Member Advisory

December 2009

2009 Canada Revenue Agency (CRA) Tax Roundtable

The annual Canada Revenue Agency (CRA) Roundtable Meeting was held in May 2009. A number of CRA representatives were in attendance, along with representatives from the profession.

As in previous years, two concurrent roundtable sessions were held, one focusing on GST issues and the other on income tax matters. All participants also attended a general wrap-up session.

For more information on the session, contact Senior Professional Advisor Al Budlong at a.budlong@icaa.ab.ca.

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GST Questions

1. ***Real Estate Co-Ownership***

It is common for several persons to enter into an agreement to acquire commercial real estate as co-owners with the express intention of leasing or constructing a building through a joint venture structure, employing an operator to account for the activities. The operator will acquire the property as bare trustee on behalf of the owners pursuant to the joint venture agreement.

Where the operator and the participants make a joint venture election under paragraph 273(1), does the election take effect so that operator can provide its GST number to the vendor of the land and use 221(2)(b) so that no GST applies to the initial purchase of the land, or is each participant required to become GST registered in order to use 221(2)(b)?

Response:

The question assumes that the person as bare trustee designated as an operator and the participants to the joint venture can validly make the election of ss. 273(1). Please note that a bare trustee cannot be designated as the operator of a joint venture for the purposes of the election for the reasons outlined below.

The *Excise Tax Act* does not define the term "operator" for purposes of the joint venture election contained in subsection 273(1). However, an "operator" for purposes of the joint venture election must be a registrant and a "participant" in the joint venture, as that term is used in subsection 273(1). CRA, in Policy Statement P-106, *Administrative Definition of a "Participant" in a Joint Venture* interprets such a "participant" as meaning:

> "(a) a person who, under a joint venture agreement evidenced in writing, makes an investment by contributing resources and takes a proportionate share of any revenue or incurs a proportionate share of the losses from the joint venture activities; or
> (b) a person, without a financial interest, who is designated as the operator of the joint venture under an agreement in writing and is responsible for the managerial or operational control of the joint venture."

Policy Statement P-015, *Treatment of Bare Trusts under the Excise Tax Act* explains the CRA's position on bare trusts and the ability of a bare trustee to register for GST/HST purposes. It provides that a bare trustee exists where the sole duty of the trustee is to convey title to the trust property on demand by and according to the instructions of the beneficiaries of the trust. The trustee must not have any independent power, discretion, or authority relating to the trust property. However, a bare trustee may perform other functions in relation to the trust property as an agent or a contractor of the beneficiaries without affecting the trust's status as a bare trust.

Under Policy Statement P-106, a bare trustee cannot make an investment in a joint venture, as described in paragraph (a) of CRA's interpretation of the term "participant" because the investors are the bare trust's beneficiaries. Also, given that a bare trustee is controlled by its beneficiaries, it is not considered as being "responsible for the managerial or operational control of the joint venture" as described in paragraph (b) of CRA's interpretation of the term "participant". Consequently, a bare trustee cannot be considered as a "participant" to a joint venture for the purposes of subsection 273(1).

Generally, the terms of the written trust agreement and other agreements will establish the nature of the relationship between the trustee and the beneficiaries. Where a bare trust exists, transactions involving the property held by the bare trustee are regarded as having been made by the beneficiaries and not by the trust; therefore, the beneficiaries would generally be required to account for the GST collectible on supplies of the property and would claim input tax credits in accordance with the normal rules.

Section 273 permits an operator and a participant in a qualifying joint venture to elect jointly to designate the operator as the person responsible for accounting for GST on behalf of both parties with respect to their purchases and sales made in the course of the activities of the joint venture. Where the joint venture agreement clearly indicates that the activities of the joint venture include the acquisition of the real property by the operator on behalf of the co-venturers, the operator is deemed to have acquired the real property.

However, where the real property is acquired by the bare trustee on behalf of its beneficiaries, the beneficiaries of the bare trust are considered to be the recipients of the supply of the real property. Where a beneficiary is registered for GST/HST purposes, paragraph 221(2)(b) and subsection 228(4) will apply, such that the supplier is not required to collect the tax in respect of the supply of the real property and the beneficiary is required to account for the GST/HST payable in respect of the supply.

2. *Line 101/Filing Frequency*

Line 101 of the GST tax return has always required the inclusion of all revenue of a registrant for the reporting period, including exempt and other non-supplies like oil and gas royalties. A few years ago the CRA began using this number to determine when a registrant was required to file GST returns more frequently, even when it was not appropriate to do so. This was brought to the CRA's attention at an earlier Roundtable and we were advised that the GST return would be modified to account for the situation with the changes that came in with Standardized Accounting in 2007.

Nothing changed and the CRA continues to automatically change reporting periods based on the revenues reported on line 101, forcing registrants to either file more frequently than required to or communicate with the CRA and request a change so that the annual or quarterly reporting is reinstated. The request for a change can be lengthy and time-consuming. Some registrants have experienced collection action resulting from the change in reporting periods when the registrant was not aware they were required to file more frequently.

Would the CRA consider adding a line 102 to Forms GST 34 and 62 to report "taxable" revenues for the period to allow the CRA to determine filing frequency and leave line 101 as total revenues?

Response:

In light of the recent announcement of the expansion of Harmonized Sales Tax to include Ontario, we are reviewing the GST/HST return and the information that is currently reported on each line and how it will be reported in the future.

3. *Application of Payments*

Prior to Standardized Accounting, every payment received was applied to the earliest debt. This was changed with Standardized Accounting to where any payment received that is not immediately applied is placed in a subaccount, while the debt it was designated to pay generates interest and is subject to collection action. We have been told that only a handful of people at the CRA can apply payments in the subaccount to a debt.

Is it possible for the CRA, as before, to combine the payments and liabilities into the same account so that payments can be applied immediately?

Response:

Payments have always been applied to the period identified on the remittance voucher or return. This was true for both the old GST system and the new Standardized Accounting system. Unfortunately, a large number of remittances are received without the period identification, which results in the payment being posted to the next unassessed period. To avoid this, taxpayers should ensure clear direction is provided of where they would like the payment applied on any documentation they submit with their cheques. Should a payment subsequently be posted other than where the taxpayer intended, they now have the option of using the Transfer Payment option within MyBA to move the payment. They can also contact the Business Window Call Centre to have the payment moved on their behalf.

4. *Bare Trust Corporations*

Bare trust corporations are created for many reasons, but one of the most common is to hold title to real property when there are multiple beneficial owners. This occurs regularly in oil and gas exploration or real property development. The CRA used to demand that bare trusts be registered (in the early days of GST), but there has been a complete reversal in this thought process and registration is no longer permitted.

Notwithstanding this prohibition, some bare trustees continue to register for GST purposes and account for GST transactions as their own.

Many joint ventures have been created for the purpose of land development where legal title is held by a corporation as trustee and all GST and ITCs have been reported in the GST account obtained by the bare trustee. Invariably, these joint ventures qualify for the section 273 election and the operator of the joint venture operator accounts for all transactions, including the GST.

If the joint venture operator is tracking and reporting GST correctly, the net tax filed is exactly the same whether reported by a bare trustee or a GST subaccount of the joint venture operator. There are two factors of significance between these two types of reporting.

First, using multiple GST subaccounts for multiple joint ventures is not practical due to the CRA's standard process of moving debits and credits from one subaccount to another. This creates significant administrative difficulties to reconcile, both for the operator and the CRA, and it ignores the fact that funds are being moved between different joint ventures with different beneficial owners.

Second, the bare trustee is not the beneficial owner of the property, making it difficult to collect taxes, penalties or interest from the bare trustee. This appears not to be a problem if GST subaccounts of the joint venture operator are used.

When a bare trustee is discovered, the CRA has approached the GST account in two ways. One is to request an indemnity from all joint venture participants and the joint venture operator. The second is to assess the bare trustee for all GST and ITCs previously reported and force the joint venture operator to re-file all amounts. This creates a situation that the CRA is incapable of resolving (in our experience) and in the end, joint venture operators are being asked to refund all of the money received by the joint venture participants through the bare trustee (with the operator acting as the agent for the joint venture participants) so that the CRA can refund that exact same amount of money to the joint venture participants through the same operator acting as agent on their behalf. At times the money is going in and out of the same bank account the joint venture operator has opened to prevent commingling of funds from different joint ventures.

There is a very simple solution for this situation—the section 273 election could be amended by the Department of Finance to require the joint venture operator to report the GST and ITCs for a qualifying joint venture through a GST account set up specifically for the joint venture.

Alternatively, this can be accomplished by administrative policy by requiring GST Form 21 to be filed with the CRA. After the election has been approved, the CRA would create a GST account for the joint venture. The joint venture operator and joint venture participants would be liable for the account as per the section 273 election.

Will the CRA consider allowing a valid joint venture operator to use the GST account set up for the bare trustee to report on joint venture activity, as long as the joint venture operator and joint venture participants accept liability for the amounts reportable in writing?

Response:

For purposes of administering the GST, the Canada Revenue Agency (CRA) will consider a bare trust to exist where a person (the trustee) is merely vested with the legal title to the property and has no other duty to perform, responsibilities to carry out, or powers to exercise as trustee of the property. The sole duty of the bare trustee will be to convey legal title to the trust property on demand by and according to the instructions of the beneficial owners. A trustee of a bare trust does not have any independent power, discretion, control or authority over the assets of the bare trust. All of these powers, authorities, and discretions are retained by the beneficiaries. As a result, the beneficial owners, rather than the bare trust, would be involved in commercial activities relating to the trust property.

Although pursuant to subsection 123(1) of the *Excise Tax Act* (ETA) a "trust" is a person for GST purposes, it is the CRA's view that the bare trust is not eligible to register for GST purposes since its severely restricted powers do not constitute a commercial activity. Rather, it is the beneficial owners, who retain all the real power to manage and administer the trust property, that are considered to be carrying on the commercial activity.

While there are situations where section 225 of the ETA would require a trustee of a bare trust to account for the GST that it collected on behalf of another person that is involved in commercial activity, there is no provision in this case to relieve the actual supplier's responsibility to account for the GST on its supplies. In addition, there is no provision that would allow the bare trustee to claim input tax credits on behalf of another person as the bare trustee is not involved in the commercial activity, nor was it the recipient of any related supplies.

In contrast, a joint venture is not a person for purposes of the ETA and therefore is not entitled to register for GST purposes. As you are aware, the participants in a joint venture activity may register in respect of their joint venture activities, or may be registered prior to their involvement in the joint venture as a result of other activities and would therefore account for their joint venture activities under their current registration, unless they have an election pursuant to section 273 in place.

Paragraph 273(1)(a) provides that where the participants of a joint venture jointly elect, all properties and services that are, during the period the election is in effect, supplied, acquired, imported or brought into a participating province under the agreement by the operator on behalf of the co-venturer in the course of the activities for which the agreement was entered into shall, for GST/HST purposes, be deemed to be supplied, acquired, imported or brought into the province, as the case may be, by the operator and not by the co-venturer. It is this deeming provision that permits an operator to account for

the GST on behalf of the other joint venture participants. In order to be designated as the "operator" of the joint venture for purposes of the provision the designated person has to be a "participant" in the joint venture. CRA interprets such a "participant" as meaning:

> "(a) a person who, under a joint venture agreement evidenced in writing, makes an investment by contributing resources and takes a proportionate share of any revenue or incurs a proportionate share of the losses from the joint venture activities; or
> (b) a person, without a financial interest, who is designated as the operator of the joint venture under an agreement in writing and is responsible for the managerial or operational control of the joint venture."

There is no provision that would allow the operator of a joint venture to account for these deemed supplies through a third party's GST account.

5. ***RC 59 Processing***

(a) What is the business protocol for CRA regarding the processing of RC59s for GST purposes? Specifically, what is the expected timeline for the processing of RC59s?

<u>Response:</u>

RC59s that are completed correctly should be processed within 15 business days of receipt in the Business Number Services units in the Tax Centres. The Winnipeg TC is currently working within this time frame; however, there are times when large quantities of RC59s are received and it is a challenge to process them within 15 business days. Delays in processing may take place as intakes increase substantially during the T2 Filing season. The large volume of requests received in this short period of time creates challenges to get the requested consent forms completed within 15 business days.

From April 1, 2008 to March 31, 2009 the Winnipeg Tax Centre alone received 274,754 RC59 requests, with as many as 11,773 in a one week period.

Incomplete forms have also delayed processing while we return the RC59 to the business to obtain all the required information.

Note: Background
RC59 requests have increase substantially due to MyBA and businesses requesting online access for their authorized representatives. Many businesses have requested on-line access for their representatives in 2008 so this may decrease RC59 requests in this upcoming year.

The WTC has found that RC59 Business Consent Forms are filed in the T2 return each year even if there are no changes to an authorized representative. This form gets automatically printed with some software packages. The CRA has consulted with the

software developers to have this changed to reduce the number of RC59 requests received.

It is important to note that RC59 Business Consent Forms are valid for the time period specified on the RC59 or until the business revokes the consent. Unless a change has to be made to an existing authorization or a new authorization is required, there is no requirement to file an RC59 on an annual basis.

(b) Is there a policy that will allow any CRA official (auditor, business windows, or otherwise) to speak with taxpayer representatives when an RC59 is presented to them in person?

Response:

Client information is available only to authorized employees of the CRA who require the information to carry out their official duties (ie., employees with the "need to know") Client information will not be disclosed to anyone outside the CRA, unless one of the following applies: The client has provided the CRA with consent, as required by the ITA and the ETA; the consent must be in writing and signed using standard CRA forms, including T1013 *Authorizing or Cancelling a Representative Form* (formerly identified as Consent Form), RC59 *Business Consent Form*; or some other form of written consent that provides all the information addressed on CRA standard forms.

Consent can be arranged by going on-line at www.cra-arc.gc.ca/mybusinessaccount. Access can be arranged for telephone, fax, mail or appointments.

6. *Complex Enquiries Referrals*

When a Business Window Officer cannot answer a question about a client's GST account, they often refer us to the "Complex Inquiries" department; however, when we phone the Complex Inquiries department, we are advised they do not deal with GST. Does this reflect an error in the reference material provided to Business Windows or a change in the scope of Complex Inquiries? Why is the Business Window referring taxpayers to "Complex Inquiries" for GST issues when that department does not deal with GST? Where should issues the Business Window Officers are unable to deal with be addressed?

Response:

It is not within the purview of the "Complex Inquiries" department in Audit to answer GST/HST questions posed by registrants. All technical advisors in that department are aware that these types of questions must be directed to GST/HST Rulings in a particular TSO. Business Windows is aware of this procedure. There have been no changes to this procedure.

7. Rebates

Some of our members have experienced situations where GST rebates claimed on line 111 of a GST return are not processed at the same time as the other items on the return. The result is the taxpayer receives statements indicating balances due, with interest. While we understand that line 111 represents an "application" for a rebate and must still be reviewed and approved, can you advise why the rebate cannot be credited at the same time as the rest of the return?

Response:

GST rebates and GST returns are two separate legal documents. As such, both are entitled to a notice of assessment. Unfortunately, the return in most every case is finalized before the rebate, therefore showing the balance owing plus interest. When the rebate is posted the debt is paid using the appropriate received date and any residual rebate balance is paid to the client.

GST returns are processed in the TC of record, whereas all GST rebates are separated and processed at the Summerside TC. As the GST rebates are sent to a different location there can be delays in processing. The GST return includes verses which state:

> "Failure to pay the balance owing may result in legal action being taken without further notice.
>
> If you have already paid this amount, please disregard this message.
>
> Any amount owing may be adjusted pending the processing of your rebate and may be subject to arrears interest."

If there are any questions as to why they are not on the same NOA, the following is a list of reasons why the return and rebate information do not go out on the same NOA:

- Rebate may not cover the entire debt or it may be disallowed or adjusted down so the taxpayer should be advised of the total debt from the return as soon as possible.
- Return may be a credit return and does not need to wait for the rebate. If we hold the refund waiting for the rebate, then we may have to pay credit interest.
- There is a legal requirement to send the assessment as the taxpayer has appeal rights.
- The rebate would be considered a separate assessment from the return.

8. Change of Nonresident's Registration

In January 2009, a Canadian corporation ("CanCo") supplies intangible personal property to a non-resident US corporation ("USCo") that is not registered for GST. Pursuant to VI-V-10.1, this supply was zero-rated. In March 2009, USCo determines that it should have registered for GST effective January 1, 2008. What effect, if any, does this have on the

earlier zero-rated charge from CanCo? Has CanCo failed to collect the right amount of GST, even though USCo was not registered at the time the supply was made? If CRA should later audit CanCo's Jan/09 return, would it assess GST on the basis that the supply was not zero-rated?

Response:

A supply of intangible personal property that is made in Canada may be zero-rated (taxable at the rate of 0%) as an export under Part V of Schedule VI in certain circumstances. Pursuant to subsection 165(3), the tax rate in respect of a taxable supply that is a zero-rated supply is 0%.

Subsection 123(1) defines a "registrant" to mean a person who is registered or who is required to be registered under Subdivision d of Division V.

Section 10.1 of Part V of Schedule VI zero-rates a supply of intangible personal property (IPP) made to a non-resident person who is not registered under Subdivision d of Division V of Part IX at the time the supply is made, but not including:

> (a) a supply made to an individual unless the individual is outside Canada at that time;
> (b) a supply of intangible personal property that relates to
> > (i) real property situated in Canada,
> > (ii) tangible personal property ordinarily situated in Canada, or
> > (iii) a service the supply of which is made in Canada and is not a zero-rated supply described by any section of this Part or Part VII or IX;
>
> (c) a supply that is the making available of a telecommunications facility that is intangible personal property for use in providing a service described in paragraph (a) of the definition "telecommunication service" in subsection 123(1);
> (d) a supply of intangible personal property that may only be used in Canada; or
> (e) a prescribed supply.

To support the zero-rating of supplies of IPP under section 10.1 of Part V of Schedule VI, suppliers must verify and maintain satisfactory evidence of the registration and residency status of the recipients of the supplies. Specifically, suppliers must verify and maintain satisfactory evidence that the recipients are not registered and are non-residents of Canada when the supplies are made.

For purposes of zero-rating supplies of IPP made over the Internet, the CRA will generally accept an online self-declaration by customers that they are not registered as proof that the customers are not registered.

To support the zero-rating of supplies of IPP, suppliers must further verify and maintain satisfactory evidence that the supplies are made to non-residents of Canada at the time supplies are made.

The CRA will generally accept an online self-declaration by customers that they are not residents of Canada along with their complete address as proof of their non-resident status, provided it is supported by another satisfactory verification method such as:

- if customers pay for the supplies of IPP by credit card or debit card, either a comparison of the customer's declared address with the billing address or a comparison of the customer's declared address with the location of the financial institution that issued the card; or
- the use of geo-location software to record their location.

Therefore, if USCo was required to have been registered at the time CanCo supplied the IPP to USCo, the zero-rating provision of section 10.1 of Part V of Schedule VI does not apply.

9. *NPO Rebate Timing*

A non-registered NPO with a December 31 fiscal year-end receives, for the first time, a large amount of government funding early in its fiscal year. This amount of funding represents 95% of the NPO's revenue for the current year. However, it is not until the NPO has its financial statements for the year prepared (possibly over a year after receiving the government grant, and likely some time after a significant portion of the funds have been spent) that it can determine its level of government funding and consider itself a "qualifying NPO" under the legislation. This means that the NPO must wait until well into its subsequent fiscal year to claim a rebate for any GST paid as a result of it spending the government funding received.

Has CRA given any consideration to administratively allowing such an entity to file QNPO rebate claims in the "current year" rather than waiting until the next year to do so? We acknowledge that this would require repayment in the event the NPO was ultimately determined not to be a QNPO, but this is the case for an existing QNPO whose government funding declines or other funding rises to a point that it no longer qualifies.

Response:

All legislative references are to the *Excise Tax Act* (ETA), unless otherwise specified.

An NPO may claim a Public Service Body Rebate (the Rebate) for non-creditable tax charged in respect of property or services for a claim period of the NPO pursuant to subsection 259(3) where the NPO is a qualifying NPO on the last day of that claim period or of the fiscal year that includes that claim period. Pursuant to subsection 259(2), an NPO is considered to be a qualifying NPO at any time in its fiscal year if the NPO's percentage of government funding for the year is at least 40%.

Pursuant to subsection 3(1) of the *Public Service Body Rebate Regulations*, an amount of government funding is considered to be government funding for a particular year if it is "… identified in the annual financial statements of the particular person for the year as government funding…" and it "was received or became receivable in the year." In addition, pursuant to subparagraph 3(1)(b) of the same regulations, for purposes of calculating the percentage of government funding for a year, an NPO can base its calculations either on its current year's revenues and government funding or the average of the amounts over the two preceding years as identified in the financial statements for those years.

Therefore, the *Public Service Body Rebate Regulations* specifically require an NPO to show that it meets the percentage of government funding criteria by identifying its government funding for the year (or two previous years) in its annual financial statements. Given such a clear statutory and regulatory framework, where an NPO does not meet the percentage of government funding based on revenues from the two previous years the CRA is unable to create an administrative provision to allow an NPO to determine if it is a qualifying NPO by estimating its percentage of government funding for the year.

10. ***Voluntary Disclosure – Interest Relief***

In a GST voluntary disclosure involving a non-wash transaction situation (i.e. over-claimed ITCs, GST not collected from persons unable to claims ITCs, etc.) there is no penalty relief for periods required to be filed after April 1, 2008. Accordingly, there is only a potential for interest relief from the current prescribed rates. We have learned through a recent disclosure process that the Minister will reduce the prescribed rate by 4% in order to approximate the pre-April 1, 2008 prescribed interest rates for GST/HST arrears.

This particular policy is not outlined in IC-001R2 or in any public document that we are aware of.

(a) Is this a new policy and head office directive that is intended to remain in place for the foreseeable future?

Response:

There is no new VDP policy.

(b) If so, when and where will this policy be published?

Response:

As noted there is no new VDP policy.

(c) Is this relief almost always automatically granted except for very egregious circumstances similar to the former wash penalty relief?

Response:

For post 2007 disclosures any relief is granted only when the disclosure meets all four conditions of a valid disclosure, and as the IC states:

> In addition to penalty relief, if a disclosure is accepted as valid by the CRA, the Minister may grant partial relief in the application of interest against a taxpayer in respect of assessments for years or reporting periods preceding the three most recent years of returns required to be filed.

(d) Is the CRA planning on considerably revamping the GST/HST aspect of the Voluntary Disclosure program (i.e. a new GST Memorandum 500-3-4R2) and if so, when is it expected to be released?

Response:

No such plans are anticipated.

11. *GST Returns Not Forwarded by Financial Institution*

We have encountered several instances over the past year under the recently-introduced GST filing protocol where a return filed by a client at a bank with payment is not forwarded by the bank to the CRA. The registrant is then charged a penalty for failure to file. We understand the Agency wishes to support tax payments at a financial institution. Please comment as to what actions a taxpayer should pursue in this situation.

Response:

On several occasions, GST/HST Returns Processing HQ have been in contact with our colleagues that liaise with the Bank of Canada and reiterated the importance of the GST/HST returns filed at financial institutions being forwarded to the Canada Revenue Agency on a daily basis. In some instances the reason that the GST/HST return has not been processed is because the taxpayer has filed the incorrect portion of the return and therefore we have been unable to process it and there wasn't enough identification information to identify and contact the taxpayer.

12. *Document Retention and Basic Tax Content ("BTC")*

The ETA contains several rules determining the GST implications related to the change in use of capital personal property and capital real property (eg., 199(3), 200 (2) and 206(2)-(5) of the ETA). Pursuant to the change of use provisions, the BTC of the property must be determined in order to calculate the amount of GST payable (decrease in commercial use) or the amount of ITCs claimable (increase in commercial use). The ETA contains exact rules, how the BTC must be calculated, whereas the ETA does not contain any explicit rules about what kind of documentation is required to support the BTC calculation.

It is almost 20 years since the GST was implemented. It is not uncommon that registrants own capital properties which either were purchased or improved not long after the introduction of the GST.   Pursuant to the 286 (3) of the ETA, every person required to keep records shall retain them [only] until the expiration of six years after the end of the year to which they relate or for such period as may be prescribed. We consider that the original purchase invoices of capital property (or improvement of capital property) do not relate to the change of use but to the year of the purchase (or, eg., to the completion year of the construction work). Contrary interpretation would mean that the retention period for records related to capital property would *de facto* be perpetual. Such an interpretation would be contrary to the wording of the ETA. As a practical viewpoint it is also clear that the GST registrants do not have the physical ability to retain their records (paper or electronic) forever. Therefore, believing there must be also other legitimate options to support the BTC calculation documentation, we kindly request your opinion on the following.

(a) What documentation is required by a registrant to support the basic tax calculation if the capital property was acquired beyond the normal six years retention period and the registrant either becomes liable to pay GST or is eligible to claim input tax credits as a consequence of a change in the commercial use of capital property?

(b) How, if at all, does the Agency's interpretation of documentation required to support the BTC content of an asset differ from their interpretation of documentation to support the income tax cost of the asset in the year in which it is disposed of, whether by way of deemed or actual disposition?

Response:

Subsection 286(1) of the *Excise Tax Act* (ETA) stipulates that every person carrying on a business or that is engaged in a commercial activity in Canada, every person who is required to file a GST/HST return and every person who makes an application for a rebate or refund is required to keep records in English or in French in Canada (or at such other place and on such terms and conditions as the Minister may specify in writing), in such form and containing such information as will enable the determination of the person's liabilities and obligations or the amount of any rebate or refund to which the person is entitled.

Subsection 286(3) provides that every person who is required to keep records shall retain them until the expiration of six years after the end of the year to which they relate or for such other period as may be prescribed. To date, there are no regulations under the ETA prescribing retention periods.

Subsection 286(3.1) provides that every person required to keep records who does so electronically shall retain them in an electronically readable format for the retention period set out in subsection 286(3).

The minimum retention period for the records referred to in subsection 286(3) is generally determined by the last year when a record may be required for purposes of the ETA and not the year when the transaction occurred and the record was created. For example, records supporting acquisition and capital cost of property held by a person (including public service bodies) should be maintained until the day that is six years from the end of the last year in which such an acquisition could enter into any calculation for GST/HST purposes, including the calculation of the BTC.

Therefore, in those situations where as a result of a change in use of capital property there has been an increase in use of capital property in commercial activity entitling a registrant to claim additional input tax credits (ITCs), the calculation of the additional ITC must be supported by adequate documentation and must be retained for a period of six years from the end of the reporting period in which the additional ITC was claimed.

The CRA's interpretation of documentation required to support the BTC of an asset is consistent with the documentation required for purposes of the *Income Tax Act* as per paragraph 29 of Information Circular IC78-10R4, *Books and Records Retention/Destruction.*

13. *Input Tax Credit (ITC) for GST Paid in Error*

When the CRA comes across an ITC claimed for GST that was actually paid in error, will the registrant be denied the ITC? Where the Minister prepares an assessment for the ITC denial, we anticipate a determination has been made by the Minister that a rebate for tax paid in error has not been made. Accordingly, we further anticipate the Minister "shall apply all or part of the allowable rebate against that net tax or overdue amount as if the person had, on the particular day, paid or remitted the amount so applied on account of that net tax or overdue amount." [ss 296(2.1)].

Is the present practice for the Minister to follow this provision? If not, why not?

Response:

In order for a registrant to be eligible to claim an input tax credit (ITC) under section 169, the GST/HST must be payable by the registrant, or paid by the registrant without having become payable. Where the registrant was charged an amount in error as or on account of GST/HST, the GST/HST was not payable or paid by the registrant without becoming payable and, accordingly, the Minister may deny the ITC when assessing the registrant.

However, where the registrant paid an amount as or on account of GST/HST in error, the registrant may be eligible to claim a rebate of the amount under section 261. That section provides that where a person has paid an amount as or on account of, or that was taken into account as, tax, net tax, penalty, interest or other obligation under Part IX of the ETA in circumstances where the amount was not payable or remittable by the person,

whether the amount was paid by mistake or otherwise, the Minister shall, subject to subsections 261(2) and (3), pay a rebate of that amount to the person.

Section 296(2.1) provides that where, in assessing the net tax of a person for a reporting period of the person or an amount (referred to as the "overdue amount") that became payable by a person under Part IX, the Minister determines that:

(a) an amount (referred to as the "allowable rebate") would have been payable to the person as a rebate if it had been claimed in an application under Part IX filed on the particular day that is

- *if the assessment is in respect of net tax for the reporting period*, the day on or before which the return under Division V for the period was required to be filed, or
- *if the assessment is in respect of an overdue amount*, the day on which the overdue amount became payable by the person.

and, where the rebate is in respect of an amount that is being assessed, if the person had paid or remitted that amount,

(b) the allowable rebate was not claimed by the person in an application filed before the day notice of the assessment is sent to the person, and

(c) the allowable rebate would be payable to the person if it were claimed in an application under Part IX filed on the day notice of the assessment is sent to the person or would be disallowed if it were claimed in that application only because the period for claiming the allowable rebate expired before that day,

the Minister **shall** apply all or part of the allowable rebate against that net tax or overdue amount as if the person had, on the particular day, paid or remitted the amount so applied on account of that net tax or overdue amount.

Accordingly, where the registrant has paid an amount as or on account of, or that was taken into account as, tax and **has met all of the conditions** for claiming the rebate under section 261 and subsection 296(2.1), the Minister **shall** apply all or part of the allowable rebate against that net tax as if the person had, on the particular day, paid the amount so applied on account of that net tax.

14. *Sale of Repossession Rights*

ACo and BCo are Canadian-controlled private corporations that deal at arm's length. BCo currently holds a judgement against another arm's length party that grants BCo the right to repossess a residential property that BCo held as security for a mortgage to that arm's length party. ACo purchases from BCo the rights under that judgment. Would there be GST on the purchase of the rights? Under s.183 ETA there is usually no GST on repossession of property. Furthermore, mortgages are financial instruments and are thus

exempt. The issue, however, is that ACo is not buying a mortgage, but the rights under the mortgage. Rights of any kind are property pursuant to 123 ETA. ACo is purchasing the rights to repossess, which is not really a financial instrument either. What is the CRA's view?

Response:

From the limited information provided, it appears that ACo purchases a court-ordered right to take ownership of a residential property that has been granted to BCo. It is our view that this right is an interest in real property which falls within the definition of "real property" in subsection 123(1) of the *Excise Tax Act* (ETA).

A sale of property is defined in subsection 123(1) of the ETA to include a transfer of ownership of the property and a transfer of possession of the property under an agreement to transfer ownership of the property. Therefore, it is our view that BCo is making a supply by way of sale of real property. The sale of real property is a taxable supply unless the supply meets the conditions of any of the exemption provisions under Part I of Schedule V to the ETA.

Subsection 183(1) of the ETA will not apply to the supply of the interest in the real property made by BCo to ACo. When ACo takes ownership of the real property, the transfer of ownership to ACo would also not fall under section 183. However, the value of the consideration for the transfer of legal title to ACo may be negligible given that ACo has paid consideration for the acquisition of the interest in the real property to BCo.

15. *Incorrectly Filed GST Returns Cancelled*

We have had a number of clients file returns with payment and later receive Reminder Notices that returns are overdue.

Through contacting the CRA, we usually determine the Registrant made an error on the return which prevented the return from being filed. The return is cancelled by the CRA without notification.

Is the CRA looking at implementing a process that will generate a notice to the registrant that indicates the return submitted could not be accepted as filed due to a specific reason/criteria?

Response:

When a GST/HST return is filed by a taxpayer but it is deemed by the CRA to have not been completed properly or with the necessary information, then the return is cancelled and a letter is issued to the taxpayer explaining what necessary information is missing and required in order to process the return and fulfill the obligation to file.

MyBA will also allow the taxpayer to view their return status.

The only situation where a taxpayer would not be notified when a GST/HST return is filed and cannot be processed is when there is not enough identification information in order to contact the taxpayer. In all other situations, a letter is issued to the taxpayer explaining what necessary information is missing in order to process the return.

16. *Date Stamping*

In Edmonton, some documents that are hand-delivered to the CRA will not be date-stamped by the CRA unless a cheque is attached to the document. It is our understanding that there are some firms in Edmonton that have been able to have documents date-stamped by CRA acknowledging receipt. Please advise which office in the CRA building is accepting documents and date-stamping them as received.

Response:

The Canada Revenue Agency (CRA) has been migrating taxpayers towards more affordable, accessible and equitable service channels. As a natural progression to the self-service options, CRA has recently implemented self-serve stamping machines in tax services offices (TSOs). When a proof of delivery is required, taxpayers can stamp a copy of their document for their records and deposit the original in the accompanying secure drop box. In Edmonton, there are two Self-Serve Stamping Stations located in the Enquiries Office on the Main Floor of Canada Place.

Prior to the installation of these stamping machines, the Enquiries Office would date-stamp hand delivered items upon request and would also stamp a copy of the covering letter or first page of the return for the taxpayer's or firm's records if a photocopy was supplied for that purpose.

With the new machines, we encourage you to bring your copy and original document, stamp your copy and deposit the original at our Self-Serve Stamping Stations.

17. *Draft Legislation*

On April 7, 1997, the Department of Finance issued press release 97-030 proposing amendments to clarify that a deemed trust for unremitted source deductions and GST (and associated Crown priority) applies whether or not other security interests have been granted in respect of the property of the tax debtor. However, the press release stated that the "deemed trust provisions will not, however, override a prescribed security interest such as a mortgage interest in real estate or other exceptions that may be provided by regulation, where the failure to remit source deductions or net GST cannot benefit the secured creditor."

The press release stated that the proposed amendments would apply from June 15, 1994 (the date the relevant provision of the *Income Tax Act* (ITA) had last been repealed and replaced). The amendments to the ITA, and ITA Regulation 2201 prescribing mortgage interests, subsequently were enacted in 1998, retroactive to June 15, 1994. The parallel amendments to the *Excise Tax Act* (subsections 222(3) and (4)) were enacted in 2000, but only came into force on Royal Assent (October 20, 2000). The proposed parallel GST regulation was not enacted (or even issued in draft form) at the same time. However, the explanatory notes to new subsection 222(4), issued on December 10, 1998, stated that the prescribed security interests under that subsection would include certain mortgage interests, as proposed in the April 7, 1997 press release. That GST regulation has yet to be issued. In informal discussions, the Department of Finance has indicated that there has not been any change in policy and that the proposed regulation still is pending.

Is it the CRA's current administrative policy to treat mortgage interests in real estate as prescribed security interests under subsection 222(4), notwithstanding that the related proposed regulation has yet to be promulgated?

Response:

Subsection 222(4) of the *Excise Tax Act* provides that for the purposes of subsections 222(1) and 222(3) a security interest does not include a prescribed security interest. Although Finance Press Release 97-030 and the explanatory notes to subsection 222(4) both suggest certain mortgage interests in real property would be prescribed, no regulations have been introduced to prescribe security interests for the purposes of subsection 222(4). Therefore, the administrative position of the Canada Revenue Agency is that there are no security interests currently prescribed for purposes of subsection 222(4).

18. *Appeals*

Income tax question 33 at last year's Roundtable dealt with the problem of arranging face-to-face meetings with an Appeals officer where a Notice of Objection is assigned to a Tax Services Office not in close proximity to the location of the taxpayer or their representative. The CRA's response included the following comment.

> "A vast majority of files are resolved without the need for a meeting. We understand that sometimes face-to-face meetings are desirable and required to facilitate the resolution of a file. If it is determined that a face-to-face meeting is necessary, arrangements can be made with the closest service delivery point to facilitate this requirement."

Whether a meeting is required can often be determined fairly shortly after an Appeals officer begins to work on a file and initiates contact with the taxpayer or representative. The taxpayer or their representative will already be aware of the issues and the likely desirability or necessity of a meeting. Would the CRA concur it would be desirable for the taxpayer or their representative to advise the CRA of their belief that the efficient

completion of the file will likely require a meeting at that early stage? If it is agreed that a meeting would likely facilitate resolution, it would then be practical to transfer the file to an Appeals Officer at the closest delivery point in the interests of maximizing efficiency of the Appeals process for both the taxpayer and their representative. It seems it would commonly be difficult for an Appeals Officer at the closest service delivery point to become involved solely for the purpose of a meeting, without being involved in either the previous or the subsequent work on the file. The other alternative would be for the Appeals officer at the other delivery point, possibly quite distant, to travel to attend the meeting, attracting additional costs for the CRA. We would consider it reasonable for the Agency to request the taxpayer's acknowledgement that the transfer of the file to the closer delivery point will likely delay the processing of the Appeal due to differing workloads between the location of initial assignment and the closer delivery point.

Response:

As stated in question 33 of last year's Roundtable, "a vast majority of files are resolved without the need for a meeting. We understand that sometimes face-to-face meetings are desirable and required to facilitate the resolution of a file. If it is determined that a face-to-face meeting is necessary, arrangements can be made with the closest service delivery point to facilitate this requirement." Where a request is made by the taxpayer or their representative to transfer the file to an Appeals Officer at the closest delivery point, as a result of a perceived need for a face-to-face meeting, these requests will be reviewed on a case-by-case basis by Appeals staff in the office where the file is being reviewed. When necessary the respective Chiefs of Appeals will resolve the request.

19. *Wash Transactions*

Except in the rare cases involving gross negligence, registrants who find errors in returns filed for periods after March 31, 2007 are generally confronted with the same penalty and interest result if they make a voluntary disclosure as would occur if the CRA discovered the errors on audit. This is particularly true where the error involves a wash transaction. Is the CRA giving consideration to providing an incremental waiver of interest in voluntary disclosure situations to encourage registrants to come forward? We note that this incremental waiver remains available for periods prior to April 1, 2007.

Response:

VDP is aware of the impact of the GST legislative changes on the program, and is administering the VDP status quo. However, VDP, in conjunction with other areas of the CRA, continues to monitor the impact and review this issue. In the meantime, the VDP/CRA would welcome any submission that you wish to make outlining concerns regarding the impact of these legislative changes.

20. *Public Service Body GST Rebates*

CRA permits GST refunds to be mailed to third party representatives. However, in the case of Public Service Body GST Rebates, the refunds cannot apparently be mailed to the third party representatives. Is this the correct policy of CRA? Please explain the rationale for this policy.

Response:

As part of our procedures we do not allow for third party representatives to file rebate applications on behalf of Public Service Bodies. This direction is derived from the *Audit Directive 96-02 PSB Rebates and Third Party Cheques,* which describes the policy and is available on the Compliance Programs Reference Material section of the CRA Library. The policy was released by the Rebates Section, Small and Medium Enterprises Division (before it came to ABSB). The system is built to allow third party service providers for Public Service Bodies, but we do not use it because we continue to follow the direction from the CPB directive (96-02).

21. *First Nations GST Refunds*

CRA refund claim procedures require that Code 1 GST Rebate claims must be supported with the submission of original documents to CRA. However, in situations involving First Nations, the requirement to support the Rebate claim with original documents often becomes an untenable or impossible requirement to satisfy. Is there a possibility of excepting the requirement to submit original documents in claims involving First Nations? Please explain the rationale behind this requirement.

Response :

For purposes of the General Rebate Application, Reason Code 1 is “Amounts paid in error”, while Reason Code 8 is specific to an “Indian band, tribal council, or band empowered entity”. Reason Code 8 normally allows an Indian band, tribal council or band-empowered entity (BEE) to recover the GST/HST that these entities have paid for purchases off-reserve for transportation, short-term accommodation, meals and entertainment that relate to band management activities, or for real property on reserve.

For both Reason Code 1 and Reason Code 8 rebate applications, original documentation is required in order to substantiate the claim. The requirement for original documentation is designed to ensure that conditions relating to the entitlement to the rebate are met, and to ensure the accuracy of the rebate payment.

For Reason Code 8 rebate applications only, the Canada Revenue Agency (CRA) realizes that some Indian bands, BEEs or tribal councils may not find it practical to submit original documentation with their rebate claim. In recognition of this, the CRA allows these entities to make a request, in writing, to waive the requirement to submit original

documentation with the rebate request, and to allow the entity to retain the original documents on file. In order for this waiver to be allowed, the entity must agree to allow the CRA the right to review the original documents, which must be kept on file by the entity. The letter requesting the waiver must include, along with identifying information and appropriate authorization, an estimate of the annual purchases subject to rebate and the expected filing frequency for the rebate applications. Once a request has been made, the waiver, if approved, will be kept on file by the CRA; therefore, it is only necessary that the Indian band, tribal council or BEE make a single request for a waiver. To simply grant a blanket waiver of the requirement to file original documentation would compromise the ability of the CRA to determine the entitlement to the rebate and the accuracy of the payment.

Please note that there is no waiver which applies to Reason Code 1 rebate applications at any time, but only to Reason Code 8 rebate requests made by Indian bands, tribal councils or BEEs. In all cases, Reason Code 1 rebate applications must be accompanied by the original documentation. The rationale for requiring original documentation in all cases for Reason Code 1 rebates is that these rebates are intended to be filed only in exceptional circumstances where an amount as GST is overcharged in error by the vendor. A taxpayer should rarely have to file a Reason Code 1 rebate application because there should be very few vendor mistakes. As well, the purchaser always has the option to request an adjustment from the vendor when an amount was incorrectly charged pursuant to section 232 of the *Excise Tax Act* (ETA). In this way the vendor becomes aware of the mistake so that it does not arise again.

In summary, as previously indicated, an Indian band, tribal council or BEE should not have very many situations where it has paid an amount as GST where the supply met the requirements for tax relief as set out in Technical Information Bulletin B-039R *GST/HST Administrative Policy – Application of GST/HST to Indians (B-039R)*.

22. *Business Registration*

We find the present registration system and rebate system of communicating through a fax machine to be problematic in many cases. Would it be possible to provide some alternative means of communicating with CRA to obtain assistance regarding registrations, outstanding filings, held refunds and similar issues? While we appreciate the greater efficiency provided by effectively restricting communications to written fax submissions, there are often occasions when direct contact facilitates a much more efficient and timely resolution for all parties. We would not suggest that the CRA communicate with taxpayers or their advisors exclusively in writing—a telephone call is often much more efficient and effective. Would the Agency consider providing an ability to make direct contact with representatives that can assist with matters such as these?

Response

The Business Enquiries line is available to anyone seeking assistance with enquiries related to business and/or self-employment. Business Enquiries (BE) Agents respond to

enquiries involving business and GST/HST registration, payroll, GST/HST (including rebates such as the new housing rebates), excise taxes and other levies, excise duties, corporations, sole proprietorships and partnerships. BE Agents are able to process certain registrations over the phone, inclusive of registrations for various program accounts, such as a GST/HST program account. In addition, agents are able to assist with account specific enquiries, such as providing information on outstanding returns and refunds being held, provided that the caller that is enquiring is authorized to obtain this information.

Taxpayers can contact the Business Enquiries line at the following numbers:

- for service in English: **1-800-959-5525**
- for service in French: **1-800-959-7775**

Telephone agents are available Monday to Friday (except holidays) from **8:15 a.m. to 8:00 p.m. (local time)**.

For those rebate situations involving Summerside Tax Center, if a Tax Center Officer speaks with clients, or if the clients have information that they want to send regarding their rebate applications, the Tax Center Officer will provide a fax number to send the information in or taxpayers are advised they can mail the information in.

If taxpayers have questions regarding a specific rebate application they have filed, ie., status enquiry, they can call our 1-800 (1-800-565-9353) and they will be provided with whatever information that the Tax Center has. The only time a taxpayer would go through the general enquiry number is if the taxpayer had not filed the application and was just looking for some general information.

Income Tax Questions

1. *Limited Partnership Investments*

Many investors acquire interests in widely held limited partnerships, and as a result are allocated business income from such entities on an annual basis. Such income is often earned in one or more provinces other than the limited partner's province of residence, and sometimes is earned in foreign jurisdictions. In some cases, this results in an allocation of business foreign taxes to the limited partners.

As partners are deemed to carry on the partnership business, they are subject to the usual requirement to allocate their income between jurisdictions using Form T2203 and to claim applicable business foreign tax credit. It is the writer's experience that taxpayers who appropriately file the T2203 form are typically assessed without considering the allocation of business income between jurisdictions, resulting in business foreign tax credit claims being denied and provincial tax being assessed only to the province of

residence. All such returns must be filed on paper, as the T2203 precludes electronic filing. We are uncertain why these forms are so consistently not processed.

This issue can be quite onerous for taxpayers and their advisors when one considers the effort often required to determine the appropriate allocations (commonly exacerbated by the T5013 forms themselves failing to reflect the necessary details) for these relatively small amounts. Often, the investor has investments in multiple limited partnerships and/or has income from self-employment activities in which they are active. However, the aggregate income of the partnerships is likely significant. Given the attention paid in recent years to appropriate allocation of the tax base between the provinces, we anticipate the provinces where these partnerships conduct business would wish to have the income properly allocated.

Does the recurring failure to process these T2203 forms reflect an interpretation that such income is exempt from the multiple jurisdiction allocation (and, if so, the technical basis for this interpretation)? If not, will the Agency take some action to educate its assessors? We would also ask that the CRA consider educating the partnerships themselves so they can provide more appropriate and accurate information to facilitate these computations.

Response:

Ensuring proper income allocation between jurisdictions is an important issue to both the CRA and the provinces. Given the short time frames, we have conducted a preliminary review of the concerns raised about the filing of the T2203 form and find that the CRA is properly assessing and processing these returns. We believe there are appropriate safeguards in place to ensure there is a proper income allocation between jurisdictions. Nonetheless, it is possible that certain T2203 forms may not have been processed as indicated in the question. It is difficult for the CRA to address specific situations without additional information. Consequently, we welcome the originator of this question to contact us with additional details in order to assist in our investigation in resolving this potential error.

The CRA is continually looking at ways to simplify and improve this process while ensuring data integrity. However, we would like to stress that the T2203 form must be filed when business income is earned by individuals in more than one jurisdiction in order to allocate taxable income to the appropriate jurisdiction. Any errors in processing such form by the CRA, if that is the case, should not be misconstrued or interpreted to mean that such income is exempt from the multiple jurisdiction allocation. Canada's tax system is based on a self assessment system and as such it is up to the taxpayer to file its returns correctly and raise any perceived errors or omissions to the Agency.

As for the Foreign Business Tax Credit not being allowed, there was a problem that was brought to our attention regarding this matter. Although the problem was not directly related to multiple jurisdiction returns, it could have caused some difficulties. We have clarified and enhanced our instructions to ensure that the T2209 – Federal Foreign Tax

Credits is carefully reviewed for claims for foreign business tax credits and to greatly reduce the possibility of human error.

Additional information on this issue may be found on our website, www.cra-arc.gc.ca. These include IT-270R3 and IT-506 dealing with Foreign Tax Credits. There are also links to form T5013 – Statement of Partnership Income and T4068 – Guide for the T5013 Partnership Information Return. We will also be considering additional publications to assist the taxpayer in the filing with respect to income allocation.

2. *Issuance of Promissory Notes*

In Technical Interpretations 2007-0229311I7 and 2007-0229431I7, the Agency indicated that the addition of a capital dividend to the shareholders' loan accounts in the corporate records would not constitute payment of the dividend, with adverse or advantageous results to the taxpayers in question. This is consistent with the comments in Interpretation Bulletin IT-109R2, paragraph 15(b), that issuance of a promissory note is regarded as a payment of the debt only if the agreement between the parties "clearly indicates that the note was accepted as absolute payment".

This same logic would seem to apply to other amounts, such as the payment of taxable dividends, inter-corporate charges or remuneration paid to employees. The timing of such payments can, of course, be extremely important in determining income tax consequences.

We are uncertain of the mischief the Agency seeks to prevent with these recent interpretations and would ask that these be explained.

We would appreciate the Agency providing some guidance as to the manner in which taxpayers are expected to document the payment of amounts such that the Agency will accept they have been paid and received as intended by the parties.

Response:

In the two Technical Interpretations mentioned above, the CRA did not seek to prevent any particular mischief. The issue to be addressed was at what point a capital dividend could be considered "received by a taxpayer" for the purposes of the Act.

We note that, in the situation described in Technical Interpretation 2007-022931, at the outset, there was not even a journal entry recording the purported non-taxable capital dividend payable, and that the purpose of the subsequent amended financial statements issued was to record retroactively the said dividend. Moreover, the facts in Technical Interpretation 2007-022943 established that the amounts of interest and salaries payable to the sole shareholder of a corporation and recorded in the sole shareholder's loan account were considered by the parties as not received by the sole shareholder.

Both Technical Interpretations state that the question of determining when an amount may be considered "received" in a particular situation is a question of fact. The manner in which to resolve such questions turns on a number of factors, including the intention of the parties. However, the case law has consistently held that the mere crediting of an amount to a taxpayer on the books of a corporation or an employer does not constitute receipt of that amount by the taxpayer. The CRA accepts and applies these principles in determining the timing of recognition of the receipt in a particular situation and the related tax consequences.

That being said, we are of the view that the case law provides some guidance as to the manner in which taxpayers are expected to document the payment of amounts such that the CRA will accept they have been paid and received as intended by the parties.

For example, in *Banner Pharmacaps NRO Ltd. v. The Queen*, 2003 FCA 367, it was held that a dividend was paid by the corporation and received by the shareholder where a resolution declaring the dividend provided that the dividend was to be paid by means of delivery of a promissory note. The Federal Court concluded that, as the promissory note was in fact delivered as the resolution required, the dividend was therefore paid.

Furthermore, generally, the CRA does not challenge the payment of an amount where a T4 or T5 slip is issued.

3. *Eligible Dividends – S 185.1(2) Election*

Subsection 185.1(2) provides that an election to convert an excessive eligible dividend designation may be filed "in prescribed manner on or before the day that is 90 days after the day of mailing of the Notice of Assessment" of Part III.1 tax. The regulations have not yet been issued, however it is our understanding they will be similar to Regulation 2106. Based on the wording of the legislation alone, it appears the election could be filed prior to assessment of Part III.1 tax. However, Regulation 2106 requires the date of the Part III tax assessment be included in the election, and we are uncertain whether a similar requirement will appear in the regulations for this election.

Will the Agency presently accept such an election prior to assessment of Part III.1 tax and process this in conjunction with an assessment, and reversal of assessment, of Part III.1 tax, or will the Agency require the taxpayer file, report Part III.1 tax, be assessed and then elect? In the latter case, will the Agency charge interest and undertake collections action related to Part III.1 tax outstanding? We would suggest that administration by both the Agency and taxpayers would be minimized if the Agency will accept such elections in advance of an assessment. Would the Agency consider recommending to Finance that the date of assessment not be a required disclosure item under the Regulations (and, perhaps, that Regulation 2106 be modified to remove this disclosure item)?

Response:

From an administrative perspective, the CRA accepts 185.1(2) and 184(3) elections prior to the assessment of Part III.1 and Part III tax respectively. This lowers the burden on taxpayers as they do not have to submit a request for reassessment after the Notice of Assessment has been issued if they know they are in an excessive position when submitting their return. As is the case with all taxes owing, it is the responsibility of the taxpayer to pay their outstanding Part III.1 tax by the applicable due date. Collections action may result from outstanding Part III.1 tax. In the event that the election is filed after the Notice of Assessment is issued, upon processing a valid election, we will reassess the return to reverse the Part III.1 tax which was initially assessed. The reassessment will also reverse any applicable interest that was charged. This principle is the same as that applied to Part III tax; when a valid Election 184(3) is filed, the assessed Part III tax and any accrued interest is reversed. The requirement to provide the date of assessment will remain a required disclosure item on 185.1(2) elections, as it is on 184(3) elections. The information must be provided when the election is filed after the Notice of Assessment is issued. When filing the election prior to the issuance of the Notice of Assessment, the Taxpayer should indicate that the Notice has not yet been issued.

CRA is not pursuing legislative changes with respect to the process of filing ss185.1(2) elections at this time.

4. T4A Filing Requirements

At the 2006 Round Table, the Agency commented on the breadth of the requirement to file T4A slips at Question 26. The Agency's response indicated they that they were "working on the best way to communicate this requirement to the business community", and that they "want to try to avoid overloading businesses with more paper burden while ensuring that the legislation is followed". Can the Agency comment on how this matter is proceeding? We are aware of no new communication initiatives in this regard. Can the Agency provide any updates on their plans to communicate with the business community in this regard?

By way of illustration, we list only a few services which would frequently be encountered in various business operations. On a strict interpretation of the regulations, these would all give rise to the requirement to file T4A slips:

(a) An educational institution engages speakers and instructors for short periods under conditions other than those of employment.

(b) A professional education program engages members to evaluate professional examinations.

(c) A business pays its accountant for its annual audit.

(d) A business engages legal counsel, information technology support or other consultants to provide advice and consultation.

(e) A medical or dental clinic retains a portion of the fees generated by its associates, representing costs incurred by the clinic in respect of those services, remitting the remainder to the associates themselves.

(f) A business pays a professional entertainer for services at a promotional function.

(g) A business pays for professional management fees from:

(h) An unrelated service provider.

(i) A related service provider.

(j) Its parent corporation.

(k) A property owner pays management fees to a professional property manager by direct withholding from the rents collected.

(l) A business pays for services to repair and maintain its business facilities (eg. an electrician, a plumber or a carpenter).

(m) A business pays commissions to a realtor on the sale of its business premises.

(n) A business pays a loan application fee to its bank in the course of a mortgage renewal. Assuming a T4A should be issued, should the regular monthly service charges (under $500 in aggregate for most years) be included in the T4A?

(o) A retailer pays fees for processing electronic payment transactions made by debit or credit card.

(p) A trucking company subcontracts freight transport services to numerous independent contractors.

(q) A business pays for repair and maintenance services related to its equipment and vehicles.

We trust this illustrates the magnitude of the administrative burden imposed on Canadian businesses (and, for that matter, the Agency to process and match these forms) if the requirement to issue T4A slips is strictly enforced in its broadest possible interpretation. Your comments would be appreciated.

Response:

CRA is considering the administration of reporting business to business fees and services as is provided for in Regulation 200 of the Income Tax Regulations.

We recognize the significance of a change to the administration of this requirement for businesses that contract services from other business and we will take a responsible approach to implementing any changes to administration of this section. Our approach will include external consultation. We may also consider studying the impacts of administering this requirement through projects designed for specific industry sectors.

There is a significant amount of work that will have to be undertaken prior to implementation of reporting on business to business fees and services for all taxpayers and CRA is committed to keeping the interested groups and associations appraised of any new and relevant information on the subject.

5. *Dividend Refunds and Losses Carried Back*

We refer you to Technical Interpretation 2001-0100755. For illustrative purposes only, this question assumes a corporation, Subco, having net and taxable income of $1,000 of investment income. In Year 1, it pays a dividend of $800 to its parent corporation, ParentCo. In Year 3, it incurs a loss, and carries $1,000 back to offset its Year 1(3) taxable income.

In Year 1, Subco has a Part I tax liability of $347, a dividend refund of $267 and a net tax balance of $80, which it pays 60 days after year end. ParentCo owes Part IV tax of $267, which it pays 60 days after year end. The loss carried back from Year 3 results in reversal of both the tax and the dividend refund, and a $80 refund, in Subco, and reverses the Part IV tax in Parentco, which recovers $267. The TI seems to indicate the Agency's position is that Subco is subject to interest on the $267 dividend refund for the period from two months after the end of Year 1 until the loss carry back application is filed as the dividend refund is reversed. At the same date as the loss application, ParentCo is entitled to a refund of $267 for the reversed Part IV tax. Assuming the $80 is repaid to SubCo, and the $267 to ParentCo, within 45 days of the loss application, no refund interest is payable to either company. Can the CRA advise:

(a) Does the above summary accurately reflect their assessing position?

Response:

As a result of the loss carryback request, SubCo's dividend refund of $267 and its original Part I tax liability of $347 were reversed. Further, Part IV tax of $267 for ParentCo is no longer payable due to the reversal of the dividend refund of SubCo.

A summary of our assessing position, including the relevant statutory provisions, is as follows:

1. The loss carryback request creates an excess refund of $267 for SubCo according to subsection 160.1(1) of the Act. SubCo is required to pay the Receiver General interest at the prescribed rate on the excess from the date it became payable to the date of payment, in accordance with paragraph 160.1(1)(b) of the Act. In this case, arrears interest is

charged from the balance due date of the Y1 return of SubCo to the date of the loss carryback request.

2. SubCo has an overpayment of $347 of Part I tax and ParentCo has an overpayment of Part IV tax of $267. Pursuant to subsection 164(3) of the Act, SubCo and ParentCo are entitled to interest on the overpayment amounts at the prescribed rate for the period beginning on the date that is the latest of the dates referred to in paragraphs 164(3)(d) and 164(5)(d) of the Act until the date that the amount is refunded, repaid or applied.

3. With respect to the computation of interest on refunds, subsection 164(5) of the Act states that for loss carrybacks under section 111 of the Act, the date of the overpayment is deemed to have arisen on the date that is 30 days after the latest of the dates in paragraphs 164(5)(i) to (l). Therefore, the CRA shall pay interest on refunds made to SubCo and ParentCo if the payments are not made within that timeframe.

(b) Is the Agency applying such interest charges in practice, or does the Agency administratively accept that the reversal of SubCo's Part I tax offsets the reversal of the dividend refund?

Response:

The dividend refund was considered to be repaid to SubCo on the date at which the excess refund arose. The refund of Part I tax in Y1 would only arise once there is a reassessment of SubCo's Y1 return to carry back the loss. In accordance with subsection 164(2) of the Act, the Minister is permitted only to offset or apply the refund against amounts owing as of the date of the reassessment. There is no Agency administrative policy to allow for the reduction or cancellation of interest when the reversal of Part I tax offsets the reversal of the dividend refund.

(c) In the event the Agency's policy is to charge such interest, would the Agency consider it appropriate to waive such interest under the Taxpayer Relief provisions, given that SubCo and ParentCo have not, at any time, benefited from the use of the $267 in question?

Response:

Any request made under the Taxpayer Relief provisions will have to be analyzed on a case-by-case basis, taking the surrounding facts and circumstances into consideration. Taxpayers are encouraged to refer to Information Circular IC-07-1 *Taxpayer Relief Provisions* for further information.

(d) Would the CRA's position differ if SubCo were owned by one or more individuals, rather than by a corporate shareholder, such that the dividend refund would not be repaid, and subsequently reversed, in the form of Part IV tax?

Response:

Part IV tax applies on taxable dividends received by private corporations in accordance with subsection 186(1) of the Act to the extent that it is an assessable dividend. Individuals are not subject to Part IV tax.

6. *Home Renovation Credit (HRTC)*

We appreciate that this credit is very new; however, it will be available for only the 2008 taxation year, so taxpayers' need for timely information on this new credit is even more pressing than for most new credits. Can the Agency comment on the impact of ancillary business use of a residence on the availability for this credit? For example, assume an individual is paid $1,200 from his corporation for use of an office and storage space in his home. This is equal to a reimbursement of 10% of the expenses incurred in respect of the home, with no capital cost allowance claimed, as 10% of his home is used for business purposes. In 2008, in addition to the $12,000 of annual home ownership costs, the individual pays for renovations eligible for the HRTC. Please comment on the following:

(a) Would the taxpayer properly claim an HRTC on the full costs of home renovations, on the basis that income-earning use is ancillary, or be restricted to 90% of the renovation costs due to the 10% business usage?

(b) Would the Agency's answer vary depending on whether the renovations benefit the property as a whole (eg. re-roofing), or whether the renovations can be specifically linked to either personal use (eg. a new deck; finishing the basement as a play area for the owner's children) or to business use (eg. installing a bathroom near the business office)?

Response (a) & (b):

Annex 5 of the 2009 federal budget documents states that individuals who earn business or rental income from part of their principal residence will be allowed to claim the credit for the full amount of expenditures made in respect of the personal-use areas of the residence. Therefore, if expenditures are incurred exclusively for renovating or altering the personal-use areas of the residence, an individual can claim the HRTC on the full amount of qualifying expenditures. On the other hand, if the renovation work is carried out exclusively in the business-use area, the entire expenditure would not qualify for the HRTC. For expenditures made in respect of common areas or that benefit the housing unit as a whole (such as re-shingling a roof), the administrative practices ordinarily followed by the Canada Revenue Agency to determine how business or rental income and expenditures are allocated between personal-use and income-earning use will apply in establishing the amount qualifying for the credit. The proposed HRTC can be claimed on the individual's **2009** income tax return and the expenditures must be incurred for work performed or goods acquired after January 27, 2009 and before February 1, 2010 for an eligible dwelling.

(c) Assume the client builds a garage. Would the Agency expect this cost to be pro-rated based on income-earning use of the vehicle(s) stored in the garage?

Response:

If the garage is used for both personal and business purposes, the cost should be pro-rated based on the personal-use and the business-use of the garage.

(d) Ignoring business use of the residence, does the CRA concur that landscaping costs with respect to a principal residence would be eligible for the Renovation Tax Credit? We note that the Budget refers to expenditures in relation to a renovation or alteration of an eligible dwelling (including land that forms part of the eligible dwelling).

Response:

Annex 5 of the 2009 federal budget documents states that expenditures will qualify for the HRTC if they are incurred in relation to a renovation or alteration of an eligible dwelling (including land that forms part of the eligible dwelling) provided that the renovation or alteration is of an enduring nature and is integral to the eligible dwelling. Accordingly, the landscaping costs with respect to an eligible dwelling will qualify for the HRTC as long as the landscaping is enduring and integral to the eligible dwelling and the land is considered part of the eligible dwelling. However, the cost of routine maintenance normally performed on an annual or more frequent basis will not qualify for the HRTC. Also, if the land is used for income-earning purposes, the landscaping costs will not qualify for the HRTC.

We hope that our comments will be of assistance to you. Please do not hesitate to contact Ananthy Mahendran at (905) 721-5204 should you wish to discuss the contents therein.

7. *Interest Deductibility*

For several years, taxpayers, their advisors and, we expect, the CRA have followed the Lipson case, finally decided by the Supreme Court of Canada earlier this year (Lipson et al vs. H.M.Q., 2009 SCC 1). While this case was ongoing, there was considerable uncertainty as to the deductibility of interest, and the CRA indicated they could not comment until the case decision was released. With the release of this case, can the CRA advise on the following:

(a) With the case decision, will the Agency reaffirm the positions set out in Interpretation Bulletin IT-533 or, alternatively, revise this Interpretation Bulletin? When might we expect to see this Bulletin formally reinstated or amended, as applicable?

Response:

At the present time, CRA has no plans to make amendments to IT 533 as a result of the *Lipson* decision.

(b) Is the CRA willing to accept the rearrangement of one's affairs to convert what would otherwise be non-deductible interest into deductible interest for the purpose of earning investment of business income as valid tax planning, provided such restructuring is legally effective and results in the "direct use of borrowed funds" test being clearly met? Specifically, would the CRA seek to challenge a transaction identical to Singleton, either on the basis of the GAAR or on some other basis?

Response:

CRA declines to answer this question as we do not know all of the facts. However, notwithstanding IT 533, if you remain uncertain about the tax results from proposed transactions to make non-deductible interest expense deductible, as outlined in paragraph 22 of Information Circular 70-6R5, an advance income tax ruling should be requested. The review of completed transactions is generally the responsibility of the local Tax Services Office.

8. *Third Party Civil Penalties*

(a) To date, it does not appear that any penalties imposed pursuant to Section 163.2 have been challenged before the Courts, however we are given to understand there have been assessments made. Can the CRA provide an update on the statistics and the types of behavior that caused a section 163.2 penalty to be levied to date?

Response:

The author of the question is correct—no TPP has yet been challenged before the Courts. As of May 13th, the CRA has assessed six individuals and one corporation with respect to their involvement in aggressive tax planning arrangement as well as 14 tax preparers with respect to false statements they have made on their clients' tax returns. The penalties associated with the aggressive tax planning arrangements were assessed to three people who promoted a gifting tax shelter involving the purchase of a timeshare property by the plan participants that was almost immediately donated to a registered charity for an amount just over three times what the donor paid. We also levied a penalty on the director of the registered charity and the corporation that was to act as Trustee with respect to the arrangement. Penalties were also assessed to the promoter of an RRSP strip arrangement. Taxpayers directed their RRSP investments to one of the promoters companies at which point the promoter refunded approximately 60 - 70% of that amount to the taxpayer, retaining the balance as his fee. A professional attested that the promoter's companies were eligible investments for RRSP purposes—he too was assessed a TPP. Some preparers who have been assessed penalties have included fictitious amounts on their clients' tax returns. Others have turned a blind eye to obvious and egregious statements made by their clients and still others have made deceptive

journal entries resulting in false statements on their client's returns. Finally, some advisors have provided their clients with tax minimization strategies that did not comply with the *Income Tax Act* and the Third-Party Penalty Review Committee determined that those advisors reasonably ought to have known, but for their culpable conduct, that the strategies were not tax effective.

(b) Could the CRA provide some comments with respect to Project Trident, specifically with respect to tax preparer fraud? The examples on the Agency's website at this time clearly reflect criminal behavior which no legitimate tax preparer would be a party to. However, tax preparers are concerned the scope of this project may be wider. For example, does this extend to an accountant who simply claims a charitable donation on the client's tax return in accordance with the information submitted from the donation plan/tax shelter administrator?

Response:

Project Trident is a CRA-wide enforcement project that helps protect the tax-base by prosecuting key players in fraudulent tax schemes and reassessing related tax returns. Project Trident targets three types of fraud: tax preparer fraud, charity related fraud, and identity theft.

Tax preparer fraud

While most preparers provide excellent service to tax filers, a few unscrupulous ones file fraudulent tax returns. Tax preparer fraud can be perpetrated in a variety of ways. Project Trident is about addressing criminal behaviour by unscrupulous tax preparers who act in a culpable manner.

If a tax preparer simply claimed a donation on a client's return and it turns out the donation was a false statement, we would consider applying penalties only where the preparer had demonstrated "culpable conduct" defined by the *Income Tax Act* as follows:

163.2 "culpable conduct" means conduct, whether an act or a failure to act, that:

(a) is tantamount to intentional conduct;
(b) shows an indifference as to whether this Act is complied with; or
(c) shows a willful, reckless or wanton disregard of the law.

It is a question of fact as to whether or not the tax preparer has behaved culpably. For example, if the donation receipt is for $50,000 and the client typically has only $35K in income, we might consider the penalty, depending on other circumstances. If the tax preparer was familiar with the scam, ie., knew that the tax shelter was being audited for its previous year activities and didn't ask any additional questions, and blindly claimed the donation amount, we may consider tax preparer penalty.

Project Trident is not about legitimate donation receipts, nor any reasonable conduct exercised by tax preparers. Tax preparers should be conscious of the particular circumstances when dealing with their client's affairs and disassociate themselves from any questionable or unscrupulous matters a client may have. If the tax preparer's actions demonstrate that they have acted in an exculpable manner, then they are protected from

tax preparer penalties by Subsection 163.2(6) of the *Income Tax Act*, which reads as follows:

> **Reliance in good faith** — For the purposes of subsections (2) and (4), a person (in this subsection and in subsection (7) referred to as the "advisor") who acts on behalf of the other person is not considered to have acted in circumstances amounting to culpable conduct in respect of the false statement referred to in subsection (2) or (4) solely because the advisor **relied, in good faith**, on information provided to the advisor by or on behalf of the other person or, because of such reliance, failed to verify, investigate or correct the information.

Each tax preparer penalty must be decided on the facts on a case by case basis. It is not the intention of Project Trident to broaden the imposition of third party penalties, but where such penalty is warranted, it is a goal to have fair and consistent application of such penalties.

The CRA takes abuse of Canada's tax laws very seriously. Tax fraud places an unfair burden on law-abiding taxpayers and businesses, and it jeopardizes the integrity of Canada's tax base.

(c) Assuming the CRA agrees this would fall short of the scope of Project Trident, which we understand is directed at fraud at a criminal level, would the CRA consider imposition of a civil penalty against such a tax preparer? This is a concern the writer has heard expressed by several tax preparers who do not market or recommend such shelters, but who have clients who have (typically without consulting, or even against the advice of, the tax preparer) become involved in such shelters.

Response:

Where a practitioner believes that he/she is being asked to use a statement that is clearly false or highly suspicious, and the client is rejecting the practitioner's advice, the practitioner should consider withdrawing from the engagement if he or she wishes to eliminate any possibility of the third-party penalty. The CRA has to prove, on the balance of probabilities, that an advisor or tax return preparer knew of the false statement or that culpable conduct existed in a given situation. This can only be established by reviewing the facts of the situation. Practioners are encouraged to review the best practices outlined in paragraph 65 of IC 01-1 for further guidance.

9. *Client Representation*

(a) Does the CRA intend to enable on-line representation for trusts? If so, when?

Response:

We are in prelimary stages of considering on-line representation for trusts. While there are ongoing discussions to make trust information available within a secure environment along the lines of "My Trust Account", we are at least 5 years away from implementation.

(b) It appears that when an individual taxpayer dies, on-line access to a deceased taxpayer's accounts by such person's representative ceases. Why? Could the representation not continue until the executor/executrix revokes such authorization?

Response:

This is correct—when an individual dies their representative's authorization ceases. When an individual dies, the only person who can act on behalf of that individual is an executor. The executor needs to be updated to our systems and then they can authorize another representative to deal with the CRA on behalf of the deceased individual.

(c) It appears that when a firm is authorized as the representative for a client, that client can no longer access information on their own account information as they are not the authorized representative. Can this be updated to allow both the client and their advisor to be authorized to obtain information? Alternatively, can there be more than one advisor authorized, such as an accountant and tax lawyer?

Response:

This situation should not happen—clients can access their own account regardless of whether or not they have a representative. In order to provide a more detailed answer we would need the specific account information, including what method of access the client was attempting to use.

(d) Can you please advise us as to what further enhancements are planned for the CRA "Represent a Client" web portal during 2009?

Response:

We anticipate that the following features will be added to the Represent a Client service later in 2009:

- Client Lists: This feature will enable a representative to download lists of clients that have authorized them for online access;
- Transactions by representatives: This feature will allow owners of tax businesses to view transactions their employees have performed on behalf of individual clients.

10. ***Transfer Pricing***

We have seen an increase in Edmonton in the number of letters being issued to clients for transfer pricing contemporaneous documentation. Can the CRA please advise:

(a) Is it standard policy for the CRA to issue such a letter if transfer pricing is identified during a regular audit?

Response:

Yes. Transfer Pricing Memorandum 05, issued on October 13, 2004 and available on the CRA website, discusses the CRA's policy in respect of contemporaneous documentation. This document states in respect of requests for contemporaneous documentation:

> "Effective immediately, requests for contemporaneous documentation must be issued at the initial taxpayer contact stage in all cases where there are transactions or arrangements between a taxpayer and a non-resident person with whom the taxpayer does not deal at arm's length. If the auditors were not aware of these transactions at the initial taxpayer contact stage, they must issue requests for contemporaneous documentation when they first identify the existence of such transactions. These requests should also be issued for each taxation year subsequently added during the audit or when commencing a new audit cycle to cover new transactions that may arise in different taxation years."

(b) What percentage of requests for contemporaneous documentation leads to a more in-depth transfer pricing audit?

Response:

The CRA is not in a position to make comments with respect to this question.

(c) What percentage of transfer pricing audits leads to an adjustment?

Response:

The CRA is not in a position to make comments with respect to this question

(d) Can the Agency provide more detailed data regarding the type and magnitude of transfer pricing adjustments arising from such audits?

Response:

The CRA is not in a position to make comments with respect to the magnitude of transfer pricing adjustments at this time.

Current high profile issues include:

- Migration of intangibles
- Loss importation
- Transfer pricing on tangibles
- Financial transactions

11. *Mediation*

What is the service standard for a request for mediation? If there is no service standard, should a taxpayer expect to wait longer than 30 days for a decision as to whether mediation is granted or not? It would be helpful if requests for mediation receive a confirmation that the matter is under consideration, similar to an Objection.

Please provide an update on mediation request since August of 2007, including:

(a) Number of requests

(b) Outcome: how many mediations were granted?

  i) how many were found (primarily) for the taxpayer?

  ii) how many months did the average mediation take from the date of request by the taxpayer, for those mediations that were granted?

Response:

Mediation requests are very rare across the country. Our survey of Headquarters and the Chiefs of Appeals across the country indicates that only one mediation has actually been completed since the inception of the program. There is no service standard for a request for mediation. Because the request for mediation goes to the Chief of Appeals and there are so few, it can be expected that individual contact would be made on receipt of the request. A letter to confirm the request can be provided but the almost non-existent use of the option has meant we have not established a formal procedure.

While there has been only one mediation completed, our survey showed that there were at least two other requests made by taxpayers that were considered but rejected by the Appeals Division. These cases were rejected as we concluded that they did not meet the criteria for mediation. Historically, almost all formal disputes are resolved at the Notice of Objection stage, and in many situations following the clarification and understanding of all the facts. The CRA also believes the resolution of factual disputes in court does not add much value to the subsequent administration or interpretation of the law by taxpayers or the CRA.

As outlined in our external website at www.cra-arc.gc.ca/gncy/prgrms_srvcs/dsgr/mdtn-eng.html, mediation is considered more appropriate for **factual** disputes rather than **interpretive** disputes. Factual disputes include:

- the fair market value of property;
- the value of benefits;
- the timing of an event;
- the nature of an expenditure; or
- the quantum of an item.

The case that was mediated to a conclusion was a Business Equity Valuation case. It took over two years from start to finish to complete because of the complexity and background work needed in the Equity Valuation by both sides. At the conclusion, all parties were satisfied with the result.

In any case considered for mediation, the amount of taxes in question has to be significant to warrant the mediator's fees and associated expenses. To go forward with a mediation that is agreed to, an agreement will be entered into outlining the issues to be mediated, how the mediator will be selected, the designated participants from both sides, the sharing of costs (usually 50-50), the non binding and voluntary nature of the process and specific rules regarding disclosure and confidentiality

12. *Disbursement Quotas and Investment Losses*

Charities, like many investors, experienced abysmal investment returns during calendar 2008 and the beginning of 2009. What are the criteria the CRA will require these charities to present in order to obtain Ministerial discretion to reduce their disbursement quota for the 2009 and subsequent taxation years, under subsection 149.1(5).

(We assume that the charity does not have any "disbursement excess" that it may carry forward, and no anticipated carryback.) Also, will the charity be entitled to make a request to the Minister for taxation years prior to the taxation year in which the request is made?

Response:

Policy commentary CPC-029, *Application for Disbursement Quota Relief,* was posted on our website on April 6, 2009.

The commentary clearly states at paragraph 2 that before relief under subsection 149.1(5) can be granted, a registered charity must use all disbursement excesses available from previous years. Further, the charity must demonstrate that it is incapable of making up any part of the shortfall in the following year. Accordingly, the CRA will not consider requests for relief until all returns have been filed and processed, and relief will not be granted in advance or in anticipation of a shortfall.

A charity must be in a shortfall situation for two consecutive taxation years before we will consider granting relief. In the example provided, if a charity has a shortfall in its 2009 taxation year, the Charities Directorate will only consider a request for disbursement quota relief until the charity's information return for the 2010 taxation year has been filed and processed.

The impact the economic downturn of 2008 and 2009 will have on the decision to grant disbursement quota relief to a particular entity will depend on the facts and circumstances of the charity's situation and provided all the other criteria are met as stated in CPC-029.

To obtain relief under subsection 149.1(5), the registered charity must complete Form T2094, *Registered Charities: Application to Reduce Disbursement Quota*, and send it to the Charities Directorate.

13. *Status of Directors – Struck Corporations*

In a July 18, 2008 Tax Court of Canada case (*Cadorette v. H.M.Q.*, 2006-2297(IT)G), the Court noted that under section 57 of the *Companies Act* (Quebec), once a company that has been stricken off the corporate register is reinstated the company is deemed never to have been struck. This is different than the decision on October 14, 2008 in the Federal Court of Appeal (*H.M.Q. v. Aujla*, A-40-08) which was under the *Company Act* (British Columbia). Could you provide some comments regarding the income tax consequences with respect to corporations struck by the Registrar under subsection 213(1) of the *Business Corporations Act* (Alberta) (the "ABCA") which are subsequently revived pursuant to subsection 208(3) of the ABCA? We would be particularly interested in your comments regarding the income tax consequences when considering subsection 208(4) of the ABCA which deems the corporation to have continued in existence after revival as if it had not been dissolved.

Response

While the Crown won at first instance in the Tax Court, in the case of *Cadorette c. La Reine* 2008 DTC 4404, 2008 TTC 416, 2008 CarswellNat 2508, it should be noted that, on appeal to the Federal Court of Appeal, the Crown consented to judgement due to an issue separate from the corporation's reinstatement.

Concerning the issue of the assessment of a director, subsection 227.1(4) of the ITA provides a two year limitation period within which to assess a director. The time commences when the director ceases to be a director.

There are two Court of Appeal decisions that suggest that a director does not continue to be a director during the period of dissolution. These two cases are:

- Aujla v. The Queen, [2007] G.S.T.C. 187, 2008 GTC 136 (T.C.C.), aff'd in 2008 GTC 1394, 2008 FCA 304, 2008 CarswellNat 3813; and
- Tupula-Yamba c. Quebéc, 2007 QCCQ 5005, aff'd in 2008 QCCA 1136, 2008 CarswellQue 5222.

Where more than two years have lapsed since the company was dissolved and an application is made to revive the company under respective companies' legislation, the application would need to include in the terms and conditions of revival the following:

1) that the company is reinstated retroactive to the date of its dissolution; and

2) that the directors of the company are considered to have never lost their position as directors and, therefore, have continued in office.

14. *efiling of Corporate Tax Returns – Attachments*

Certain documents are required to be provided to the CRA at the time of filing of a tax return—one of the most common situations would be where notes to a company's financial statements have been prepared. Schedule 141 asks, if notes exist, whether certain matters were covered by those notes (for example whether subsequent events were mentioned in the notes); however, even where all detailed questions on lines 102 to 107 are answered "No", the requirement to send in a copy of the notes remains.

As a result, we believe a number of T2 returns are being filed on paper where they could easily be efiled, because of the need to attach paper to the return.

Can you advise us as to whether any progress has been made to allow PDF attachments to be forwarded to the CRA along with various forms that can be filed electronically, in order to cut down on paper, speed up the filing and allow the CRA to reduce processing workload and time. One would assume that it is technically possible to have some method of checking PDF documents for viruses, to allow them to be attached to documents sent to the CRA.

Response:

The X12 Standard format, also known as the International Electronic Data Information (EDI) Standard format, used in the electronic transmission of a Corporate return, does not recognize PDF files as the EDI format is not set up to do so. Headquarters is investigating various methods of accepting PDF files. Timeframes for implementation are not available.

External Reference for filing returns can be found at:
1. The Corporation Internet Filing website http://www.cra-arc.gc.ca/corporation-internet/ which states that financial statements should be included with the transmission:

> **FAQ - Filing the electronic return**
>
> > ***5. Should I submit notes to the financial statements with the electronic return?***
> >
> > *Yes. Enter notes to the financial statements in your tax preparation software at line 100-0001 on the General Index of Financial Information (GIFI).*

2. The *CCH Preparing Your Corporate Tax Returns* book states, in paragraph 332 on page 82:

> Notes to the financial statement must be filed with the T2 return whether the statements or the GIFI is filed. (If you file electronically notes can be included in the text format with the transmission.)

In addition, notes to the financial statement are entered at field 100 0001. Notes that contain tables or graphs cannot be converted and Internet-filed. Therefore, the taxpayer should:

1. Type "Financial statements to follow" at field 100 0001,
2. Internet file the return, and
3. Mail the financial statements in separately.

If a corporation has an investment in a joint venture or a partnership and has copies of the financial statements, the financial statement information should NOT be submitted in the GIFI format, and as such, cannot be filed via the Internet. In this situation, the corporations' financial statement should be Internet-filed and the financial statement of the joint venture or partnership should be paper-filed.

For T2 processing purposes, a corporation is not required to submit the financial statements of a joint venture or partnership unless the corporation happens to have the financial statements on hand.

15. *Voluntary Disclosures Program*

The delay in processing voluntary disclosures continues to be of concern. It has become common to experience delays of over two years or more. Our members' experiences indicate that the total time to process a voluntary disclosure seems to be increasing rather than decreasing.

Can you please advise us as to the current voluntary disclosure workload and whether it is getting better or worse from an inventory standpoint? If worse, what are the CRA's plans to improve this situation?

Response:

Intake of Voluntary Disclosures has nationally been increasing every year, contributing to the large inventories in some offices. The Calgary and Edmonton TSOs' VDP Inventories are at their lowest levels. Temporary additional staffing for the program has cleared the backlog from prior years.

There will always be some disclosure files that take longer to complete due to:

a. Assistance required from other CRA Divisions to give an opinion on technical issues;
b. Issues awaiting formulation or finalization of VDP HQ policy;
c. Time extensions granted in limited circumstances to complete the disclosure.

Taxpayers/representatives can expedite their disclosures by making a complete disclosure for all applicable program lines of the taxpayer and related entities, and providing information and supporting documentation promptly.

16. *Change of Control - Trustees*

The CRA has stated in various Views (see, for example 2004-0087761E5) that a change in trustees of trust could, unless there is evidence to the contrary and/or the excepting provisions of subsection 256(7) apply, cause a new group to be in existence for purposes of determining *de jure* control of a corporation that the subject trust may control. Such a view has been the subject of much controversy and discussion. Can the CRA inform us if their view has changed or is being reconsidered?

Response:

As confirmed in the following documents:

- (i) *Reports of Proceedings of the Eleventh Society of Trust and Estate Practitioners (STEP) National Conference*, 2007, Round Table, Question 12 (2007-0240431C6),
- (ii) *Reports of Proceedings of the Fifty-Ninth Tax Conference*, 2007, Round Table, Question 7 (2007-0255461C6) , and
- (iii) *Income Tax Technical News* no. 34 (April 27, 2006),

the principles established in technical interpretation 2004-0087761E5 reflect CRA's views regarding the *de jure* control implications of the replacement of one or more trustees of an *inter vivos* trust holding the majority of the voting shares of a corporation.

17. *Provincial Residency Audit*

It appears from recent audit activity that the CRA has taken an active interest in certain transactions that allege to shift residency of individuals (including trusts) to a lower tax rate province. Can the CRA provide criteria that might assist taxpayers in determining whether or not such transactions would be offensive? In other words, what types of transactions are currently under review?

Response:

CRA currently administers provincial income taxes for eight provinces in Canada. The determination of whether or not transactions that allege to shift residency of individual (including trusts) to a lower tax rate province would be offensive is a question of fact to be determined according to the circumstances in each case. The CRA will consider all the surrounding facts on a case-by-case basis.

In determining the residence of an individual, the CRA will generally apply the criteria in Interpretation Bulletin IT-221R3 (Consolidated*), Determination of an Individual's Residence Status*. As stated in Paragraph 1, an individual who is resident in more than one province on December 31 of a particular taxation year will be considered to be resident only in the province where he or she has the most significant residential ties, for purposes of computing his or her provincial tax payable. The CRA has issued two tax alerts regarding the individual's residence entitled "Working Away From Home" and

"Where You Live Matters". For more information about the tax alerts, please go to http://www.cra-arc.gc.ca/alert.

In determining the residency of a trust in ordinary situations, the CRA will generally apply the criteria in Interpretation IT-447, *Residence of a Trust or Estate*. Where the residency of a trust was shifted to a lower tax rate province, the CRA seeks to ensure that the trust property is effectively under the control of the trustee and that trustee is not simply acting as an agent of the settlor, beneficiary or other persons whom have transferred property to the trust. Where transactions involved the use of a trust which created unintended benefits, the CRA may seek to challenge the use of the trust through the application of the GAAR.

On behalf of the provinces and territories with which we have a Tax Collection Agreement, CRA intends to identify and challenge all abusive inter-provincial tax avoidance arrangements.

Additional questions and answers:

1. *Are there any projects ongoing to identify income shifting from province to province?*

   As part of its strategy to combat aggressive inter-provincial tax avoidance, the CRA has established Centres of Expertise whose primary responsibilities include the identification of potential aggressive inter-provincial tax planning strategies and to identify participants of these strategies. Any tax planning strategy which creates a lower tax liability may be reviewed; however, whether or not a particular inter-provincial strategy is abusive is a question of fact to be determined according to the circumstances in each case. Results of our research efforts have been or will be shared with the tax administration of our Non-Agreeing provinces (ie., Alberta and Quebec).

2. *Why are we looking at this at the federal level?*

   The CRA administers the corporate income tax on behalf of most provinces and territories under a Tax Collection Agreement ("TCA"). Under the TCAs, the CRA is mandated to safeguard the interest of these provinces and territories. From this perspective, the CRA intends to identify and challenge all abusive inter-provincial tax avoidance arrangements whose primary purpose is the erosion of the tax base of one or more of our Agreeing Provinces.

3. *Does the Province of Alberta really care about the allocation and why do we audit PIA?*

   The Provincial Income Allocation (PIA) refers to the mechanism used to allocate taxable income amongst the provinces and territories when a taxpayer has a permanent establishment in a specific jurisdiction. The PIA formula is also used in

allocating other taxes including capital tax and the GST portion of the HST for selected financial institutions. Based on the potential provincial tax at risk, it is not surprising that each stakeholder is very concerned about their specific allocation.

While we cannot speak for the Province of Alberta, it is clear that they have a vested interest in this matter and that, historically, they have been very pro-active on PIA issues affecting their province. Each PIA change affecting the Province of Alberta will result in either the collection or payment of provincial tax, thus increasing or eroding the provincial tax base. As previously stated, it is not surprising that the Province of Alberta takes PIA very seriously. Alberta is an active member of the Allocation Review Committee (formally the Tri Party Allocation Review Committee) which meets semi-annually with the CRA and Non-Agreeing Provinces to discuss double taxation issues specific to PIA.

18. *Corporate Attribution Rule*

The corporate attribution rule contained in section 74.4 of the *Income Tax Act* is drafted in broad terms and it is often unclear whether the rule is applicable in particular circumstances.

(a) Could the CRA provide statistics regarding assessments that have been made using the corporate attribution rule.

(b) Please provide examples of the circumstances in which the corporate attribution rule has been used to assess a taxpayer.

(c) Please consider the following fact situations and comment on the potential application of the corporate attribution rule:

i) A husband and wife each own voting common shares of the same class in a corporation that is not a small business corporation (Holdco). A discretionary family trust is created, the beneficiaries of which are the husband the wife and their two adult children. The husband and wife exchange their common shares for preferred shares having a redemption value equal to the fair market value of the common shares and new common shares are issued to the family trust. The husband and wife receive preferred shares of the same class on the exchange of shares.

ii) Same facts as in (i) above but husband and wife receive preferred shares of a different class on the exchange of shares.

iii) A husband and wife own voting common shares of different classes in a corporation that is not a small business corporation (Holdco). The Articles of Holdco permit dividends to be paid on one class of common shares to the exclusion of other classes of common shares. A discretionary family trust is created, the beneficiaries of which are the

husband the wife and their two adult children. The husband and wife exchange their common shares for preferred shares having a redemption value equal to the fair market value of the common shares and new common shares are issued to the family trust. The husband and wife receive preferred shares of the same class on the exchange of shares.

iv) Same facts as in (iii) above but husband and wife receive preferred shares of a different class on the exchange of shares.

v) A husband and wife own preferred shares of the same class in Opco. The husband owns 60% of the preferred shares and the wife owns 40% of the preferred shares. All of the common shares in Opco are owned by their adult children. The husband and wife incorporate Holdco and common shares of one class are issued to the husband as to 60% and the wife as to 40%. The husband and wife transfer their preferred shares in Opco to Holdco on a tax-deferred basis pursuant to section 85 of the Income Tax Act and each of them receives preferred shares in Holdco of the same class having a redemption value equal to the redemption value/fair market value of the preferred shares that they own in Opco. The husband and wife are the only shareholders in Holdco. Holdco is not a small business corporation.

vi) Same facts as in (v) above but each of the husband and wife receive preferred shares of Holdco of different classes on the exchange of shares. The husband and wife are the only shareholders in Holdco. Holdco is not a small business corporation.

vii) A husband and wife own preferred shares of the same class in Opco. The husband owns 60% of the preferred shares and the wife owns 40% of the preferred shares. All of the common shares in Opco are owned by their adult children. The husband and wife incorporate Holdco and common shares of different classes are issued to the husband and the wife. The husband and the wife are issued 60% and 40% respectively of the total outstanding common shares issued by Holdco. The Articles of Holdco permit dividends to be paid on one class of common shares to the exclusion of other classes of common shares. The husband and wife transfer their preferred shares in Opco to Holdco on a tax-deferred basis pursuant to section 85 of the *Income Tax Act* and each of them receives preferred shares in Holdco of the same class having a redemption value equal to the redemption value/fair market value of the preferred shares that they own in Opco. The husband and wife are the only shareholders in Holdco. Holdco is not a small business corporation.

viii) Same facts as in (vii) above but each of the husband and wife receive preferred shares of Holdco of different classes on the exchange of shares.

Response:

The CRA declines to answer this question. Statistics and general type examples are not available regarding assessments made using section 74.4. Furthermore, without knowing the background and all of the facts related to each situation, including the review of the relevant documents, CRA declines to respond to the numerous general issues submitted. Again, as outlined in paragraph 22 of Information Circular 70-6R5, an advance income tax ruling should be requested when a request for a technical interpretation relates to specific proposed transactions. The review of completed transactions is generally the responsibility of the local Tax Services Office.

19. *Thawing an Estate Freeze*

Given the current economic situation, it is likely that there are some corporations that have been the subject of an estate freeze transaction in the past and now have issued preferred shares with an aggregate redemption amount that exceeds the current fair market value of the corporation. The CRA commented on this issue in 1997 (refer to question 2.5 from the 1997 APFF convention). Could the CRA please comment on their current position with respect to the thawing of a freeze transaction. In particular, could the CRA comment on the following:

(a) Whether your position differs between a thawing of a freeze transaction that is accomplished by way of a section 51 or section 86 exchange of new preferred shares for the existing preferred shares which exchange takes place directly with the corporation that had issued the preferred shares on the prior freeze reorganization versus by way of a section 85 rollover of the old preferred shares to a new holding corporation in exchange for preferred shares in the new holding corporation. Note that in each case the new preferred shares would have a redemption value equal to the current fair market value of the old preferred shares.

(b) Whether your position differs depending upon whether all of the common shares are currently held by the holder(s) of the preferred shares or whether the holder(s) of the preferred shares (having all of the current value) and the holder(s) of the common shares (having no current value) are different persons.

Restated Question per HQ Rulings Directorate:

Given the current economic situation, it is likely that there are some corporations that have been the subject of an estate freeze transaction in the past and that now have outstanding preferred shares with an aggregate redemption amount that exceeds the current fair market value of the corporation. At Question 2.5 of the 1997 Congrès de l'Association de planification fiscale et financière (1997 APFF conference), CRA indicated that the preferred shares in this case could be refrozen at a lower fair market value without adverse tax consequences, provided certain conditions were met. This was a modification of CRA's previous position set out in its response to Question 53 at the 1985 Roundtable of the Canadian Tax Foundation.

Could the CRA please confirm that their position with respect to a refreeze of frozen preferred shares that have declined in value remains as set out at the 1997 APFF conference?

Response to restated question:

In its response to Question No. 53 from the 1985 Roundtable of the Canadian Tax Foundation, CRA stated that it would normally consider that a benefit had been conferred on the holders of common shares where the holder of preferred shares refreezes the preferred shares at a lower fair market value.

In its response to Question 2.5 at the 1997 APFF conference CRA modified its position (see CRA document 9M19020, October 10, 1997). CRA stated that it would no longer consider that a benefit had been conferred upon common shareholders under a refreeze transaction where preferred shares were initially issued as part of an estate freeze or a freeze to benefit key employees, provided that the reduction in the fair market value of the preferred shares had not been caused by a stripping of the assets of the corporation, and the fair market value of the new preferred shares issued on the refreeze corresponds to the present fair market value of the preferred shares that are eliminated on the refreeze.

CRA's position with respect to a refreeze of frozen preferred shares that have declined in value remains as set out at Question 2.5 at the 1997 APFF conference. CRA's position in this regard has also been confirmed in technical documents: 9607635 (May 28, 1997), 9229905 (June 3, 1997), 2000-0029115 (November 17, 2000), 2003-0046823 (December 11, 2003).

Response to questions a) and b) per ICAA Roundtable:
With respect to your two specific questions, we note that estate freezes are usually complex transactions, and that the questions do not provide sufficient detail for us to provide a meaningful response. Taxpayers with specific questions are encouraged to submit a request for a Technical Interpretation or an Advance Income Tax Ruling.

20. *Value of Corporation Attributable to Voting Fixed Value (non-participating) Shares*

In *Income Tax Technical News No. 38* dated September 22, 2008, the CRA stated that the value of a corporation that is attributable to voting non-participating shares will depend on the facts and circumstances. Would you please provide your comments on the impact on the value of voting non-participating shares in the following circumstances:

(a) Where the corporation is a passive investment corporation holding only investments such as a portfolio of publicly-traded securities or rental properties rather than the corporation carrying on an active business. It would

seem that a control premium would be less relevant for an investment corporation.

(b) Where the voting non-participating shares are held by unrelated shareholders with no shareholder owning more than 50% of the voting shares.

(c) Where the voting non-participating shareholder does not own participating shares.

(d) Where the voting non-participating shareholder also owns participating shares and the corporation has issued only one class of participating shares.

(e) Where the voting non-participating shareholder also owns participating shares of a different class than other shareholders that own participating shares and the corporation's authorized capital permits the payment of dividends in respect of one class of shares to the exclusion of other classes of shares.

(f) Where the voting non-participating shares are redeemable for a fixed price at the discretion of the corporation.

Response:

The value of a corporation that is attributable to voting non-participating shares is dependent on the applicable facts and circumstances in a given situation. As stated in September 2008, the CRA does not have an established position on valuing different types of property. Information Circular 89-3 (IC 89-3), *Policy Statement on Business Equity Valuations,* outlines the valuation principles and policies that the CRA uses in the valuation of securities and intangible property of closely held corporations for income tax purposes.

The CRA is not currently considering the issuance of a policy or formal position regarding the valuation of voting non-participating shares in a private company.

When considering any of the circumstances described in this question it is necessary to consider the highest price a prudent arms-length party would pay for the shares in an open, unrestricted market where there is no compulsion to transact. In valuing different classes of shares in a company, the CRA generally determines the “en bloc” fair market value and then allocates the value to each class in isolation. The fair market value of each class of shares must be determined on its own merits according to the individual rights and restrictions of each class. One of the rights and restrictions that may have significant value is the ability to control the corporation, and hence the distributions to the participating shares and potentially the ability to change the rights and restrictions of share classes or to issue new shares. This could potentially dilute distributions to participating shareholders.

The issue deals with voting control, and the value of this control. Therefore, if voting control of a corporation is held by one shareholder or a group of related shareholders, the

value of this control may be a concern. The quantum of the value would be affected by the percentage of voting shares held by the shareholder in question and the dispersion of voting shares amongst the other shareholders.

Whether the shareholder who owns voting non-participating shares also owns non-voting participating shares is not a consideration. The concern is the determination of the amount a potential purchaser of one of the classes of shares would pay for those shares and not the amount a potential purchaser would pay for both classes together.

In response to Question 13 at the CRA Roundtable Thirty-Second Tax Conference (1980), the CRA discussed the terms and conditions attached to shares received as consideration under Subsection 85(1) of the Act. It is not the intention of the CRA to change the long-standing stated position with regard to consideration received on a rollover under subsection 85(1) of the Act.

21. *SRED – Contract Work*

At the March 2006 APFF conference, the CRA was asked if payments to placement agencies to contract the labour services (labour contracts) of engineers, machinists and similar technical people would qualify as a SR&ED contract payment. The CRA explained that such payments would not be considered SR&ED contracts. However, the CRA stated that although they are not SR&ED contracts, as an administrative concession the CRA was willing to consider such labour contracts to be SR&ED contracts provided the person hired under the labour contract spends 90 per cent or more of the time performing SR&ED work.

During the January 2007, conference, the CRA, in reply to a related question, stated they had reviewed the issue of labour contracts, and had concluded that a labour contract is a SR&ED contract, and therefore, the contract costs will qualify as a contract payment, provided the person hired under the contract performs SR&ED work as defined in subsection 248(1) and the work is carried out on behalf of the payor. In cases where the person hired does SR&ED and non-SR&ED work, an allocation would have to be made.

At the conference the CRA did not explain what is meant by SR&ED work, however, a review of the many CRA publications provides insight and clarification with respect to what is meant by SR&ED work. For example, Information Circular 86-4R3: *Scientific Research and Experimental Development* issued by the CRA states in section 2.8: "We determine whether an activity is eligible or ineligible under subsection 2900(1) of the Regulations solely by examining the nature and characteristics of the activity itself". This would mean that if SR&ED work carried out by employees qualify to be included in line 300 of the Form T661, then any such work done under contract will be SR&ED work.

It is well understood that most of the time no one person will carry out work that will meet all of the three criteria required for science eligibility. The interrelated activities carried out by various individuals, put together, comprise a SR&ED project, and the collection of activities will be evaluated in aggregate to determine if the three criteria are

met for the project. These interrelated activities could include work performed by people such as engineers, machinists, welders, technologists, electricians, etc., working under the direction of an engineer or scientist.

In light of the above, we would like to receive confirmation from the CRA regarding the following questions:

(a) Contract payments made to placement agencies, engineering firms or other organizations to engage workers such as machinists, welders, electricians, operators or other workers who carry out SR&ED work as explained in the various CRA documents for work that is performed on behalf of the payor will qualify as SR&ED contract payment under subparagraph 37(1)(a)(i) and subclause 37(8)(a)(ii)(B)(II) of the Act.

Response:

When elected under the Proxy method, subclause 37(8)(a)(ii)(B)(II) of the *Income Tax Act* (ITA) allows the taxpayer to claim an expenditure incurred for the prosecution of scientific research and experimental development (SR&ED) in Canada directly undertaken on behalf of the taxpayer. Similarly, subparagraph 37(1)(a)(i) refers to SR&ED carried on in Canada, directly undertaken by or on behalf of the taxpayer, and related to a business of the taxpayer.

The determination of whether or not a payment can be considered as a payment for SR&ED will depend on what work was undertaken on behalf of the taxpayer. In order for a contract to be for SR&ED undertaken on behalf of the taxpayer, the contractor must undertake work as described in the definition of SR&ED in subsection 248(1) of the ITA.

(b) If the answer to question (a) is in the negative, we would like to receive CRA's definition of what constitutes "SR&ED work" and how it differs from "directly engaged" work and clarify the answer given at the APFF conference with respect to payments made to placement agencies.

Response:

SR&ED work is considered to be the work which meets the definition of SR&ED as per the subsection 248(1) of the ITA. "Directly engaged" in SR&ED is explained in our publication Application Policy SR&ED 96-06, *Directly Undertaking, Supervision or Supporting v "Directly Engaged" SR&ED Salary or Wages.* The CRA considers "directly engaged" to be "hands-on" work that is integral to the work described in paragraphs 248(1)(a) to (d) of the definition of SR&ED in the ITA. The term "directly engaged" has no direct relevance in determining eligible SR&ED contract expenditures for SR&ED.

The term "directly engaged" is **only** used in reference to salary or wages of an **employee** as per subsections 37(8)(a)(ii)(IV) of the ITA and 2900(4) of the Regulations. Workers of placement agencies, engineering firms, other similar organizations, or contracted labourers are not employees of the taxpayer claiming for SR&ED, and therefore cannot be considered to be "directly engaged" in SR&ED.

(c) If the answer to question (a) is in the negative, we would also like the CRA to explain what is meant by “engineering work” as stated by the CRA at the APFF conference in answer to the question “What is meant by engineering as described in paragraph 248(1)(d) of the Act”.

Response:

The term "engineering" (and its translation "travaux de génie" used in the French version of the ITA) is not limited exclusively to the practices of engineers, as regulated by the various pieces of provincial legislation relating to engineers, nor is it limited to work performed only by engineers who are members in good standing of a professional order of engineers of a Canadian province. The expression “engineering” has a somewhat broader meaning, and includes work performed in a scientific or technological field by individuals, and includes work performed in a scientific or technological field by individuals who have been trained in the field of applied sciences insofar as the engineer's knowledge or knowhow must be applied to perform the work. Work performed by chemists, physicists or computer specialists who have not necessarily received training in chemical engineering, engineering physics or computer engineering could also be considered engineering for the purposes of paragraph (d) of the definition of an SR&ED activity in subsection 248(1) of the ITA. The nature of the work being performed by the individual is what is important.