MEMBER ADVISORY
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May 2004 CRA Roundtable

The annual Canada Revenue Agency (CRA) Roundtable Meeting was held in Ponoka in May, 2004. CRA representatives from Calgary, Edmonton, Red Deer and Lethbridge were in attendence along with representatives from the ICAA.

As in previous years, three concurrent roundtable sessions were held focusing on income tax matters and good and services tax. All participants attended a general wrap-up session. General process and procedure topics were also discussed, including the training of auditors, access to working papers, payroll remittances and customer service.

Please note that the CRA contact list can be found in the Members-Only Area of the ICAA website. Navigate to Resources and access the Reports & Surveys section.

Income Tax Questions

Question 1

A Canadian corporation ("Canco"), a subsidiary of a US parent corporation ("Parentco"), is audited for transfer pricing issues and transactions. As a result of the audit and some negotiation and discussion of the transfer pricing issues, proposals are made by the CRA and concurred to by the taxpayer that increases the taxable income of Canco in the audit years. Canco admits that the transfer pricing may have been flawed but is somewhat neutral about whether the income is taxed in Canada or the US as long as it's not taxed in both countries. A secondary adjustment under Part XIII of the *Income Tax Act* (a deemed dividend) is avoided through a repatriation of the amount of the transfer pricing adjustment back to Canco.

Parentco seeks relief from double taxation on the relevant income by requesting the assistance of the US Competent Authority (US Internal Revenue Service). A corresponding request is made by Canco to the Canadian Compentent Authority (CRA). At the same time, a notice of objection is filed by Canco to protect its domestic avenue of recourse in the (unlikely) event the competent authorities can not reach an agreement on avoiding double taxation. A request is made to the CRA's Appeals Division to put the notice of objection in abeyance, pending the conclusion of the mutual agreement procedure of the competent authorities.

Our question is whether the CRA's administrative policy allows the reopening of the transfer pricing audit to reassess a higher amount of transfer pricing income adjustments to Canco predicted on a "bad faith" withdrawal of concurrence. Does the CRA follow the practice of reopening audits because a notice of objection is filed? Note that the notice of objection will contain the required basis for an objection - for example, the inappropriate application of the provisions of section 247 of the *Income Tax Act*.

There exists a CRA transfer pricing website at **www.craadrc.gc.ca/tax/nonresidents/business/pricing-e.html**. Included at this website is a discussion of the repatriation of funds by a non-resident in the context of a transfer pricing audit adjustment. The statement is made by the CRA:

The taxpayer must provide an unconditional waiver of the right to object to a transfer pricing adjustment before a request for

Table of Contents

Call for Tax Questions

The next Roundtable Meeting with CRA will be in May 2005. If you have a question regarding tax or CRA procedures you would like the participants to address, please send it to Monika Siegmund CA *(c/o ICAA) or Wayne Kauffman* FCA *at* ***w.kauffman@icaa.ab.ca***

repatriation is granted. If the taxpayer decides not to sign the waiver at the audit stage, a request for repatriation may still be considered during the appeal process.

Note in the situation above, Canco did not receive nor did it sign a request for a waiver of the right to object. If such a waiver had been signed, would Canco be precluded from filing a "protective" notice of objection to provide another avenue of recourse in the event double taxation remained after review by the competent authorities? It should also be noted that the standard acknowledgement of a request for assistance by the Canadian Competent Authority includes this statement:

"…if you have not already done so, you may wish to protect your right of appeal of the taxation years under consideration by filing a Notice of Objection with the appropriate Tax Services Office. Please be advised that you must hold in abeyance any Notices of Objection pending resolution of your competent authority request."

Response

It is our understanding that the CRA is reviewing a case with a similar set of facts and therefore we will address this query with our general comments.

The CRA does not generally reopen an audit when a notice of objection is filed, even where there has been a "bad faith" withdrawal of concurrence. However, a notice of objection will result in a review of the audit and adjustments. The review of the audit and adjustments can result in an increase to the disputed (re)assessment or a decrease to any downward reassessment that would otherwise have been issued (an offset adjustment) (in this section, the expression "upward adjustments" means adjustments that bring about one of these results).

In situations where an auditor would have processed a higher (re)assessment had it not been for taxpayer concurrence, the ability exists for Appeals to process an upward adjustment at the objection stage should it be warranted. The Appeals Branch Report Clarifying our Mandate recognizes that the ability to proceed with upward adjustments is essential to maintaining the integrity of the tax system. Appeals will process upward adjustments when the following conditions are met:

a) the adjustment relates to a matter under dispute or an item related to it;
b) the normal reassessment period has not expired or, there has been misrepresentation that is attributable to neglect, carelessness or wilful default or the commission of any fraud in filing a return or supplying any information under the ITA;
c) the upward adjustment is of relative importance, and
d) the upward adjustment has been approved by the Chief of Appeals.

Note: The term "relative importance" refers to the significance of the upward adjustment in relation to the value of the underlying disputed item and is a matter of judgment.

Upward adjustments can be processed regardless of whether or not a "bad faith" withdrawal of concurrence has occurred. It should be noted that pursuant to subparagraph 152(4)(b)(iii) of the ITA, the normal reassessment period is extended for an additional 3 years in transfer pricing situations. Should the objection process or the competent authority process extend beyond the normal reassessment period, Appeals policy is not to process any upward adjustments. Clients that are seeking upward adjustments should consider filing a waiver pursuant to subparagraph 152(4)(a)(ii) of the ITA prior to the expiry of the period referred to in paragraph 152(4)(b) of the ITA.

Where a client has waived its objection rights in writing, the client cannot file a "protective" notice of objection. Subsections 165(1.2) and 169(2.2) of the ITA preclude the filing of a objections regarding an issue for which the client has waived, in writing, the right to object. As such, there is no alternate avenue of recourse in the event that double taxation exists after the review by the competent authorities.

The CRA considers the waiver of objection rights, at the audit stage, an appropriate method for settling transfer pricing disputes as it provides both the CRA and the client with assurance and certainty that the issue in dispute has been resolved. A client may waive objection rights in respect of one or more issues where agreement has not been reached on the (re)assessment as a whole. Provided there is no evidence of coercion, bad faith or false pretences, a properly executed waiver is binding.

Question 2

Is an extended-cab pick-up truck used by a farm corporation employee excluded from the definition of an automobile and therefore also excluded from the definition of a passenger vehicle, due to the remote location of the farm?

Response

Subsection 248(1) of the Act defines an "automobile" as:

(a) a motor vehicle that is designed or adapted primarily to carry individuals on highways and streets and that has a seating capacity for not more than the driver and 8 passengers,

Since pick-up trucks, particularly those that have extra passenger capacity, have generally been designed primarily to carry individuals on highways and streets, it is reasonable to conclude that an extended-cab pick-up truck meets the requirements in paragraph (a) of the definition of automobile.

However, for taxation years that begin after 2002, subparagraph (e)(iii) excludes extended-cab pick-up trucks from the definition of automobile in subsection 248(1) of the Act, if they are used primarily for the transportation of goods, equipment or passengers in the course of earning or producing income at one or more remote or special worksites that are at least 30 kilometres from the nearest urban community having a population of at least 40,000 persons.

It is therefore a question of fact as to whether or not the pick-up would be excluded by virtue of subparagraph (e)(iii). For example, where the employee lives on the farm or could

reasonably be expected to maintain a "self contained domestic establishment" on the farm, it will therefore not be considered a remote work location for the employee and consequently, the pick-up truck will not be excluded from the definition of automobile by virtue subparagraph (e)(iii).

While it is not specified in the question, it should be noted that the extended-cab pick-up truck could also be excluded from the definition of automobile by virtue of subparagraph (e)(ii) where it is determined that in the year the truck was acquired it was used all or substantially all for the transportation of goods, equipment or passengers in the course of gaining or producing income.

Question 3

For several years, these Round Tables have discussed the issue of timing of filing T3 and T5013 slips. With the rising popularity of income trusts and limited partnerships, many of whom file their slips on the last possible day, more and more taxpayers are faced with a shrinking window of opportunity for filing their personal tax returns. This compression results in errors and omitted income, not all of which is identified by the Agency. Has any progress been made in determining some means of dealing with this? Only two reasonable approaches exist.

Extending the T1 filing deadline (and deadline for remittance of taxes owing) to provide individual taxpayers with a more reasonable timeframe between the deadline for the issuance of common T slips and the deadline for filing their tax returns might be reasonable. Perhaps the filing deadline could be extended to May 31 for al personal taxpayers, and the June 15 deadline for the self-employed eliminated. While this would defer due dates for balances due, it would similarly delay the deadline for CRA to issue refunds without refund interest and likely delay many taxpayers' filings such that refunds would be paid out later.

Requiring publicly traded trusts and partnerships to file returns by February 28, an obligation already faced by all employers and corporations in Canada for T4 and T5 slips, would also be a reasonable alternative. If this imposes to great a burden on such entities, perhaps this deadline could be accompanied by either a mandatory or an elective year end of November 30, thus providing three months for completion of these filings. Alternatively, a March 15 deadline would divide the burden between the taxpayer and these entities

Response

Thank you for your suggestions. This issue has been raised in previous discussions and our response remains the same. The Department of Finance is responsible for changes in legislation. They are aware of the concerns of tax professionals and those of the mutual fund industry. We suggest the issue be pursued through the Department of Finance.

Question 4 – My Account Feature

This is a welcome improvement to the personal tax system. However, there appears to be some confusion as to whether it is or is not available to third parties, with explicit permission of the taxpayer. The tax preparer will usually have the client's 4 key pieces of ID required for access to this secure area available at their fingertips, and in addition (usually following the filing of the initial return for a new client), will have a consent on file at the CRA. The web site states:

> *"Information on the My Account service is provided for your exclusive use and is not intended for use by third parties."*

However, we have been advised by the e-service Helpdesk for My Account that this area is in fact being accessed by tax preparers for their clients, and this is permissible as long as the clients have given the tax preparer permission to do so (and this is assumed if the client has given the preparer sufficient personal information to be able to do so).

There has been discussion in the past about a separate Internet portal for tax advisors, which would allow them access to additional information such as is provided on the "dump" that can be requested in writing for clients—such as various carry-forward balances which may not be made available in the My Account section—such as CNIL, capital gain/capital loss history, tuition carry forwards, etc. Please advise as to the status of this initiative.

Response

The existing "My Account" feature is intended for use by clients; not their representatives. Any CRA interaction with representatives must be through our other avenues of communication; telephone, written correspondence, and in person.

It is not the intention that third parties access their clients account directly through "My Account" or the "Address Change Online" features on the CRA website. There is nothing presently preventing such access provided the necessary information is available to the third party. The client is responsible for sharing their access information and any consequences that may flow from this. There may well be privacy implications for third parties relating to access, use and retention of this information.

The e-service Helpdesk has been instructed to advise clients about the hazards of providing their information to a third party. It is possible that this warning may have been misconstrued as condoning the practice.

Third parties may well have their clients access their personal information, while in their offices, to retrieve information for the representative's use in completing work on behalf of the client.

We recognize the need to provide a portal through which representatives can view some of a client's information. The initiative is in development and tentatively scheduled for release in 2005.

Question 5

Part XIII Tax Reassessments - In a situation where a taxpayer been disallowed an expense and assessed tax under Part I of the

Act, the taxpayer also may be deemed to have paid a dividend to a non-resident for the purposes of Part XIII and, therefore, liable to tax under Part XIII. We are aware of situations where the taxpayer has not received the Part XIII reassessment for some considerable period after the date of its issuance. In one case, the Part XIII tax reassessment was received only 4 or 5 days before the expiration of the Notice of Objection period. We understand that the Part XIII tax reassessments are issued from Ottawa and this may cause part of the delay. Please comment on this situation and if you are considering any changes in the issuance of Part XIII tax reassessments that would remedy these delays.

Response

The Ottawa Technology Centre of the Canada Revenue Agency handles the production and distribution of the *Notices of Assessment* or *Reassessment* related to a Part XIII tax liability that are processed by the Tax Services Offices located across the country. The fact that these notices are issued from Ottawa would not contribute to the delay experienced by some clients who received their notice shortly before the expiration period for filing a *Notice of Objection*.

In most cases, the *Notices of Assessment* or *Reassessment* are issued promptly and received by our clients to allow them sufficient time to exercise their right to file a formal *Notice of Objection* under the Act. However, there will be circumstances where clients may not reasonably be expected to file a timely objection. For example service interruptions, technical disruptions or using an invalid mailing address may contribute to the delay in receipt of the *Notice of Assessment* or *Reassessment*.

The Canada Revenue Agency has existing measures for clients to request an extension of time to file a *Notice of Objection* if they are unable to file an objection on time due to circumstances that were beyond their control. Along with the objection, the client may apply for a time extension to file the objection by writing to the Chief of Appeals of the applicable Tax Services Office.

We would encourage clients to contact the applicable Tax Services Office to enquire about the reason for the delay should the date of mailing upon receipt of the *Notice of Assessment* or *Reassessment* be quickly approaching the expiration period for filing an objection. The reason, if any, may help explain why the client was unable to file an objection on time and therefore requesting an extension to file the objection. For more information please refer to CRA publication P148(E) Rev.03, Your Appeal Rights Under the Income Tax Act.

Question 6 – Partnership Information Return (T5013)

On form T5015, Reconciliation of Partner's Capital Account, it is unclear whether Column 5, Income (or loss) allocated during the fiscal period, refers to accounting or taxable income (loss). According to the CRA Guide for the Partnership Information Return (T4068), accounting information should be used. However, in the same Guide, Chapter 10 refers to the column 5 income allocation as to the amounts shown on the partner's T5013 information slip. The T5013 slip includes taxable amounts only. We, therefore, have 2 questions in this regard:

1. Should accounting income or taxable income be used on Form T5015, Column 5?
2. It may also be helpful if you could indicate the intended purpose of Form T5015.

Response

1. Accounting income should be used when completing Form T5015, *Reconciliation of Partner's Capital Account*. The partner's capital account is an accounting term. It is not defined in the Income Tax Act. As such, amounts affecting the partner's capital account should be derived from the partnership's books, records and financial statements.

   We are revising the *Guide for the Partnership Information Return*, which would delete the reference to the partner's T5013 Information slip regarding the completion of Column 5.

2. The Partnership Information Return is intended to provide a complete financial picture of the partnership.

   Prior to the introduction of the Partnership Information Return in 1989, there were significant deficiencies in the reporting of partnership income. While the income/losses were allowed to flow-through from the partnership to the partners, there was a wide variance in how this information was communicated to the partners and consequently how it was supported and filed for tax purposes. The Partnership Information Return was introduced to improve the reporting of the following items: financial statement information, identification of general partners, location of books and records and details of ownership.

   Form T5015 provides financial information and details of the ownership of the partnership.

References

- T4068 Guide for the Partnership Information Return 2003, pgs. 5 & 44
- T4068 Guide for the Partnership Information Return 2002, p. 43
- 1988 Revenue Canada Round Table, Paper 7 - Tax Reform and Administration

Question 7

The CRA seems to be extremely zealous in rooting out perceived evaders of employment insurance and CPP premiums. In many cases, their zeal seems to overcome any reasonable interpretation of the law.

a) We have seen several cases where CRA has attempted to impose an employment relationship on parties. The reasoning behind such conclusions, where reasons are even given, are generally inconsistent with established legal principals in respect of such determinations. Would the Agency consider obtaining the assistance of the Justice Department in making such interpretations prior to issuing rulings, so as to spare

both themselves and taxpayers the costs of appeal of such rulings?

b) We have also seen several cases where CRA's interpretation of the EI act as it applies to non-arm's length employees seems inconsistent with the law. The Agency rulings we have seen generally commence with the question "is the employee related to the employer?" Where the answer is no, they conclude that employment is insurable. Where it is yes, they seek to assess whether, despite the relationship, the terms of employment are on an arm's length basis. However, this is not what the law says. Subsection 5(2)(i) of the Employment Insurance Act provides that employment is not insurable where "the employer and employee are not dealing with each other at arm's length." Subsection 5(3) clarifies that the determination of whether parties act at arm's length shall be in accordance with the Income Tax Act. Under Subsection 251(1) of the Income Tax Act, persons are deemed not to be dealing at arm's length where they are related. Subsection 5(3) of the Employment Insurance Act goes on to state that, even if employee and employer do not act at arm's length, they will be deemed to so act where "it is reasonable to conclude that they would have entered into a substantially similar contract of employment if they had been dealing with each other at arm's length." It seems to us that this is intended to bring persons deemed by the Income Tax Act not to act at arm's length (ie related parties) within the EI scheme where, in fact, they do act at arm's length. The Agency seems unwilling to address the question of whether employee and employer are not acting at arm's length in fact where the deeming rules for related parties do not apply. How does the Agency justify this departure from what seems to be fairly clear legislation (as tax legislation goes)?

Response

a) The courts have determined that an appropriate approach to determining the employment status of an individual is to analyze the whole of the working relationship between the worker and the payer. The courts have provided four criteria or principles that when analyzed as a whole, will help establish the employment status of a worker. These four criteria are: control, ownership of tools, chance of profit/risk of loss and integration. The rulings process involves the gathering and the analysis of all the relevant factors, which define the working relationship between the worker and the payer using the four criteria. When the information is gathered and analyzed, one must evaluate whether the combined influence of these four principles are more indicative of a contract of service or more indicative of a contract for service. Each case has to be analyzed on the whole of the facts surrounding that particular working relationship.

   Head Office provides assistance to the Rulings Officers to ensure consistency in the application and interpretation of the legislations. All policy documents are reviewed by Legal Services prior to being made available to the Rulings Officers. Both parties subject to the ruling may appeal the ruling. The Appeals Division will ensure an independent and unbiased review of the case.

b) We understand your concerns regarding this issue. In the determination of a non-arm's length employment relationship with non-related persons, pursuant to paragraph 5(2)(i), the ruling officer has to analyze all the facts in accordance with the common law principles. It is important to understand that each case must be looked at based on its own facts.

   CRA (Headquarters) in concert with the Department of Justice is working on guidelines regarding non-arm's length relationships with related and non-related persons in accordance with recent jurisprudence. These guidelines should be available for our local office in the near future.

Question 8

Many taxpayers have experienced losses on speculative investments, primarily real estate and shares held for resale. Most recently, this was in the form of "Tech Shares." The purpose of acquiring such shares is almost always the expectation of resale at a profit. These shares cannot reasonably be expected to pay dividends—many of the companies have written policies which clearly state this—and the only avenue for profit is resale. It seems, therefore, that these investments are properly classified as inventory, and not capital property, for income tax purposes. It is our experience that the Agency is far more prone to view such transactions as being on account of income where the investment is successful than when it fails. In fairness, the reverse is often true of taxpayers, and sometimes of their advisors. CRA's standard approach to reviewing such losses seems to be demonstrating that the taxpayer is not a "trader or dealer" in securities. However, if it were impossible for any other taxpayer to incur an income loss or gain on share sales, Subsection 39(4) would be meaningless. What are the criteria the Agency uses to evaluate the proper classification of such gains or losses? What steps is the Agency taking to make their representatives aware of these criteria and educate them as to the issues surrounding these transactions?

Response

The CRA's views with respect to reporting of gains and losses from the disposition of securities are outlined in Interpretation Bulletin IT-479R, Transactions in Securities. As noted in paragraph 9, whether a specific transaction would be considered on account of income or capital is dependant on the facts of each case. The tests that the Courts have applied in making such a determination include the taxpayers "course of conduct" and "intention".

As indicated in paragraph 10 of IT-479R, if an individual's course of conduct indicates that the individual is disposing of securities in a way capable of producing gains, with that object in view, and the transactions are of the same kind and carried on in the same fashion as a trader or dealer in securities, the individual would generally be considered to be carrying on a business with respect to his or her securities transactions such that the

transactions would be on income account. In addition, as explained in paragraph 12 of this bulletin, the term "business" includes "an adventure or concern in the nature of trade", which the Courts have held can include an isolated transaction in shares where the "course of conduct" and "intention" clearly indicate it to be such.

Some factors to be considered in ascertaining whether a taxpayer's conduct indicates the carrying on of a business are listed in paragraph 11 of IT-479R and are as follows:

(a) **frequency of transactions** - a history of extensive buying and selling of securities or of a quick turnover of properties;
(b) **period of ownership** - securities are usually owned only for a short period of time;
(c) **knowledge of securities markets** - the taxpayer has some knowledge of or experience in the securities markets;
(d) security transactions form a part of a taxpayer's ordinary business;
(e) **time spent** - a substantial part of the taxpayer' time is spent studying the securities markets and investigating potential purchases;
(f) **financing** - security purchases are financed primarily on margin or by some other form of debt;
(g) **advertising** - the taxpayer has advertised or otherwise made it know that he is willing to purchases securities, and
(h) **in the case of shares, their nature** - normally speculative in nature or of a non-dividend type.

Thus, the determination of whether a particular transaction in respect of securities results in business income (or losses) or on account of capital can only be made after an examination of all the facts and circumstances.

Question 9

We have had unpleasant experiences with CRA valuators who seem, at best, inexperienced. We have experienced dealings with CRA appraisers whose explanation for variances between their appraisal and others is limited to "valuation is an art, not a science." Asked why the comparables used by another appraiser were not considered, their response is "they are not comparable." No further details can be provided. Similarly, we have had a valuator, after much pressure from both ourselves and an Appeals Officer, provide a reference supporting his selected approach. This reference was the Canada Valuations Service. Referring to the section cited, we noted that it included the statement that the approach in question was not accepted by the Tax Courts. Rumor has it that, when an appeal is filed before the Courts, the Agency uses external valuators exclusively, due to the inability to rely on their internal "expertise." Given the above experiences, the writer can well understand why. However, it seems excessively costly to force taxpayers through the costs of both the Objections and Appeals process in order to have a competent business valuator look at the case. Our firm's practice has always been to seek a reasonable settlement at each stage of the audit/appeals process. However, these experiences seem to suggest the more cost efficient approach for our clients where matters of valuation are involved is to ignore the auditor, file Notice of Objection, wait 30 days and file Notice of Appeal to the Tax Court. This is hardly ideal for taxpayers, nor, we expect, is it the approach the Agency would prefer. What, if any, action is the Agency prepared to take in order to improve the quality of valuation work undertaken at the pre-court stages, such that taxpayers and their advisors will not come to see this as the most efficient approach?

Response

CRA is committed to providing a high level of valuation service, and will continue to strive for fair and reasonable resolutions to contentious valuation issues.

CRA employs an experienced staff of professional valuators to prepare both business and real estate valuations. Business Valuators receive training from the Canadian Institute of Chartered Business Valuators to receive their designation as a Chartered Business Valuator. Real Estate Appraisers are certified by the Appraisal Institute of Canada. Tax courts generally place a high value on these designations when deciding whether to accept a valuator/appraiser as an expert witness. The majority of CRA's valuators and appraisers have these designations and appear as witnesses on the Agency's behalf.

Once a valuator/appraiser prepares a report, his/her team leader reviews it. If a taxpayer disagrees with a business valuation or an appraisal prepared by the Agency, he or she is encouraged to meet with the valuator/appraiser to discuss the approach taken. The taxpayer may also request a meeting with the valuator/appraiser's team leader. If the taxpayer has documentation to support his/her own valuation the Agency's valuator/appraiser will (in consultation with the team leader) review it. This review may result in changes to the Agency's original position.

Question 10

An article in the July 25, 2003 edition of Lawyers' Weekly (text attached) by Hugh Neilson CA addressed the uncertainties of taxation of some child support payments under the Alberta Maintenance Enforcement Act. It seems unreasonable that a taxpayer's income tax situation will be determined based on which judge hears their case. A coin toss would have similar predictability with far less expense! What, if any, action is the Agency considering to resolve this situation and provide some certainty for these taxpayers?

Response

On March 25, 2004, the FCA allowed Robert Fraser's appeal. The CRA has decided not to appeal this decision to the Supreme Court of Canada.

The issue was whether payments made under a paternity agreement pursuant to the Parentage and Maintenance Act (PMA) in the province of Alberta meet the conditions in paragraph (b) of the definition of "support amount" in subsection 56.1(4) of the Income Tax Act (Act) in order to be deductible under Subsection 60(b) of the Act.

The FCA concluded that the phrase "in accordance with the laws of a province" found in the definition of "support amount" is broad enough to refer to all provincial laws regarding the legal obligation to pay child support, including the provincial laws governing the procedure by which such a legal obligation is made enforceable. The Court added that there was no justification to narrow the interpretation in a manner to exclude procedural aspects of the provincial law relating to child support.

This decision clarifies the position of the Court on the definition of "support amount." This clarification was necessary as a number of conflicting decisions have been adopted by the TCC on the topic and the result varied depending on whether the taxpayer involved was the payer or the recipient.

This decision also applies to support the inclusion of amounts received under a paternity agreement into the recipient's income.

Question 11

No round table would be complete without an update on civil penalties. Can CRA advise of situations where application of these penalties has been considered, where such consideration has been rejected, and whether (and, if possible, in what circumstances) civil penalties have been applied to date?

Response

The third-party civil penalty (TPP) is applicable to statements made after June 29, 2000. Since the penalty was enacted, the Agency has considered eleven referrals for application of the penalty. Of the eleven referrals, four were rejected for TPP audit, four were accepted for TPP audit, two are under consideration for TPP audit, and one referral was assessed the TPP.

With respect to the referrals that were rejected for TPP audit, these were rejected based on the circumstances of the particular referral. Of the referrals currently under TPP audit, the referrals considered include the deduction of fictitious expenses, and the promotion of a tax credit arrangement. The TPP has been applied once to-date, a referral involving fictitious expenses.

Question 12 – CAS

International Tax Services in Ottawa (i) will not stamp and return "receipt" letters; this is due to ITSO's volumes and backlogs, per their enquiries personnel (ii) will, on occasion, advise that it is "too early in processing" to determine if a given return or request has been received or is in the processing queue; for instance, given the minimum 12 -16 week time earlier this year, at eight to ten weeks, we get erroneous answers—item is in processing—and find later it is lost, not yet logged in.

Response

It is not CRA's policy to issue an acknowledgment when a return is received in one of our processing centres. However, the International Tax Services Office will acknowledge the receipt of a return when a self-addressed envelope with sufficient postage has been provided.

Our enquiries personnel will provide an update concerning the processing of a particular return based on the information available at the time of the enquiry. We welcome the opportunity to follow up on any specific case of concern that you may have.

Question 13(a)

Numerous errors are made on ITSO processed returns, many which cannot be explained, as they bear no relation to the values in the return. The "Problem Resolution" number given out contacts only the regular enquiries line.

Response

As you know, our tax system is based on self-assessment and we make every effort to produce an accurate assessment according to the information provided with the return. If an error is detected on the assessment, we welcome the opportunity to review your concerns.

Question 13(b)

The ITSO "Problem Resolution" number published connects directly to the ITSO Call Centre (general enquiries line), where the telephone agent will direct the call as required. The ITSO Call Centre follows standard CRA procedures for referrals to Problem Resolution Program (PRP) and calls are directed as required. There are specific criteria for referrals to PRP since it is a program designed to resolve client' issues that cannot be resolved through normal procedures.

Officers on the enquiries line will not connect one with a prior contact and will not transfer one to "true" Problem Resolution.

Response

The ITSO Call Centre follows the same procedures as other CRA Call Centres in that the agents first actively offer to assist the client themselves. If it is determined that it is absolutely necessary for an individual to speak to a specific agent it will usually be done as a call-back since the specific agent may be busy with other clients.

Question 13(c)

Finally, local Problem Resolution officers, Edmonton and Calgary, appear they cannot liaise w/ITSO problem resolution officer. Given the client service mandate of CRA, when could we expect changes in the ITSO operations?

Response

We are not aware of these difficulties. We appreciate the information, and we will follow-up with the affected parties and ensure the appropriate corrective measures are taken.

Question 14

Has any consideration been given to collections practices, which begin within 30 days of mailing of a notice of tax due, given the appeals period is 90 days, or longer for personal tax current year issues?

Response

Although, the general appeal period is 90 days (along with the legislative restrictions that prohibit most legal actions), it is important to remember that any amount owed is payable immediately when assessed or reassessed. The excerpt below is a direct quote from document 98-1R "Collections Policies".

"after sending you a notice of the debt, we will make additional requests for payment, whether by mail or by telephone if you have not paid the balance owing. You will have an opportunity to discuss your assessment or reassessment with our Client Services personnel if need be."

This "Collections Policies" information circular provides information pertaining to payment arrangement, financial disclosure, postponement of payment, and timeliness of legal action. The initial "soft" contact generated during this period is often beneficial to both the client and the CRA. By providing the client with the requested information at an earlier date, the client will be able to make any initial enquiries regarding the assessment, discuss payment options, and help to avoid any further interest or possible legal action that may arise.

The link to the CRA website with respect to our Collections policies is as follows: **www.ccra-adrc.gc.ca/E/pub/tp/ic98-1r/ic98-1r-e.html**

Question 15

Please advise what specific actions the CRA - Alberta Tax Services Offices are undertaking to ensure that audits of taxpayers, especially large taxpayers, become more current. As you can appreciate, it is often more difficult to obtain the necessary information to properly answer audit queries when the queries arise many years after the transaction has taken place. Often, there are no employees available that assisted in the implementation of the transaction being questioned.

Response

CRA recognizes that being current contributes to an effective and efficient audit program. Also, CRA believes that getting and staying current is a shared responsibility that reduces the administrative and compliance burden to both the client and CRA.

CRA is engaging its clients to help solve this issue. In conjunction with the Future Directions Initiative, Calgary Tax Services Office has, in partnership with the Large File community, formed an Industry Liaison Committee. This committee provides a forum though which both parties can exchange information and identify issues, with the opportunity for each to provide input and propose best practices.

CRA has identified internal impediments that must be addressed in order to improve the timeliness of the audit process. These include:

- Improving turn around times on referrals to Headquarters;
- Better scheduling of auditors from speciality areas;
- Developing appropriate materiality and risk analysis guidelines and;
- Supporting CRA's Appeals Division's goal of dealing with issues in a more timely manner.

CRA has introduced a continuous training program for staff assigned to the Large File Program. The training focuses on improving an auditor's knowledge and expertise in the areas of audit techniques and tax law as well as technical knowledge of the client's business.

CRA is introducing the Account Manger concept on a pilot basis. The objective of the Account Manager is to achieve a professional business relationship between the CRA and Large File clients by providing clients with a single point of contact and improved access to CRA's client-centred services.

CRA continues to promote Audit Protocols with Large File clients. Protocols, tailored to the client's unique needs, establish guidelines for the audit process. They increase co-operation, openness and flexibility in the audit process and assist in defining the compliance relationship.

CRA believes that by working co-operatively with the client, improvements can be made in the areas of:

- Client response time to requests for information, queries or proposals;
- Responses to queries given to the client that are incomplete which then result in additional queries and create more delay and;
- Better access to client records, other documents and client staff who work outside the client's tax department.

Question 16

Please explain the approach taken by the CRA - Alberta Tax Services Offices in determining a materiality level to be used during the course of an audit. Large numbers of relatively small adjustments unnecessarily result in a deterioration of the relationships between the auditors and the taxpayers.

Response

The question of establishing a materiality level for tax audits is a matter of balancing voluntary compliance with responsible enforcement. Determination of materiality levels for audit adjustments must always be made bearing this in mind.

In the 2001-2002 Annual Report to Parliament, the Canada Revenue Agency Tax Services Business Line made clear that it has one expected outcome: That Canadians pay their fair share of taxes and the tax base is protected:

> Although quality service and the efficient processing of returns help to promote compliance, there will always be some instances where individuals and businesses either unintentionally or intentionally fail to be fully compliant. A knowledgeable, skilled, and appropriately staffed workforce that understands compliance behaviour and identifies areas of non-compliance is key to protecting the tax base, which the government relies on to fund its social and economic policy objectives. This, along with a sound risk management

> approach for guiding audit, review and debt collection activities helps ensure that any leakage in the tax base (non-compliance) is kept to a relatively low level, thereby contributing to greater equity and fairness in the administration of tax laws.

One of the criteria for measuring the success of that outcome is that the Agency employs an appropriate mix of education and enforcement activities to effectively target and address compliance issues.

In chapter 5 of its March 2004 report, the Office of the Auditor-General stated its expectations that CRA will have an appropriate compliance strategy for the small and medium enterprise sector. The Auditor-General refers to an observation made in a study for the Department of Finance Canada's Technical Committee on Business Taxation about tax planning that occurs in small businesses:

> A prevalent attitude among small-business owners is that, given the risks and uncertainty that come with self-employment, they are entitled to organize their affairs to pay less tax than someone who enjoys the comfort of a regular salary:

The Agency employs sophisticated methods to help determine where the risk of non-compliance is greatest. This strategy helps ensure that the burden on compliant individuals and businesses is minimized. Bearing in mind the compliance objective, it follows that there cannot be a standardized formula for determining materiality that can be applied to all audit files. The circumstances faced by auditors are different with each file assigned. Accordingly, materiality levels must be determined on a case-by-case basis, taking into account the effect of potential adjustments on future compliance.

Question 17

Has the recent announcement regarding the limitation period adjustment to 10 years affected the operations of the CRA - Tax Services Offices, particularly the Collections branches?

Response

The *Budget Implementation Act, 2004*, amending the *Income Tax Act*, the *Excise Tax Act*, the *Excise Act, 2001*, the *Excise Act* and the *Air Travelers Security Charge Act*, to provide for a 10-year limitation period for the collection of debts assessed pursuant to these acts, received Royal Assent on Friday, May 14, 2004 and is now law.

The limitation period for tax debts assessed prior to March 4, 2004 is deemed to begin on March 4, 2004 while the limitation period for debts assessed after March 3, 2004 will either begin 90 days after the date of assessment or on the day when the Minister is able to take collection action. The passing of the legislation will enable collection officers to once again proceed with legal action on all tax debts for a minimum of ten years from March 4, 2004 or from the date of assessment, if this date is subsequent to March 4, 2004. Provincial income tax debts in all but two provinces will also be governed by this 10 year limitation period.

Question 18

Based upon the specific situation presented at the 1981 Round Table and subsequently, CRA has stated that they would not challenge the reasonableness of salaries or bonuses in the context of a Canadian Controlled Private Corporation ("CCPC") paying a bonus to a shareholder-manager in order to reduce the CCPC's taxable income to the small business deduction limit. Recent examples have also suggested that the policy of allowing the deduction can be extended to non-active income provided the other principles are met. Can you confirm that recapture recognized by a CCPC is covered by your administrative policy on active income and that subject to the other requirements being met that a bonus can be paid to an active shareholder-manager to reduce income of the CCPC to the small business limit? Given that recapture can be significant, can you confirm that there is no limit on the amount provided all of the other conditions are met?

Response

Remuneration paid from income earned from the normal, ongoing business operations will not be challenged for reasonableness, provided the other conditions outlined in the shareholder-manager remuneration policy are met. This policy was also addressed by the Income Tax Rulings Directorate at both the 2001 and 2003 Canadian Tax Foundation conferences. (See Income Tax Technical News (ITTN) No. 22 for Qs & As for the 2001 CTF and ITTN No. 30 for Qs & As from the 2003 CTF.)

In technical interpretation 2003-0046624, the CRA holds the view that income generated from a major sale of business assets is not earned in the normal course of business operations, but rather is an indication of the cessation of business operations. The CRA considers remuneration paid from the proceeds in this situation to be beyond the intent of the policy and reserves its right to challenge the reasonableness, as stated in the 2003 Canadian Tax Foundation conference. This would encompass all sources of income triggered by the proceeds, including capital gains, recapture of capital cost allowance, and income arising from the disposition of eligible capital properties. The CRA would not *generally* be concerned with a situation where there is an incidental sale of business assets during the normal course of business operations. (*emphasis added*)

Also beyond the intent of this policy would be a situation in which the income of a CCPC is derived from management fees or dividends that have flowed through a complex corporate structure. In this situation, the income used to pay the remuneration is not derived from the normal business operations of the CCPC.

For those situations that are considered to be beyond the intent of the policy, Income Tax Rulings has indicated that they are prepared to consider any proposed factual situation in the context of an advance income tax ruling. This does not mean that remuneration paid in such circumstances will necessarily be considered unreasonable for purposes of section 67 of the Act, merely that the CRA reserves the right to review the

reasonableness of the amount.

When an advance income tax ruling is requested, Income Tax Rulings will consider all of the income tax consequences of the proposed transactions, including the application of section 67 of the Act. In our view, the advance income tax ruling process will provide certainty to taxpayers as to the taxable status of remuneration paid in situations that may be outside the scope of the policy.

Question 19

In a February 27, 2004 Release (2004-015) CRA announced changes to the CPP legislation to permit a corporation that acquires a distinct part or major portion of the vendor's business to receive credit for the CPP paid by the vendor for the employees for the year. Are there any guidelines as to what constitutes a major portion or a distinct part of the vendor's business?

Response

The *Budget Implementation Act*, 2004 (Bill C - 30), which was tabled in Parliament on March 23, 2004, includes amendments to the Canada Pension Plan (CPP) and the *Employment Insurance Act* (EIA). In particular are amendments which consider employee's employment to be continuous in cases where an employee has a new employer as a result of changes in the corporate structure of this employer, provided there has been no interruption of service by the employee.

On May 14, 2004, Bill C-30 received Royal Assent. Although both the CPP and the EIA amendments were adopted by Parliament, only the EIA amendments have come into force. The legislative changes to the CPP will only become effective once 2/3's of the provinces with at least 2/3's of the population ratify the amendments. The comments below are therefore only applicable, for the time being, to the EIA. Where an employer had restructured, notably as a result of a winding-up and immediate reconstruction under a different legal structure or the acquisition of a major portion of the employer's property or of a distinct part of the employer's business (e.g., a distinct division of a business is sold to another enterprise), employees were treated as if they had joined a new employer. As a result, the employer was required to begin making and withholding CPP contributions and EI premiums anew without being able to take into consideration the amounts made or withheld by the employees' "previous" employer, even if there had been no interruption of service by the employees.

As a result of the amendments to the EIA dealing with employer restructuring, the legislation allows the new employer to consider the employees' employment to be continuous in specific cases where there is a change in the business structure of the employer, provided there has been no interruption of services by employees.

If, in a year after 2003 (on or subsequent to January 1, 2004), one employer—with the agreement of the former employer or by operation of law—immediately succeeds another employer as the employer of an employee as a result of:

- the formation of a corporation or
- the dissolution of a corporation or
- the acquisition of a business or part thereof

then the restructured employer may take into account the amounts deducted, remitted or paid under the EIA by the former employer in respect of the year in relation to the employment of the employee as if they had been deducted, remitted or paid by the restructured employer.

It is important to note that no matter the type of restructuring such as; the formation of a corporation, the dissolution of a corporation or the acquisition, in order for the restructured employer to meet the conditions of the EIA amendments, the restructured employer has to acquire all or part of the business assets, tangible or not, of the former employer. The act of simply moving the staff from a former employer to a new employer does not meet the requirements of the new EIA provisions. Also, there can be no interruption of service by the employees.

Once the CPP amendments come into force, the rules governing CPP contributions to the plan will allow an employer who immediately succeeds another employer during a year after 2003 as a result of a change in business structure to take into account amounts relating to contributions for an employee of the predecessor employer in determining contributions for the employee of the restructured employer. Equivalent treatment is extended to self-employed individuals who become employees of a corporation controlled by them.

Question 20

On October 23, 2003 CRA announced an increase in the rate transportation sector employees can use for unreceipted meal expenses commencing in 2003. The rate will be $15.00 per meal up to a maximum of $45.00 per day ($15.00 U.S. if incurred in the United States).

Would this be available if the transport employee left a city at, say, 6 a.m. and returned to the same city at, say, midnight such that he was not required to stay overnight away from his home? Alternatively, if he was required to stay away from his home overnight but, slept in the cab as opposed to incurring accommodation costs, would these guidelines be allowed?

Also, we understand that CRA may have permitted an individual to redo his/her 2002 return to use the $15.00 per meal, rather than the $11.00 per meal, if this T1 Adjustment was done within one year of the due date of the 2002 return. Is this correct?

If so, will there be an extension to the deadline for the 2002 return considering that the October 23, 2003 announcement implied that this would only be available for years commencing in 2003?

Response

Paragraph 8(1)(g) of the *Income Tax Act* contemplates journeys of such substantial distance and duration as to require disbursements for both meals and lodging while away from the

relevant municipality and metropolitan area, if there is one. Therefore, to make a claim under paragraph 8(1)(g) of the *Income Tax Act*, employees must generally be away from home overnight in the performance of their employment duties. The deduction claimed under paragraph 8(1)(g) of the Income Tax Act is not intended for employees who return to their homes at the end of each day, and make disbursements for meals only as a matter of course.

However, the CRA is prepared to allow a deduction for meals only, even though no disbursement has been made for lodging, provided the duties of employment required the employee to stay away overnight and the employee can demonstrate that, rather than paying for lodging, he or she used other facilities. This may be the case where a transport employee uses a truck equipped with a sleeper cab.

A deduction for meals only may also be allowed (to the extent of a reasonable number of meals) where a transport employee, although regularly required to travel away on journeys of substantial distance and duration so as to require disbursements for both meals and lodging, occasionally travels, as part of the employment, on journeys of shorter distance and duration not requiring him or her to stay away from home overnight. Where the shorter journey is scheduled for ten hours or less, the CCRA would expect the transport employee to eat breakfast and dinner meals at home, as is the case with most other employees. Accordingly, only one meal per day, namely lunch, will be permitted in these circumstances.

CRA accepted requests for increases to meal claims for 2002 when the request was made within the time frame allowed to file a Notice of Objection which would be April 30, 2004.

Further information on this deduction may be found on our website: Information Circular IC,73-21R8, *Claims for Meals and Lodging Expenses of Transport Employees*, (**www.cra-arc.gc.ca/E/pub/tp/ic73-21r8/README.html**)

Question 21

Penalties on Late Payroll Remittances. On April 16, 2002 the Auditor General's Release noted in Paragraph 2.54 that CRA has a policy to allow a taxpayer to submit payroll deductions late, without penalty, once every 13 months.

On June 20, 2003 CRA noted that, effective July 2003, it will be lowering the penalties for employers who pay their payroll remittances a few days late. We understand that CRA are now taking the position that effective July 2003 they will no longer permit a taxpayer to submit payroll deductions late, without penalty, once every 13 months. Is this correct?

What types of criteria would permit a waiver of the penalty under the Fairness Provisions?

Response

There is currently no legislation nor is there any Agency policy that states that an employer will be allowed to remit late without penalty once in a thirteen month cycle.

All late payments are penalized. However, those employers who voluntarily remit late (no enforcement action) will have the Late Remittance Penalty reduced as long as the payment is 7 days or less late. A waiver of this penalty under the fairness provisions would fall under the same criteria as any other fairness submission. (Natural or Man-made disasters, Civil Disturbances or Disruptions in Service, Serious Illness or Accident, Serious Emotional or Mental Distress, Agency Processing Delays, Incorrect Written or Verbal Information given by CRA)

Question 22

Find below a copy of an email recently received by the Charities Directorate with respect to a question posed about proposed subsections 248(30)-(32) and its impact on Information Circular IC 75-23.

DATE: Fri, 28 Nov 2003 09:00:02 -0700

RE: Subsection 248(30) - (32)

Mr. _____:

I am responding to your e-mail of October 15, 2003 to Jocelyne Dumoulin, Charities Directorate wherein you ask us to comment on whether the draft legislation in 248(30) - (32) will impact the CCRA's administrative position in IC75-23. I can advise that the proposed legislation, once it becomes law, will necessitate modification to IC 75-23 (e.g., the current policy does not allow for an "eligible amount of gift".) However, I cannot comment at this time on the extent of the modification or the specific impact of the draft legislation or recent case law on the subject (Woolner). Until the proposed legislation becomes law and IC 75-23 is modified, the current administrative treatment therein applies.

I recognize this answer is not as complete as you may have hoped but we simply are not in a position at this time to comment on the full implications on the policy in IC 75-23. I would be happy to be in touch when a more complete answer is available.

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Government of Canada | Gouvernement du Canada

Given that many private religious schools rely on the administrative policy in IC 75-23 and also rely on such policies for future budgetary planning, can you please provide an update as to what changes, if any, will be made to the administrative guidelines in IC 75-23?

Response

The draft changes to the Income Tax Act respecting the treatment of gifts—[allowing for the donor to obtain a receipt despite the fact that he/she receives some consideration in respect of the transfer]—remains a proposal. The Minister of Finance has yet to introduce a Bill or table a Notice of Ways and Means Motion to implement the proposed changes. Until the law changes we cannot comment on the extent of the modification or specific impact the proposed changes and the Woolner case will have on IC 75-23.

Question 23

It has been debated for years as to whether or not a corporation under applicable provincial corporate law can declare a stock dividend whereby the fair market value (i.e. the redemption value) of the issued shares is a higher amount than its stated capital of the shares (i.e. paid-up capital). Given the definition of "amount" under subsection 248(1), the recipient (assuming such recipient is an individual) will only pay income tax on the amount by which the paid-up capital of the corporation that paid the dividend is increased by reason of the payment of the dividend. Many technical interpretations that the CRA has released on such an issue have consistently said that it will respect a "high-low" stock dividend only to the extent that provincial corporate legislation allows for the payment of such a stock dividend. Can you provide comments as to whether or not it is the CRA's belief that Alberta provincial corporate legislation provides for the ability to pay a high-low stock dividend?

Response

It is a question of corporate law whether a high value low stated capital share could be legally issued upon the declaration of a stock dividend. With respect to a similar request involving the Business Corporations Act (Alberta) by an Alberta CA the CRA stated in document E2001-0094305 that:

"if the Business Corporations Act (Alberta) allows AlbertaCo to declare a dividend of $1 in the hypothetical scenario, which is then added to the stated capital account as outlined above, the amount of the stock dividend, as defined in subsection 248(1) of the Act, would be $1." (*Emphasis added*)

However, CRA is of the view that if the high/low stock dividend was issued as part of an arrangement or series of transactions, the primary purpose of which was to obtain an unintended tax advantage, and the transactions are not within the object and spirit of the Income Tax Act, the General Anti-Avoidance Rule (GAAR) may apply to deny any tax advantage sought.

Question 24

Can the CRA provide a list of its top 10 tax avoidance projects that it is currently working on?

Response

The CRA does not have a top 10 list with respect to tax avoidance projects. The types of cases the Calgary and Edmonton Tax Avoidance offices are reviewing include surplus strips, RRSP strips, donation arrangements, use of non-resident trusts to shelter offshore income, deductibility of interest expense, and foreign currency and commodity loss arrangements.

Question 25

In recent transfer pricing audits involving multinational corporations, the Canada Revenue Agency ("CRA") has been requiring the multinational corporation to pay for airfare and hotel accommodations for CRA auditors to attend at the head offices of these multinational corporations. What is the legislative basis that permits the CRA to request these types of payments?

Response

Pursuant to Section 230 of the Act "...every person carrying on business and every person required by the Act to pay or collect taxes or other amounts, must keep records and books of account (including an annual inventory) at his place of business or residence in Canada or at such other place as may be designated by the Minister. The books and records are required to be kept in such form and contain such information as will enable the taxes payable under the Act or the taxes or other amounts that should have been deducted, withheld or collected to be determined."

When the client cannot make the books and records available for audit in Canada and the client requests that the audit be conducted outside Canada, the Agency obtains an undertaking from the client that costs such as, airfare, accommodation, meals, all car rental expenses and incidentals incurred for conducting the audit outside Canada shall be incurred by the client or reimbursed to the Agency.

GST Questions

Question 1

It is our understanding that where a registrant has come forward on a no-names basis through its advisor that the CRA will only protect the applicant and apply the Voluntary Disclosure Program ("VDP") policy in situations where the client has been named. If this is not the case, under what circumstances will a no-names disclosure be protected by the VDP. The current administrative policy seems to be contradictory to the whole scheme of the VDP, which is to promote voluntary compliance and to encourage persons who are not in compliance to come forward.

Response

Paragraph 11 of IC 00-1R states "Clients, representatives, and agents who are unsure they want to make a voluntary disclosure are entitled to discuss their situation on a no-name (hypothetical) basis with an officer responsible for handling voluntary disclosures." The CRA will continue to offer advice on a no-name basis prior to a client making a disclosure. Headquarters is reviewing the no-name process because of reports of suspected abuse of the process and reports of inconsistencies in the application of the process. As the process is under review it is premature to offer any comments on the date at which

protection to the client will be offered. In the interim, each case will be decided on its own merits. The client should be identified as soon as practical in the process and they may be allowed a reasonable amount of time to complete the disclosure after the client is identified.

From GST/HST Memoranda Series 16.3.1 - Reduction of Penalty and Interest in Wash Transaction Situations.

A "wash transaction" occurs when a supply that is taxable at 7% or 15% is made and the supplier has not remitted an amount of net tax by virtue of not having correctly charged and collected the tax from the recipient who is a registrant who would have been entitled to claim a full input tax credit (ITC) if the tax had been correctly applied.

Where there is a wash transaction, the CRA will consider waiving or cancelling the portion of the penalty and interest, payable at the time of assessment, that is in excess of 4% of the tax not properly collected by the supplier where the conditions identified in paragraph 11 of the memoranda 16.3.1 are met. The remaining 4% will be considered penalty under the memoranda.

If the Voluntary Disclosure Program (VDP) guidelines are met the taxpayer will only have to pay the tax they owe plus the interest.

In the situation as described, it would appear that this transaction would qualify as a wash transaction with only a 4% penalty applicable and under the VDP the 4% penalty would be waived. The result would be that only the applicable taxes for GST/HST would be owing.

Question 2

In the oil and gas sector, there are many instances where a Supplier and a Purchaser enter into a Master Agreement that contains general clauses with respect to the agreement in principle between the two parties. The parties may then enter into several Transaction Agreements under the umbrella of the Master Agreement that specifies many facts necessary in determining the GST status of the supply, including the place of supply, the determination of the pricing, and the manner in which the purchase/sale transactions will be documented. In many cases, it is the Purchaser that possesses the necessary information used to determine the amount owing to the Supplier, and the Purchaser generates a detailed Purchase Statement which it provides to the supplier along with payment for the purchases. The Purchase statement itemizes the volume of commodity purchased, the place of delivery, the price paid for the commodity and the GST applicable to the transaction. There generally is not a formal confirmation from the Supplier that it agrees with the Purchaser's determination of the GST status of the supply as this would be redundant. Would the CRA please confirm that as long as the collective documents (Master Agreement, Transaction Agreement, and the Purchase Statement) contain the required information pursuant to subsection 169(4) and the ITC Regulations, the Purchaser is entitled to claim an ITC on the purchase of the commodity from the Supplier.

Response

There is no provision which requires all requisite information in support of an ITC claim to be presented in a specific kind of document or format or that all required information be contained within a single document, in the Excise Tax Act or in the related regulations.

Subsection 286(1) requires that books and records be kept in such form and contain such information as will enable the determination of liabilities and obligations under Part IX of the Act. A "record" is broadly defined under subsection 123(1) and includes, in part, "an agreement…a statement…and any other thing containing information, whether in writing or in any other form."

Paragraph 169(4)(a) states that, in order to claim an ITC, the registrant must obtain "sufficient evidence in such form containing such information as will enable the amount of the input tax credit to be determined, including any such information as may be prescribed."

The prescribed information, per the Input Tax Credit Information GST/HST Regulations, should allow the Minister to ascertain:

- the identities of the supplier and recipient;
- the Business number of the supplier;
- when the supply took place;
- the nature of the supply;
- the tax status of the supply;
- the value of the consideration paid or payable;
- the terms of payment; and
- the amount of tax paid or payable.

An ITC would be allowed to the extent that this information is available in support of a registrant's claim, and to the extent that the supply is for consumption, use or supply in the course of commercial activities of the recipient. It remains a question of fact, verifiable on audit, whether a particular document or record, or set of documents and/or records, is sufficient to support a specific ITC claimed by a registrant.

More information is available in the CRA publications GST/HST Memoranda Series 15.1, *General Requirements for Books and Records* and GST/HST Memoranda Series 15.2, *Computerized Records*.

Question 3

What is the CRA's formal position with respect to relocation allowances as addressed in 3859681 Canada Inc. and Zellers Inc. v the Queen 2002-3291 (GST) I?

Response

The CRA's Policy on allowances and reimbursements (P-075) was revised on July 6, 2004. For income tax purposes, a moving allowance of up to $650 is treated as a non-taxable reimbursement to the employee, as long as the employee certifies that the amount was spent on moving expenses. A person paying

such an amount is then able to claim an input tax credit or rebate subject to any other restrictions in the *Excise Tax Act*. An allowance or reimbursement that results in a taxable benefit to the individual under *Income Tax Act* is for the personal benefit of the individual and is in reality remuneration or income of the individual. As income, the payment is not subject to GST/HST and hence employer is not eligible for an input tax credit or rebate entitlement under *Excise Tax Act*.

Question 4

An individual provides management services exclusively to GST registrants. The individual mistakenly assumes that he/she is not required to be registered for GST purposes and never registers. The individual is fully compliant with respect to income tax returns to be filed and has an exemplary history of compliance to this regard. The individual subsequently determines that he/she was making taxable supplies, was required to be registered for GST purposes and initiates a Voluntary Disclosure on a named-basis. Will the CRA apply the wash penalty provision to the supplies disclosed and waive the 4% penalty that would have been otherwise applicable? If not, why not?

Response

From GST/HST Memoranda Series 16.3.1 - *Reduction of Penalty and Interest in Wash Transaction Situations*.

A "wash transaction" occurs when a supply that is taxable at 7% or 15% is made and the supplier has not remitted an amount of net tax by virtue of not having correctly charged and collected the tax from the recipient who is a registrant who would have been entitled to claim a full input tax credit (ITC) if the tax had been correctly applied.

Where there is a wash transaction, the CRA will consider waiving or cancelling the portion of the penalty and interest, payable at the time of assessment, that is in excess of 4% of the tax not properly collected by the supplier where the conditions identified in paragraph 11 of the memoranda 16.3.1 are met. The remaining 4% will be considered penalty under the memoranda.

If the Voluntary Disclosure Program (VDP) guidelines are met the taxpayer will only have to pay the tax they owe plus the interest.

In the situation as described, it would appear that this transaction would qualify as a wash transaction with only a 4% penalty applicable and under the VDP the 4% penalty would be waived. The result would be that only the applicable taxes for GST/HST would be owing.

Question 5(a) – CRA Administrative Procedures

CRA has overall responsibility to ensure that taxpayers pay only their "fair share". Yet many times, difficulties arise in dealing with the various departments and divisions of CRA and their respective roles and responsibilities. In one example, a taxpayer filed several rebate claims. An audit was undertaken and completed over the course of a year. However, there was a significant delay in the taxpayer receiving the refunds. Upon questioning the delay, we were advised that GST returns were outstanding for several years. (The auditor had not once indicated this to be a problem and no one had contacted us after the completion of the audit to indicate that the refunds were being held). The returns were filed - they were nil returns as the client had no commercial activity since the last return had been filed and had simply not deregistered. What steps should the taxpayer take to ensure that administrative holds are not in place? Is there a hierarchy of checks to be performed by CRA of the taxpayer?

Response

The responsibility of filing the proper GST returns lies with the registrant. An auditor will only audit those returns or rebates filed. Should the registrant not receive a refund in a timely manner, the registrant should contact the Agency to determine why refunds due to them have not been received. At any time during the audit they can question the Agency to see if there were any other outstanding issues, e.g., outstanding returns, that would delay the processing of the refund. Currently, there are no automatic checks performed by CRA employees of the registrant's account but it is something we could consider implementing.

Question 5(b)

Once the rebate cheques were received, we noted that interest had not been paid on the rebate in accordance with section 297 of the ETA. Upon questioning the matter, we were advised that the effective date of the interest was set at the time that the account became compliant. We argued that section 297 did not provide the variation in the effective interest date as does section 229 with respect to refunds. While all CRA staff with whom we discussed this issue agreed with our argument, not one department would agree to help to get the assessment amounts changed. The reason provided to us was that Summerside handled all rebate assessments. As a result, our client must object to the assessments, incurring additional fees to prepare and handle the objection, and then wait while the Appeals Division gets to the file. It would have just taken some initiative on the part of one of the other divisions part to resolve this error made by CRA on a more timely and cost-effective basis. Who can we contact on problems like this to ensure a more timely and cost-effective solution for the taxpayer?

Response

If a registrant does not agree with the calculation of system generated interest on the payment of a rebate, they can contact the Telephone Enquiries Unit at STC at 1-800- 565-9353.

Question 5(c)

We have examples of refunds which have been approved, but which are delayed for months because of CRA account holds which have been put in place and never removed. Repeated assurances are received from CRA that a cheque has or will be issued. Further follow-up proves this to be wrong. Is there a

check list or some documented level of responsibility/accountability on the part of CRA employees to ensure that once a refund has been approved, all holds are automatically removed? If not, perhaps this is a procedure that should be considered.

Response

Sometimes there are administrative holds put on an account by other Divisions, e.g., Collections. Currently, there is nothing in place to ensure that once a refund is approved all holds are automatically removed. It may be appropriate, however, for the auditor to refer the registrant to the appropriate Division and that is something we could consider.

Question 5(d)

Historically, where GST refund claims were filed, an audit was usually begun before a refund was issued. Recently, the procedures appear to have changed and refunds have been issued before CRA has reviewed the claim in detail. Is this a change in procedure? Can we request that the refund not be issued until CRA has considered the issue and reviewed the claim amounts? This is particularly important where the refund claim is based upon new jurisprudence.

Response

Generally, we review credit returns before they are paid and if we are going to audit them we do so. Occasionally, due to operational requirements, a refund will be paid to the registrant and a post audit will be completed at a later date but in those instances the registrant is usually so advised. Post audits on the other hand, are raised for various reasons, and could cover periods where credit returns were filed. The registrant can always contact the Agency prior to filing a return on a possible contentious issue to request that it is reviewed before it is paid.

Question 5(e)

In recent refund claims, where the technical issue and taxpayer's filing position is provided to CRA's with the claim form, an audit has commenced without a copy of the claim form and explanation of the technical issue having been made available to the CRA auditor assigned to review the claim. Accordingly, the auditor has not researched or otherwise become aware of the issue. This necessitates more time and costs being borne by the taxpayer or the taxpayer's representative to educate the auditor to the issue at hand. Is it common procedure that the actual refund claim document is not made available to the auditor before contact is made with the taxpayer?

Response

The actual return is not included as part of the audit. We use the information processed on our system. If a registrant submits information with a return, it is not always forwarded to the local office. A number of registrants and accounting professionals forward information directly to the Audit Division of the TSO to reduce any delay in auditing the refund.

Question 6 – Late–Filed Elections

CRA has advised that the consideration of late-filed elections for GST purposes is beyond the scope of the Voluntary Disclosure Program. However, there has been no clear guidance as to where we should direct requests for consideration of late-filed GST elections. Please identify the parties who will consider this type of request in each of the Calgary and Edmonton offices.

Response

The CRA already has in place fair and balanced policies and procedures regarding the consideration of several types of late filed elections. For example, registrations and elections under subsection 167(1) are both cases where significant latitude is allowed. In cases where no formal policies exist, Agents may exercise discretion in processing these elections, normally in consultation with their Team Leader, depending on the circumstances.

Late filed elections will be considered on a case by case basis in exceptional circumstances. Where there is an election filed that clearly falls outside the statutory provisions regarding the time of filing, and where there are compelling reasons to allow the election, please contact:
Calgary: Anne Cowick, BW Team Leader, (403) 691-8639
Edmonton: Lise Norris, BW Team Leader, (780) 495-6033

Two of the primary elements which will be used in determining whether to allow a particular late filed election are: the degree of lateness (e.g., 2 days or 2 years), and the potential for the mitigation of tax liability.

Please note that late filed elections which have the effect of mitigating tax liability (i.e. could be construed as retroactive tax planning) will generally not be allowed under any circumstances.

Question 7 – Voluntary Disclosure Program

Our understanding of the VDP is to bring the taxpayers back on board while minimizing the bureaucracy to accomplish this. The vast majority of taxpayers choose to carry out their business within the law and most disclosures are the result of errors or lack of understanding of the issue. As such, taxpayers want to clear up the issue and move on with minimal cost. We have encountered situations where the VDP officers are insisting on having us perform tasks that, while technically correct, serve to create more administrative burdens for both CRA and the taxpayer, and significantly more costs for the taxpayer. Can we work with the CRA to help to identify and eliminate some of these potential barriers to using the VDP?

There have been difficulties in consistent application of the Voluntary Disclosure Program guidelines between CRA offices and even between officers assigned to cases within the same office. Can we receive confirmation of CRA's position on the following:

- Issues less than the one year time limit will be considered under the VDP where the disclosure is not merely to avoid a late-filing penalty.

- Taxpayers are afforded protection from audit for the issues identified in a no-name disclosure from the date of the disclosure on a no-name basis?

Response

In order that consistency is achieved in the Voluntary Disclosure Program, guidelines have been developed that are being followed across the country. As part of these guidelines, VDP officers are required to insist on completeness of records for the periods at issue. Having adequate books and records to substantiate a Voluntary Disclosure is a requirement that in fact protects taxpayers in case there are future audits that may involve the period under disclosure.

As indicated in the Conditions For A Valid Voluntary Disclosure under information circular IC-00-1R *Voluntary Disclosures Program*, or GST/HST Memorandum 16.5, the Agency will review disclosures that involve a penalty under the VDP with the following requirements:

The disclosure must include information that is:
- At least one year past due, or
- If less than one year past due, not initiated simply to avoid the late filing or installment penalties. (Income Tax Act and Excise Tax Act)

The VDP is not intended to act as a vehicle for clients to intentionally avoid their legal obligations under the Acts administered by the CRA. For example, a client cannot use the VDP to disclose a current year income tax return simply to avoid paying the late-filing penalty. However, when the details of the disclosure include penalties or the possible application of a discretionary penalty (see VDP Guidelines section 8.2.5) other than late filing penalties or installment penalties, a valid disclosure can be less than one year past due.

With respect to the no-name disclosure issue, please refer to the response to Question #1.

Question 8 – Documentation for Rebates

Many rebates require that original documentation be submitted to support the claim. Taxpayers and practitioners are hesitant to send original documents to CRA. We have established some exemplary processes in Edmonton to deal with First Nations rebate claims to minimize the volume and type of information required by the officer to complete the review. (For example, the officer at the TSO level chooses a sample of invoices to review and only those invoices are submitted to the TSO.) This makes the assessment of First Nation rebate claims very efficient and timely from the perspective of all parties involved. Would CRA consider implementing similar processes for other rebate claims?

Response

The majority of general rebate claims that are filed are processed through the Summerside Tax Centre and the original documentation must be sent with the rebate claim. For certain rebate claims (legal aid plan, taxable sale of real property by a non-registrant, lease of land for residential purposes, non-resident recipient of a taxable supply of an installation service, segregated fund and specified services supplied to an investment plan or a segregated fund) original documentation is not to be sent in but must be maintained. For all other types of general rebate claims original documentation must be sent with the rebate claim.

For claims by Indian bands, tribal councils or band-empowered entities the original documentation is to be included. The Verification and Enforcement Division of the Tax Services Office closest to where the Indian band is located may approve the filing of rebate applications without filing original receipts. The claimant should make the request in writing to the particular Tax Services Office. The letter of request should include the expected filing frequency for rebate applications and an estimated amount of annual purchases subject to the rebate. The claimant will be notified in writing of the decision.

At this time it is not anticipated that a similar process will be initiated for other rebate claims. Any request to change the Agency's policy would have to be made to Head Quarters, Compliance Branch Directorate.

Question 9

Several court decisions have supported the premise that registrants (outside of Quebec) are responsible for ensuring the validity or GST numbers provided by suppliers [or purchasers using 167 and 221(2) to avoid paying the tax]. The Business Window [1- 800 - 959 - 5525] purports to provide confirmation of GST/HST registration when a caller has the legal name of the person and their supposed Business Number. Recently I was told that the officers will **not** provide the effective date of the person's registration, but only whether they are registered **today**. This is a new policy to my knowledge. Given the fact that invoicing is normally after that fact, and the occurrence of charging GST/HST for past transactions, how are we supposed to confirm the supplier's legal right to collect GST if the CRA will not provide the timing of the supplier's agency for the Crown?

Response

The CRA is committed to providing a high level of service to all Canadians and has special and specific guidelines for facilitating the flow of information required for the conduct of business by registrants. Our policies regarding the release of information are designed to ensure that confidentiality of client information is maintained, while at the same time allowing businesses to function with a high level of certainty regarding their business affairs.

Accordingly, Business Window Agents may confirm information regarding the GST registration status of businesses, and whether a person is registered as of a specific date, provided that the Agent is satisfied that the caller has a legitimate business reason for requesting the confirmation of this information.

For GST accounts only (i.e. NOT payroll, corporate or any other account(s)), where the enquirer provides both the name and the BN of the entity, and a valid business reason as to why the

information is required, the Agent will provide confirmation of the BN in relation to the date of the supply.

Examples

Caller provides the name and BN of entity, and states that he is trying to determine whether to charge GST on a supply of real property.

NAME AND BN MATCH: Agent will confirm. If the supply of real property took place last month, the Agent will confirm registration as of that date, or state that the account was not registered as of that date.

NAME AND BN DO NOT MATCH: Agent will advise caller that the BN is not associated with that name. The Agent will not reveal what name is attached to that BN.

NAME AND BN DO NOT MATCH BUT ARE CLOSE: The agent will use their own judgement to determine whether the match is close enough to warrant confirmation of registration.

Please note that the Agent is not required to provide the effective date of the registration of the entity, but only whether the entity was registered on the date that is relevant to the business need of the enquirer (that is, the date of the relevant transaction).

Agents will NOT:

i) disclose any information regarding the account, including the name on the account, where only the BN is provided;
ii) disclose any information regarding the account, including the BN, where only the name is provided;
iii) provide confirmation of any other program account but the RT (GST) account;
iv) provide any information about the history of the particular 9 digit BN, the GST account, or any other program account.

Where written confirmation of the registration of an entity is requested, please note that this information must be sent by mail, picked up in person by the requestor, or sent by secure facsimile transmission only. Only where specifically requested by the client or an authorized representative, and where a facsimile transmission authorization is provided, will this information be sent by the CRA via a non-secure facsimile device.

Question 10

We have been under the GST/HST Rental Property Rebate regime for some time now. What problems have been encountered that have caused applicants to be denied the rebate?

Response

Other than the claimant of the New Residential Rental Property Rebate (NRRPR) not meeting the requirement of section 256.2 of the Excise Tax Act, the only other problem the Agency has encountered in the denial of this rebate is when one rebate is filed for more than one owner of the property. Each owner must file their own NRRPR for their allocated ownership of the property.

Question 11

The Edmonton TSO currently has 50 prepayment auditors (including 40 field auditors). We have found in recent past that many assessments by this group have been technically incorrect and while these have been reversed by the Appeals Directorate, the pressure this places on that body is tremendous. There has been a single technical specialist supporting primarily the non-field prepayment group, and a second has been added to provide assistance to the entire prepayment team. We applaud this as a great step in the right direction. What provisions exist in the other Alberta TSOs with respect to prepayment audits?

Response

Each office has a unique structure with the number of prepayment auditors based upon the registrant base. In the Calgary TSO there is a separate Technical Applications Team, which is available as a resource for all auditors and team leaders. Prepayment auditors and their team leaders are encouraged to seek technical advice as issues arise. In the Red Deer TSO the technical advisor is not in the same team as the prepayment auditors. In Lethbridge the technical advisor is on the same team as the prepayment auditors. In all offices, the team leader, prior to processing, reviews audit assessments for technical accuracy based on the information available at the time of audit.

Question 12(a)

Section 28 of Part VI of Schedule V of the Excise Tax Act (Canada) (the "ETA") exempts a supply between a municipal body and any of its para-municipal organizations and between para-municipal organizations of the same municipal body. The CRA document titled "GST/HST Information For Municipalities" at page 5 states that a para-municipal organization must be established by a province at the request of one or more municipalities or be established by one or more municipalities. Where an organization is established by multiple municipalities and no municipality controls the organization, can it be a para-municipal organization *vis a vis* the supplies made to each of its member municipalities?

Response

Yes, the organization may be determined to be a para-municipal organization. However, the municipalities as a group must have the control features specified by the Act. The GST/HST Guide for Municipalities explains the Para-municipal organization as:

Para-municipal organizations

Municipalities often create autonomous boards, commissions, and other organizations to carry out certain activities. To qualify for determination as a municipality, such an organization has to meet the following two criteria:

- it has to be an organization established by a province at the request of one or more municipalities, or established by one or more municipalities; and
- it has to be owned or controlled by one or more municipalities.

The CRA will consider an organization to be owned if:

- one or more municipalities own at least 90% of the organization's shares; or
- one or more municipalities hold title to the organization's assets or control their disposition so that in the event of a winding-up or liquidation, 90% of these assets are vested in the municipality or municipalities.

We will consider an organization to be controlled if:

- the municipality or municipalities have to approve the organization's periodic operating budget and, where it applies, capital budget; and
- the municipality or municipalities appoint the majority of the members of the organization's governing body, such as the directors, governors, or commissioners.

Organizations that meet the above criteria qualify for municipal determination, and once this determination is received they are considered to be Para-municipal organizations for GST/HST purposes.

Question 12(b)

For example, could the pooling of property insurance and accident insurance risks through a separate organization owned by multiple municipalities be a function that could be designated for a para-municipal organization with respect to the costs of providing insurance coverage for each member municipality?

Response

Yes, the insurance organization may qualify as a para-municipal organization, provided the two criteria to qualify for municipal designation are met. However, in order for the organization to be considered to be a Para-municipal organization, the organization is required to be either designated or determined to be a municipality by the Minister and meet the ownership and/or control criteria. Once these conditions are met, then the supplies could flow between the Para-municipal organization and the municipalities for which it is a Para-municipal organization exempt of GST/HST.

Question 12(c)

If so, is it necessary for each member municipality to request a designation of the insurance organization as a para-municipal organization or can the insurance organization itself request a designation of itself as a para-municipal organization for each of its member municipalities?

Response

There is no requirement for the member municipalities to request the designation of the insurance organization as a Para-municipal organization. Therefore the organization itself can apply for status, and once approved by the Minister, the organization would be considered to be a Para-municipal organization of the group of municipalities that formed it.

Question 13

How does the substantial renovation definition apply to a building that consists of a number of separate residential condominium units that are on separate titles? For example, if a builder acquires a used strata title condominium complex that contains many separate residential condominium units and if the builder substantially renovates the entire building, is the 90% substantial renovation requirement applied on a residential condominium unit by a residential condominium unit basis or is the 90% test applied to the entire building or both? If the builder has substantially renovated the entire building and is selling the separate residential condominium units as new residential properties, are the purchasers of the separate residential condominium units entitled to the new home rebate?

Response

It is the CRA position that the determination as to whether or not a substantial renovation had occurred would be evaluated on a residential condominium unit by residential condominium unit basis rather than the entire complex.

Where a residential unit is owned under separate title from the rest of the units in a complex, it is itself viewed as a separate residential complex for the purposes of the definition of "substantial renovation." As such, it is capable of being substantially renovated. It would not be necessary for the entire building to be substantially renovated. The rebate eligibility is determined on a unit-by-unit basis, depending on whether the particular unit being held under separate title is substantially renovated.

The determination of whether a residential condominium unit has been substantially renovated (i.e., whether the 90% threshold has been met) does not include renovations done in respect of the areas (hallways, reception area, etc.) that are owned in common by all of the residents.

Therefore, in the scenario described, a person acquires an existing condominium complex, consisting of a number of separately titled residential condominium units, and carries out renovations to the complex to such an extent that all of the residential condominium units situated in the complex have been substantially renovated. The person would be considered the "builder" of the complex for purposes of the Excise Tax Act, as the definition of builder found in subsection 123(1) includes a person who has an interest in the real property on which the complex is situated and carries on or engages another person to carry on for the person the construction or substantial renovation of the complex. The ensuing supply of the substantially renovated residential condominium units by way of sale would be subject to the GST/HST and the purchasers would be eligible to claim a New Housing Rebate provided they otherwise meet all of the conditions of subsection 254(2).

The definitions of "residential complex" and "residential condominium unit" in subsection 123(1) include units that are "intended" to be owned under separate title. The CRA would require sufficient evidence to demonstrate such "intention". In the case of a condominium unit where title is not yet registered since approval of the condominium plan is forthcoming, we would require that the condominium plan be at least filed with the appropriate authorities before accepting that "intention" test has been met.

Question 14

In the draft Policy Statement on section 272.1 dated April 24, 1996, the situation discussed involves a three person partnership which becomes a two person partnership because of the death of one of the partners. The old three person partnership is considered to have terminated because of the absence of any continuation provisions in the Partnership Agreement. The two surviving partners buy-out the estate of the deceased partner and contribute all of the former partnership property to a new partnership. Subsection 272.1(7) deems the new partnership to be a continuation of the old partnership. However, the draft Policy Statement goes on to require the old partnership to collect GST on the supply of property to the three partners and denies any input tax credits to the two surviving partners that have contributed the assets to the new partnership. How can the CRA take the position that such a receipt of property from the old partnership and contribution of property to the new partnership is not in the course of a commercial activity where there is a clear opportunity for profit from the partnership activities? In addition, it is difficult to see why the Estate of the deceased partner should be denied input tax credits for the property that is received from the old partnership and sold to the two surviving partners.

Response

We assume that you are referring to the *Draft Policy Statement on the GST/HST Implications of the Transfer of Property Referred to in Paragraph 272.1(7)(c) of the Excise Tax Act*, which was released for discussion purposes in May 2003, with an effective date of April 24, 1996. The policy statement states that where subsection 272.1(7) applies, the supplies of property from the predecessor partnership to the partners, and from the partners to the new partnership, are subject to the normal GST/HST rules in the ETA.

The example in that draft policy statement indicates that the two surviving partners are not required to collect or remit GST/HST and are not eligible to claim ITCs for the GST/HST that they paid on the property because they are not supplying the property to the partnership in the course of commercial activity. They had no reasonable expectation of profit from the supply, and therefore were not engaged in commercial activity as it is defined in subsection 123(1) of the ETA.

The example assumes that the estate was also not engaged in commercial activity when it made the supply of property to the two individuals.

The example assumes that the supplies at issue were supplies of personal property rather than real property, or if real property was supplied, that the lease had no value.

Since the partnership is a separate person for purposes of the ETA, the fact that the partnership is engaged in commercial activity does not cause the estate or the individuals in this example to be engaged in commercial activity

Question 15

In meeting the "all or substantially all" test in subsection 167(1) which entitles the supplier and recipient to make a joint election, is it necessary that all or substantially all of the property be supplied under a single agreement between the supplier and the recipient or can multiple agreements between the same parties be used in meeting the all or substantially all test? In particular, we are wondering whether the supply of accounts receivable, equipment, inventory and goodwill under a transfer of assets agreement and the transfer of a leasehold interest under a separate assignment of lease agreement (but between the same parties) could collectively be used to meet the all or substantially all test?

Response

Subsection 167(1) of the ETA deals with the situation where a person sells or transfers all or substantially all of the assets used in a business. No GST/HST is required to be paid or collected in respect of the qualifying assets where the vendor and the purchaser jointly agree and an election to this effect is filed.

For the purpose of determining the eligibility to make the election under subsection 167(1), the parties to the transaction must meet certain conditions, including the following two tests:

- the supplier must sell a business or part of a business that was established or carried on, and
- the recipient must acquire, under the agreement, ownership, possession or use of all or substantially all (generally interpreted as 90% or more) of the property that can reasonably be regarded as being necessary for the recipient to be capable of carrying on the business or part as a business.

It is a question of fact as to whether "all or substantially all" of the necessary property is being acquired by the recipient.

Where there is an agreement between one supplier and one recipient for the supply of the supplier's business and where the assignment of a lease agreement is separate from the transfer of assets agreement for the other assets but both agreements are between the supplier and the recipient, those two agreements collectively could be used to evaluate the all or substantially all test in section 167 provided the other conditions of section 167 are met.

Question 16

Is the transfer of commercial real estate from a partnership to its partners on a dissolution of the partnership a "sale" of the real property for the purposes of the partners who are registered having to self-assess under paragraph 221(2)(b)?

Response

The definition of "sale" under subsection 123(1) includes any transfer of the ownership of the property. Where a partnership holding real property is dissolved, and ownership, legal or equitable, of the property is transferred to a former member of the partnership, the transfer will be considered to be a sale for purposes of paragraph 221(2)(b). Consequently, where the recipient of the taxable supply of real property is registered for

GST/HST purposes, the recipient is required to account for the tax payable pursuant to subsection 228(4).

Furthermore, pursuant to subsection 272.1(4), where the transfer of ownership is a result of the dissolution of the partnership, the consideration for the supply of the property is deemed to be equal to the fair market value of the property immediately before the time the property is transferred to the former partners.

Question 17

GST is levied on imports of goods under Division III of the Excise Tax Act, but collected and administered by the Canada Border Services Agency (CBSA) under the Customs Act as if the tax was duty. The importer claims an input tax credit, if available, administered by the Canada Revenue Agency ("CRA") under section 169 of the Excise Tax Act. The administrative policies of the CBSA and CRA can differ considerably with respect to matters such as audit approach, wash transactions, voluntary disclosures, interest and penalties. Can the CRA advise whether the two agencies are attempting to co-ordinate these policies so that they are applied consistently with respect to assessments and voluntary disclosures of GST liabilities?

Response

The CRA continues to be responsible for interpretation and policy concerning the application of Division III tax on imported goods.

With the establishment of the CBSA, Customs will continue to consult the CRA on issues related to Division IIII. Formal arrangements will be developed to clearly establish the role of each Agency in this area and to provide for appropriate sharing of information to ensure consistency in application of Division III and related administrative policies.

Question 18

The case involving *AAi.FosterGrant of Canada Co.* was argued at the CITT. The issue was whether the Canadian wholly-owned subsidiary, AAi.FosterGrant of Canada Co. ("AAi Canada"), of a United States parent corporation (the "U.S. Parent") was a "purchaser in Canada" for the purposes of the *Customs Act* and the *Valuation for Duty Regulations*. The Crown won at the CITT, with the result that AAi Canada was found not to be "carrying on business in Canada." Instead, the CITT concluded that the U.S. Parent was carrying on business in Canada. As a result, the value for duty of the imported goods could not be based on the inter-company transfer price between AAi Canada and the U.S. Parent. Instead, the CITT held that the value for duty of the goods imported into Canada during the relevant period was to be the price at which the U.S. Parent sold the goods directly to the Canadian retailers. The case has been appealed to the Federal Court of Appeal.

a) Is the Crown rethinking the merits of this case?
b) Insofar as the phase "carrying on business" is not defined in any of the *Customs Act*, the *Income Tax Act* or the *Excise Tax Act*, are we to assume that the findings of the Court of Appeal will be applied consistently to all three of these statutes? That is, will the Crown apply the Court of Appeal decision in respect of the concept of "carrying on business" to the *Income Tax Act* and the *Excise Tax Act*, in addition to the *Customs Act*?
c) Since AAi Canada is not carrying on business in Canada, it follows that it has no "permanent establishment" in Canada for purposes of the *Customs Act*. Presumably that will be the same result for purposes of the *Income Tax Act*. That being the case, can you please confirm that neither AAi Canada nor the U.S. Parent will be obligated to pay Canadian income taxes. We believe this to be the case because AAi Canada is neither carrying on business in Canada and has no (per the findings of the CITT) permanent establishment in Canada. Similarly, U.S. Parent will not be subject to Canadian income tax because it has no permanent establishment in Canada such that the Canada-U.S. Tax Treaty displaces the application of Canadian corporate income tax.
d) As a result of the current decision of the CITT, who is responsible for the GST on the importation of the goods that the FosterGrant group brings into Canada? That is, does proposed section 178.8 of the Excise Tax Act focus on the Canadian retailer, AAi Canada, or U.S. Parent?

Response

A corporation incorporated in Canada is generally deemed to be resident in Canada for Income Tax purposes. This means that such a corporation is liable for income tax in Canada. For GST purposes, in a situation such as in this case, the CRA would in all likelihood consider the corporation to be making supplies through a permanent establishment in Canada as the term is defined for GST purposes. On July 14, 2004 the Federal Court of Appeal allowed AAI. Fostergrant Canada's appeal. In doing so, the Court found that the Appellant was carrying on business in Canada.

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