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November 2006

Member Advisory

2006 CRA Roundtable

The annual Canada Revenue Agency (CRA) Roundtable Meeting was held in Ponoka in May 2006. CRA representatives from Calgary, Edmonton, Red Deer and Lethbridge were in attendence along with representatives from the ICAA.

As in previous years, two concurrent roundtable sessions were held focusing on income tax matters and goods 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—Voluntary Disclosures

Effective April 1, 2006, we understand that the Voluntary Disclosure Program (VDP) was transferred from Appeals to the Verification and Enforcement (V&E) unit. Accordingly, we have the following questions:

(a) Has the CRA set up a special unit in V&E to administer the program? If so, who will lead the unit and be responsible for making key decisions including the determination as to whether a disclosure is both voluntary and complete?

(b) Does the CRA plan to make changes to the way it administers the program in light of the move from Appeals to V&E?

(c) If a special unit is not created, will the auditor assigned to a file or who has previously audited the disclosing party be involved in the disclosure, or will an independent auditor be asked to review the disclosure?

(d) Although we note the CRA's comments that were released on April 7, 2006, regarding this issue (see email from CRA to David Sherman regarding no-name policy), could you provide further comments on how V&E will administer no-name disclosures?

(e) Further to (d) above, there is some uncertainty whether a no-name disclosure can be made if the "information required to be able to link the disclosure to the client at a later time" will identify the taxpayer without overt disclosure of same. Could you comment on this please?

(f) Could you enlighten us on the average turnaround time for a voluntary disclosure file? We note that we asked a similar question at last year's roundtable given our experience of significant delays. Have improvements been made over the last year? If so, what improvements or what plans are there in place to reduce turnaround times?

Response

(a) As you are aware, the VDP promotes compliance by encouraging taxpayers to voluntarily correct previous omissions in their dealing with the CRA.

In the context of an overall CRA realignment exercise, the CRA reviewed the VDP to determine whether its alignment with the mandate and core competencies of the Appeals recourse function was the best fit from a CRA perspective. As a result, it was determined that, to maximize its mandate, the VDP was best aligned with Compliance Programs.

Therefore, effective April 1, 2006, the responsibility for the management of the VDP within the CRA was transferred to the Disclosures and Enforcement Directorate (formerly the Investigations Directorate) of the Compliance Programs Branch. The assistant director of the Enforcement Division in the Calgary Tax Services Office is Terry Harder and in the Edmonton Tax Services Office is David Poon.

This internal transfer will facilitate better access to broader expertise to enable easier and more efficient review of complex disclosures, which are becoming more frequent as the program matures. We consider that further access to broader CRA expertise in Compliance Programs will enhance taxpayers' dealings when making a disclosure.

(b) The VDP policies, procedures and guidelines are not changing as a result of the transfer from Appeals to Compliance Programs. Furthermore, the CRA is committed to the on-going enhancement of the program, such as revisions to update the VDP information circular, and these will continue within the Disclosures and Enforcement Directorate. The VDP will continue as a distinct program within Compliance Programs.

(c) In the Calgary Office, a special unit will be created within the Enforcement Division. Further, all of the current employees assigned to the VDP have agreed to transfer to the Enforcement Division. The transferring of the existing staff will greatly assist us in ensuring continuity of the program.

The CRA is committed to a seamless transition and to ensuring taxpayers continue to receive high quality and timely service.

(d) The changes made to the no-name policy over the past year remain in effect at this time. See memorandums 2005-01, 2005-02, 2005-05, 2005-06.

There should be no changes to the administration of the no-name policy with the VDP Program realignment within the Enforcement Division.

Regarding the email from CRA to David Sherman, no changes to the no-name policy have resulted to date. However, having received representations from various practitioners in regard to the no-name policy, we are in the process of reconsidering some of the positions we have taken. To further assist us, we would appreciate your input in this respect so that any changes, which may be done to this portion of the no-name policy, may be fully explored and revisions made as are necessary. Please provide your suggestions on this matter to **Rick.Power@cra-arc.gc.ca** by **May 31, 2006**. When our review of this particular issue has been completed, we will advise of our position.

We will be further defining these procedures and policies issues and will be including some of them in a revision to the Information Circular 00-01R – Voluntary Disclosures Program.

(e) It is my understanding through discussions with headquarters that where a no-name disclosure does not develop into a named VDP file, the disclosure is considered withdrawn and the VDP file will be closed. While the taxpayer would remain at risk, the details received during the process are dropped with no further actions (i.e., not forwarded for further review).

(f) Response time will depend on a variety of factors, including the complexity of the disclosure, inventory levels, staff availability and the completeness of the disclosure.

The Enforcement Division and VDP are committed to a high level of taxpayer service and will try its best to handle all the voluntary disclosures in a timely and professional manner.

Question 2—CRA Administration

Could you provide a general update on the case load in Appeals? Are files still being transferred to other offices?

Response

The number of income tax objections received by the Calgary Appeals Division has remained constant from the prior year. However, last year, an increased number of tax avoidance file objections moved into our "workable" inventory as a result of test cases before the courts being resolved. We expect this trend to continue during the current fiscal period.

As has been the case for a number of years, Calgary Appeals will continue to transfer files to other taxation offices that have the ability to action them on a timely basis. This is part of our continuing efforts to provide a timely and quality review of issues in dispute.

Question 3

Could you please update us on the application by the CRA of Section 163.2?

Response

Please see Question 10.

Question 4

With respect to the CRA's Slip Matching program, while well intentioned, it seems to have been run far too late with respect to 2004 T slips and also seems to lack human intervention in some cases. Clients have been receiving reassessment notices, some dated far into the 2005 T1 season, where the CRA is revising their 2004 tax returns for apparent discrepancies between the returns and slips in the CRA system—and in many cases these reassessments are incorrect. It is very frustrating, for example, to have a professional accountant who knows that income on a particular T-slip has to be attributed to someone other than the recipient of the slip do so and then have the CRA reassess the original recipient of the slip for failure to report the income that had to be attributed elsewhere. A simple telephone call to the professional who prepared the return would often clear up the question of whether or not the income was reported and by whom.

When the CRA's records show that a professional firm filed a T1 return in the first place, is it possible to implement a policy or procedure to telephone the professional income tax preparer (assuming proper authorizations are in place) before simply reassessing? Your comments on this would be appreciated since we believe that it could greatly reduce errors and extra work by the professionals and the CRA.

Response

The matching program takes place after the notice of assessment has been sent. It is an important element of the Agency's compliance programs that ensure the integrity of Canada's self-assessment tax system. We compare the information on an individual's tax return to the information provided by third-party sources, such as employers or financial institutions. As part of the program, we also administer the Beneficial Client Adjustments Initiative by identifying under claimed credits relating to tax deducted at source. The peak period for our matching program is September to March. This timing is necessary to ensure that our program includes returns that are filed throughout the year and that we have the most current information available to us on which to base our review. While we are normally able to complete our matching program in mid-February, this year due to the program size, our program was completed in mid-March.

The matching program identifies cases where a client has under-reported income received in a year. As part of this process, we also look at spousal returns in situations where there is an indication on a T slip that the account is held jointly. This minimizes unnecessary reassessments for clients who have split the income. Most reassessments are straight forward and do not require client contact.

It is in our best interest to ensure that our reassessments are accurate to avoid client frustration and unnecessary reversal adjustments. In cases where it cannot be established with certainty whether an adjustment or additional information or clarification is required, assessors are instructed to contact the client or their representative either by telephone or in writing. Assessors are to check to verify the existence of an authorized representative for the tax year under review. Assessors are to contact the authorized representative in an attempt to solve the discrepancy before contacting the client. When we request supporting documentation, I can assure you that we want to give individuals every opportunity to respond to our requests before action is taken to reassess the return. We have initiated a second contact policy for matching and processing review cases where a partial reply is received, and where it is reasonable to believe contact could result in the missing information being provided, assessors will make a second contact. Where no response is received, a reassessment is prepared based on the information we have. The expectation is that this second contact will result in a lower adjustment rate and reduce the number of reversals required. This was proven in our results with both the adjustment rates and reversals in the last two programs being reduced.

We believe that the request to introduce a policy or procedure to telephone the representative before reassessing each file is not feasible due to the volume of reviews conducted. Assessors make every effort to verify the case in the appropriate manner. They are first required to review the details of the case provided by our system and then to review the applicable system options and entries that may assist in the verification of the case. In some cases, it is necessary to review the taxpayer's return, attachments, permanent documents and/or the same documentation for the spouse or common-law partner. Every effort is made to provide the client with a correct reassessment. We will, however, undertake a review during the coming matching program of those filed by professionals and initiate this contact as a test sample. If the results support it, we will consult with head office and review our approach accordingly.

With respect to attribution, we are currently looking at two options that may assist us in identifying these situations in the future. One is the possibility of expanding both our 2D bar code initiative and our electronic filing requirements so they would include attribution information that is already being captured by most tax preparation software packages. The other is the possibility of allowing an E receipt type function where individuals/preparers would scan receipts or include documentation they deem necessary to process the file and attach them to the electronic record. While both these initiatives are not expected to be available in the near future, they are currently being discussed.

Question 5

In files where penalties pursuant to Section 163 of the *Income Tax Act* are proposed to be assessed or are assessed, what is the percentage of files where the penalties are not ultimately assessed or, if assessed, are ultimately reversed on appeal to the Appeals Division?

Response

Meaningful statistics are not available in relation to the eventual application of Subsection 163(2) penalties.

The application of penalties may be considered if there is apparent audit evidence to support their application. However, initial discussions with the taxpayer or representative, or additional documentary evidence brought to light, may negate the penalty consideration before the penalties are formally proposed in writing. Similarly, rebuttal evidence may be produced in response to a proposal letter that would also result in penalties no longer being considered. During the appeals process, the Appeals Division would also consider new evidence that was not made available to the auditor. In all cases, penalties are not casually applied and the required standards of proving gross negligence must be met.

Question 6

What are the 10 most common business audit areas being reviewed by the CRA?

Response

1. Oil and Gas Issues – Resource Pool Additions and Resource Allowance
2. Unreported Income – Informant Leads and Internal Referrals
3. Low or Declining Net/Gross Profit – Excessive Expenses
4. Shareholder Loan – Appropriations
5. Capital Gain vs. Income Transactions
6. Partnerships – At-Risk Amount
7. Charter Surrender Files
8. Corporate Reorganizations/Amalgamations
9. Section 85 Rollover
10. Discrepancy Between GST and Income Tax Returns

Question 7

What are the most common types of transactions where the general anti avoidance rule (GAAR) has been the primary or secondary basis for a reassessment?

Response

A breakdown of cases reviewed by the GAAR Committee and where Section 245 has been considered and/or applied is as per the spreadsheet attached. Overall, the

Issue	Y	N	N/A	D/D	Total	%
Offshore Trusts	8	1	1		10	1%
Cross-Border Lease	11	0	0		11	2%
Part XIII Tax	2	8	1		11	2%
Losses, Rental	11	2	0		13	2%
Kiwi Loan	14	0	0		14	2%
Losses, Stop Loss	9	5	2		16	2%
Charitable Donations	9	10	1		20	3%
Capital Gain	13	4	4	1	22	3%
Interest Deductibility	16	16	4	1	37	5%
Debt Parking	17	7	3		27	4%
Indirect Loan	25	3	2		30	4%
Debt Forgiveness	29	10	1		40	6%
Losses, Capital & Non-Capital	21	9	2		32	4%
Loss Creation Via Stock Dividend	13	1	1	1	16	2%
Part I.3 Tax	37	11	6		54	7%
Provincial Issues	0	2	1		3	0%
Surplus Strips	82	27	12	1	122	17%
Treaty Exemption Claim	1	1	0		2	0%
Miscellaneous	109	101	29	3	242	34%
	427	218	70	7	722	100%

Cases Referred to GAAR Committee:	652	
* See note below		
GAAR Applied	427	65%
GAAR Not Applied	218	33%
Decision Deferred	7	1%
GAAR as Primary Position	188	44%
GAAR as Secondary Position	239	56%

** Note: statistics do not take into account the following:*

RRSP Project	1,239 files
Barbados Spousal Trust project	76 files

In these cases, GAAR was applied as a secondary position.

Legend

Y	GAAR Applicable
N	GAAR Not Applicable
N/A	Technical Issue Only, Not Referred to GC
D/D	Decision Deferred by GC

*** Table refers to Question 7**

statistics indicate that the committee has considered 652 cases as of February 7, 2006. Of these, the GAAR was applicable to 427, the others being considered technical issues not requiring the application of Section 245.

The statistics indicate that the single most common issue requiring the application of the GAAR has been in the area of surplus strips followed by issues surrounding Part I.3 taxes. The statistics do not include the recent projects done on Barbados Spousal Trusts or RRSP Strips.

Question 8

Has the Agency ever contemplated streamlining the process for removing excess RRSP contributions (Form T3012) and the calculation and remittance of the penalties (Form T1-OVP) for such excess contributions? The current process is time consuming, complex and not easy to complete.

Response

We will comment on withdrawing RRSP excess contributions first and then on calculating and remitting the 1% monthly tax on such contributions.

If a taxpayer has RRSP excess contributions subject to the 1% monthly tax under Section 204.1 of the *Income Tax Act* (the *Act*), the taxpayer can leave the contributions in the plan or withdraw them. If the taxpayer chooses to withdraw them, it is not required that they be withdrawn with a Form T3012A that has been approved by the CRA. In fact, we suggest that the contributions be withdrawn without using an approved Form T3012A. This will minimize the taxpayer's liability for the tax if approval of the form is delayed due to CRA workloads or incomplete information provided on the form.

Excess contributions withdrawn without an approved Form T3012A will have income tax withheld. However, the taxpayer can claim that tax as a credit on the tax return for the year in which the amount is withdrawn. The taxpayer can use Form T746, Calculating Your Deduction for Refund of Unused RRSP Contributions, to determine whether a deduction can be claimed for the excess contributions that are withdrawn and included in income. This process is simple and straightforward.

Withdrawing an RRSP excess contribution without income tax withholdings is driven by Part I of the *Income Tax Regulations* (the *ITRs*) and Subsection 146(8.2) of the *Act*. Part I of the *ITRs* provides that the payer does not have to withhold tax from an RRSP payment if the payer has reasonable grounds to believe that the payment may be deducted under Subsection 146(8.2) in calculating the income of a taxpayer. A Form T3012A that has been approved by the CRA is those reasonable grounds.

Accordingly, to approve a Form T3012A, we must determine that the taxpayer can claim the deduction under 146(8.2) in respect of an amount that has not yet been withdrawn. To do this, we must be able to substantiate that the conditions in Subsection 146(8.2) are met. Those conditions are that:

1. The taxpayer has never deducted the contribution to be withdrawn, and it was contributed to an RRSP under which the taxpayer, or the taxpayer's spouse or common-law partner, is the annuitant.
2. The payment to be received has to be paid from the same type of plan to which it was contributed (i.e., either a personal RRSP or a spousal RRSP) and cannot be in respect of an amount that was directly transferred to the RRSP from:
   - a registered pension plan;
   - a deferred profit sharing plan (DPSP) under Subsection 147(19); or
   - the Saskatchewan Pension Plan (SPP) where Subsection 146(21) applied to that transfer.
3. The taxpayer or the taxpayer's spouse or common-law partner must receive the payment of the undeducted RRSP contribution:
   - in the year the contribution was made, or in the following year; or
   - in the year we send the taxpayer a notice of assessment or notice of reassessment, for the year the contribution was made, or in the year after that.
4. The payment cannot be a "qualifying withdrawal" that the taxpayer intends to withdraw from his or her own RRSP so that the taxpayer's certifiable past service pension adjustment (PSPA) can be certified.
5. The taxpayer reasonably expected to be able to fully deduct the contribution for the year in which it was made or for the previous year, or the taxpayer did not pay the contribution with the intent of getting a payment for which an offsetting deduction could be claimed under Subsection 146(8.2).

To conclude, the requirements of Subsection 146(8.2) prevent us from streamlining the process of withdrawing RRSP excess contributions without income tax withholding. However, as indicated above, the process for removing RRSP excess contributions with tax withheld at source is simple and straightforward.

Calculating and Remitting Part X.1 Tax on RRSP Excess Contributions

We acknowledge that calculating the 1% monthly tax on RRSP excess contributions is complex and that completing the T1-OVP, Individual Tax Return For RRSP Excess Contributions, is time consuming. However, the complexity of the return is driven by the complexity of Section 204.1 of the *Act*.

With the view of simplifying the completion process for as many taxpayers as possible, we recently developed a simplified version of the T1-OVP return. This return is called the T1 OVP-S, "Simplified Individual Tax Return for RRSP Excess Contributions." Taxpayers who are not carrying excess contributions made before February 27, 1995, and who are not making mandatory contributions under a group RRSP can use it. This return, which is year specific, has been available for use since 2004. It does not include parts B, C and D of the ordinary T1-OVP return.

In addition, we are currently considering the development of a "no cal" version of the T1-OVP, but are uncertain whether the return will be developed, or when it will be available if a decision to develop it is made. We are also looking at other solutions to ease the filing of the T1-OVP Return such as an online fillable form with detailed completion instructions. However, we are uncertain whether this will go forward.

To conclude, headquarters will consider specific suggestions to simplify our products and processes and is prepared to address any concerns the ICAA has with our existing products and processes. Comments should be mailed to Ian Gray, Director, Winnipeg Tax Centre, 66 Stapon Rd, Winnipeg, MB, R3C 3M2, or faxed to (204) 984-2479. We will ensure that they are forwarded to the appropriate headquarters officials.

Question 9

(a) We continue to encounter problems with the processing of Form RC59, "Business Consent Form". Despite the form being submitted to CRA with consent for all business number (BN) accounts for all years, it appears that if the RC59 is submitted with a T2, only the RC account consent is updated. We also note that there have been situations where the RC59 is provided directly to an auditor but is not forwarded by the auditor for processing. When the audit is complete and we make a follow up call to CRA, we very often do not have consent and have to resubmit the RC59 or track down the auditor. In addition, more and more often we are encountering situations where we have had consent on the file for many years, yet when we call the Business Window, the consent does not appear to be on file any longer. Will CRA agree to review its procedures with respect to the registration of third-party authorizations throughout all of its varied computer systems to ensure these types of frustrations are kept to a minimum?

(b) Will CRA agree to review its procedures with respect to the registration of third-party authorizations throughout all of its varied computer systems to ensure these types of frustrations are kept to a minimum?"

Response

(a) There are two situations when this may occur:

The first scenario is if the client had supplied the RC59 prior to 1999. At that time, they were input on a system that held both individual and business authorizations. All business information was removed from this system as of April 2003.

For 1999 and subsequent years, the RC59s are keyed to the BN system. Each time a consent or query was received that required access to the system, the employee was to delete any existing authorization from the original system and update the correct screen on the BN system. These actions were taken with the understanding that system limitations prevented a bulk transfer of the information. Access to the old system for business accounts was closed on April 7, 2003, which allowed almost four years for the transition.

An authorized representative can only be deleted at a client's request. Unless a new authorization has been received since that time, our system will not reflect the old information. In consideration of the volumes of consent forms received in the last seven years, the number of accounts that this affects should be minimal.

The second situation is if the RC59 consent form is received with a T2 return and it does not indicate a program type, the BN staff only input the authorization to the corporation (RC) program account. When the RC59 indicates 'all program accounts', 'all years', they input the authorization under the 'Legal Entity' (LE) to indicate that the authorization is valid for all program accounts. Communication is regularly sent to the field to ensure employees are aware that the authorizations under LE are encompassing all program accounts.

The contents of a T2 return are reviewed at different stages of processing to ensure the form is detached from the physical return. These checkpoints are to ensure all pertinent documents are removed from the return prior to filing for retention.

When a client supplies an auditor, collections officer or a Business Window agent with an RC59 to authorize his representative to discuss the account with the officer, we recommend that the officer immediately fax this to the BN unit at (204) 984-0418 for updating the BN system. This method prevents delays in the processing. We will endeavour to ensure that internal sources do not wait to forward the authorization form until they are finished with the file.

(b) Once again, with the implementation of keying RC59s into one area of the BN system, the authorization is in fact only keyed into the BN system, and no other system. The BN system is the owner of the tombstone information.

In 2007, CRA plans to release a new electronic service titled "My Business Account". This will allow business clients to electronically and securely update their own third party authorized representatives. This information will populate the BN system thereby alleviating processing delays.

Question 10

We understand that some third-party civil penalties have been assessed by the CRA. Would the CRA please comment on the nature of the cases that resulted in such penalties being assessed?

Response

As of April 25, 2006, three cases have had the third-party penalties assessed.

Summary of cases assessed:

- Inclusion of a fictitious business loss where no business ever existed.
- Through the creation of a fictitious T-4 slip, the tax preparer claimed non-existent credits on his client's T-1 Individual Income Tax Return. On the same client's GST return, the preparer indicated there were no taxable sales when the preparer in fact knew GST had been collected.
- Despite documented and unresolved suspicions that the client was urging the making of a false statement in the preparation of an income and expense statement to be used for taxation purposes, the preparer acquiesced to his client's request and completed the financial statements without resolving those concerns. In an effort to dissociate from the unreliable financial statement, the preparer refused to use the firm's letterhead in connection with the defective report

Question 11—Travel

Will CRA accept as reasonable travel allowances amounts paid by employers to employees in accordance with the treasury board rates as noted on website **www.tbs-sct.gc.ca/pubs_pol//hrpubs/TBM_113/tb-dv-c_e.asp?**

Response

CRA will not accept treasury board rates as a reasonable travel allowance paid by employers to employees. Allowances paid to public servants are established as a term of their employment and are negotiated by the parties involved. There is no provision in the act to allow these amounts as deductions. Please refer to *Kasaboski v R.* 2005 TCC 356 for further discussion. CRA will allow a reasonable travel allowance that would be supported by the specific facts on a case-by-case basis. Such facts would include the amount of time away from the place of business, the location to where the employee has traveled, cost of accommodations, cost of meals, and incidentals.

Question 12

There have been a number of cases recently involving travel. For example, see *Champaigne* 2006 TCC 74 (which the Federal Court of Appeal in *Dionne* 2006 FCA 79 cited with approval). See also *Toutov* 2006 TCC 187. These and other cases conclude that travel expenses from an employee's residence to a worksite that is not a "place of business" of the employer will not be personal expenses. Does the CRA accept the logic of these recent decisions? If so, what will the CRA be doing to change its assessing practices?

Response

Paragraphs 8(1)(h) and 8(1)(h.1) provide that in order for an employee to claim travel expenses and motor vehicle expenses, an employee must ordinarily be required to conduct his or her duties of employment away from the employer's place of business; be required by the employment contract to pay for these travel and motor vehicle expenses; not be in receipt of an allowance for such expenses that was by virtue of 6(1)(b) not included in the taxpayer's income and not claim a deduction under paragraph 8(1)(e), (f) or (g). In addition, paragraph 8(10) requires confirmation, by the employer, that the above conditions have been met. The CRA position is that "ordinarily" means "customarily" or "habitually," not "continually" but with some degree of regularity. The traveling or vehicle expenses must be required for the employee to successfully complete his/her duties. CRA is of the opinion that traveling between home and work is generally considered personal; however, where an employee proceeds from home to a worksite other than the employee's regular place of employment, the travel is considered work-related. Whether the worksite is the regular place of employment can only be determined on a case-by-case basis.

Question 13

Many energy companies employ individuals and require them to carry out their activities in Fort McMurray. The individuals' remuneration packages provide for "tax free" living and travel allowances, in addition to their taxable employment earnings. Furthermore, many energy companies provide independent contractors similar "tax free" living and travel allowances. Some of these independent contractors are also incorporated. Accordingly, given the above background, we have a number of questions:

(a) If an individual employee's actual cost of living while away from his/her ordinary principal residence and the travel costs back and forth to his/her ordinary principal residence exceed the "tax free" allowances, do the individuals have the option of including the "tax free" allowances in income and deducting his/her actual living (in Fort McMurray) and travel expenses (to and from Fort McMurray)?

(b) If the answer to (a) above is "yes", are there any prescribed limits on the deductible living expense or number of return trips home?

(c) Will the above answers to the questions change if the individual is not an employee but is an unincorporated independent contractor (proprietor) or incorporated independent contractor?

(d) Can an incorporated independent contractor in receipt of "tax free" living and travel allowance maintain the "tax free" characterization of the living and travel allowances upon receipt, and then flow the same living and travel allowances out to its employee(s) on a "tax free" basis (such that the corporation is simply a conduit for the allowances to the individual employee(s))?

Response

(a) If an employee receives an allowance for personal or living expenses or an allowance for any other purpose, that allowance is included in the employee's income pursuant to paragraph 6(1)(b), unless it meets one of the exceptions provided for in paragraph 6(1)(b) or meets the conditions of Subsection 6(6). Specifically, subparagraphs 6(1)(b)(v) to (vii.1) provide that certain reasonable allowances for *travel* will be excluded from income. An allowance may be considered *unreasonable* if it is excessively high or inadequately low, or not based solely on the number of kilometres (for an auto allowance). Subsection 6(6) provides that an allowance for board and lodging at a special work site, or transport to and from the special work site, *not in excess of a reasonable amount*, will be excluded from income. Whether an allowance is for travel expenses or for board, lodging and transport relating to a special work site is a question of fact.

Considering the foregoing, for purposes of paragraph 6(1)(b), where an allowance is considered to be unreasonable because it is inadequately low, it will be included in income and the employee may claim reasonable expenses in paragraphs 8(1)(h) or 8(1)(h.1) if all of the conditions in those provisions have been met. However, for purposes of Subsection 6(6), where an allowance is considered to be below a reasonable amount, it is not included in the employee's income (because it is not "in excess of a reasonable amount"), and therefore the employee is not entitled to claim the deductions in paragraphs 8(1)(h) or 8(1)(h.1).

Please note that an allowance for travel expenses is not considered unreasonable (inadequately low) merely because the employee's total expenses for business travel exceed the total travel allowance received in the year.

(b) Where the employee includes the allowance in his or her income pursuant to paragraph 6(1)(b) and meets the conditions provided for in paragraphs 8(1)(h) and (h.1), there are no prescribed limits on the deductible living expenses or the number of return trips in the scenario outlined above. However, the general limitation regarding expenses pursuant to Section 67 could result in any unreasonable expenses being denied. Furthermore, the actual meal expenses would be subject to the 50% restriction pursuant to Section 67.1.

(c) Yes, the answer would be different for an individual that is not an employee. If the individual is a proprietor or an incorporated independent contractor, the allowances must be included in business income pursuant to Subsection 9(1). Actual documented expenses in relation to business travel would then be deductible subject to the general limitations in both Section 67 and Subsection 18(1); particularly paragraphs 18(1)(a), (h) and (r)—which relate to the prescribed limits for kilometre allowances outlined in Regulation 7306. Furthermore, the meal portion of the allowance may be restricted to 50% pursuant to the provisions in Section 67.1.

Refer to (a) and (b) above regarding how employees would be treated.

(d) An incorporated independent contractor cannot be in receipt of a "tax-free" allowance. This allowance must be included in business income under Subsection 9(1). Then the reasonable travel allowances, which are paid to employees, may be deducted subject to Subsection 18(1), and Section 67, as mentioned in (c) above.

The travel allowances may be exempt from the income of the employee, depending on the individual circumstances of each employee and the nature of the allowance. To be "tax-free" to the employees, the travel allowances must fall within one of the exceptions in paragraph 6(1)(b) or meet the conditions of Subsection 6(6).

Question 14—Canadian-Controlled Private Corporations (CCPC)

In *Sedona* 2006 TCC 80, released by the Tax Court of Canada on March 2, 2006, the Court found that Sedona was not a CCPC because of paragraph 251(5)(b). The Court interpreted this paragraph as being applicable with respect to the stock options owned by the non-qualifying shareholders (public companies and non-residents) without considering the options owned by the qualifying shareholders—Canadian residents. This appears to apply a unilateral approach to the application of paragraph 251(5)(b). However, the Court noted that with respect to association in paragraph 256(1.4)(a), the holder of option rights is deemed to own the shares that seems to apply the test on a simultaneous exercise basis.

Further, in an April 20, 2005 CRA Technical Interpretation (2005-0119901E5), CRA appears to apply paragraph 256(1.4)(a) as a "simultaneous exercise" on treasury share options but not on shareholder agreements. Therefore, it appears that CRA feel that a unanimous shareholder agreement for OPCO, where the shares are owned by Mr. A and Mr. B, may associate OPCO with Mr. A's corporation and Mr. B's corporation if there are provisions in the agreement that permit an acquisition other than on bankruptcy, permanent disability, death, right of first refusal, or a shotgun provision. What is CRA's interpretation of the application of paragraph 256(1.4)(a) to unanimous shareholder agreements considering the comments in the Sedona case? (Note that three other recent Technical Interpretations have discussed this issue—2005-0121951E5, 2004-008676 and 2003-0048571C6.

Response

For the purposes of determining whether a corporation is associated with another corporation, with which it is not otherwise associated, in a situation where several persons have a right described in paragraph 256(1.4)(a), the CRA has taken the view that "control" of the corporation must be determined as though the rights are exercised simultaneously in determining the number of shares deemed to be owned by a particular person and the number of shares of the corporation that are deemed to be issued and outstanding. The rationale for this position is that, under the provisions of paragraph 256(1.4)(a), the holder of the rights is deemed to own the shares, and the shares are deemed to be issued and outstanding at the time of the determination. This position applies regardless of whether the rights are stock options or shareholder agreement rights. The difference between the two situations is that a stock option will increase the number of shares of the corporation that are deemed to be issued and outstanding, whereas a shareholder agreement right will not increase the number of shares that are deemed to be issued and outstanding. We do not think that the comments in the Sedona case will affect our stated position.

Question 15—Statute Barred Years

In *Papiers* 2005 DTC 979 released by the Tax Court of Canada on June 20, 2005, the Court found that the 1993 to 1995 years of the taxpayer were statute-barred and, therefore, CRA could not change those years or the investment tax credit (ITC) carry forward from those years. Based on this case, will CRA always accept carry forwards from statute-barred years that are deducted in non-statute-barred years?

Response

The CRA has appealed this decision to the Federal Court of Appeal on the basis that the Court erred in law among other factors. The CRA maintains the view that the ITC is a pool of currently available tax credits that is calculated on an ongoing basis for a particular taxation year. In this regard, it is our opinion that the definition of ITC in Subsection 127(9) of the *Act* is not subject to the statute-barred limitations under Subsection 152(4) of the *Act*.

Question 16

Can loss carry-over balances or undepreciated capital cost of depreciable assets be adjusted by the CRA to change these balances in current years as a result of revisions made that relate solely to a prior statute-barred taxation year?

Response

Loss Carry-Over Balances

The CRA is not precluded from adjusting the carry-over amount of a prior year loss in a current taxation year unless a notice of loss determination/redetermination has been issued pursuant to Subsection 152(1.1) of the *Income Tax Act*. In this regard, paragraphs 4 and 6 of IT-512, "Determination and Redetermination of Losses," provide the following relevant comments:

"4. Where at the initial assessing stage or as a consequence of a reassessment arising from an audit or other investigative action by the Department the Minister ascertains a loss in an amount other than that reported by the taxpayer, a notice of assessment or reassessment (including a notice of "nil" assessment or reassessment) will be issued with an explanation of the changes. As well, the notice will inform the taxpayer that upon request the Minister will make a determination of the loss so ascertained and issue a notice of determination/redetermination. In this context, the Minister will not be considered to have ascertained that the amount of a loss differs from an amount reported by the taxpayer where the difference fully reflects a change requested by the taxpayer as a result of amended or new information."

"6. A taxpayer who has received a notice of determination/redetermination of a loss has the usual rights of objection and appeal. The Minister may redetermine the amount of the loss within three years from the date upon which the notice of determination was sent or at any time in the circumstances described in paragraph 152(4)(a). Subject to these rights, Subsection 152(1.3) provides that a determination of loss is binding upon both the Minister and the taxpayer for the purposes of calculating the taxpayer's taxable income in any other year. That is, having initiated the determination procedure, the taxpayer (and of course the Minister) is bound by the ultimate result and may not appeal the amount of the loss so determined or redetermined when it is deducted under Section 111. On the other hand, a taxpayer who chooses not to initiate the determination procedure may object or

appeal, in respect of the amount of the loss, in the year in which it is deducted since Subsection 152(1.3) does not apply in these circumstances."

Undepreciated Capital Cost of Depreciable Assets

Undepreciated capital cost (UCC), as the term is defined in Subsection 13(21) of the Act, is a cumulative amount that is determined at any point in time. By way of the definition, the carry forward of UCC balances will not be restricted by the statute-barred limitations. Accordingly, the CRA is not precluded from adjusting the opening UCC balance of a particular capital cost allowance class as a result of adjustments occurring in statute-barred years. Further comments in this regard are provided in paragraph 14 of IT-478R2. A portion of this bulletin has been reproduced below:

"14… If a revision is to be made to the capital cost of a depreciable property (e.g., because of a reallocation of the total purchase price of a piece of real estate between the land and the building) acquired during a taxation year that is now statute- barred, the amount of capital cost allowance (CCA) actually deducted in respect of the depreciable property in any statute-barred year will not be adjusted. Instead, the Department will recalculate the UCC as of the beginning of the first non-statute-barred year by using the revised capital cost (rather than the original capital cost) of the property for purposes of the increase described in ¶2(a) while continuing to use the actual CCA deducted in each statute-barred year for purposes of the decrease.

Question 17—Capital Dividend Account

As you know, the non taxable one half of capital gains realized by a private corporation is added to the corporation's capital dividend account and the corporation may pay a non taxable capital dividend to its shareholders from the capital dividend account. Given such brief background, we have a number of questions:

(a) If a corporation pays a dividend in excess of its capital dividend account, it is subject to a tax pursuant to Part III of the *Act*. Section 152 of the *Act* provides, generally speaking, that a taxation year may not be reassessed after three years from the date that the taxation year is first assessed. If changes to a carry forward balance are made by the CRA as a result of changes to a prior statute barred taxation year and if a capital dividend has not been paid until after the taxation year in which the capital gain realized has become statute-barred, would the capital dividend account be based upon the capital gain as assessed for the particular taxation year, or is it possible for the CRA to adjust the current capital dividend account balance based, for example, on a revised calculation of the capital gain or a determination that a gain in the statute-barred year was on income account rather than capital account?

(b) Similar to (a) above, if a capital dividend had been paid reducing the capital dividend account to nil, could the CRA adjust the capital dividend account balance to a negative amount on a go forward basis if the CRA determined that the capital gain reported in the statute-barred taxation year should be revised?

(c) What is the limitation period for the assessment of Part III tax relating to the payment of an excessive capital dividend? When does the limitation period commence?

(d) Recently, a practitioner has had an experience where the capital dividend resolutions, required by Regulation 2101, were rejected by CRA. The situation involved a corporate redemption of shares that resulted in a deemed dividend, and such dividend was elected to be treated as a capital dividend pursuant to Subsection 83(2) of the *Act*. The resolution submitted with the capital dividend election spoke to the redemption value per share and the total redemption proceeds, as well as the total capital dividend declared. It did not, however, speak to the reduction to the paid up capital that resulted from the redemption. The CRA representative insisted that this information was required in order for the T2054 election to be considered valid. The lawyer who had drafted the resolution did not agree with the CRA representative's interpretation of what constitutes a valid director's resolution—his point was that paid-up capital is a tax concept that is a calculated amount, one that is a fact, not something that the directors can resolve on. Given such, does the CRA have suggested "standard" or required wording for directors' resolutions available for taxpayers in a publication?

Response

(a) The following except from our Reference manual clearly answers the Part (a) question.

Note: keep in mind that the capital dividend account (CDA) is always based on actual capital gains/losses, etc. The CDA is not based on Part I tax assessments. For example, suppose Audit has determined that capital gains reported by the client in three consecutive taxation years should be treated as business income and not as capital gains, but the Department is prevented from reassessing the oldest of the three returns because it is statute-barred. The CDA would not reflect an addition from the capital gain in any of the three years even though the oldest was originally assessed with a capital gain. Similarly, if the client failed to report a capital gain on a return, and that return is statute-barred, the amount relating to the correct capital gain is added to the CDA.

(b) The CDA is calculated as follows:

Paragraphs 89(1) (a) + (b) + (c) + (d) + (e) + (f) + (g) exceeds the total of all capital dividends that became payable before the most current election.

Therefore, the CDA can never be negative.

The CRA strongly recommends that all clients maintain a continuity schedule. This schedule should show negative balances, if applicable. A properly maintained continuity schedule should reduce the number of excessive elections filed on an annual basis.

In the situation described in Part (b), please refer to CCH's Tax Topics, Number 1271 dated July 18, 1996:

Topic is "Capital Dividend Account – Reassessment of

Capital Gains". This is a reproduction of a technical interpretation from CRA's Reorganizations and Foreign Division dated January 19, 1996.

(c) Generally, Section 152 applies to determine the limitation period for an assessment under Part III, pursuant to Subsection 185(3). Pursuant to Subsection 185(5), the provisions of Division I of Part I apply to an assessment under Subsection 184(3) as though it were made under Section 152. The limitation period starts after the day of mailing of the notice of assessment in respect of the tax that would otherwise be payable under Part III, pursuant to Subsection 184(3).

(d) The lawyer was correct that the "paid-up capital" is not a requirement to be included in the resolution. When there is a disagreement between a client and an assessing officer, it is quite reasonable for the client to request a second opinion from the supervisor.

A resolution requires the following:

- A certified copy of the directors' resolution authorizing the election.
- These resolutions should state the amount of the dividend, which correspond to that shown on the election form.
- The date the dividend becomes payable should be included in the resolution and should correspond to the election.
- If the wording on the election or resolution indicated the date payable as "the date on which Revenue Canada confirms the amount of the capital dividend account", it is not valid.
- The resolution should either refer to a specific date on which the dividend becomes payable, or to a description of how the date is ascertained, on a basis that is not conditional on any action by the department.

Question 18—Additions to UCC Pools

Section 201 of the *Excise Tax Act (ETA)* limits the input tax credits in respect of a passenger vehicle to the maximum capital cost of the vehicle for income tax purposes. Paragraph 13(7)(g) of the ITA and Regulation 7307(1) deem the capital cost limit in 2006 to be $30,000 plus the federal and provincial taxes thereon. For example, in Alberta this limit is $30,000 plus GST of $2,100 for a total of $32,100. Do you agree that the GST input tax credit in Alberta is 7% of $32,100 or $2,247? Also, would the addition to Class 10.1 for income tax purposes be $32,100 - $2,247 = $29,853?

Response

The input tax credit determined in section 201 of the *ETA* by a registrant for a passenger vehicle used in commercial activities does involve the amounts determined in paragraphs 13(7)(g) or (h) of the *ITA*. In the example provided, we concur with your calculations as the maximum input tax credit is based on the amount determined in paragraphs 13(7)(g) or (h) along with Regulation 7307(1).

Subsection 13(7.1) of the *ITA* deems the capital cost of certain property when the taxpayer acquires property and is entitled to government assistance. Subsection 248(16) of the *ITA* deems input tax credits to be government assistance. In the example provided, Subsection 13(7.1) deems the capital cost of property, for which government assistance is received, to be calculated as the amount by which the capital cost, as determined under paragraphs 13(7)(g) or (h), of the property exceeds the government assistance received or entitled to receive.

Question 19—Owner-Manager Remuneration

What are the CRA's current assessing practices with employees profit sharing plan (EPSP) trusts established by private corporations including:

(a) whether contributions to an EPSP are subject to CPP contributions and/or EI premiums?

(b) whether contributions to an EPSP are subject to income tax source deductions?

(c) whether the deduction in computing income for contributions to an EPSP is subject to Section 67 of the *ITA* and, if so, what circumstances would be reviewed in determining the reasonableness of the contribution?

(d) any other comments that would help taxpayers understand the CRA's position with respect to EPSPs.

(e) Subsection 144(5) providing that an amount "paid" within 120 days is deductible to an employer. To be considered paid, is it necessary for a cheque to be issued, or will legal documentation including a promissory note be sufficient?

Response

(a) Provided that the EPSP is a valid EPSP (see comments in (d) below), contributions to an EPSP are not subject to CPP contributions and/or EI premiums.

(b) As is noted in Interpretation Bulletin IT-379R, "Employees Profit Sharing Plans - Allocations to Beneficiaries," withholding and remittance of tax pursuant to Subsection 153(1) of the *Income Tax Act* (the *Act*) is not required when an employer contributes to a valid EPSP.

(c) Section 67 of the *Act* requires that any deduction to be taken in respect of an outlay or expense in computing income will be limited to an amount that is reasonable in the circumstances. Amounts to be deducted pursuant to Subsection 144(5) and paragraph 20(1)(w) of the *Act* by employers participating in EPSPs are subject to the provisions of Section 67 of the *Act*. The determination as to whether an outlay or expense is reasonable in the circumstances will be a question of fact. As the wording in Section 67 of the *Act* requires the particular circumstances that relate to a particular outlay or expense must be considered, thus it is not possible to provide an exhaustive or a typical list of the circumstances that would be reviewed to determine reasonableness.

(d) CRA has recently considered several arrangements purporting to be EPSPs that were, in our view, arrangements set up to split income among family members, avoid contributions to the Canada Pension Plan (CPP) and premiums under the *Employment Insurance* (EI) *Act*, avoid withholding tax under Subsection 153(1) of the *Act*, and as a means of eliminating tax on profits.

We have also considered some arrangements in which the reasonableness of excessive contributions of the employer's profits is questionable. Such unduly large contributions may result in the shareholders of a corporation being precluded from ever receiving a return on their investment in the form of dividends, and the company may be unable to retain any of its profits for business contingencies or expansion. This is especially true where the company's available cashflow does not support such contribution levels.

Only upon full consideration of the relevant facts in each case, can it be determined whether the arrangement is a valid EPSP.

(e) Paragraph 20(1)(w) of the *Act* allows a deduction in computing a taxpayer's income for a taxation year from a business or property where an amount is paid by the taxpayer to a trustee in trust for employees of the taxpayer or a non-arm's length corporation under an EPSP, as permitted by Subsection 144(5) of the *Act*. A determination as to whether the issuance of a promissory note would constitute a payment of a contribution to an EPSP is a question of fact that can only be answered after a detailed examination of all the facts related to a particular situation.

Question 20

Has CRA's administrative practice changed since Safety Boss?

Response

No, it has not. The Income Tax Rulings Directorate at the 2001 Canadian Tax Foundation Conference and the Income Tax Technical News No. 22 addressed this policy.

The Safety Boss case does not change our position because the facts of the case are not consistent with our position. At the time of the payments in question:

- Safety Boss Ltd. was not a CCPC;
- the bonus was paid to a shareholder/manager who was not a resident of Canada; and
- the management fees were paid to a related non-resident corporation.

The CRA questioned the reasonableness of the bonus and management fees. Based on the particular facts of the case, the Tax Court found the payments were reasonable.

Question 21

The hot topic for income tax auditors seems to be a disallowance for unreasonable wage expenses in a corporation, notably for the spouse of a shareholder. What are the criteria used by CRA auditors to determine the parameters of reasonableness? What procedures are to be followed by CRA auditors in their determination of reasonableness?

Response

The CRA has a long-standing policy that it will not generally challenge the salaries paid by a CCPC to an active resident principal shareholder manager who is a resident of Canada. This policy was discussed in Income Tax Technical News #22 and #30. However, this policy does not extend to spouses or other family members of the principle shareholder.

Salaries paid to a spouse are subject to the general limitations in paragraph 18(1)(a) and Section 67 of the *Income Tax Act*. The CRA is concerned that amounts paid represent actual remuneration, and are not a form of income splitting.

The CRA will accept a reasonable salary paid to a spouse as a result of a bona fide employer-employee relationship. In the absence of such bona fide employer-employee relationship, the whole amount of any expense for salary paid to a spouse is not deductible. However, if any employer-employee relationship exists, the amount of the salary paid to a spouse is deductible to the extent that it is reasonable in the circumstances.

Whether salary paid to a spouse will be considered reasonable is based on the facts of each case. In general, the CRA will seek to determine the reasonableness of the compensation in relation to the contributions made by the person to the business.

The following is an example of the general criteria for determining if salary paid to a spouse is reasonable:

- Determine the duties performed by the individual, the nature of the tasks performed, the time required to complete them and whether existing arm's length employees could do the tasks.
- Consider if the salaries paid are commensurate with the value of the responsibilities assumed and services performed. In other words, the salary is similar to what would be paid to an employee who performs similar services for an employer of a similar size in a similar business.
- In determining the value of the employee's services, due regard must be given to the employee's educational background, experience, special training, good judgment, and business acumen/expertise.
- The circumstances are such that a reasonable businessman would have paid the salaries.
- Salaries or bonuses should relate to the expertise, skills and services provided to a corporation and should not be based on number of shares held. There should be a material discrepancy between the salary paid to a spouse and the value of the services provided before considering any reduction of the salary expense.

Question 22—Trust Returns

Each year, practitioners are faced with a number of trusts that have had no income or activity during the taxation year. Some clients do not wish to prepare a nil return—in fact, the T3 guide states that a return is not required if the trust has had no activity and/or income during the taxation year. However, filing no return generally results in the CRA contacting the trustee requesting a questionnaire and/or returns to be filed. Some practitioners have adopted a process whereby they will send a "no income, no activity" letter to CRA for these inactive trusts, and these are delivered annually to the CRA. It appears that CRA does not have the ability to enter "no income/no activity" on their T3 compliance database since such practitioners still receive requests for completion of the return and/or questionnaires from the various taxation centres. Given the above, is there some way for the CRA to document on the T3 compliance database that they have received verification of no income/no activity for a particular taxation year of a trust so that compliance follow-up is not required? Alternatively, can CRA develop a form that these trusts can submit indicating that there is no income or activity?

Response:

The Non-Filer/Non-Registrant (NF/NR) Program for T3 estates and trust returns is not integrated into SUDS, the case management system used for delinquent actions on T1 and T2 returns. It is a manual system handled by staff at the Ottawa Tech Centre (OTC). We are currently working toward the development and integration of the T3 workloads into SUDS by 2008. Last fiscal year, the OTC completed a clear up of some outstanding 70,000-75,000 accounts requiring delinquent action.

In 2006-2007, subsequent to the filing due date of the estate/trust, the staff have been instructed to physically draw each file from Taxroll and review the prior year returns and correspondence before manually issuing a request to file. It was noted that some CA offices submit a letter stating that the estate/trust has no income or was inactive for the period in question. Should the OTC staff note such a letter on file or a "nil" return, then no delinquent action would be required for that particular year.

It is recommended that until such time as the T3 program is integrated into SUDS, the CAs should continue to file a "nil" return, or a letter indicating the estate/trust has no income/no activity by the due date. If there is no response from the delinquent action notices sent by OTC, the account is then referred for follow-up to the NF/NR section at the local TSO.

Question 23—Safe Income

Our question concerns the calculation of safe income under Subsection 55(2) of the *Act* or more specifically the interpretation of "income earned or realized" contained therein. Both the decision in *Kruco* 2003 DTC 5506 and Income Tax Technical News No. 33 suggest that "income earned or realized" should be determined under Division B of Part I of the *Act* (net income for tax purposes) adjusted by paragraphs 55(5)(b),(c) or (d). From this amount, it is suggested that cash outflows that occur after the determination of "income earned or realized," such as taxes and dividends, be deducted in computing safe income on-hand. Presumably, this means that items deducted in the calculation of taxable income under Division C of Part I of the *Act*, for example charitable donations, would not be deducted in computing safe income on-hand available for tax-free inter-corporate distribution. Could you please comment on our interpretation?

Response

The simple answer to this question is that the income earned or realized must be on hand or it cannot be paid out as a dividend as found by the FCA in *Kruco*:

The Queen vs Kruco (FCA) 2003 (FCA) 284

[38] There can be no doubt that this exercise calls for an inquiry as to whether "the income earned or realized" was kept on hand or remained disposable to fund the payment of the dividend. It follows, for instance, that taxes or dividends paid out of this income must be extracted from safe income (see Deuce Holdings Ltd., supra and Gestion Jean-Paul Champagne Inc., supra).

The terms "net income" or "taxable income" are irrelevant.

Therefore the charitable donations would reduce the safe income on hand.

Question 24—T4 / T4A Reporting

Can the Agency please provide us with the background reasoning as to why the term “management fees” was quietly added in 2004 to the various categories of income that must now be reported in a T4 slip—it was introduced in Employer’s Guides T4001 (Employer’s Guide: Payroll Deductions and Remittances), RC4120 (T4 Guide) and RC4157 (T4A Guide). We say “quietly” because each of these guides mentions the term “management fees” a grand total of once: the T4001 guide refers to management fees as amounts that are subject to CPP contributions; the RC4120 guide only mentions the term once you get to the detailed instructions on what goes into Box 14 in completing the T4 slip itself—the term is found in a long list of types of “employment income” that are to be included in gross income reported in Box 14; and the RC 4157 (T4A) guide mentions management fees only in a negative way, under the heading “Do not complete a T4A slip for,” stating that these are to be reported on a T4 slip. Please comment.

Response

We have reviewed your comments, and our research shows that the information that you quoted has been in the RC 4120, the RC 5127 and the T4001 guides since at least 2001.

There are provisions in the *Income Tax Act* that specifically define individuals who hold certain positions to be "employees". For example, pursuant to the definitions of "office" and "employee" in Subsection 248(1) of the *Act*, “any position of an individual entitling the individual to a fixed or ascertainable stipend or remuneration, the incumbent of which is elected by popular vote or is elected or appointed in a representative capacity, is considered to be the position of an office and, consequently, the individual is considered to be an officer and employee.”

Management fees are considered to be employment income since they are paid to individuals in their capacity as an officer. Income from an office or employment must be reported on a T4 slip and is subject to deductions at source. The reference to management fees was specifically added to our guides to ensure that employers would make the appropriate CPP, EI and income tax deductions. Prior to the inclusion of management fees in the guides, employers often omitted declaring these amounts on the individual's T4 slip. It is important that employers make the correct CPP and EI deductions at source and remit their corresponding share of these contributions to ensure the individuals eligibility in the social welfare programs to which they are entitled.

Question 25

How does the Agency reconcile this new administrative policy in Question 23 above with case law that treats management fees in many cases (depending on the facts) as business income (i.e., how can the CRA justify applying a blanket approach to state that **all** management fees—presumably including management fees paid to third parties who are not officers, directors or shareholders of the paying entity—now constitute employment income)?

Response

As stated in the reply to Question 24, this is not a new position adopted by the CRA. That reply outlined CRA's general policy with respect to management fees, that they are generally considered to be employment income. However, each case should be taken on its own merit considering the facts unique to that case.

Question 26

Could CRA please elaborate on its policies for determining when T4A slips are required for payments made to independent contractors? Numerous CRA technical interpretations refer to the need to file a T4A slip for all payments to non-employees for "fees or other payments for services" aggregating $500 or more in a given year.

It seems to us that this broad interpretation would, in theory, require every Canadian to track payments made to, for example, accountants, lawyers, plumbers, automobile mechanics, trades people, carpet installers, lawn care providers, ad infinitum, and issue T4A slips to each such service provider annually. While we agree one can read the words of the Act and regulations to require this depth of reporting, we find it difficult to believe this was the intent of Parliament.

Response

The *Income Tax Act and Regulations* require all payers (any person, corporation or self-employed individual) who make a payment for fees and services to report it on a prescribed form. The T4A is the prescribed form for this type of payment. This applies even when no income tax is required to be withheld.

The CRA has not aggressively enforced this legislative requirement when there is no employer/employee relationship. Legislatively, this requirement would apply to all payments made for fees and services; however, the CRA is not interested in capturing payments in a non-business relationship, that is payments made for personal fees and services. We are working on the best way of communicating this requirement to the business community. We want to try to avoid overloading businesses with more paper burden while ensuring that the legislation is followed.

Question 27—Home Office Expenses

Does the CRA accept the conclusion of the Tax Court in *Vanka* [2001] 4 C.T.C. 2832 that telephone "meetings" from home are sufficient to establish a taxpayer regularly meets with clients/customers (in the Vanka case, patients of a medical doctor) to support a claim for workspace in home?

Response

Please see Question 28.

Question 28

Similar to the *Vanka* decision, does the CRA accept the result of *Hemond* 2003 CCI 705 that one or two appointments per week constitutes "regularly meeting with clients/customers" supporting a claim for a workspace in home?

Response

CRA's position as it relates to "Work space in home expenses" is set out in IT-514 "Work space in home expenses," and deals with conditions and restrictions placed on the deductibility of such expenses when they relate to an office or other work space in the home of an individual. Expenses incurred in earning income from a business are normally deductible in computing income to the extent they are reasonable. Paragraph 18(12)(a) disallows the deduction of any amounted expended on a home office or work space in the individual residence **unless** the work space is either:

(i) the individual's principal place of business, **or**

(ii) used exclusively for the purpose of earning income from the individual's business **and used on a regular and continuous basis for meeting clients, customers or patients in respect of the business.**

While principal place of business is not defined in the *Act*, if an individual's work space is the "only" office used in the business, the work space will qualify under 18(12)(a)(i). If the work space is not the individual's principal place of business, the expense incurred will still be deductible if the conditions outlined in (ii) above are met.

IT-514 paragraph 3 states that …

"3. The first requirement of 1(b) above is that the work space must be used exclusively to earn business income. This requirement is met if a segregated area, such as a room or rooms, is used in a business and for no other purpose. The second requirement is that the work space must be used for meeting clients, customers or patients on a regular and continuous basis. The regularity and frequency of meetings in a work space to meet the requirement of being on a regular and continuous basis will depend on the nature of the business activity and is determined on the facts of each situation. However, a work space in respect of a business which normally requires infrequent meetings or frequent meetings at irregular intervals would not meet the requirement. A home office used by a doctor to meet one or two patients a week is an example of a work space which would not be considered used on a regular and continuous basis for meeting patients. On the other hand, a work space used to meet an average of 5 patients a day for 5 days each week would clearly be used for that purpose on a regular and continuous basis. Unless 1(a) above applies, both requirements in 1(b) above must be met in order to deduct expenses relating to a work space.

The CRA is of the position that the decisions in *Vanka* and *Hemond* were found on their own facts and does not adopt the court's conclusion. As such, we will continue to follow the policy outlined in paragraph 3 of the IT-514. Furthermore, both of these adverse decisions were informal procedure decisions that have no precedential value. The Tax Court Act said that, "A judgment on an appeal referred to in Section 18 shall not be treated as a precedent for any other case" (TCC s18.28). The courts will consider the specific facts of a case, and they will not automatically follow *Vanka*. Case in point is the favorable decision in (2004 *Molckovsky v The Queen* UDTC 48) in which the court found the facts in the two cases different and dismissed the taxpayer's appeal.

Question 29—Valuation Issues

The use of discretionary dividend shares in private "family corporations" has become commonplace. The valuation of such shares is a matter of some uncertainty in the valuations community. Valuation is critical in many income tax contexts, including taxation on death, allocation of proceeds on sale of a corporation, transfers between related parties, and estate planning. While we appreciate that the CRA has commented on this issue in the recent past, any further insights that the Agency can offer with respect to the CRA's view of the appropriate valuation of such shares would be appreciated.

This is perhaps best illustrated by example. Assume a corporation, Opco, has the following classes of issued shares:

(a) 100 Class A voting common shares held by Mr. A

(b) 100 shares each of four classes of non-voting common shares, with all issued shares of each held by one of Mr. A's four children

The corporate articles provide that the dividends may be declared on any class, or classes, of shares to the exclusion of the other classes.

Mr. A has recently died, and it is necessary to value his 100 Class A common shares for purposes of the deemed disposal on death (Subsection 70(5)). Assume that the issued shares of Opco, in the aggregate, have a fair market value (FMV) of $5 million. On what basis would the CRA generally consider the value to attribute to the various share classes? Further, see the options below. What methodology would the CRA generally follow?

- Mr. A's Class A shares have a value of $5 million, as the holder of the Class A shares can vote to extract all of the value of Opco as dividends on these shares and direct no value to the holders of other share classes
- Mr. A's Class A shares have a value of $1 million, as they represent 20% of the issued shares, all of which would share equally in the proceeds if Opco were to be liquidated
- While a control premium would apply to the value of Mr. A's shares, the magnitude of such premium cannot be determined without a full analysis of the dividend history and/or other factors

Response

CRA does not issue policies on how the valuators within the Agency should deal with specific valuation issues. Business Equity Valuations is an area that requires the application of professional judgment when dealing with issues such as the one described above. Therefore, just as there isn't a general approach to this issue being followed in the private sector, there isn't a general approach that CRA will apply in all situations.

A valuation assignment involves a detailed due diligence process. Each valuation will have a number of issues that require a determination based on professional judgment. A valuator will not be able to make these decisions without a thorough knowledge of the company, industry, and economy, as well as the rights and restrictions attached to the subject shares, and any other legal agreements involving a shareholder, and the future prospects for continuation, a wind up or a sale of the business or the company shares.

A valuation is based on the highest price obtainable from an arms length party based on the rights and economic expectations of the subject shares versus those of the other shareholders. It is expected that a family member interested in purchasing or selling the subject shares would also transact at the FMV. Value to owner, such as a shareholder of a private family owned company, is not equivalent to FMV.

The family control policy, which is accepting ratable value for each common share of a company, does not apply to non-voting exclusionary dividend shares, as they do not have equal rights to the voting control shares. They must be valued on their own merits without assuming an en bloc sale of the entire company.

Court cases should also be considered. In *J.A. McClurg v Minister of National Revenue* (DTC 91 5001), the Supreme Court stated that the discretionary dividend clause was a "valid exercise of contractual rights between the company and its shareholders in accordance with the common law and statute" and that shareholders must be expected to be "fully aware of their entitlements and privileges to the extent that the presumption of equality is rendered inapplicable." In *Melville Neuman v Her Majesty the Queen* (DTC 98 6297), which involved exclusionary dividend shares, and dividends to a spouse being attributed back to the controlling shareholder, the Supreme Court commented, "This approach ignores the fundamental nature of dividends; a dividend is a payment which is related by way of entitlement to one's capital or share interest in the corporation and not to any other consideration. Thus, the quantum of one's contribution to a company, and any dividends received from that corporation, are mutually independent of one another."

In addition, the FMV of these types of shares should not be dependant on the transaction that precipitated the valuation. That is, there is a concern that for one transaction the voting shares are valued at ratable value, after consideration of the relevant issues, and then shortly after the same shares are valued at total company value, when circumstances have not been shown to have changed.

Question 30

We understand that valuations performed by CRA valuators in the course of an audit should be available to the taxpayer before the audit is completed. Specifically, we understand advisors/taxpayers should be able to discuss such valuations with the valuator and his/her team leader, and provide documentation and information to support the taxpayer's position.

Particularly with respect to real estate valuations and the construction industry, several practitioners have been finding that the auditor and team leader will not release the valuation or discuss the valuation at the audit stage. Taxpayers have been told by the audit personnel that the valuation is performed by an appraisal professional and cannot be questioned or changed. It appears that an appeals officer in this situation can only send the taxpayer's documentation and information to the valuations group for a review. Over the past year, according to audit and appeals staff, the valuators do not appear to be available to meet with taxpayers. All communications flow through the auditor or appeals officer.

However, we understand it is not unusual to see a difference of 30% to 40% between a CRA valuation and a third-party valuation obtained by the taxpayer for the same property. This suggests more than a minor or trivial difference between two qualified professionals.

We understand difficulties with the valuations process that were discussed in the 2004 Roundtable. What action does the Agency propose to bring a greater degree of transparency to the valuation process with taxpayers?

Response

Our mandate is to provide good quality services to the clients, both internally and externally. It is common practice of the Calgary Real Estate Appraisal unit to release a copy of the completed appraisal report to the taxpayer on request. The Calgary appraisers and their team leader are always available to meet and discuss appraisal issues with the taxpayers and to review their submission.

The CRA appraisers will answer whatever questions and comments clients may have. Our appraisal reports are open for discussion, and changes could be made if they are justified.

When qualified professional appraisers complete their assignments with diligence, the opinions of value seldom vary widely. Large differences usually occur when there is insufficient market data or improper valuation methods being used.

It is to our best interest to meet and discuss issues and facts with the taxpayer when there is a difference in the opinion of value. We found that a mutually satisfied agreement can be reached in the majority of the cases as a result of the meetings.

Question 31

The recent case of *Flood* 2006 TCC 186 deals with the deductibility of legal fees. However, the history of the case and its related facts deal with valuation matters and is disturbing. Specifically, as it relates to valuation matters, the history involved an executor of an estate who filed the deceased's final tax return and reported a deemed disposition of real property as required by Subsection 70(5) of the *Act*. The executor used a value of $71,000 (arrived at by averaging the value from a letter of opinion provided by the real estate broker and the assessed value of the land). The CRA valued the property at a much higher value. Given such, the CRA chose to pursue criminal tax evasion charges against the executor that were subsequently dismissed by the Courts. On its face, this appears troubling. Why would the CRA choose to lay criminal charges on a valuation matter? Will it attempt to do so again in matters involving valuation disputes?

Response

The decision to lay criminal charges is ultimately that of the Department of Justice. In every criminal investigation undertaken by the Agency, we examine all the available evidence and determine if a recommendation to lay criminal charges is appropriate.

For every case that is referred to the Department of Justice, the Agency will establish the Actus Reus (how the injury occurred) and the Mens Rea (the guilty mind). In other words, the Agency establishes that the failure to pay taxes was the result of a dishonest act. The Assistant Director of Enforcement must approve every case that is referred to the Department of Justice.

It is only after the Department of Justice approves the laying of charges that the Agency proceeds with this step.

The decision to refer a case to the Department of Justice will depend on the facts of that particular case, and consequently it is impossible to answer this question.

Question 32—Proposed Section 56.4 – Restrictive Covenants

Given that proposed Section 56.4 has not yet received royal assent and it is likely that the Department of Finance will release further amendments to the July 18, 2005, draft legislation, could the CRA provide practitioner guidance on how such matters should be dealt with. For example, how is the CRA administering the proposed elections in draft subsections 56.4(3) and (7)?

Response

The CRA has not yet published a prescribed form for the elections contained in proposed paragraphs 56.4(3)(b) and (c) of the *Act*. As provided in our document F2004-0103551E5, the vendor and purchaser may file a jointly signed letter to make the election. A copy of the letter "Election for Restrictive Covenants" can be found on our website at **www.cra-arc.gc.ca/tax/business/topics/life-events/selling/restrictive/election-e.html** and must be completed by both parties and sent with their income tax returns for the tax year that includes the date of the covenant. Similarly, a signed letter may be filed to make the election under proposed Subsection 56.4(7) of the *Act*, provided all the required information, as required by that paragraph, is included in the letter. The CRA and the Minister of Finance are currently studying the possibility of modifying Section 600 of the *Income Tax Regulations* to add proposed paragraphs 56.4(3)(b) and (c) to the list of prescribed provisions for late elections for the purposes of paragraphs 220(3.2)(a) and (b) of the *Act*.

GST Questions

Question 1

Many vacation condominium owners were subject to audit activity and were assessed a clawback for GST recovered at time of purchase on the basis that the percentage of personal use over actual use (as opposed to available for use) exceeds 10%. Is the CRA still pursuing audits in this sector, or are they being held in abeyance until Appeals has rendered its decision?

Response

We will still be pursuing audits relating to condominiums of all types, including vacation. There are many cases where specific issues are under appeal, and this does not result in audit actions being stopped. So, we would still pursue this type of issue based on our existing interpretation.

A GST/HST Info Sheet on the subject of vacation properties is scheduled to be issued by the Agency in the near future. This publication will set out the Agency's views on the application of various aspects of the GST where vacation properties are acquired for mixed use.

Question 2

What is the CRA's position in respect of the percentage of use in commercial activities to enable the filing of the Section 211 election? We have experienced Section 211 elections being denied where on the question of the percentage of use in commercial activity, it was replied "to be determined". We have resubmitted the elections with the percentage indicated as "greater than 10%" and they appear to have been accepted. Our question relates to the original denial of the election. The legislation does not support the CRA's denial of the election. The percentage of use in commercial activity is relevant for ITC eligibility, but not for the filing of the election. For example, consider the situation where a non-profit organization owns a building and rents out 5% of the space to a corporation who has requested GST be charged on the lease. The election under Section 211 can be filed to facilitate the charging of the GST notwithstanding the commercial use is less than 10%. Could you comment please.

Response

Your question deals with the eligibility and information requirements to make an election under Section 211 of the *Excise Tax Act (ETA)*.

A public service body that is making a Section 211 election must file the election in prescribed form containing prescribed information. The information specified by the Minister includes the percentage of use of the particular real property in commercial activity at the time the election is made. The public service body is required to indicate this information to ensure that the election is filed in the manner authorized by the Minister.

Background

Section 211 permits an election to be filed by a public service body in order to have Subsection 193(1) and Section 206 apply, and Section 209 not apply, in respect of the real property specified in the election. Once the election is made, supplies of the property by the public service body will be excluded from the exemptions under Section 1 of Part V.1 and Section 25 of Part VI of Schedule V, and will be taxable unless exempted pursuant to another provision of the *Act*. The effect of a Section 211 election is to allow a public service body to opt out of the "primary use" rules with respect to capital real property and thus to qualify for ITCs based on the actual extent of use of the property (expressed as a percentage) in commercial activity.

In order to elect, Subsection 211(5) states, in paragraph (a), that the public service body shall make the election "in prescribed form containing prescribed information." Form GST 26 is the prescribed form that is required to be used to make this election, and all requested information—as detailed in the form—is required to be provided. Section D, Question (d) requires the public service body to specify the percentage of use of the particular property in commercial activity at the time the election is made.

This information is relevant to the tax adjustments that the person is required or eligible to make as a result of making the election, pursuant to Subsection 211(2). The purpose of Subsection 211(2) is to ensure that the body is put in the same position, for the purposes of claiming input tax credits for the property, as if the body had acquired the property at the time the election takes effect. In essence, the body is treated as having sold and repurchased the property. It is also treated as having collected tax on the sale. To prevent double taxation of the property, the body is able to claim an input tax credit in respect of any un-recovered tax previously paid on the initial acquisition of the property. Finally, the public service body is entitled to claim an input tax credit in respect of the tax payable under this subsection on the deemed sale to the extent to which the property is used (more than 10%) in commercial activities.

As long as the election remains in effect, the tax consequences of selling, leasing or changing the use of the property follow the normal rules that apply to commercial owners of real property.

The public service body is eligible to make the election if it can respond in the affirmative to one of the three questions in Part E of the form. However, it is still necessary that all prescribed information be provided, as required, on the prescribed form. Any issues that the electing public service body may have with respect to the processing of a particular election form by the CRA should be referred to the team leader in the processing unit in the Business Window. Verification of the eligibility of the public sector body to make the election is the responsibility of the Compliance Programs Branch.

Question 3

It appears to be a CRA policy that no statement of account is ever issued with a credit balance. Is this true? If so, taxpayers/registrants cannot easily identify filing or payment errors if they do not realize they exist. Given the benefits of transparency, should such policy be eliminated? This is especially important when there is a policy of canceling credit balances after a period of time, even though the taxpayer/registrant has never been told that the government appears to owe them money.

Response

Due to current system limitations, the balance for a particular registrant is only produced in the case of an amount owing to CRA. Credit balance reports are produced and reviewed monthly. To resolve these balances, officers attempt to contact the owner through phone and/or letter. If unsuccessful in contacting the client, credit remains on account until validated. This activity highlights the importance of clients advising CRA of any changes to phone numbers and addresses to their GST/HST business accounts.

A statement of account can be requested by phoning 1-800-959-5525.

Future system initiatives, currently planned for the spring of 2007, will mirror the current T2 corporate platform. Clients will receive regular notices indicating both credit and debit balances for all payments, returns and adjustments processed.

Question 4

The current format for the notice of (re)assessment used by the CRA is understood by few people, particularly CRA auditors and appeals officers. We are constantly seeing examples of incorrect numbers in the various boxes in the statement, and even when the numbers are correct, it is virtually impossible to tie them back to the CRA RT (GST/HST) Account. It would be preferable to see a better statement showing all original filing, amendments filed by the registrant, payments and refunds, audit assessments, appeals re-assessments, penalties and interest, so the final balance (and all related entries) is easily reconcilable. Will the CRA please consider revising this document? Would the CRA like input from the professional community in arriving at a solution?

Response

Currently, CRA is undertaking a GST/HST systems and communications review. The GST/HST redesign team in the Audit Programs Operations Division has designed a new notice of (re)assessment (NOA) as part of this review. The NOA will undergo a change in the format that is meant to clarify what the audit changes are and the account balance that the registrant owes, and the audit adjustments by reporting period. General feedback that had been received in the past from practitioners was taken into account as the changes to the NOA were made. Due to the fact the NOA redesign must be compatible with several CRA internal reporting systems, no external consultations are planned at this time.

Question 5

The GST reporting of any registrant should be available to that person and to their authorized representative. When the CRA audits a registrant, it demands the original books of entry and not simply a summarization (even if done by a competent professional). Why do we have to request a summary of the GST transactions stored in the CRA reporting system, and why does it take weeks or sometimes months to receive? We have historically found errors in posting into this system (even in the calculation of penalties and interest), so it is essential that the CRA be able to provide a print out of the original entries in a timely manner. Could you please comment?

Response

An account summary or statement of account (SOA) is a document generated manually in the Winnipeg Tax Centre and is not produced by the Audit Division. Audit, as well as the registrant, may request the SOA for a particular account. The time necessary to generate the SOA is dependant on the complexity of the file and the number of requests received by the Winnipeg Tax Centre. The national service standard is to provide a SOA within 30 business days of the request. The statements are prepared in first in, first out (FIFO) order.

Any concerns regarding the statement of account, such as discrepancies, should be brought to the attention of the auditor or the tax centre contact. An officer will review the account, make adjustments, or provide an explanation of any variances.

Future system initiatives, currently planned for the spring of 2007 will mirror the current T2 corporate platform. Clients will receive regular notices indicating both credit and debit balances for all payments, returns and adjustments processed.

Question 6

When can we expect to see the actual account details when a registrant wishes to verify the CRA numbers in a timely fashion?

Response

Future system initiatives, currently planned for the spring of 2007, will mirror the current T2 corporate platform. Clients will receive regular notices indicating both credit and debit balances for all payments, returns and adjustments processed.

Question 7

From our experience, written responses to ruling requests on GST technical questions submitted to the CRA can take approximately a year or more to be issued. While this is often a result of the complicated world we inhabit, life goes on and people cannot wait for answers in order to carry on business. Given such, is it possible for the CRA to adopt a policy of issuing interim rulings, with a stated proviso that the ruling is only valid until a final decision is made. The interim ruling could possibly have an expiry date (although this might create the problem of having many rulings expire, leaving us where we are today) or be open until replaced by a final decision. Could you please comment.

Response

As stipulated in paragraph 23 of GST/HST Memorandum 1.4, Goods and Services Tax Rulings, the Canada Revenue Agency will respond to requests for rulings in the order in which they are received.

The time required to process a ruling request will vary and is primarily dependent on the complexity of the issue(s) inherent within the request. For example, the issuance of a ruling may be delayed if it requires a review of an issue on which the CRA has not yet adopted a position, or if the CRA is currently in the process of reconsidering its existing position. Other factors that delay a response are an incomplete set of facts or description of transactions, the lack of pertinent supporting agreements or other documents, the need for consultation within the CRA or with other government departments, or the lack of client co-operation, etc. If a ruling is required by a particular deadline (e.g., before the closing date of a contract), the request for the ruling must be submitted with reasonable lead time for the request to be processed and the ruling produced.

Given the factors outlined above, it would be impossible and impractical for the CRA to issue interim rulings with a possible expiry date and a stated proviso that the ruling is only valid until a final decision is made, as these factors will also directly impact the interim ruling provided. Furthermore, we would not want clients to rely on an interim ruling particularly where the decision provided in the final ruling is adverse to the decision provided in the interim ruling.

We should point out that our officers are trained to ensure that all clients are provided with timely service that is of the highest possible quality, and our goal is to continue to improve our timeliness. For example, in 2003-2004, 79% of rulings and interpretations issued by our regional rulings centres were responded to within 45 working days; in 2004-2005, the rate increased to 86%; and in 2005-2006, the rate increased to 88%.

Question 8

What is the CRA's view on a business not charging GST during a period that the CRA cannot provide a determination of the tax status of a particular supply? It would seem only fair that no assessments should be issued for a period during which there is so much doubt that even the best minds in the CRA cannot say if tax applies.

Response

The Canada Revenue Agency is responsible for administering the *ETA* as passed by Parliament. According to Section 165 of the *ETA*, every taxable supply is subject to GST/HST, and every person who makes a taxable supply is required to collect and remit GST/HST from the recipient of that supply pursuant to Section 221 of the *ETA*. Nevertheless, where possible, the CRA strives to identify those situations where the determination of the tax status of a particular supply is under review. For example, we have in the past had situations where assessing action is held in abeyance at the request of audit headquarters because they are reviewing the issues that have national impact on an industry sector (i.e., jewellery, coin operated devices, municipalities, universities, schools and hospitals (MUSH) supplies, etc). Otherwise, we are obliged to continue with our normal practice; that is to review the transaction, determine if it is considered taxable under the provisions of *ETA* and assess the tax if the registrant has failed to charge or collect GST.

It should be noted that if the supply was found to be not subject to tax, there are mechanisms to provide for the correct result (i.e., tax paid in error claims and Section 232 of the *ETA* adjustments against credit returns).

Question 9

Will the CRA consider releasing binding public rulings on issues common to many registrants, as opposed to non-binding policies? We have seen instant reversals of government policy that auditors are assessing back into periods before the change became public, and this is inherently unfair to suppliers and consumers alike.

Response

The CRA, through its GST/HST rulings and interpretations program, is committed to providing registrants and others with timely, accurate, and accessible technical information on entitlements and obligations found in Part IX of the *ETA* and related regulations.

As such, a binding GST/HST ruling provides a particular registrant the certainty needed to fulfill their *ETA* obligations as the ruling outlines the CRA's position on specific provisions of the *ETA* as these relate to a clearly defined fact situation of the particular registrant. On the other hand, the issuance of binding GST/HST public rulings on issues common to many registrants would not be able to offer individual registrants the degree of certainty they need and demand.

For this reason, the CRA does not have any plans to issue GST/HST binding public rulings. Rather the CRA will continue to incorporate the policy content of precedent-setting GST/HST rulings into such publications as the GST/HST Memoranda Series, Technical Information Bulletins, and Policy Statements. CRA will continue to communicate significant changes to the law, its interpretation and administrative policy in the Excise and GST/HST News in as timely a manner as possible.

The CRA will also develop new types of technical publications, where necessary, to improve communication of technical information and legislative changes. For example, the CRA has recently developed GST/HST Info Sheets that are written in plain language and designed to provide clear and brief explanations of specific GST/HST issues. Tax professional associations have welcomed the Info Sheets and the quantity produced continues to grow each year.

Furthermore, public consultations and communication with industry associations and other stakeholders are invaluable to the implementation of new policies and in addressing changes to existing policies, and the CRA will continue to pursue such avenues in hopes of improving public awareness of policy changes.

Question 10

Is it true that both the Edmonton and Calgary tax service offices (TSOs) are contemplating applying the 25% gross negligence penalty found in Section 285 of the *Excise Tax Act* to entire assessments if they can show a false statement or omission in relation to any part of the assessment? If so, does this not go against the purpose of the section as stated in the technical notes that accompanied the legislative changes in December 1999 that stated:

"Section 285 imposes a penalty on a person for knowingly, or under circumstances amounting to gross negligence, making or being a party to the making of a false statement or omission in a return or other document relating to a

reporting period or transaction of the person. The **penalty is equal to** *the greater of $250 and* **25% of the total of any reduction in tax owing** *and* **any increases of refunds or rebates as a result of the false statement or omission.**" (Emphasis added.)

To apply the penalty to an entire assessment appears to exceed the intent of Section 285. The issue seems to be the interpretation of the phrase "the amount that would be the net tax of the person for the period if the net tax were determined on the basis of the information provided in the return." The word "return" is defined in this section to mean: "a return, application, form, certificate, statement, invoice or answer" and ties back to the condition "if the false statement or omission is relevant to the determination of the net tax of the person for a reporting period," and clearly was intended to have the penalty equal to the difference in net tax that the false statement or omission directly causes.

Given the above, could you please comment?

Response

This issue is currently under review.

Question 11

It appears that GST auditors avoid contact with registrants' authorized representatives. For example, we continue to have situations where auditors refuse to return telephone calls or not change their voice messages to indicate extended absences from the office. The result of this is that final assessments are issued before the registrant or their representative has had any opportunity to reply to auditor's allegations or proposal letters. Often times, such final assessments are issued resulting from misinterpretations of the facts and/or the legislation. With the team leaders seeming to have little time to review the audit files in detail, why does it appear that we are we not given the chance to provide input to the final audit decision, and why are the audits taking so long to process?

Response

CRA auditors are instructed to contact the authorized representative after advising the registrant that the account has been selected for audit and confirming the name of the representative in the file. Authorization must be on file prior to contacting the representative.

CRA has established guidelines regarding the type of greeting that CRA staff should use in their voice mail system. CRA staff have been encouraged to change their voice mail greetings on a daily basis. When on an extended absence, greetings are to begin with "absence alert" and to identify when the auditor will return and provide a name and contact number of the individual who will be acting on their behalf.

CRA auditors have been instructed that a proposal letter providing details of all proposed adjustments should be sent to the registrant after completing the audit procedures. The registrant should normally be given 30 days from the date of the proposal letter to provide any response, rebuttal, explanation or further documentation relating to the proposed adjustments. A reasonable extension of time requested by the registrant to consider the proposed adjustments and to prepare a response should not be denied. The extension should be confirmed in writing. If the registrant fails to respond within the time period, the assessment may be processed. However, the auditor should contact the registrant to ensure that a response is not "in the mail" or to determine whether the registrant needs more time to complete his/her response. Where it is clear that the registrant is simply attempting to delay the inevitable by requesting further time or is unwilling to meet to discuss the issues, the registrant may be informed that the assessment will be processed without delay. (Audit Manual)

As stated in the publication "Your Rights – In Your Dealings with Canada Revenue Agency," CRA's corporate values are integrity, professionalism, respect, and cooperation. If the registrant feels he/she has not been treated in accordance with these values, they should discuss this with the auditor and/or team leader.

Question 12

It appears that blank GST returns (GST Form 62) and installment payment forms are not being distributed by the CRA any more. They have not been available on the CRA website for some time. With our clients repeatedly losing these forms or having the post office misplace them, it is impossible to ensure that the clients are current with their filing requirements if we have to ask for personalized forms and wait for them to be mailed. The cash window staff apparently have been told not to give this form out and the forms room staff likewise. What is the rationale behind these new restrictions, and can we arrange for professional advisors to have access to the forms in some manner to expedite our work for the client?

Response

Form GST62, Goods and Services Tax/Harmonized Sales Tax (GST/HST) Return (Non-personalized) and Form GST426, Goods and Services Tax/Harmonized Sales Tax Remittance (Non-personalized), can be ordered individually or in bulk through the Forms and Publications Call Centre at 1-800-959-2221 or through Canada Revenue Agency's (CRA's) website using the following links:

Forms order page (English) **www.cra-arc.gc.ca/cgi-bin/puborder.cgi?lang=en**

Forms order page (French) **www.cra-arc.gc.ca/cgi-bin/puborder.cgi?lang=fr**

Accordingly, accounting firms may be able to order several of these non-personalized forms to keep on hand for those situations where the clients have misplaced the personalized versions.

Also, each CRA Enquiries Counter (at the self-service kiosk) and Forms Counter also stocks a limited number of Form GST62. A person may obtain up to a maximum of 25 copies at these counters.

Due to the technical requirements of the magnetic ink character recognition technology that these forms use, they are not available for downloading and printing from our website. Financial institutions will not accept payments submitted with photocopies of these forms and vouchers, since photocopies do not contain magnetic ink.

Please note that these non-personalized forms cannot be ordered through the Business Enquiries Call Centre; however, the personalized versions of these forms (Forms GST34 and GST58) should still be ordered through the Business Enquiries Call Centre at 1-800-959-5525, rather than through the Forms and Publications Call Centre.

Question 13

In light of the recently issued draft policy on senior's homes, how would CRA view the sale (i.e., taxable or exempt) of such a facility that was used 40% for residential (i.e., minimal care provided) and 60% for non-residential (i.e., institutional health care services)? Assume that the seller was the 'builder' of the facility. Following the draft policy would indicate that the sale would be taxable as V,I,5 would not be applicable.

Response

The draft GST/HST Policy Statement - The GST/HST Real Property Implications of Constructing or Purchasing, and Operating a Residential Care Facility applies to facilities that are generically described as care homes, personal care homes, assisted living residences, seniors' residences, retirement residences, nursing homes and homes for the aged. A residential care facility includes a facility as described in paragraph (c) of the definition of "health care facility" in Section 1 of Part II of Schedule V to the *ETA*, but does not include a facility described in paragraph (a) or (b) of the definition. As such, the following response will address the sale of a residential care facility that is a residential complex, as described in the draft policy, by the builder of the facility.

It is assumed that the facility in question consists of a single building. The builder/operator of the facility supplies the residential units to seniors for use as a place of residence or lodging on a long-term basis. Forty per cent of the units are supplied to seniors who are independent and who require minimal assistance or services. A resident moves into this part of the facility (Part A) for the purpose of receiving accommodation and minimal property and services. Part A of the facility does not provide nursing and personal care. The balance of the units (Part B) are supplied to seniors who require significant assistance with the activities of daily living. Residents move into Part B of the facility for the purpose of receiving nursing, supervisory and personal care services, as well as accommodation, property and services.

Based on the factors as set out in the draft policy paper, the predominant element of the supply by the builder/operator to a resident in Part A of the facility is that of a residential unit, while the predominant element of the supply to a resident in Part B of the facility is the supply of personal care services. As such, while the supply of a residential unit to a resident in Part A will constitute an exempt supply of a residential unit under Section 6 of Part I of Schedule V, the supply to a resident in Part B is not a supply that is exempt under Section 6. Since the nature of the supply in Part B is that of providing care services, the supply is not that of a residential unit (i.e., the unit is not the predominant element of the supply).

Under Subsection 191(3), the builder of a multi-unit residential complex is required to self-supply on the fair market value of the complex at the time possession of a unit in the complex is first given to a resident to occupy the unit as a place of residence after substantial completion of the construction of the complex. Based on the facts provided above, since the whole of the building is a residential complex, the builder will be required to self-supply on the fair market value of the entire residential complex, which includes Part A and Part B of the facility.

Section 5 of Part I of Schedule V exempts the sale of a multiple unit residential complex by a builder of the complex where the builder either:

- received an exempt supply by way of sale of the complex, or
- was deemed to have received a taxable supply of the complex by way of sale under Subsection 191(3),

and that was the last supply by way of sale to the builder, provided the builder did not substantially renovate the complex after that last acquisition and has not claimed ITCs in respect of the last acquisition or improvements (other than ITCs in respect of the construction of the complex).

Based on the facts as set out above, the vendor/builder would have been required to self-supply under Subsection 191(3). At the time the builder first makes a supply of a residential unit in the facility to a resident for purposes of occupancy of the unit as a place of residence, the builder is deemed to have received a taxable supply of the complex by way of sale. Provided the builder did not substantially renovate the residential complex after the last acquisition (i.e., deemed acquisition under Subsection 191(3)) and did not claim ITCs in respect of the acquisition or improvements to the residential complex, the sale of the residential complex will be exempt under Section 5 of Part I of Schedule V.

Question 14

Due to a number of restructuring and business-related problems, a taxpayer neglected to file a GST return for its 2000 fiscal year. It then ceased to exist. Early in 2005, the professional advisors were contacted by the former director of the taxpayer with notification that the CRA had processed an arbitrary return for that fiscal year. The advisors, on behalf of their client, contacted the collections officer and were given a short deadline to determine the correct net tax and file an amended return. That was in August 2005, and the advisors provided the amended return to the collections officer before the deadline. In March 2006, the taxpayer's file has yet to be assigned to an auditor for review. We find this unacceptable. Does the CRA agree? If so, what steps will be implemented to ensure that a similar experience will not happen again?

Response

It is difficult to answer this question without all of the facts, and the registrant and representative may be waiting for an audit that is not in fact being undertaken. In general, a notional assessment is issued by the Collections Division to establish a debt that the collectors use to begin their collection activity. Once the registrant's actual return is received, it should be processed to reverse the original notional assessment. In either case, the taxation centre will issue a collection notice referred to as a statement of arrears (which is not a notice of assessment). There is no automatic audit activity, although the collections staff may at their discretion make a referral to the Audit Division and may mention that the return may be subject to audit.

Question 15

This question was raised in 2004 and 2005 and continues to be a problem. We are still encountering many situations where CRA staff will not confirm whether a GST number is valid. Can CRA confirm when the Business Number Registry will be put in place? What are our options when we encounter a CRA staff member who refuses to confirm or deny registration when we do not have authorization?

Response

The GST/HST Registry is now operational online at our website at the following address: **www.cra-arc.gc.ca/eservices/tax/business/gsthstregistry**

The registry allows users to confirm whether a supplier was registered for GST/HST on the date of a transaction after the following information is entered:

- GST/HST number
- Business name
- Transaction date

Only the first nine numbers of the GST/HST number need to be entered (i.e., do not include the RT suffix). The business name that must be entered is a supplier's legal, operating or trading name. The transaction date is the invoice date or the date on which GST/HST was paid or payable.

Callers who contact the Business Window to request confirmation of GST/HST registration must provide the legal name, the GST/HST number and a valid business reason for requesting the information. The effective date of GST/HST registration will not be provided; however, the Business Window agent will:

- Confirm whether the GST/HST number is valid
- State whether or not the legal name matches the GST/HST number
- Confirm GST/HST registration status
- Indicate whether the supplier was registered on the date that is relevant to the business need of the caller

Please note that agents will not disclose the name of the account where only the GST/HST number has been provided. In addition, all other information regarding a business number and any associated accounts (payroll and corporate tax, for example) is confidential and will not be divulged to anyone including a purchaser, without the written authorization of the supplier.

If the business name provided by the caller is similar to but is not an exact match to the name associated with the GST/HST number provided (for example, the caller provides a trade name that does not match the legal name), agents will use their own judgement as to whether to confirm GST/HST registration.

If callers believe they have given the required information and the Business Window agent is not willing to confirm GST/HST registration, callers may ask to speak to the agent's supervisor for clarification.

Question 16

We have had a situation where a GST registrant paid tax in error on the acquisition of real property due to an error by the lawyer. Unaware that GST had been paid to the vendor because of vague wording of the sales agreement, the registrant reported the required self-assessment of GST on acquisition and claimed an offsetting ITC, since the property was to be used exclusively in commercial activity. A subsequent change in use of the property triggered a self-supply and the requirement for the registrant to remit GST on the fair market value. When the tax paid in error was discovered, we were beyond the two-year limitation to file a rebate under Section 261. Since the registrant has paid a significant amount of GST twice on the same property, once on the original purchase and a second time on the self-supply, can the registrant claim the original GST paid to the vendor as an ITC on its GST return, provided we are within the four-year limitation to claim ITCs? Or alternatively, will CRA accept a late filed Section 261 rebate to refund the tax paid in error on the original purchase to correct an obviously unintended double taxation? If not, is there any relief available to the registrant?

Response

In the situation you describe, a registered purchaser of real property paid an amount on account of tax, in error, to the vendor of the property. The registrant also properly accounted for the tax payable on its own GST/HST return, as required by Subsection 228(4). More than two years elapsed before the registrant discovered the error, and you question what relief is available for the recovery of the amount paid in error.

Section 165 requires a person, who is a recipient of a taxable supply, to pay tax in respect of that supply calculated on the value of the consideration for the supply. Pursuant to subsection 221(1), a supplier generally is required to collect the tax payable by the recipient of the supply. An exception is made in Subsection 221(2), whereby a supplier of a taxable supply of real property is, under certain circumstances, not required to collect tax where the supply is made to a person who is registered.

Where Subsection 221(2) applies, tax must be remitted by the registrant/purchaser directly to the receiver general and not paid to the supplier of the property. This requirement must be complied with even if the purchaser paid the tax to the vendor in the expectation that the vendor would make the remittance. If the registrant recipient pays the tax to the supplier in error, the recipient's obligation to self assess the tax under Subsection 228(4) is not relieved.

As you are aware, Subsection 261(3) imposes a two-year limitation on the filing of an application under Subsection 261(1) for a rebate of tax paid in error: "A rebate…shall not be paid under Subsection (1) to a person unless the person files an application for the rebate within two years after the day the amount was paid or remitted by the person."

There is no discretion available, either to the CRA or to the Tax Court of Canada, to accept a late-filed application for a rebate under this section.

An ITC entitlement arises, pursuant to Section 169, where a person who is a registrant acquires or imports property or service for consumption, use or supply in the person's commercial activity, and tax in respect of the property or service becomes payable or is paid without becoming payable by the person.

A registrant may not claim as an ITC an amount that has been paid in error as or on account of GST/HST. Pursuant to Section 169 of the *Act*, an ITC may only be claimed for tax paid or payable. Subsection 123(1) of the *Act* defines "tax" as being tax payable under Part IX of the *Act*. This would include actual amounts that are payable under the legislation at a rate of 7% or 15%. Any amount that a registrant purchaser pays, in error, to the supplier where no such amount was payable under Part IX of the *Act*, is not considered to be "tax paid or payable," pursuant to Section 169, and accordingly no ITC entitlement exists.

Where a recipient has paid an amount as or on account of tax in error, the recipient may either seek a refund or credit of the amount from the supplier or apply for a rebate of the amount under Section 261 of the *Act*. If the two-year statutory time limit for the claiming of the rebate has expired, there is no relief available to the person under the *Excise Tax Act*.

Question 17

This question was also raised in 2005, and we would appreciate a revisit. CRA auditors need to be reminded of the financial costs borne by taxpayers in responding to audit queries. We are still seeing many examples where the costs to respond are disproportionately high in relation to the audit amount at issue. In a recent example, a GST auditor was assigned to review the input tax credit claim on an annual GST return where the ITC claim was just over $1,000. Upon providing the auditor with the general ledger detail that agreed to the ITC claim, rather than choosing a sample of invoices for review, the auditor requested copies of each and every invoice, including multiple invoices from the same supplier (i.e., monthly telephone bills). Could the CRA comment on this please?

Response

Auditors are aware that there is a cost involved to the registrant in the work that is performed. However, one of the primary focuses of audit is compliance, and the auditor must determine the amount of testing that is required to assure that the registrant is compliant. Auditing is based on judgement and the level of risk involved in a specific audit. An auditor may determine, based on the circumstances and level of audit risk, that a larger or smaller sample of invoices is required to gain a reasonable level of assurance that input tax credits are accurately claimed. If a registrant believes that the amount of audit work or sample requested is unreasonable, they should discuss this with the auditor and/or with the auditor's team leader. It is the registrant's prerogative whether the cost involved in the request for documentation is considered worthy of their effort in relation to the possible assessment due to lack of documentation.

Question 18

We are encountering situations where auditors are demanding responses to queries with unreasonable deadlines. We have experienced situations in the past year where auditors have sent letters to clients demanding that information be provided in as little as five days or the file will be closed without further notice. While the five-day deadline has been rare, and was resolved, it is not uncommon for auditors to send correspondence to a taxpayer requesting a response within 15 days. Especially if this is the first contact with the client, this timeframe is unacceptable from the taxpayer's and the practitioner's perspective. Could the CRA comment please?

Response

There is no written policy within CRA that governs the response deadlines for audit queries, although there is a 30-day policy for proposal letters. Audit queries are a written form of communication, asking questions, which are a simple and necessary part of every audit process. They are to be distinguished from a proposal letter, which obviously requires more extensive review and deliberation by the taxpayer and representative. Depending upon the nature of the query, we do not believe that 15 days would normally be unreasonable. Lengthy or continuous delays in responding to audit queries may contribute to the ultimate perception by a taxpayer of an excessively long audit, as alluded to in other questions in this roundtable.

There may be extenuating circumstances to consider or to be aware of, where the deadline given by the auditor would be for such a short period of time. Each situation would have to be reviewed to determine the reason for the shorter time period being given to the taxpayer.

If more time is required to provide the information, the taxpayer can speak with the auditor and request an extension for time to provide the information or documentation, explaining why additional time is required.

Question 19

We regularly receive telephone calls from CRA staff calling from the GST Compliance Call Centre where, despite the fact that a CRA staff member is calling us without notice, the CRA staff member will not tell us why they are calling unless we can immediately confirm specific details related to the client file. If the call centre is calling our office for information on a taxpayer for which we have consent, why do they insist on confirming client information with our staff member before they will tell us what they are looking for? This is a very frustrating and time consuming exercise for professional service firms. If we do not have consent on file, why is CRA calling us for information? If we have consent, why not tell us the reason for the call up front?

Response

There are two possible scenarios.

The first deals with contact initiated by officers working in the National Collections Call Centre (NCCC). The call centre uses an automatic dialer to make outbound calls to the 'contact' telephone number on record. They do not have access to the account prior to the dialer connecting to the client or authorized representative, at which time the information on the client/taxpayer's account shows up on their computer screens. Once the officers in the NCCC are connected to the client or his/her authorized representative, they will confirm the client's address, postal code and perhaps the client's phone number before discussing any particulars relating to the account. If the telephone listed is an authorized representative who cannot immediately confirm the address, the NCCC officer provides a 1-800 number for the representative to call back once the information is retrieved from their files. The returned phone call will connect to the next available officer at the call centre who will confirm the information the representative provides and proceed with the initial intent of the outbound call. The NCCC officers must follow guidelines to protect the confidentiality of taxpayer information. When they are in doubt about identity, they may seek other confirming information in order to satisfy themselves of this.

The second scenario deals with contact initiated by a compliance officer. In this case, before attempting to contact a client/taxpayer or an authorized representative for information on a GST account, the officer will verify the authorized name and phone number from our BN system. When calling the client/taxpayer or authorized representative, the officer will confirm they are speaking with the client or authorized representative before discussing any particulars relating to the account. If a specific individual for a firm is listed as the authorized representative on our system, the officer will need to speak directly with this individual on any details relating to the account. Officers do not normally require the client or authorized representative to provide specific details from the client's file unless they are unable to confirm the identity/authority of the individual.

As outlined above, the nature of these calls requires that our officers continue to verify identity in this way when conducting business over the telephone. The officer needs to validate that they are speaking with either the client or an authorized representative to protect the confidentiality of the client's information. Where the address of record is that of the representative, this usually doesn't create a difficulty. We encounter frustration when the address on our system is that of the client, causing the representative the need to research their files prior to confirming. If the 'contact' telephone number on the BN system is that of the authorized representative, the owner would need to request a change through Business Window Services at 1-800-959-5525.

The following website link provides helpful information regarding contacts and representatives for a business:

www.cra-arc.gc.ca/tax/business/topics/bn/before/contact-e.html.

If there are any other issues for the GST Compliance area, please contact the manager, Laurie Kirby, at (204) 984-3529.

Question 20

This question deals with GST registration of a member of a partnership that is involved exclusively in commercial activity. Recently, we had a staff member submit a completed Form RC1, "Request for Business Number," for a corporate member of a partnership to the local Business Window for processing and activation of a GST account. Despite the fact that GST registration in this situation was permitted under subparagraph 272.1(2)(b) of the *Excise Tax Act*, and the reason for registration was stated on the RC1, the CRA staff member contacted a technical advisor who advised that a partner in a partnership could not register for GST purposes. What should we do when we encounter CRA technical advisors who are not aware of the provisions in the *Excise Tax Act* that permit voluntary GST registration?

Response

In a case such as this or any other situation where there is a concern about the accuracy of information provided by a Business Window agent, the practitioner should ask to speak to the supervisor or use the TSO contact list to call the appropriate manager. In addition to responding to the practitioner's issue this will enable us to identify training needs and take the necessary action.

Question 21

Do CRA GST personnel use discretion in evaluating the "fairness" of GST situations? While it appears that income tax auditors have some degree of latitude to interpret the *Income Tax Act* to arrive at a "fair and reasonable" position for a taxpayer, it also appears that GST staff are either reluctant or unable to use the same degree of latitude or interpretative discretion with the *Excise Tax Act* to achieve a "fair and reasonable" result for the taxpayer's GST position.

Response

We understand this question to be about applying legislation in a fair and reasonable manner, as opposed to the "fairness provisions." All CRA auditors receive the same or similar training and have some degree of latitude to interpret the *Income Tax Act* and *Excise Tax Act* to arrive at a "fair and reasonable" position for a taxpayer. It is possible that there are perceived differences especially in relation to ITC claims, where the documentary requirements of Section 169 of the *ETA* can be more stringent than the criteria used for evaluating the deductibility of an expense in accordance with the *ITA*. Even in these cases, auditors strive to achieve consistency wherever possible.

Question 22

Given the length of time the new housing rebate has been available and given the increases in average house prices across the country and across time, not only in Alberta, has there been any consideration to advising the Department of Finance to increase the threshold at which the rebate phases out?

Response

The Department of Finance is responsible for matters relating to tax policy and amendments to the *Excise Tax Act*, which governs the GST/HST. Any legislative changes to the threshold amounts for the new housing rebate would have to be considered by Finance. The Canada Revenue Agency is responsible for administering the GST legislation as passed by Parliament. Finance officials are aware of the views expressed on this matter.

Question 23

A partner is generally considered to be an agent of the partnership. Subsection 272.1(1), however, generally deems that anything done by a person as a member of a partnership is done by the partnership in the course of the partnership's activities and not by the partner. This rule is needed in the *ETA* due to the fact that a partnership is considered to be a separate person for the purposes of the *ETA*, whereas a partnership is generally not considered to be a separate person under common law. It is not clear whether or to what extent this rule in the *ETA* overrides the more general rule set out in the provincial partnership legislation.

Subsection 177(1.1) states that where a registered agent acts on behalf of a principal in making a supply, the principal is required to collect tax in respect of the supply and they make a joint election, the agent shall collect and remit the tax and the agent and the principal are jointly and severally liable for the tax and any related obligations under the *ETA*. This subsection does not explicitly preclude a partner from making the election with its partnership where the partner is making supplies on behalf of the partnership.

Under Subsection 272.1(5), a partnership and all of its members are jointly and severally liable for all obligations that arise under the *ETA*. The effect of a Subsection 177(1.1) election between a partner and its partnership therefore would be to move the obligation to collect and remit the tax on the supplies subject to the election from the partnership to the partner. Liability, however, would be shared between the partnership and all of the partners whether or not an election is made.

Therefore, are a partner and its partnership able to make a joint election under Subsection 177(1.1) in respect of supplies made by the partner on behalf of the partnership?

Response

Subsection 177(1.1) provides for an election in cases where a registrant, in the course of a commercial activity of the registrant, acts as agent in making a supply on behalf of a principal who is required to collect tax in respect of the supply. It allows the agent and the principal to elect jointly to have the agent report and remit tax as if it were collectible by the agent.

While it may be that, under common law, every partner is an agent of the firm and of the other partners for the purpose of the business of the partnership, under the *Excise Tax Act*, a partnership is a separate person from the partner and Section 272.1 applies. Under Subsection 272.1(1), for the purposes of Part IX of the Act (including Section 177), anything done by a person as a member of the partnership is deemed to have been done by the partnership in the course of the partnership's activities and not to have been done by the person.

Therefore, it is difficult to see how, for purposes of the *Act*, a partner acting as a member of a partnership could be making supplies as an agent under Section 177, since Subsection 272.1(1) specifically deems supplies made by the partner to be made by the partnership, rather than the partner, and the Section 177 election requires the supplies to be made by the agent (i.e., the partner) in the course of its own commercial activities.

It may be possible that a partner may make supplies as an agent outside of the partner's activities as a member of the partnership. Any such case would have to be examined on its own merits.

Question 24

What is CRA's current administrative policy on assessing under paragraph 296(1)(b) for the GST owing on payables to suppliers when a GST registrant is subject to the proceedings of the *Companies' Creditors Arrangement Act*? If the assessment is rendered and the full GST payable to creditors is assessed by CRA, is there a process to provide relief to the registrant if payments are subsequently made to the creditors?

Response

Generally, when the Agency becomes aware that a registrant is insolvent or bankrupt it may consider an assessment under paragraph 296(1)(b) of the *ETA* of any tax payable under Division II where a potential revenue loss exists. An assessment of tax payable may be made under this provision where the insolvent person has claimed an input tax credit in respect of a taxable purchase, for which payment to the supplier remains outstanding. Although the decision to assess will depend on available resources and the potential for collectibility, the Agency's general position on this issue and how it will be applied on a national basis is detailed in Policy Statement P-112R.

Due to a potential case in litigation, no further comments will be made regarding a process to provide relief to the registrant if payments are subsequently made to the creditors.

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