 7% to 6%, with a further reduction to 5% effective January 1, 2008. On July 1, 2010 British Columbia and Ontario harmonized their respective PSTs with the HST. British Columbia subsequently reverted to its preexisting GST/PST regime effective April 1, 2013. That same day Prince Edward Island adopted the HST. Manitoba raised its PST rate by 1% effective July 1, 2013, and Nova Scotia announced a reduction of its HST rate from 15% to 14% effective July 1, 2014, with a further reduction to 13% effective July 1, 2015.

The transitional rules applicable to each rate change have not been consistent and have created significant challenges for businesses. For example, with the 2006 and 2008 GST rate reductions, the transitional rules set the invoice date as the determining factor

for applying the correct tax rate for a transaction. When British Columbia and Ontario harmonized their respective PSTs with the HST, an "extent of service" method was used requiring businesses to apportion the service for a billing period that straddled the implementation date resulting in a blended tax rate for the invoice. When British Columbia reverted to the PST on April 1, 2013, the transitional rules established the invoice date for determining which regime – PST or HST – applied to the transaction. PEI used yet a different set of rules for its transition from PST to the HST, which took effect on the same day. Finally, when Manitoba implemented its PST rate increase on July 1, 2013, it adopted a customized approach whereby continuous services would use the invoice date, while charges for usage would be taxed based on the usage date, regardless of the invoice date.

TEI would like to better understand the process behind the selection of transitional measures for GST, HST, and PST rate changes, and is interested in working with Finance and CRA on more consistent transitional rules that would minimize the administrative burden inconsistent rules impose on businesses and the government.

5. Joint Ventures

a. *Joint Venture Activities – Exploring or Exploiting a Mineral Deposit (CRA Only)*. Under the ETA, a joint venture (JV) is different from a partnership because the JV is not included in the definition of a "person" and thus cannot register and account for the GST/HST in its own right. Section 273 of the ETA provides for a simplified remittance and compliance process for JVs engaged in "the exploration or exploitation of mineral deposits, or a prescribed activity." Under this provision, a joint election can be made by the JV participants to elect one party as the JV "operator" who accounts for the GST/HST collected by the JV and claims the ITCs in relation to the taxable expenditures of the JV (the JV Election).

In *Dunbar v. The Queen*, 2005 TCC 769 (November 29, 2005), the Tax Court of Canada interpreted the phrase "the exploration for or exploitation of petroleum, natural gas, minerals or other similar resources" in the context of the overseas employment tax credit included in the *Income Tax Act*. The court held that "[e]xploitation means more than simply extracting and selling…. [A]ll stages necessary to take the natural resource to its maximum value for the pursuit of profit is [sic] part of the exploitation process."

During our liaison meeting last year, CRA noted that it was "currently reviewing its interpretation of the term 'exploitation' in subsection 273(1) of the ETA, and the term 'exploit' in paragraph 162(2)(a) of the ETA in light of the Tax Court of Canada's Dunbar decision. Please be assured that your comments will be taken into consideration in that review." Has CRA reached any conclusions in this regard since our last meeting?

b. *Joint Venture Election – Other Commercial Activities (Finance Only)*. Many commercial activities – such as the rehabilitation or repair of bridges; operation and maintenance of real property; environmental consulting services; the construction of ships and vessels; and the construction and operation of a liquid natural

gas facility – may not be considered prescribed under existing law making them ineligible for the JV Election. Since the intended purpose of the JV Election is to simplify the GST/HST compliance and tax filing process, TEI urged Finance during our liaison meeting last December to amend subsection 273(1) of the ETA and expand the list of prescribed activities in the Joint Venture (GST/HST) Regulations extending the JV Election to all joint ventures engaged in commercial activities, or, in the alternative, to treat a JV as a person for purposes of the ETA in the same manner as a partnership. Finance, at that time, indicated that it was in the process of performing a review of its JV policy. TEI invites a discussion regarding the status of this project.

6. Natural Resource Royalties
(CRA Only)

a. *GST/HST Memorandum 3.7, Natural Resources*. In February 2012, CRA published GST/HST Notice 269 containing a draft, updated version of GST/HST Memorandum 3.7 requesting comments by April 30, 2012. The final version of this memorandum has not been released. Can CRA provide an update as to when the final version of GST/HST Memoranda Series 3.7, *Natural Resources*, will be published?

b. *Natural Resource Royalties and Revenue Sharing*. Under subsection 162(2) of the ETA, the right to explore or exploit a mineral deposit is not considered a supply and any amount paid (including a royalty) related to that right is deemed not to be consideration for that right. The application of subsection 162(2) remains unclear when a contract containing royalties for mineral deposits also includes amounts for other items. Consider the following example: A company (not a consumer or non-registrant) enters into an agreement with a third party to explore and exploit a mineral deposit and pays the property owner a royalty based on the units of production under a royalty agreement. The royalty agreement also contains a provision governing the sharing of "backfill dumping fees" collected from third parties for the right to dump certain approved materials into the excavated area.

Does the existence of revenue sharing for "backfill dumping fees" in an agreement preclude the treatment of the exploration and exploitation royalties in that same agreement from the nil consideration provisions of subsection 162(2) of the ETA?

c. *Input Tax Credits for the Supply of a Mineral Deposit Right*. Often, companies deal with small GST/HST registrants that do not understand the significance of subsection 162(2) of the ETA. Those small registrants may charge GST/HST on transactions that qualify for the nil consideration provisions of subsection 162(2). In those situations, can a GST/HST registrant claim input tax credits (ITCs) for GST/HST paid on royalties falling within subsection 162(2) assuming that the registrant satisfies the proper documentary requirements to substantiate the input tax credit?

7. Financial Services

a. *Imported Supply Rules for Financial Services*. Could CRA and Finance please discuss any changes they are considering to the imported supply rules as a result of representations made by the financial services sector, for example in the area of reinsurance? Are any changes being considered in relation to loading, or will any further guidance be released on this concept?

b. *Appraisal Services (Finance Only)*. Is any consideration being given to expanding paragraph (j.1) of the definition of financial services in section 123 of the ETA to allow exemption for the supply of appraisal services provided by insurance appraisers to other appraisers who are in turn providing these services to an insurer or adjuster? Changes in the industry have resulted in a growing trend where appraisers are subcontracting work to other appraisers resulting in a loss of the exemption for services provided between appraisers.

c. *Pension Plans (Finance Only)*. TEI would like to thank Finance for the changes made to simplify the pension rules.

(i) Are any changes being considered around master trusts?

(ii) Would Finance consider adding an election to allow a pension plan to be recognized as the recipient of services where the services 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?

d. *Financial Institution GST/HST Annual Information Returns*. Could CRA and Finance discuss any changes that are being considered for the Financial Institution GST/HST Annual Information Returns?

(i) Could CRA and Finance discuss any changes that are being contemplated to help alleviate the complexity of certain information requirements currently found within the Annual Information Return?

(ii) Would Finance consider relieving *de minimis* financial institutions of the annual obligation to complete and file these returns?

(iii) Is consideration being given to incorporating the Annual Information Return into a selected listed financial institution's (SLFI's) annual GST/HST Return to avoid burdensome duplicate reporting?

(iv) Would it be possible to exclude the reporting of items that have already been reported to the CRA or Canada Border Services Agency (CBSA) through another return or process?

e. *Required Forms Related to Funds and Group Registrations (CRA Only)*.

(i) Would it be possible to simplify the forms used to add a fund to a group registration, and the related elections? The original forms allowed multiple funds to be added to a group, and the related elections could be made by checking a box. The existing forms allow multiple funds to be added for two of the elections, but two of the elections require a form to be completed for each fund being added. Would it be possible to allow the use of these forms where the elections will not apply to all funds, but revert to the ability to check a box to put the elections in place in situations where the elections will apply to all funds being added? It would seem this would save time for both taxpayers and CRA.

(ii) Could CRA also advise whether a form(s) should be completed when an investment plan is closed? If yes, which form number(s) should be completed?

f. *Status of Internal Review of Financial Services (Finance Only)*. Could Finance provide an update on the status of the financial services review?

g. *CRA's Administration of the QST for SLFIs (CRA Only)*. Could CRA provide an update on the status of elections or returns to facilitate the CRA's administration of the QST for SLFIs? Could CRA advise on which elections or returns will continue to be provided by way of a separate form from the GST/HST returns or elections?

8. Threshold Amounts and Procurement Cards
(Finance Only)

a. *Indexing Threshold Amounts for Inflation.* Since the introduction of the GST in Canada, the Consumers Price Index has increased by approximately 55%. Many threshold amounts in the ETA have never been adjusted to reflect the effects of inflation. Those amounts include the *de minimis* financial institution rules in paragraph 149(1)(b), the small supplier rules in section 148, and the documentation requirements of the Input Tax Credit Information (GST/HST) Regulations. Does Finance have any plans to review these and other threshold amounts in the ETA and its regulations that have never been adjusted to reflect inflation?

b. *Procurement Cards.* TEI's initial request for administrative tolerance regarding documentation requirements of subsection 169(4) of the ETA was answered with CRA's publication of GST/HST Notice 199, *Procurement cards - Documentary Requirements for Claiming Input Tax Credits*, in June 2005. The success of the administrative policy contained in that notice can be measured by the very limited number of GST registrants who have applied for exemption under subsection 169(5).

In 2006, Finance and TEI established a sub-group in an attempt to find a better

solution. Much work was completed by Finance and TEI, which culminated in an alternative proposal being presented by TEI on November 7, 2007. Progress on this matter stalled due to a reallocation of resources within Finance, particularly in respect of Ontario and British Columbia harmonization.

Is Finance prepared to reopen this file with a view to improving the solution proposed in GST/HST Notice 199?

9. Deposits
(CRA Only)

Consideration for a supply is due or deemed due, and the associated GST/HST becomes payable, on "the day the recipient is required to pay that consideration…pursuant to an agreement in writing," under paragraph 152(1)(c) of the ETA. An exception applies for deposits. Under subsection 168(9), deposits given in respect of a supply are generally not treated as consideration "until the supplier applies the deposit as consideration for the supply." Certain issues related to deposits, however, remain unclear.

TEI requests guidance from CRA on the application of paragraph 152(1)(c) and subsection168(9) to the following situations:

a. *Deposit Equal to Estimated Consideration*. If a written agreement requires a customer to pay a deposit equal to 100% of the estimated consideration for a service to be supplied in the future, is that still a deposit subject to subsection 168(9), or is it a payment in advance to which paragraph 152(1)(c) would apply?

b. *Application of the Deposit*. With respect to subsection 168(9), what would constitute "[applying] the deposit as consideration for the supply" prior to the actual making of the supply of the service?

10. The CRA GST/HST Registry Online Service
(CRA Only)

TEI recognizes that the CRA's GST/HST Registry online service has a useful feature that permits a query by specific transaction date. However, one aspect which remains very problematic for users of this service is the requirement to enter both the registrant's GST/HST registration number and the name of the registrant, as recorded in CRA's file for that particular registrant. Often, a business name used on an invoice will differ slightly from the name in its CRA file resulting in authentication errors.

The online registries for both the Quebec Sales Tax and the British Columbia Provincial Sales Tax require entry solely of the registrant's number to receive a validation. It should be noted as well that the Validation of a QST Registration Number online service offered by Revenu Québec displays the name of the registrant when a valid QST number is queried.

Can CRA comment on any steps it has taken to improve the GST/HST Registry online service, and if it is contemplating removing the requirement for a user to enter the registrant's name as it appears in CRA's records?

11. My Business Account and Communication Via E-mail
(CRA Only)

a. *Appreciation for Positive Changes to My Business Account.* TEI would like to recognize the continuing outreach efforts of the My Business Account team. In particular, we would like to acknowledge that CRA has modified some of its policies in a very practical manner, which has eased the administrative burden of registering a company (or registering many related companies) for the My Business Account.

b. *Communication via E-mail*. TEI members are interested in communicating with their CRA auditors via e-mail. Will something comparable to the Electronic Transfer of Accounting Data be developed within the My Business Account Message Centre that would permit a registrant to correspond via e-mail with a CRA auditor?[2]

12. Excise Tax on Insurance Premiums
(CRA Only)

Part I of the ETA imposes a 10% tax on insurance premiums against risks in Canada that are placed with:

- An insurer authorized under the laws of Canada or a province to transact the business of insurance, if the contract is entered into or renewed through a broker or agent outside Canada; or

- An insurer not authorized under the laws of Canada or a province to transact the business of insurance.

The statute provides that the tax does not apply "to the extent that the insurance is not, in the opinion of the Commissioner, available in Canada."[3] The term "not available in Canada" is not defined in the ETA, and the only reasons CRA deems acceptable are the unavailability of the particular class of insurance from authorized insurers or a lack of market capacity at the time a taxpayer purchases that class of insurance. The latter exception has not been defined. To qualify for exemption from the Insurance Premiums

[2] Over the past several years, the U.S. Internal Revenue Service has been implementing a secure email system to correspond with large-file taxpayers during audits. All or nearly all large-file taxpayer cases now employ that system.

[3] R.S., 1985, c. E-15, s. 4; 1999, c. 17, s. 147.

Tax, CRA requires taxpayers to provide five declination letters from licensed Canadian insurers each year the exemption is claimed.

a. *Status of Policy Changes.* Can CRA provide an update on the progress and status of draft changes to CRA Form ETSL68, *Statement of Availability or Declination from Authorized Insurers – Tax on Insurance Premiums (Part I of the* Excise Tax Act*)*, and Memorandum X7-1, *Special Levies – Insurance Premiums*, or any changes in CRA policy and administrative procedures with respect to the Part I insurance premiums tax?

b. *Documentary Evidence Issues.* Would CRA consider providing examples or a list of documentary evidence other than declination letters identifying other acceptable support for insurance not being available in Canada? If so, would CRA accept as one such example declarations from an Alberta Special Broker that are accepted by the Province of Alberta for purposes of the *Alberta Insurance Act*?

13. Accounting Periods for GST/HST

Section 239 of the ETA enables a registrant engaged in one or more commercial activities to request permission to file separate GST/HST returns in respect of a branch if (i) the branch can be separately identified by its location or the nature of its activities, and (ii) separate records, books of account, and accounting systems are maintained in respect of the branch.

Section 243 enables a person to file its GST/HST returns based on its accounting periods, as opposed to calendar months, if the accounting periods meet certain conditions. Pursuant to subsection 243(3), a person choosing to use its accounting periods rather than calendar months for its GST/HST returns is required to file Form GST71, *Notification of Accounting Periods for GST/HST*, with the CRA prior to the first day of each fiscal year.

With this background, TEI invites a discussion of the following scenarios:

Scenario #1 (*CRA Only*):

- The registrant has special accounting periods that meet the conditions of section 243;
- the registrant has filed Form GST 71 before the beginning of the fiscal year to notify CRA of the accounting periods that should be used for its GST/HST returns;
- CRA has **not** processed the notification and therefore has **not changed** the registrant's fiscal periods for the upcoming fiscal year; and
- CRA refuses to convert the registrant's fiscal periods from calendar months to the registrant's accounting periods after the beginning of the fiscal year due to system limitations.

What mechanism is in place to allow CRA to change the registrant's filing periods in the course of a fiscal year where CRA has not processed a timely filed Form GST 71? If system constraints do not allow CRA to apply the accounting periods during the year, what alternatives can be explored to ensure that the registrant will not face challenges upon a GST/HST audit?

Scenario #2 (*CRA Only*):

- The registrant has special accounting periods that meet the conditions of section 243;
- the registrant has filed Form GST 71 before the beginning of the fiscal year to notify CRA of the accounting periods that should be used for its GST/HST returns;
- the CRA has processed and approved the notification prior the beginning of the upcoming fiscal year;
- the registrant adopts a new accounting system part way through a fiscal year and begins to use calendar months, as opposed to the accounting periods previously used.

Is there a mechanism in place to allow the registrant to convert to calendar month filing part way through a fiscal year where CRA has previously approved another accounting period for that registrant for that fiscal year? If this is not allowed under section 243 of the ETA, is there administrative relief available? For example, Revenu Québec annotates the registrant's file to indicate the filing periods used on a go forward basis. These notes are available to Revenu Québec GST/QST auditors, and the process is facilitated by the Revenu Québec Large Case Manager.

Scenario #3:

- A registrant is filing separate GST/HST returns for the commercial activities of its branches pursuant to section 239;
- the head office and the branches have special accounting periods that meet the conditions of section 243 in a given fiscal year;
- the head office and all the branches (except one branch) change their accounting periods to calendar months at the end of a fiscal year;
- accordingly, Form GST 71 is not filed for the new fiscal year;
- one branch, however, remains on the special accounting period. This branch files, on a timely basis, Form GST 71 to notify CRA of that particular branch's accounting periods; and
- CRA approves the notification and incorrectly applies the request for special accounting periods to the head office and all branches although it has not received any request from the registrant head office or any of the other branches, except for the single branch mentioned above.

(i) (*Finance Only*) Section 239 allows separate branches to file separate returns. It does not appear, however, that separate branches can use different filing periods (*i.e.*, use of accounting periods versus calendar months). TEI would like to understand the policy behind this restriction. Would Finance consider changing these provisions to allow separate filers to choose their own reporting periods independent from the reporting periods used by their head office and associated branches?

(ii) (*CRA Only*) Branches occasionally use different accounting systems, and it is possible that a branch's accounting period will differ from the head office. In such a case, would CRA consider accepting the separate GST/HST filings from the head office and the branches using different periods on an administrative basis?

14. Role of Large Case Manager in GST/HST Audits
(CRA only)

For income tax purposes, Large Case Managers are assigned to large corporations with multiple subsidiaries that are subject to numerous compliance requirements and various tax audits. The role of the Large Case Manager is to act as a single point of contact and to facilitate communication between CRA and the taxpayer. Generally, the audit plan is established by the Large Case Manager and discussed with, and agreed to by, the taxpayer. The audit plan includes the entities that will be subject to audit, the periods covered, as well as a discussion regarding the timing of the audits. This role has proven effective for income tax audits.

In discussions with Large Case Managers, certain TEI members have been advised that the role of the Large Case Manager includes the management and handling of GST/HST matters, including audits. The process on the GST/HST side, however, appears to be less effective. More specifically, when issues relating to GST/HST matters are brought up, the Large Case Manager does not appear to have the tools to effectively identify and communicate with GST/HST resources within CRA. Also, the selection of GST/HST audits has not been part of the large corporation's audit plan. Unlike the income tax process, there does not seem to be effective coordination for GST/HST audits within a corporate group that includes numerous affiliated companies.

Could CRA confirm whether the current role of the Large Case Manager includes handling GST/HST matters? If so, could CRA explain the process, including how various GST/HST audits for entities forming part of a large group of entities are coordinated within CRA and how the Large Case Manager is involved?

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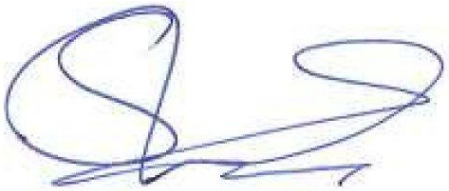
CONCLUSION

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 3-4, 2013.

Respectfully submitted,

Tax Executives Institute, Inc.

By: 

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