Member Advisory

October 2010

2010 Canada Revenue Agency (CRA) Tax Roundtable

The annual Canada Revenue Agency (CRA) Roundtable Meeting was held in May 2010. A number of CRA representatives were in attendance, along with representatives from the profession.

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

For more information on the session, contact Director of Professional Services Sean Johnson CA at s.johnson@icaa.ab.ca or Senior Professional Advisor Al Budlong FCA at a.budlong@icaa.ab.ca .

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Income Tax Questions

1. General Anti-Avoidance Rule (GAAR)

Assume a taxpayer's fact situation precisely matches those of a GAAR issue resolved by the courts, such that the taxpayer is absolutely certain the GAAR applies to a transaction just completed. The provisions of s.245(7) provide that the tax consequences of the GAAR shall only be determined through a notice of assessment or reassessment. Does the Agency concur that this provision precludes the taxpayer from filing returns on the basis of the GAAR? What action would the Agency consider appropriate where a taxpayer believes that GAAR properly applies to increase their income tax costs?

Response:

While s.s.245(7) precludes a taxpayer from self assessing under s.245, if the Agency agrees with the results as filed by the taxpayer no further action would be considered necessary.

2. Employee Profit Sharing Plans

Assume the taxation year of an employer ends on December 31 each year. The employer makes a contribution to an Employees Profit Sharing Plan after its 2009 taxation year, but on or before April 30, 2010 (i.e. within 120 days of the previous taxation year). If the employer does not claim the deduction in 2009 taxation year, would the Agency permit this amount to be deducted in the year of contribution? The wording in subsection 144(5) is unclear in this regard.

If the answer to the preceding question is yes, could the employer choose to deduct a portion of the contribution in its 2009 taxation year and the remainder in its 2010 taxation year?

Response:

Subsection 144(5) provides that the amount paid (i.e. the contribution by the employer) in taxation year 2009 or the first 120 days of 2010 may be deducted in the 2009 taxation year. Where, however, the amount paid in the first 120 days of 2010 is not deducted in the 2009 taxation year, subsection 144(5) allows it to be deducted in 2010.

The phrase "to the extent that it was not deductible in computing income for a previous taxation year" ensures that a contribution paid in the first 120 days of a particular taxation year and which was deducted in the prior taxation year cannot be deducted a second time in the particular taxation year. For example, in the case at hand, this ensures that where a contribution paid in the first 120 days of 2010 was deducted by the employer in its 2009 taxation year, the contribution is not deducted a second time in 2010.

With respect to the second part of the question, subsection 144(5) does not impose any limitation on the allocation of a contribution made in the first 120 days of 2010, i.e., the employer may deduct in its 2009 taxation year a portion of the contribution made in the first 120 days of 2010 and the remainder in its 2010 taxation year.

3. Directors' Liability

While we appreciate the Directors' Liability provisions of the *Income tax Act* (ITA), it seems inappropriate for initial contact with directors by collection agents of the CRA to consist of a statement that the corporation in

question has a balance owing, that the directors of the corporation are liable, and that a cheque should be issued immediately by the individual to pay the tax debt of the corporation. Typically, there has been no assessment issued against the director, which seems to the writer to imply that there is, at that time, no liability.

In addition, it appears that in some cases the CRA does not maintain up to date records of current directors. Can the CRA advise:

(a) what are the guidelines made to their collections officers regarding the timing and the manner of communication of Director's Liability, particularly when no assessment has been issued to the director? Are they, for example, instructed to enquire as to the individual's present status as a Director, or the timing of any resignation, to establish that liability exists prior to requesting payment?

(b) what recourse would an individual have who assumed the liability was genuine and remitted payment of amounts for which they are not, in fact, liable?

(c) would the Agency consider a policy of requiring steps to be taken to confirm current directors (or the directors two years prior to initiation of such collections action) from the appropriate Corporate Registry to ensure such liability is asserted only where it truly exists? It seems likely the Agency may be missing the opportunity to collect from current directors when their records are not current in this regard. As well, because CRA uses its records to determine individuals authorized to sign on behalf of the corporation, the failure to update these records could easily result in persons who should not have access to corporate information being granted such access, an issue we know from prior ICAA/CRA Roundtables is a matter of significant concern to the Agency.

Response:

The directors of a corporation have the responsibility to ensure that the corporation withholds certain amounts on behalf of the Crown and remits them to the CRA. If a corporation fails to do so, its directors may be held jointly and severally liable with the corporation under the provisions of the *Income Tax* Act, section 227.1. It is appropriate for collections officers to inform directors of their contingent liability during their initial contact with them; however, legal action to collect from directors cannot proceed until directors' liability assessments have been issued.

It is the Agency's policy to issue a pre-assessment proposal letter to all directors prior to the assessment of any directors' liability. The pre-assessment letter gives each director an opportunity to present relevant facts which may prove that they should not be held liable for the corporation's unpaid source deductions. The letter advises the director of the CRA's intention to assess and provides a specific period in which to respond. It also informs the director of the amount of the proposed assessment. The letter further advises the director that information regarding the CRA's position regarding a due diligence defence can be found in Information Circular 89-2R2.

The Agency does not rely solely on its internal records to determine who the directors are for the purpose of assessing Directors' Liability. Collections officers search the Corporate Registry to determine who the directors were at the time the liability occurred. They may also consider information submitted by or on behalf of the corporation which is not filed at the Corporate Registry. As there can be several types of directors, including de factor and nominee directors, other avenues of enquiry and verification are pursued. When interviewing a director, collections officers are to enquire as to whether or not the individual is presently a director. If the individual is no longer a director, the collector is to determine when they ceased to be a director and obtain the relevant details. Information provided by directors is verified through a Corporate Registry search.

A director who pays an amount in respect of a directors' liability assessment is entitled to take certain actions to collect the amount from the other directors. Subsection 227.1(7) of the *ITA* stipulates that a director who

makes the payment of the liability can proceed with action against the other directors to recover a portion of the amount that was paid on behalf of the corporation. The fact that a director has personally paid a Directors' Liability claim is sufficient for him to file claim against the other directors. Based on the above procedures that are in place and the opportunity that is given to each director to make representation, the scenario presented in part (b) of this question would be unlikely.

Additional Questions

1. *What is the exact wording in the pre-assessment proposal letter that is referred to above? Does the letter indicate that the director is liable or just contingently liable?*

2. *What is the interaction between Director's Liability and Section 160? That is, if the CRA can't assess Director's Liablility, would they assess under Section 160?*

Response

1. *The pre-assessment proposal letter clearly states that the directors can be held jointly and severally liable with the corporation to pay the corporation's arrears. It advises the director(s) that they may be held liable and that the Agency is considering assessing the director(s) should they not provide a due diligence defence within 30 days. It goes on to say that failure to reply may result in an assessment against the director(s) without further notice.*

2. *The purpose of sections 160 of the Income Tax Act and 325 of the Excise Tax Act is to prevent a taxpayer from avoiding his tax liability by simply transferring his assets. Where a transfer of property has been made either directly or indirectly by means of a trust or by any other means to a spouse, to a minor, or to any other person with whom the transferor did not deal at arm's length, the transferor and the transferee are jointly and severally liable for the payment of certain taxes. This provides another avenue for tax recovery from shareholders of corporations, particularly those corporations that are closely held. In these corporations, a few shareholders hold most, if not all, of the corporate shares. Traditionally, these shareholders perform work for the company in a variety of roles. They would take compensation by way of an advance from the corporation, and convert such at year's end into a dividend to obtain a tax credit. When this is the case, and the corporation is indebted for income tax or GST, the Agency can raise an assessment pursuant to section 160 of the Income Tax Act or section 325 of the Excise Tax Act against the shareholders. The transferee's liability is triggered at the time of the transfer and it is limited to the lesser of these two amounts:*

   i. *the value of the benefit conferred by the transferor*

   ii. *the amount of transferor's tax liability*

   The Agency explores all avenues of collection when determining the best course of action to pursue to recover amounts owing to the Crown, including the application of Section 160.

4. My Account/Represent a Client

Would the Agency consider the following enhancements to My Account/Represent a Client to enhance the benefits enjoyed by both practitioners and the Agency:

(a) refundable dividend tax of corporations reflected on their records;

Response: Not available in My Business Account and not currently on the list of enhancements being considered.

(b) capital dividend account balances, or alternatively the components reflected for years where this is on file;

Response: Not available in My Business Account and not currently on the list of enhancements being considered.

(c) General Rate Income Pool and Low Rate Income Pool balances;

Response: Not available in My Business Account and not currently on the list of enhancements being considered

(d) correspondence from the Agency for individual accounts (this is already available for business accounts—often we find clients are reassessed "in accordance with previous correspondence" that clients cannot recall receiving or have misplaced);

Response: CRA is considering adding this feature to *My Account* in the future.

(e) a version for Trusts (noted in prior years as anticipated, but with no fixed timeframe);

Response: We have a "My Trust Account" option as part of the plan for future electronic service options for trusts. A timeframe for implementation is not available at this time.

(f) corporate accounts: payment transfers between the various accounts that a corporation has with CRA (i.e. corporate tax, payroll, GST) as well as between taxation years;

Response: This is not currently available in My Business Account but is planned for a future enhancement.

(g) corporate accounts: allow for instalment transfers between related corporations;

Response: This is not currently available in My Business Account but is planned for a future enhancement

(h) individuals: provide for tracking status of pre-assessment reviews and post-assessment reviews;

Response: There are no plans to add this feature to *My Account* at this time.

(i) where Service Canada amends CPP, OAS or EI information slips, the CRA does not get the updated data so the slips that are shown may be out of date, and the taxpayer may not be aware that amended slip(s) have been issued—please include original slips and amended slips on line; and

Response: *My Account*: CRA does receive some amended slips and we do display that data. If we don't receive the amended slip, we advise the taxpayer to contact Service Canada.

(j) the statement of account in the personal web portal only goes back approximately one year —unlike the corporate account statement that spans a longer period—can the period be extended?

Response: There are no plans to add this feature to *My Account* at this time

(k) Is it practical for the Agency to track the nature of requests from taxpayer representatives internally to assess the information most commonly requested, with a view to prioritizing the items to be added to the Represent a Client service?

Response: *Represent a Client* - Represent a Client (RAC) continues to add new features to our service, based on feedback we receive from representatives, submissions to our online survey, and the consultation sessions we host each year. We cannot state specifically what we plan to release each year, as upcoming development enhancements along with other CRA IT development priorities must be taken into consideration.

Additional Question

The CRA has indicated that the following applications are not currently on the list of enhancements being considered:

1) *Capital dividend account balances or, alternatively, the components of the CDA*
2) *Refundable dividend tax of corporations reflected on their records*
3) *General Rate Income Pool and Low Rate Income Pool balances*

Would the CRA please comment on what factors are involved in reaching the decision to not consider an enhancement.

Response

1. The CRA does not have the capacity to provide access to the Capital Dividend Account (CDA) balance via My Business Account, as this calculation is not stored electronically in our systems. Upon receipt of a request to verify a CDA balance, the CRA extrapolates the pertinent information from our electronic and archived paper records to validate the calculation provided. Transactions included in the CDA calculation can date back several decades; therefore, the collection of required source information and the manual determination of the calculation itself is a laborious process. It is the CRA's practice to validate a corporation's CDA balance where a copy of the taxpayer's own CDA records has been provided, or when a corporation files an Election for a Capital Dividend Under Subsection 83(2) of the Income Tax Act (T2054).

Because the requirements for collection and review of a corporation's records in the confirmation of the CDA calculation are considerable, both on the part of the taxpayer/tax practitioner and the CRA, requests must be completed on a case-by-case basis. To pre-determine CDA balances for all corporations would be prohibitively expensive and is not warranted given the existing level of demand for this information. The CRA aims to assist tax practitioners in obtaining the information they require to serve Canadian taxpayers, and will continue to provide the most accurate and timely information available, upon request.

2. and 3. The CRA strives to make current and accurate information available to taxpayers in a manner that best suits their needs and preferences, and to provide taxpayers with increased convenience and accessibility through the use of electronic services. To this end, the CRA is currently investigating the feasibility of posting the Refundable Dividend Tax on Hand (RDTOH) and the General Rate Income Pool (GRIP) balances on My Business Account, where they would be readily accessible to taxpayers and their representatives. As our analysis of the new functionality is ongoing, we are not able to provide a specific time frame for any change. Your continued patience in this matter is appreciated.

5. Taxpayer Relief Provisions

The appropriate standard of review to apply to the Minister's decision in respect of taxpayer relief applications is "reasonableness" (Lanno v. Canada (Customs and Revenue Agency) 2005 FCA 153). In the matter of Nixon v. H.M.Q., 2008 DTC 6539, it was noted that the Minster denied the taxpayer's request for relief on the

basis that the taxpayer's forgetfulness did not constitute "extraordinary circumstance to which the Taxpayer Relief provisions would apply". It was noted that Information Circular IC 07-1, *Taxpayer Relief Provisions* makes reference to "extraordinary circumstances".

In finding for the taxpayer the Court noted that "this interpretation is contrary to s.220(3.1) of the [Income Tax] Act and is a misapprehension of the content of the Guidelines".

One penalty which often seems inordinately harsh is the s.163(1) 10% federal penalty (and analogous provincial penalty) applicable where a taxpayer fails to report income for two taxation years within a four-year period. This significant penalty often occurs because a slip is not received, or where the missing slip (such as a T4 or T4RSP) has sufficient source deductions. This seems especially inappropriate where the penalty exceeds the penalty which would have applied had the taxpayer been grossly negligent in failing to report the same income.

Is the CRA considering any change to its practices in reviewing taxpayer relief requests in light of this jurisprudence?

Response:

The Minister's authority to waive penalty and interest can be found in sub-section 220(3.1) of the ITA. These provisions are generally referred to as "Taxpayer Relief Provision" and further explained in Information Circular (IC) IC07-01. CRA recognizes that not all taxpayer circumstances warranting relief fall within the guidelines. CRA decides on a case-by-case basis whether it would be reasonable to grant relief based on the specific set of circumstances. We are not considering any changes to our practices in reviewing taxpayer relief requests, although we take into account jurisprudence. The onus is on the taxpayer to demonstrate in their request why their situation should merit relief.

6. Employee Life and Health Trusts

On February 26, 2010, the Department of Finance released new tax proposals to accommodate Employee Life and Health Trusts ("ELHT"). The proposals (which, if passed, will apply for 2010 forward) create a new type of taxable inter-vivos trust that will enable funds to be accumulated within the ELHT by employer contributions for the benefit of employees' health benefits. It would appear that these proposals will replace the administrative material in IT-85R2. Can you please confirm the CRA's intent to withdraw IT-85R2 if the ELHT proposed legislation is passed.

Response:

The CRA is currently considering the impact of the proposed ELHT legislation on the administrative regime authorizing health and welfare trusts.

As you know, the Department of Finance invited comments on the proposed legislation, to be submitted by April 30, 2010. These comments will be reviewed and considered and until that process is complete it remains possible that the proposed legislation would be amended further. Any such amendments may have an impact on the factors relevant to the review of the interaction between ELHTs and the health and welfare trust regime.

Consequently, at this point we are not in a position to comment definitively on the effect the ELHT legislation may have on health and welfare trusts.

7. Federal SR&ED Tax Credit in Relation to Issues with the New Alberta SR&ED Tax Credit

What is the status of discussions with the Alberta Government with reference to the "Double Grind" issue (described below)?

The Alberta SR&ED legislation contains provisions that result in two reductions or "grinds" to qualifying SR&ED expenditures eligible for SR&ED Tax Credits.

The first occurs because the Alberta SR&ED Tax Credit reduces the expenditures to which the Federal SR&ED Tax Credit applies, thereby reducing the amount of the Federal SR&ED Tax Credit available. This has the effect of reducing the Federal and Alberta SR&ED Tax Credits to an effective rate of 41.5% for a qualifying Canadian-controlled private corporation (CCPCs) and 28% for other corporations. The grind occurs as part of Federal law and is one that Alberta does not have any control over.

The Alberta legislation contains a second grind which no other province imposes (see line 23 of the AT1 Schedule 9).

The second grind reduces the expenditures to which the Alberta SR&ED Tax Credit applies by the amount of the preceding year's tax credit from the Federal SR&ED Tax Credit. The effect of this second grind is:

(a) for qualifying CCPCs, the effective rate of SR&ED Tax Credit from both governments is 39.4% (versus 35% received under the Federal SR&ED Tax Credit legislation alone); and

(b) for large corporations, the effective rate of SR&ED Tax Credit from both governments is 26.5% (versus 20% under the Federal SR&ED Tax Credit legislation alone).

The above rates do not consider the fact that both the Federal and Alberta governments impose tax on the SR&ED Tax Credits.

The practical issue with this is that the relevant SR&ED tax forms (both Federal and Alberta) will need to be filed for at least five years following the last taxation year that SR&ED work is claimed. This is because the Federal SR&ED Tax Credit is reduced on the Alberta SR&ED tax form and, with no current Alberta SR&ED expenditures, results in a negative Alberta SR&ED Tax Credit, which then becomes a positive amount that is included in calculating the Federal SR&ED Tax Credit. This yearly cycle continues until the values become insignificant (under $5 after year five).

On a related note, can you clarify that the second grind is on Federal SR&ED Tax Credits "received" rather than "received or receivable" with respect to when the Alberta grind of the Federal SR&ED Tax Credit occurs.

Response:

There are no ongoing discussions between the Canada Revenue Agency and the Province of Alberta with respect to the Alberta SR&ED tax credit. The CRA is not involved in policy development as it relates to the Alberta SR&ED tax credit. Although the Alberta SR&ED tax credit relies on the Federal program in determining the eligibility of the work undertaken, the calculation in determining the eligible expenditures for the Alberta tax credit rests solely with the Province of Alberta.

All provincial/territorial R&D tax credits are government assistance for federal SR&ED purposes. They reduce the federal pool of deductible SR&ED expenditures and the federal qualified expenditures for ITC purposes.

Eligible expenditures of a Qualified Corporation for Alberta purposes for a taxation year are calculated using the following formula:

A – B + C + D – E + F

- **Amount A** is the costs incurred in Alberta after 2008 that are SR&ED expenditures included in the qualified corporation's federal qualified expenditure pool at the end of the taxation year for purposes of the federal SR&ED investment tax credit. Amount A is the Alberta portion of the amount on line 559 of the federal form T661.
- **Amount B** is the costs, if any, included in the amount determined in amount A for a prescribed proxy amount included in the federal qualified expenditure pool of the qualified corporation.
- **Amount C** is the qualified corporation's Alberta proxy amount, if any, for the taxation year. The Alberta amount is equal to 65 percent of the salaries and wages incurred in Alberta that were used in the calculation of the federal prescribed proxy amount. There will be an Amount C only if there is a prescribed proxy amount included in the federal qualified expenditure pool.
- **Amount D** is the amount of any Alberta SR&ED tax credit that reduced the federal qualified expenditures of the qualified corporation in the taxation year.
- **Amount E** can be calculated as follows:

Federal ITC received in the immediately preceding year X Total eligible expenditures for Alberta purposes for years in which the expenditure was incurred

E = ____

Total federal expenditures in the years in which the expenditure was incurred

- **Amount F** is the amount of any repayment of government assistance (other than the Alberta SR&ED tax credit) or contract payment in the taxation year that can reasonably be considered to relate to amounts included in Amount A above in the taxation year or any prior taxation year.

In a taxation year where no current SR&ED expenditures are claimed, a negative expenditure amount eligible for the Alberta credit may arise when using the above calculation. Pursuant to provincial legislation, this negative expenditure amount will result in a recapture of 10% of the negative expenditure amount. This recaptured amount would be considered a repayment of assistance on the federal form T661 in the subsequent year.

With respect to determining Amount E in any given year, the calculation is based on Federal ITC **received** in the immediately preceding year.

8. Oil and Gas

A landowner who owns the mineral rights may grant the exploration rights by means of a petroleum and natural gas lease (PGN). Often, a one-time bonus payment will be paid in addition to the annual lease amount at the time the lease contract is signed. Our understanding is the CRA regards all amounts received in respect of the PNG, including the bonus payment, as proceeds of disposition of a Canadian resource property, and the entire proceeds are to be deducted from the cumulative Canadian oil and gas property expense pool (COGPE). To the extent that the pool balance is negative, that amount is included in the taxpayers income pursuant to s.66.2(1) and p.59(3.2)©.

How does the signing of a PGN lease constitute a disposition of resource property and why is the bonus payment also included as proceeds of disposal to the COGPE? Shouldn't the lump sum bonus payment be treated the same as incentive payments paid in respect of the leasing of surface rights, which according to IT-200 are generally considered to be capital?

Response:

A right to explore for, drill for or take petroleum, natural gas or related hydrocarbons in Canada is defined in subsection 66(15) as a Canadian resource property (CRP). The granting of this right by the freehold landowner is a disposition of the CRP as this right cannot be granted to another person. The bonus payment is consideration for granting the right and is on account of capital; however, the disposition of a CRP is specifically excluded from the calculation of a capital gain and capital loss pursuant to subparagraph 39(1)(a)(ii). The tax treatment of the proceeds of disposition of a CRP is described in paragraph 2 of IT-125R4:

> *Similarly, when a taxpayer disposes of a Canadian resource property described in (a), (c) or (d) of that definition or any right to or interest in any such property (see (g) of that definition) and the proceeds from disposition become receivable, the net proceeds of disposition reduces the taxpayer's cumulative Canadian oil and gas property expense (CCOGPE), under F of the definition of CCOGPE in subsection 66.4(5).*
>
> *If a credit balance occurs in the CCOGPE in respect of a taxation year, such a balance must be deducted when calculating the* [cumulative Canadian development expense] *CCDE, under L of the definition of CCDE in subsection 66.2(5). If there is a credit balance in the CCDE in respect of a taxation year, such a balance must be included in income, under paragraph 59(3.2)© and subsection 66.2(1).*

The annual lease payments are treated as income receipts.

9. Non-Resident Withholding Tax Issues

A Canadian corporation owned by a non-resident may own only non-cash assets, such as shares in private corporations. Where this Canadian corporation is dissolved and distributes its non-cash assets to its non-resident shareholder, could you please advise as to how any withholding tax obligation of the Canadian corporation pursuant to Part XIII should be handled? Can you also comment on the withholding tax obligations of the Canadian corporation that pays a dividend-in-kind (i.e., not in cash) to a non-resident shareholder.

A Canadian corporation that pays a stock dividend by issuing shares in its own share capital may have non-resident shareholders. Could you please advise as to how any withholding tax obligation of the Canadian corporation paying the stock dividend pursuant to Part XIII should be handled where there are no cash payments to the shareholder?

Response:

A Canadian corporation paying a dividend is required to withhold Part XIII on the payment of any cash dividend, as well as on a stock dividend (or "dividend-in-kind") to a non-resident. Although this may create a problem since there may be no cash from which to withhold the tax to be remitted, the Canadian corporation is still liable to pay the tax on behalf of the non-resident and is required to make the remittance. In the case of non-cash assets being distributed on a wind-up, which results in a deemed dividend that is subject to Part XIII, the corporation is still responsible for withholding and remitting Part XIII tax. How the Canadian corporation finances the payment of the Part XIII tax and/or recovers the amount paid on behalf of the non-resident receiving the dividend is a matter to be resolved by the Canadian corporation and the non-resident recipients.

Additional Questions:

(a) What financing arrangements have the CRA seen?
(b) What happens if the corporation cannot obtain financing?

(c) If the corporation has no cash with which to pay the withholding taxes, would the CRA consider waiting until the disposition of a Taxable Canadian Property and then take the withholding tax from the proceeds?
(d) Is the withholding tax ultimately a liability of the directors under 227.1?
(e) Would the CRA consider a Waiver?

Response

(a)(b)(c) As previously stated, it is not within the scope or mandate of the CRA to provide advice or information on how a taxpayer should finance the payment of a tax liability.

(d) The Directors would ultimately be liable for any withholding tax pursuant to Section 227.1(1) as it makes reference to the withholding tax covered under Section 215:

> *227.1(1) Liability of directors for failure to deduct*
>
> *Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or 135.1(7) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.*

However, there are limitations, as addressed in Subsection 227.1(2):

> *227.1(2) Limitations on liability*
>
> *A director is not liable under subsection (1), unless*
> *(a) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 223 and execution for that amount has been returned unsatisfied in whole or in part;*
> *(b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or*
> *(c) the corporation has made an assignment or a bankruptcy order has been made against it under the Bankruptcy and Insolvency Act and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the date of the assignment or bankruptcy order.*

One additional situation in which the director is not liable is contained in Subsection 227.1(3):

> *227.1(3) Idem*
> *A director is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.*

Information Circular IC89-2R2 discusses Director's Liability at length and also provides examples.

(e) There are a variety of situations under which the Canada Revenue Agency will consider a reduction or a waiver of the remittance requirements under Part XIII, such as the NR5 request for reduction in the amount to be withheld on pensions and like payments; the NR6 - Undertaking to file an income tax return by a non-resident receiving rent from real property or receiving a timber royalty - this undertaking allows for a withholding on the net income rather than the gross payments. But under no circumstances would we grant a waiver or reduction for a distribution of non-cash assets or dividends-in-kind.

10. Civil Penalties – S 163.2

Please provide us with an update of the Agency's use of these provisions.

1. How many penalties have been issued since the inception of the provisions?

Response:

The third-party penalty legislation was enacted in June 2000, and to date, close to 100 third-party penalty audits are either in progress or have been completed.

As at December 31, 2009, third-party penalty audits were completed and applied in 27 cases. The aggregate TPP amount is $6,314,848, of which $4,709,551 pertains to the promoters and the balance of $1,605,297 pertains to the preparers. In addition to the application of TPP and other civil penalties, several third parties are also facing criminal prosecution. Moreover, the CRA has revoked the registration of 33 charities that participated with third parties in abusive tax shelter gifting arrangement schemes.

2. Are any details available in respect of the circumstances of more recent assessments, say since January 1, 2008?

Response

Please find below a brief description of four recently completed TPP cases.

1. *RRSP Strip*

As part of an RRSP strip arrangement, the promoter incorporated four different corporations and had documentation prepared identifying these corporations as "qualified investments" for RRSP purposes. In fact, these corporations carried on no activity and were not qualified investments. Through advertisements in newspapers, the promoter claimed that he could assist people in withdrawing money from their RRSPs without attracting income tax. He advised investors, sometimes through agents who sold the arrangement, that they could convert their RRSP investments to self-directed RRSPs by instructing the bank or trust company that managed their RRSP to direct amounts to one of the promoter's corporations. Once the RRSP funds were directed to one of the corporations, the promoter returned approximately 65% of the amount to the taxpayer— the exact percentage varied from client to client—and the promoter retained the other 35%. A total of approximately 80 taxpayers participated in the RRSP strip and avoided federal tax of approximately $800,000 as a result. The promoter made approximately $1.9 million, most of which was directed to a bank offshore.

Decision

The Third Party Penalty Review Committee agreed that the promoter knew or would reasonably be expected to know, but for circumstances amounting to culpable conduct, that the RRSP strip did not comply with the provisions of the ITA. A penalty of $1.9 million as calculated under subsection 163.2(3) has been assessed.

2. *False invoices and fictitious expenses*

In preparing the tax returns for a client, the preparer prepared invoices for management services allegedly provided by the client's spouse's inactive corporation and deducted these amounts against the client's business revenue. There was no evidence that any work had been performed by the company or that any amounts had been paid. In addition, the preparer grossly and negligently overestimated the client's motor vehicle expenses and bank fees. In carrying out her business, the client received trips in both years as an incentive award for having met sales objectives and this amount was properly recorded as income by the client. The preparer, however, deducted the amount as a business expense. In one year the preparer

reported no business income for the client, claiming she had become disabled. The preparer had advised the CRA that the client was unable to respond to certain CRA enquiries because she was out of the country working. Based on subsection 163.2(5), the Third Party penalty calculated was $50,000 based on audit adjustments of about $100,000 in each of the three years.

Decision

The Third Party Penalty Review Committee concluded that the preparer caused false invoices to be created and fictitious expenses to be deducted. In addition, he knew his client had earned income in one of the years in question, and made no attempt to report it.

3. Fictitious business losses

The preparer caused 70 taxpayers to file a total of approximately 220 tax returns containing false statements. The false statements consisted of fictitious business losses, rental losses and child care expenses. In the majority of these cases, the taxpayers had no businesses, rental operations or child care expenses. In a minority of cases, where the taxpayer did have some business or rental operation, the expenses were exaggerated and not based on information provided by the client. The penalty calculated pursuant to subsection 163.2(5) came to over $225,000.

Decision

The Third Party Penalty Review Committee agreed to assess the penalty.

4. Fictitious farm losses

The Third Party preparer included farm losses in the T-1 Individual Income Tax Returns for a number of his clients. After auditing the tax returns, it was discovered that the preparer had included a variety of false statements in these returns. These included the creation of a fictitious cattle feeder program, failure to report drought deferral income, manipulation of capital cost allowance and the inclusion of personal expenses as farming expenses. In the majority of cases, the individuals had undertaken no farming activity and the preparer created fictitious Statements of Farming Activity indicating farming losses.

Decision

The Third Party Penalty Review Committee has agreed that penalties described in section 163.2(4) should be assessed in 10 cases and total just over $30,000.

Additional Questions

(a) Would the CRA consider publishing the Third Party Penalty results on the CRA website?

Response

The CRA is prohibited by section 241 of the ITA and section 295 of the ETA from disclosing to a third party any information relating to a Third Party Penalty audit without the written consent of the taxpayer, except where authorized by law to do so.

(b) Has the CRA assessed Third Party Penalties where the underlying assessment involved GAAR?

Response

No. The penalties are not intended to apply to arrangements by reason only of a determination that they are subject to the application of the general anti-avoidance rule (GAAR). The GAAR applies only if an arrangement is otherwise technically effective. This means that the particular filing position is based on true statements rather than false statements. Thus, the penalties cannot apply. However, if a person takes a filing position contrary to well-settled jurisprudence on an identical issue, the third-party civil penalties would be considered.

(c) Are there any situations where the CRA attempted to levy Third Party Penalties but were unsuccessful?

Response

We are not aware of any situations where a Third Party Penalty has been assessed and subsequently vacated by either CRA's Appeals Division or a court of law.

(d) What is the typical time frame, from start to finish, in assessing a Third Party Penalty?

Response

The typical timeframe for assessing a Third Party Penalty varies from audit to audit. This depends on many factors, such as the cooperation of the taxpayer, and access to their books and records. Also, the CRA strictly controls the application of the penalties. Procedural checks and balances are in place to ensure that no one person can direct the application of the penalties or otherwise inappropriately apply the penalties. Owing to these checks and balances, a Third Party Penalty Audit may take longer than a regular audit.

11. Pre- and Post-Assessment Review

There seem to be some items that are followed up regularly. In our experience, support for child care, moving expenses, larger foreign tax credits and "other deductions" is requested on most or all filings. If supporting documentation is expected to be requested for all, or virtually all, such claims, would the Agency consider requiring submission of such documents with the return, or by separate filing at or about the time the returns are prepared? Many of our members are frustrated by this process, as it requires time, and client contact, after the tax returns have been completed, which is inconvenient and often unbillable. For many of our members, the solution is to file returns with commonly requested information on paper, rather than using the EFILE system, so that the supporting documentation can be submitted with the paper return, and thus subsequent time cost minimized or avoided. Please comment and indicate if you are reviewing certain types of claims or income tax returns more regularly than others?

Response:

Our Validation Programs promote compliance and help maintain confidence in the fairness of our programs through increased education, effective risk-scoring systems, and a balanced approach to our file selection process. Our CRA webpage, "Review of your tax return by CRA" provides more information regarding our Pre-assessment Review and Processing Review programs.

We conduct an annual random sample of individual income tax returns filed to estimate the non-compliance rate for individuals with respect to key deductions and credits that are not subject to third-party reporting. We also conduct targeted reviews of claims based on statistical analysis of results including trend analysis data. Overall, we review a small percentage (approximately 6%) of the population. We will focus on those claims demonstrating the need for attention and, naturally, those individuals or tax preparers who have a larger

proportion of these claims may notice a higher proportion of validation reviews. We continually refine our selection criteria in order to target only those returns with the highest likelihood of error.

With respect to requests for documentation, we do review many files without making contact with the preparer, but when contact is necessary we strive to only request what is needed. Given that an average of only 6% of files are subjected to review in these particular programs, we suggest that the administrative work to submit receipts for 100% of these files could be more of a burden than submitting the documentation for the minimal number of returns we do select. Nonetheless, the CRA is always looking for ways to reduce the burden on preparers and are examining new methodologies to expedite the requests for information. Note that we do accept facsimile which helps to expedite the process and avoid postage and other handling costs.

Additional Questions

(a) *For example, say donations claimed on a T1 Return were in excess of $50,000. Is there any way that CRA could indicate whether this Return would be selected for review?*

***Response**: The automated system used to identify claims for review considers various criteria that change each year and are not solely value based; therefore, we cannot provide a dollar limit.*

(b) *For pre-assessment review purposes, is it possible to have a separate code for each issue instead of just one code, as is currently the case?*

***Response**: It is only possible to provide one code which is displayed to inform the preparer that a delay in assessment could occur. Often, CRA clears the issue without making contact with the preparer.*

(c) *What will be the criteria used to select the 2% of Returns that will be reviewed for the HRTC?*

***Response**: To protect the integrity of CRA's file selection methodology, this type of information is not released. CRA will select the HRTC by both targeted and random selection.*

(d) *An individual reports foreign income on line 104 every year but does not receive a T4 for it. Each year the CRA requests information regarding this line item. Is there a way of recognizing that this individual reports this type of income each year from the same source so he will not be continually questioned on it?*

An individual reports T4PS income on line 104. He has received 3 requests from 3 different offices in the same year to submit information to support this income. Is there a way for CRA to keep track of which office is reviewing this information in order to prevent the taxpayer from being contacted 3 times?

***Response**: The CRA is responsible to ensure that income is reported accurately. We acknowledge that in certain situations this may cause additional work for the taxpayers and/or their representatives. Your concerns have been communicated to Headquarters for their consideration.*

12. Matching Program

Practitioners have experienced a significant number of enquiries arising from the matching program which, on investigation, result because the Agency has either mis-processed slips (in one case, a decimal place was missed and the amount of $1,259.77 on the slip was reflected in CRA's records as $125,977), has not processed amended slips which were received by the taxpayer (slips received by the taxpayer in time to be included in their returns, filed by the April 30 deadline, and questions asked in November or December) or

has not considered where the slips might be reported (a common issue with T4A slips received in respect of self-employment revenues).

We appreciate that the Agency must follow up on discrepancies, and that these issues are generally ultimately resolved at the assessment or reassessment level. However, these resolutions require time spent by the taxpayer and their professional advisors, which carries a cost. It is frustrating for taxpayers that they are the ones required to pay for the Agency's processing errors—and, of course, their taxes pay for the added time costs incurred by the Agency.

Are there any steps the Agency is considering to ensure the matching program is accurately reflecting the slips which have been filed, and the line(s) on which such income would be reported? Would the Agency consider enhancing the details of slips provided by income tax software through the bar code and/or EFILE programs? Would the Agency consider adding a line to the various self-employment statements to disclose revenues reflected on a T4A slip separately from other revenues?

Response:

We would like to clarify that not all information produced by tax preparation software is received by the Agency. We only receive the data captured in the keying fields listed in Appendix G of the Electronic Filers Manual. All other data either calculated or accumulated by a software package (e.g., the T4A summary schedule) is not received by the Agency. Moreover, there are no specific keying fields or selected financial data fields (see form T2125, *Statement of Business or Professional Activities*) that record the amounts from T4A, T1204 and/or T5018 information slips that have been included in self-employed income.

While the amounts shown on the T1204 or T5018 slip will generally be reported as self-employed, the same cannot be said for amounts reported as "Other income" on the T4A slip. As you are aware, there are many different types of payments reported in box 28 of the T4A slip which poses various challenges when matching the information to a taxpayer's return. Although the nature of most payments is defined by a footnote code included in box 38, there is currently no such code associated with fees or other amounts paid for services. This problem will be resolved when the redesigned T4A slip is introduced in 2011.

When an income discrepancy is identified in respect of an unknown amount in box 28 of a T4A slip, the matching staff is required to verify whether the income was included in self-employment income before adding it to the taxpayer's income. If the taxpayer is reporting self-employment income, the assessor is to verify the income and expense statement to determine if the T4A amount was included in gross self-employed income. Where it cannot be determined with certainty that the amount was included as self-employment income, the assessor is to contact the taxpayer for clarification.

Although the CRA commits significant resources to training staff and developing support tools, errors do occur from time to time. The Matching Program, like other CRA programs, strives at all times to provide quality service. In this regard, we will take measures to reinforce the review procedures mentioned above.

We would also like to confirm that the Matching program and other affected areas will be reviewing enhancements similar to those mentioned in your query with the objective of automating, in the future, the validation of self-employed income against information slips that report such income.

13. Half-Year Rule

We have historically had many situations where property acquired from a related party was properly treated as not subject to the half-year rule, and this was not accurately processed by CRA. Recently, a CRA representative contacted us to question a CCA discrepancy resulting from this situation. The Agency noted that such acquisitions should be reported as "Adjustments" (column 205 of Schedule 8) and not "Additions" (column 203).

If the above information is correct, would the Agency please communicate this to software developers? Most software data entry provides for assets not subject to the half year rule, and classifies these as additions. It would seem simple for them to have these additions flow to Adjustments instead. We discussed this with the Agency representative, who indicated the concern has been raised to Head Office in the past, but that they were uncertain whether it has been communicated to the software developers.

Finally, the CRA representative noted that, in the past, they received copies of the data entry information with many returns, which facilitated addressing this issue. However, with bar-coded returns (and the advent of mandatory electronic filing), such data is no longer received. Would the Agency consider more detailed instructions to software developers to ensure the data CRA requires to fully capture relevant information to assist the Agency's assessing process in bar codes and electronic filing.

Response:

Property transferred under section 85 or upon amalgamation/windup is not subject to the half-year rule. Both the *T2 Corporation – Income Tax Guide* and the T2 Schedule 8, *Capital Cost Allowance (CCA),* instruct the taxpayer to enter the capital cost of such property at Line 205, Column 4, Net Adjustments. The software that is certified by the CRA will not apply the half-year rule to this type of property if the schedule 8 has been completed accordingly.

With regard to your second question, all the data that was previously available on the "Keying Summary" is part of the 2D Barcode Return, as well as the transmittable ".COR" file for Corporation Internet Filing.

Additional Question

We still maintain that, in our experience, the tax preparation software does, in fact, incorrectly classify assets not subject to the half-year rule as additions and not adjustments. Would the Agency consider communicating this to the software developers?

Response

As indicated on our website, the Canada Revenue Agency certifies commercial tax preparation software packages for use with the Corporation Internet Filing service.

*Corporation Internet Filing has been designed to accept a specific file format ("**.cor**" extension), and the CRA-certified software will include instructions on how to save your income tax return in that format.*

"Certified" tax preparation software means that the developer of the tax package has gone through a process with the CRA to establish that the particular package is compatible with the CRA systems. This process does not include the testing of tax calculations nor does it mean that we endorse or recommend any one product over another.

Use of the software, and any omission or error in the information provided, are the responsibility of the user and the developer. Consequently, the CRA cannot be held responsible for programming errors that affect the calculation of income tax and contributions payable. If you encounter difficulties with the software, please contact the developer for technical assistance.

14. Eligible Dividends

At the Canadian Tax Foundation National Conference in 2009, the Agency's response to a roundtable question confirmed that a dividend paid to a non-resident of Canada could not be an eligible dividend, by

definition. The response to that question confirmed that such dividends would therefore not reduce the General Rate Income Pool of a CCPC making such a dividend payment. However, non-CCPCs and the Low Rate Income Pool (LRIP) were not discussed. We have the following questions:

(a) Where a non-CCPC declares and pays an eligible dividend, is it the Agency's interpretation that dividends paid to non-resident shareholders (which are not, by definition, eligible dividends) will reduce the LRIP of the non-CCPC for purposes of determining whether any portion of the eligible dividends paid to the Canadian resident shareholders constitute an Excessive Eligible Dividend Designation (EEDD)?

As a simplistic example, assume a non-CCPC, PubCo, has two shareholders, a Canadian resident (CanCo) owning 75% and a non-resident of Canada (ForCo) owning 25%. PubCo has an LRIP balance of $200,000. It declares a dividend of $1 million. Does PubCo's LRIP balance get reduced by the $250,000 non-eligible dividend paid to ForCo before the $750,000 eligible dividend is paid to CanCo (such that there is no EEDD), or does the $750,000 eligible dividend include a $200,000 EEDD (equal to LRIP prior to these dividends), attracting Part III.1 tax at the rate of 20%, imposing a $40,000 cost on PubCo?

(b) Assuming the Agency does not consider the non-eligible dividend to the foreign shareholder(s) to reduce LRIP prior to determining whether the eligible dividend to the Canadian shareholder(s) automatically, could the payer structure the timing of dividend payments to pay their foreign shareholders first, such that LRIP would be reduced before the eligible dividends were paid (assuming such a structure is effective legally)?

(c) Would the Agency consider application of GAAR if a non-CCPC were to restructure to issue separate share classes to its Canadian and foreign shareholders in order to control the timing of eligible and non-eligible dividends?

(d) On a broader note, would the Agency consider application of GAAR to any corporation which issues different classes of shares to different shareholders in order to direct eligible dividends to some shareholders and non-eligible dividends to others?

Response:

Eligible dividends received by individuals resident in Canada benefit from an enhanced dividend tax credit. Under subsection 89(14), a corporation can designate any dividend as an eligible dividend. Where the designation is an EEDD made in respect of an eligible dividend paid by the corporation in the taxation year, the corporation is subject to an additional tax under Part III.1.

EEDD, made in respect of an eligible dividend paid by a corporation at any time in a taxation year, is defined under subsection 89(1) to mean the amount determined by the formula: A x B/C where "A" is the lesser of (i) the total amount of all eligible dividends paid by the corporation at that time; and (ii) the corporation's low rate income pool; "B" is the amount of the eligible dividend; and "C" is the total amount of all eligible dividends paid by the corporation at that time.

In general, in the case of a non-CCPC, an EEDD will arise to the extent that the corporation has a LRIP at the time such dividend is *paid.*

LRIP is defined in subsection 89(1) to be the amount, at any particular time in a particular taxation year, of a corporation that is a non-CCPC that is determined by the formula in that subsection. Pursuant to variable "G" of the formula, LRIP is reduced, among other things, by the total of all amounts, each of which is a taxable dividend (other than, among other things, an eligible dividend) that became *payable* in the particular taxation year but before the particular time by the non-CCPC.

Where a non-CCPC pays a taxable dividend that is designated as an eligible dividend pursuant to subsection 89(14) and a portion of such dividend is received by persons resident and persons not resident in Canada, only the portion of the dividend that is received by persons resident in Canada is an eligible dividend. The

portion of the dividend that is received by persons not resident in Canada is a taxable dividend that is not an eligible dividend. Provided the dividend became payable, in a taxation year, before the dividend was paid, that portion of the dividend paid and received by the non-residents will be an amount described in variable "G" of the formula and will be deducted in computing the non-CCPC's LRIP at any time in the taxation year after the dividend becomes payable.

It is a question of law when a dividend becomes payable. Depending on the circumstances, the possible application of paragraph © of the definition of EEDD in subsection 89(1) or the general anti-avoidance rule under subsection 245(2) to any of the foregoing would also have to be reviewed if transactions are undertaken to artificially manipulate a corporation's LRIP.

The foregoing is illustrated in the following numerical example. Assume that in a particular taxation year, a non-CCPC declares a dividend of $1 million to be paid on a single class of shares. 75% of such shares are held by persons resident in Canada. The remaining 25% of such shares are held by non-residents of Canada. The non-CCPC had a LRIP of $200,000 immediately before the dividend is declared. The non-CCPC makes a designation under subsection 89(14) with respect to the full amount of the dividend. The dividend is paid by the non-CCPC in the taxation year. The $750,000 portion of the dividend received by persons resident in Canada is an eligible dividend. The $250,000 portion of the dividend received by the non-residents of Canada is a taxable dividend that is not an eligible dividend. Provided the dividend became payable, in the taxation year, before it was paid, the $250,000 is included in variable "G" of the formula and will be deducted in computing the non-CCPC's LRIP at any time in the taxation year after the dividend became payable. The determination of whether an EEDD has been made with respect to the $750,000 eligible dividend paid by the corporation in the taxation year will be made at the time the dividend is paid based on the non-CCPC's LRIP at that time. Assuming that no other amounts are added to the non-CCPC's LRIP in the taxation year prior to the time that the dividend is paid, no EEDD will be made by the corporation in respect of the eligible dividend paid by the non-CCPC.

15. Late-Filed Elections

Subsection 220(3.201) provides CRA with the opportunity to accept late-filed and amended Form T1032 pension splitting elections for three years, without penalty (s.220(3.5)). Does CRA have an official position or has it prepared guidelines with respect to this?

Response:

The Department of Finance has stated that new subsection 220(3.201) of the Act provides that the Minister of National Revenue may—where the Minister considers it just and equitable—extend the time for making, revoking or amending a joint election to split pension income under section 60.03 provided the request is made by a taxpayer resident in Canada and is made within three calendar years of the filing due date for the year in which the election applies.

Pension income splitting questions are dealt with by the TSO. Any request to the Minister to permit a late, amended or revoked election must be made in writing and jointly by the taxpayer and the taxpayer's spouse or common-law partner. If the taxpayer wants to amend the amount elected previously, a new fully completed and signed Form T1032 would be required. If the taxpayer wants to revoke the election to split pension income, the taxpayer has to send a letter requesting to revoke the election and the letter must be signed by both parties.

16. Elections Required Where Returns are E-filed

Is it possible to obtain a list of elections which must be filed with CRA on a personal tax return even though the return is EFILED? For example, we understand that the pension splitting election on Form T1032 and the

principal residence exemption election do not have to be sent in; however, the business investment loss election, subsection 50(1), does. Similarly, is the election that is required under Regulation 1101(5b.1) (eligible non-residential building) required to be sent in by letter if the return is electronically filed?

On a technical point, the ITA requires the taxpayer to elect "in the taxpayer's return of income for the year" when seeking to have particular provisions apply (see, for example, s.50(1)). For income tax returns that are E-filed, how are such elections validly made?

Response:

For ease of discussion in this part, all elections, designations, agreements, waivers, and special elective returns are referred to as "elections." The ITA provides for these various elections to be made. Some are made on authorized Canada Revenue Agency forms while others are made by providing specific information in a letter/note format.

CRA does not have a listing available for elections that must be filed with the personal income tax return. Each specific form or guide will normally advise if the form must be submitted with the return or if it can be filed separately. However, for electronic filing, if the ITA makes reference to "elect in the taxpayer's return of income for the year", the election must be submitted in writing.

Example: There is no prescribed form for the 50(1) election. For a paper return, to make this election, attach a letter signed by the taxpayer that states they want subsection 50(1) of the Income Tax Act to apply. For electronic filing, the same letter that would normally be attached to a paper return must be forwarded to CRA to indicate a subsection 50(1) election has been made.

Example: To prescribe a separate class for each eligible non-residential building, under Regulation 1101(5b.1), the election should be made in writing and forwarded to CRA.

When electronically filing, depending on the forms the software guides you to complete when making an election, an elections indicator would be present. When an elections indicator appears, a field code is updated (7 is entered at Field 9906). Completion of this field code does not constitute an election; it is designed only to inform us that an election form or a letter/note containing the required information is being submitted in paper format. The indicator would not identify what election is being made.

17. Tax Shelters

Does CRA have a formal position with respect to the election under s.237.1(6) to disclose participation in tax shelters by filing CRA Form T5004? Can this be late filed, is it subject to penalties, does it have to be sent in if a return is E-filed, etc.?

Response:

A promoter applies for a tax shelter identification number on form T5001. If the application is complete we issue the number.

The promoter is required to report sales of the tax shelter by end of February of the following year (237.1(7)). The reporting form is T5003 and prescribed information includes copies of slips sent to investors (T5003 slips). This is how the participants are identified although, as explained below, they also identify themselves filing the tax shelter forms.

Investors claiming a tax shelter benefit "must" file a T5004 and related T5003 slips; the T5004 is just a summary of the T5003s issued to him or her. This is not an option or election for the investors to disclose their participation. If the forms are not there the benefit can be denied.

Field 6765 from the T5004 can be transmitted electronically via EFILE/NETFILE. There is no need to send a paper copy of the form.

18. Acquisition of Control and Amalgamation

It is possible for control of a corporation to be acquired and for an amalgamation of the acquired corporation with one or more corporations to occur on the same day. Both the acquisition of control and the amalgamation results in a year end being triggered and a new taxation year commencing. If no s.256(9) election is filed and the applicable amalgamation agreement and related documents are silent as to the effective time of the amalgamation, would both the deemed year end resulting from the acquisition of control and the deemed year end resulting from the amalgamation occur at the same time, being the commencement of the day on which these transactions occur?

Response:

There would be one year end, but it would be at the end of the day, on the day before the acquisition of control and amalgamation took place. According to paragraph 11 of IT 474R2, the CRA will accept that the target will have only one deemed year end as a result of the acquisition of control of target and its subsequent amalgamation, provided that the acquisition of control and the amalgamation occur on the same date, no election under subsection 256(9) is made in respect of the acquisition of control, and no time is specified in the certificate of amalgamation. This position is based on the fact that the taxation year ends of target which are deemed to occur under both subsection 249(4) and paragraph 87(2)(a) will occur at the same time.

19. Self Review Letter Initiative

A number of our clients have received a “Self Review Letter” from the Agency, which we understand stems from a CRA program called “Self Review Letter Initiative” (“SRLI”). These letters appear directed at individuals who have reported self-employment or rental income on their T1 personal income tax returns. Our members have indicated awareness of such letters in BC, Alberta and Manitoba, and we assume this is either a regional or a national project. We would request you provide us with details of this program, including the following:

(a) What is the rationale in sending these letters? Are there specific provisions in the Income Tax Act which they are intended to address and, if so, what are they?

Response

The CRA has undertaken this letter writing campaign as part of its commitment to address areas of possible non-compliance. Each year, the CRA conducts a number of review activities aimed at promoting compliance with the laws we administer in order to sustain and enhance the integrity of the Canadian tax system, which would in turn increase Canadians’ confidence in the fairness of the system. This campaign includes two types of letters; one which will provide information about eligibility criteria for certain deductions that taxpayers may have claimed in their most recent income tax and benefit returns, and the other that will provide, in addition to the same information, a statement advising them of the possibility of audit actions by the CRA of their industry.

The campaign was not meant to address a particular provision of the *Income Tax Act*. However, every year, the CRA performs reviews on taxpayer segments that have been identified as being a potential high risk for non-compliance. The CRA uses that information to focus its resources on areas of higher risk. Each region could have different sectors that could be a potential high risk

for non-compliance, and, therefore, each has identified specific areas for the issuance of these letters.

(b) Is it the Agency's intention to embark on similar initiatives targeting other types of income or deductions? If so, please advise us which areas we may expect to see addressed in future letters.

Response

The CRA is committed to having another letter writing campaign in January/February 2011 similar to that in 2010. Until there is further analysis of the possible impact of both campaigns, there are no other commitments to continue with a campaign of this nature. However, the CRA continues to be committed to inform taxpayers of their obligations and provide them with the necessary tools in the most effective manner possible.

(c) Which Tax Services Offices are, or will be, involved in the SRLI program, or equivalents, in 2010?

Response

In regards to the sending of letters, the Office Audit Section of all the Tax Services Offices from across the country took part in this campaign except for the Quebec Region. In that region it was decided that both Tax Centres would send the letters. Any audit work that results from the letter writing campaign will be done in the Tax Services Office that serves the area where the taxpayer's file is located.

(d) Will these SRLI letters be considered to be an "enforcement action" for the purposes of the Voluntary Disclosure program?

Response

The purpose of the letters is to educate taxpayers of their obligations and provide them with useful information to correct past filings or to help them with future filings. It is not meant to be considered an enforcement action for the purposes of the Voluntary Disclosures Program (VDP). Having said this, eligibility for the VDP is determined on a case-by-case basis and will be reviewed on the merits of each case.

(e) Will the Agency consider receipt of such a letter as the basis for assessing subsection 163(2) penalties should they find any errors or omissions on future audit on the basis that the individual was "warned" about such claims?

Response

The purpose of the letters is to educate taxpayers of their obligations and provide them with useful information to correct past filings or to help them with future filings. As the application of penalties (or the possibility thereof) is determined on a case-by-case basis, any such application will be reviewed on the merits of each case.

Additional Question

What specific deductions were targeted in the Alberta offices?

Response

Each Region picked its own topics based on the risk assessed. The “education” letters focused on rental losses while the” intent to audit” letters concentrated on automobile and business use of home deductions.

20. Capital Dividend Account (CDA) Confirmations

At the 2008 ICAA/CRA Roundtable (question 37), CRA indicated that the Prairie Region Correspondence Centre in Regina was providing written confirmation of a corporation’s CDA on written request. The request was to include a calculation of the CDA balance or an explanation for its absence. We were recently advised that, once CRA has performed a review of a corporation’s CDA or if the corporation has filed a previous CDA election, they refuse to do a review in advance of a future capital dividend being declared.

(a) Is it the CRA’s policy to restrict each corporation to a single CDA confirmation over its history, and to refuse such confirmations to corporations which have previously elected to pay capital dividends?

(b) If so, can the CRA advise why this policy was adopted?

(c) Would the CRA consider revising this policy to provide confirmations on some other basis, such as after some specific period of time, or where there is a valid reason provided for the corporation’s concern its records may not match those of the Agency?

We realize that such confirmations are a courtesy, not a legislative requirement, and consumes Agency resources. However, where the CDA balance is not certain, practitioners have limited alternatives if such confirmations are refused. Some practitioners file elections for a nominal amount in order to verify the CDA balance, then file a second, larger, election. Alternatively, they risk an overpayment which will be elected to be a taxable dividend. These alternatives impose additional costs on the Agency (in addition to still reviewing the CDA balance) and imposes costs and delays on the taxpayer. A system for such confirmations would seem to benefit both taxpayers (and their advisors) and the Agency. At a previous Round Table, the possibility of providing information relevant to CDA computations through My Business Account and Represent a Client was discussed, and the CRA seemed open to this approach at the time. Has there been any progress towards this objective?

Response

This policy has been adopted by the local offices within the Prairie Region as a continuation of the Calgary TSO policy when they were responsible for this particular workload.

Our policy since the inception of the Prairie Region Correspondence Centre has been to provide a one-time-only confirmation. When there is a calculation done, either the one-time calculation or when an election is made, a copy is filed in the taxpayer’s Permanent Document file in the applicable Tax Centre. A copy can be obtained at any time by calling the Business Window. There are no plans at this time to revise this policy. It is the Agency’s position that, in light of our self-assessment tax system and the provisions of Subsection 230(1), the onus is on the taxpayer to maintain books and records in such form as will allow taxes payable to be determined. This would include monitoring the balance in a taxpayer’s Capital Dividend Account. However, there are always exceptions. In extenuating circumstances, such as those beyond the taxpayers/representative’s control (fire, flood, etc.), or in the case where the corporation has retained a new representative and the continuity of record-keeping has been lost, we will provide the CDA confirmation a second time.

Where a corporation requests a CDA balance confirmation, a letter is sent stating the following, “We have, as a courtesy, provided a confirmation of the calculation. In the future, it is incumbent on the corporation to maintain this information.” If this letter has been issued previously, we will not provide another balance confirmation. Instead, the officer will send out a “Second CDA Request Denial” letter which will have a copy of the original CDA confirmation and date of the letter enclosed. This letter also refers to the phrase above.

21. Trust Issues

We have a number of questions regarding Trusts, as follows:

(a) The CRA has recently taken the position that an amount of income is not payable to a beneficiary of a discretionary trust unless a promissory note is issued by the Trust to the beneficiaries. We understand that, on this basis, the Agency has proposed to deny the deduction by the Trust of such income on the basis it was not payable to the beneficiary.

It seems to us that many amounts are "payable" in the ordinary sense of that word without the issuance of a promissory note. Legally, a promissory note is evidence of debt, but does not itself establish a debt. Could the Agency please provide their legal support for the assertion that the issuance of a promissory note by the Trust is required in order for an amount to be payable to a beneficiary? Alternatively, could the Agency please comment on what other documentation could also support income being payable to a beneficiary (for example, a trustee resolution; appropriate accounting records)? Would the Agency's position differ where the Trust Deed provides a mechanism by which income is made irrevocably payable to a beneficiary (for example, that this may be evidenced by the Trustees signing a minute or resolution recording the Trustees' decision)?

Response:

Each case must be based on the facts at hand, which must provide proof that "***the person to whom it is payable is entitled in the year to enforce payment***". The policy which outlines how the CRA determines if an amount is payable would be the following paragraph taken from IT-342R: *Meaning Of "Amount Payable"*

> Pursuant to subsection 104(24), an amount is not considered to be payable in a taxation year unless it is paid in the year to the person to whom it is payable or the person to whom it is payable is entitled in the year to enforce payment thereof. However, subsection 104(18) provides that where a right to the income of a trust has vested in a minor, income of the trust which has not become payable in the year to such beneficiary, solely because the beneficiary was a minor, shall be deemed to have become payable in the year. It should be noted that foreign accrual property income of a non-resident trust is included in the income of a beneficiary pursuant to paragraph 104(13)(c) to the extent that the amount may reasonably be considered to have become payable to a beneficiary within the meaning of subsection 104(24). That amount is deductible by the non-resident trust by virtue of subsections 94(3) and (4).

(b) We understand that there is a CRA initiative, the Regional Domestic Trust Project, to carry out audits on Intervivos Trusts. This project was mentioned in a Kitchener Waterloo CRA Seminar on November 25, 2009, as being undertaken by several Ontario Tax Services Offices. Attendees at this seminar indicated that issues expected to be reviewed included:

(i) promissory notes which were unenforceable under Ontario creditor law (not relevant in Alberta), or practically because the cash has been distributed to the Trust by other parties (eg. the parents of young beneficiaries)

(ii) inability to locate the Trust settlement property (eg. the silver coin)

(iii) failure to maintain accounting and trust records (eg. Trustee minutes).

Can the Agency please provide details regarding this initiative, including whether similar projects are planned for other regions (i.e. Alberta) and the significant issues and concerns CRA intends to review?

Response

The 2009-2010 Regional Domestic Trust Project follows a national project conducted from fiscal years 2005 -2008 in response to a recommendation made by the Auditor General in its November 5, 2005 report. The objectives of the project are to make a more efficient and effective use of compliance resources to raise awareness on the importance of proper document preparation; to let the tax professionals know that the CRA carefully reviews domestic trusts for compliance to Canada's tax legislation and continually examines ways in which the CRA can better organize audit teams to efficiently conduct these types of specialized audits.

Currently, this project is underway in Alberta for fiscal 2010-2011 and includes the audit of both inter-vivos and testamentary trusts. Issues that are expected to be reviewed include losses reported on the sale of real property, business and rental losses reported by the trusts as well as the allocation of amounts to beneficiaries.

(c) In a prior Federal Auditor General Report, a recommendation was made to have financial statements be submitted with a trust's T3 return. This would be problematic for many Trusts, as few Trusts prepare financial statements. Is the CRA considering this proposal? Would such a requirement be for true financial statements, or for a GIFI-type form?

Response

The CRA is still in the process of considering options to ensure proper reporting of income and analysing the impact of requiring trusts to include a statement of assets and liabilities with the T3 *Trust Income Tax and Information Return*. We continue to meet with internal stakeholders to assess the usefulness of a statement of assets and liabilities, the extent of the burden that this requirement would have on taxpayers and the CRA, and the value of imposing different requirements for different types of trusts. The analysis and consultations are ongoing.

22. Outstanding Legislative Amendments

A recent Federal Auditor General Report was very critical of the significant delay in how Federal income tax legislation is introduced into law. There appear to be many cases where draft legislation will, if enacted as written, apply to taxation years which are already statute barred. Can the Agency comment generally on how it intends to deal with such amendments, once passed? Specifically:

(a) Where a taxpayer has filed on the basis of the law as enacted at the time of filing, does the Agency consider it possible to reassess for changes subsequently enacted where the return is past the normal reassessment period?

(b) Where a taxpayer has filed on the basis of the law as proposed at the time of filing, however that legislation is ultimately not passed, or passed in a different form, does the Agency consider it possible to reassess where the return is past the normal reassessment period?

(c) Would the Agency's position in (a) or (b), above, differ depending on whether the legislation was passed prior to the end of the normal reassessment period?

(d) Would the Agency consider reassessing a return under the circumstances described in (a) or (b), above, on the taxpayer's request to do so?

(e) To what extent does the Agency intend to review transactions which have been reported in a manner other than that reflected in the legislation as ultimately passed (either for statute barred or open taxation years)?

(f) Would the Agency agree that taxpayers who file in accordance with the law as enacted, or in accordance with proposed changes the Agency has requested be complied with, would not be subject to penalty for such filings?

Response:

Tax legislation is often enacted retroactively, with numerous provisions applicable from the date they are announced by the Minister of Finance. It is the CRA's longstanding practice to ask taxpayers to file on the basis of proposed legislation. This practice eases both the compliance burden on taxpayers and the administrative burden on the CRA. However, where proposed legislation would result in an increase in benefits (e.g., a proposal to increase Canada child tax benefits) or a significant amount of rebate or refund to a taxpayer, generally, the CRA's past practice has been to wait until the measure has been enacted.

An amendment to the *Income Tax Act (ITA)* that is in a taxpayer's favour is generally treated as though it were law, effective on the coming-into-force date provided in the announcement. CRA auditors who encounter situations where taxpayers filed income tax returns based on proposed legislation, should not reassess taxpayers to deny a benefit solely because the proposed legislation has not been enacted. On the other hand, if the proposed legislation is not beneficial to taxpayers, the CRA cannot require the taxpayer to file on the basis of proposed legislation. However, taxpayers should be aware that they are responsible for applying the legislation in accordance with the enacted legislation after Royal Assent and that they may be subject to interest. It should further be noted that, as with other administrative policies, it is subject to exceptions.

If a taxpayer files an income tax return based on existing legislation and subsequently requests an adjustment to the return to reduce tax payable based on proposed legislation to amend the ITA, the CRA will not allow the request. In accordance with IC75-7R3 – *Reassessment of a Return of Income,* it is not CRA policy to reassess if a previous assessment or reassessment is correct in law. In such instances, taxpayers should be advised to file a T2029, *Waiver in Respect of the Normal Reassessment Period*, to protect their interests by permitting the CRA to issue a reassessment beyond the normal reassessment period.

The CRA has the authority to examine the tax returns of all taxpayers to ensure that they are correct and agree with existing or proposed legislation. The application of penalties in such situations will be dealt with on a case-by-case basis by examining the surrounding facts and circumstances.

23. Issuance of T3 and T5013 Slips

Our members continue to have significant issues regarding tax compliance for investors in partnerships or mutual fund trusts. The introduction of Regulation 204.1, intended to deal with this concern, has had limited practical effect, especially for personal intervivos trusts or partnerships who own investments in private partnerships and/or trusts. Assuming that the Agency agrees this is a significant problem, is the Agency working with the Department of Finance to propose a resolution so that practitioners and their clients can finally have an end to this long standing issue? If the CRA is not currently in discussions with the Department of Finance on this matter, will they consider doing so?

Response:

The Society of Trust and Estate Practitioners (STEP) has also posed the same question for the CRA to respond to in their June 2010 annual conference. The Rulings Directorate had provided the following

comment: "*The question is directed re investments in private trusts/partnerships where regulation 204.1 does not apply. A similar question was posed at the 2007 Conference and we do not have anything further to add.*" As such, the STEP has agreed to drop the question in the 2010 conference.

The following is the question and response provided in the 2007 STEP conference:

> ***Question No. 5: Compliance Problems in Trust Reporting***
> *It is becoming increasingly common for trusts to have investments in other trusts. These investments may be income trusts, or mutual funds that are structured as trusts. In such circumstances, the filing due date for the trust is coincident with the date on which T3 information slips are to be furnished. Thus, as a practical matter, it is difficult to complete a tax return for the trust by the due date. This difficulty was acknowledged in the March 19, 2007 federal budget. Until this matter is resolved in some way, possibly by legislative amendment, what would you advise practitioners to do in these circumstances? It is noted that while it is possible to file an amended T-3 return, it is not possible to retroactively make income payable to a beneficiary.*
>
> ***CRA Response:***
>
> *The CRA has long recognized this difficulty. The difficulty arises because the T3 is both an income tax return and an information return with the result that a trust issuing a T3 slip and a trust receiving a T3 slip have the same filing deadline. Section 132.11, the provision in the Income Tax Act that allows a mutual fund trust to elect to have a taxation year of December 15th rather than December 31st, was intended to alleviate, in part, the problem created by concurrent filing deadlines. As noted in the question, the 2007 federal budget stated that the government is working with the investment funds industry to develop a process that will balance the trustees' need to have sufficient time to compute the trust's income for the year and the beneficiaries' need for timely information concerning the income that was made payable to them in the year. The government expects to release the new draft regulations in time for the 2007 taxation year filing deadlines.*
>
> *Obviously, nothing prevents a trust, including a mutual fund trust, from filing its T3 Trust Income Tax and Information Return early to ensure that all of its beneficiaries will have the T3 information slips in time to file their respective income tax returns. Even so, a trustee of a trust that is itself the beneficiary of another trust is often faced with the difficulty of completing the trust's tax return without having received the T3 information slips from the trusts in which it holds an interest. As outlined in the T3 Guide and consistent with the other guides for filing income tax returns, where the preparer of a trust return does not have all of the information slips needed to complete the return when it is due, the income should be estimated. If the estimate differs from the actual amounts shown on the information slips, the information slips, including any revised information slips that are being issued by the trust, should be sent to the Ottawa Technology Centre accompanied by a letter requesting an adjustment to the trust's tax return.*
>
> *The comment made with respect to the inability to retroactively make income payable is a good point. A trust is only entitled to a deduction under subsection 104(6) of the ITA for amounts of income that became paid or payable to the beneficiaries in the year in which the income was earned, and is not entitled to a deduction for amounts that only became payable after the end of the year. For a detailed discussion on the meaning of "paid or payable" for the purposes of subsections 104(6) and 104(13) of the ITA, we refer you to CRA document 2005-015908. Generally, an amount will be considered to have become payable in a taxation year to a beneficiary for purposes of these provisions if, in the circumstances, the amount was paid in the taxation year to the beneficiary or the beneficiary was entitled to enforce payment of the amount in the taxation year. In determining whether an amount was payable to the beneficiaries before the end of the taxation year in which the income was earned, we would look to the terms of the trust and any resolutions of the trustees in respect of the exercise of any discretion they might have in respect of the distribution of the trust's income.*

24. Qualifications for Tax Preparers

The United States restricts the persons who can appear before the US Internal Revenue Service ("IRS"), very generally to CPAs, lawyers and "Enrolled Agents". We understand current proposals/discussions would restrict preparation and filing of US income tax returns to qualified preparers, with minimum education standards. Would the Agency see any benefit to having similar standards, particularly minimum education requirements and/or ongoing education to keep current, in order to file tax returns?

Response:

The CRA is continuing to look at various aspects of how they interact with tax intermediaries but a measure such as referred to in the question is not contemplated at this time.

25. Inter Vivos Farm Transfers

What is the current interpretation of "immediate" in Subsection 73(3), as it relates to intergenerational rollover of farm property? At one time, we understand that the rollover was available if the property had been farmed within the family linage. We understand this interpretation was revised to consider whether the property had been farmed for a substantial amount of time, with "substantial" being considered greater than 50% of the ownership period. On February 27, 2008 Gerald Lanconde, Director of Tax Legislation Division Tax Policy, issued a comfort letter indicating "immediate" may be an overly restrictive term, and consideration was being given to its removal; however, no such legislative proposal has been released to date. We note that subsection 70(9), which applies to testamentary transfers on a similar basis, lacks the word "immediately". How is the CRA assessing eligibility for the intergenerational rollover of farm property given the above? Does the CRA perceive a difference between the criteria required for an intervivos rollover, and the criteria required for a rollover on death of the taxpayer?

Response:

As a result of amendments generally applicable to dispositions after May 1, 2006, subsection 73(3.1) provides for an *inter vivos* transfer on a tax-deferred basis (rollover) of certain Canadian farm or fishing property from a taxpayer to a child of the taxpayer where the requirements of subsection 73(3) are met. Paragraph 73(3)(a) currently requires that the property was, *immediately before the transfer,* land in Canada or depreciable property in Canada of a prescribed class, of the taxpayer, or any eligible capital property in respect of a fishing or farming business carried on in Canada by the taxpayer. For dispositions of farm property before May 2, 2006, the rollover to a child and the requirements to be met were in the pre-amendment subsection 73(3). In particular, the requirements to be met for the rollover were set out in the preamble of pre-amendment subsection 73(3), which did not contain the phrase "*immediately before the transfer*". In a comfort letter dated February 27, 2008, the Tax Policy Branch of the Department of Finance agreed that the current subsection 73(3) may be overly restrictive with regards to the circumstances under which parents are permitted to transfer assets to their children on a tax deferred basis. Accordingly, the Tax Policy Branch advised that it would be prepared to recommend to the Minister of Finance that an amendment, with retroactive application, be made to paragraph 73(3)(a) to remove the word "*immediately*".

At the 2009 Annual Canadian Tax Foundation Conference, the CRA confirmed at its Roundtable Discussion its position regarding filings based on proposed changes to law. While it is the CRA's longstanding practice to ask taxpayers to file on the basis of proposed legislation, a comfort letter is not considered proposed legislation and usually only reflects Finance's views on a particular issue affecting a specific taxpayer. Under the self-assessment system of filing tax returns, taxpayers may decide to file based on a comfort letter. Generally the CRA will not reassess taxpayers who have filed on the basis of and in conformity with a comfort letter.

GST/HST Questions

Question #1:

With respect to the implementation of HST in BC and Ontario, there is some confusion regarding the whole issue surrounding restricted Input Tax Credits (ITCs) with respect to energy consumption for manufacturers. The administrative material seems to indicate that a manufacturer (Manufacturer A) that is manufacturing goods under contract for another manufacturer (Manufacturer B) will be restricted.

1. Does this mean that Manufacturer B (ie., the person who is having the goods manufactured for them) is not restricted from claiming ITCs on the energy it acquires?
2. If Manufacturer A (the physical manufacturer) was to charge Manufacturer B for the energy it consumed is:
    a. Manufacturer A required to restrict its ITC?
    b. Manufacturer B required to restrict its ITC?

Response:

Based on the British Columbia Ministry of Finance Tax Information Notice #4, *Temporary RITC Recapture of Input Tax Credits* dated May 14, 2010 and Ontario Ministry of Revenue Information Notice No. 5, *Temporary Recapture of Input Tax Credits Requirement* dated May 14, 2010, our response is as follows:

In general, the requirement to recapture input tax credits (RITCs) will not apply to specified energy used by a large business directly in the production of tangible personal property for sale, or production equipment or conditioning materials used by a large business in the production of tangible personal property for sale.

The requirement to recapture input tax credits (RITCs) will, however, generally apply to specified energy that is used by a large business to facilitate the production of tangible personal property (i.e, not used directly in the production process), including specified energy that is used to light, heat, air condition or ventilate a production facility.

I. Manufacturer A is manufacturing goods and supplying the manufactured goods by sale to Manufacturer B

Manufacturer A and Manufacturer B, if not large businesses, would not be subject to RITCs.

Manufacturer A, if a large business as defined in the notices, and producing and selling goods to Manufacturer B, would not be subject to the RITC requirements on the energy it acquired for use in the production process.

Manufacturer B, if a large business as defined in the notices, and acquiring the manufactured goods from Manufacturer A, and using these goods as inputs into its production with the goods produced intended for sale, would also not be subject to RITCs on the energy acquired for use in the production of the goods.

It is a question of fact what Manufacturer A is supplying to Manufacturer B. The electricity acquired by A if anything would have been an input into the production of goods sold by Manufacturer A to Manufacturer B, and is not being resupplied per se by Manufacturer A to Manufacturer B.

II. Manufacturer A is providing a service of assembling components for Manufacturer B

If Manufacturer A is a large business, and is providing Manufacturer B under a contract a service of assembling components into goods that are different from the components by their nature or characteristics, this activity meets the definition of production as defined in the Notices. The RITC requirement for energy would generally not apply for Manufacturer A. Manufacturer B, as a large business, if acquiring the assembled goods from Manufacturer A without further production, for resale would be subject to RITCs on the energy it acquires.

Additional Question

Could you please clarify the concept of "producing products for sale".

Response

There are 2 definitions contained within the New Harmonized Value-added Tax System Regulations No. 2 that clarify what is meant by " producing products for sale":

"Production" means an activity (other than the assembling, processing or manufacturing of tangible personal property in a retail establishment or the storage of finished products) that is

(a) the assembling, processing or manufacturing of particular tangible personal property to create other tangible personal property that is different in nature or character from the particular tangible personal property;

(b) the generation of any form of energy or its transformation into another form of energy;

(c) the restoring of tangible personal property by its owner;

(d) the recording of images or sound on media;

(e) the cutting, transforming and handling of timber in a forest and the building and maintenance of forest access roads in the course of those activities;

(f) the extraction and processing of a mineral until the first stage of concentration or the equivalent;

(g) the transformation of toxic industrial waste into a non-toxic product; and

(h) if performed in conjunction with an activity referred to in any of paragraphs (a) to (g) by the same person that performed that activity,

> *(i) the detection, measurement, treatment, reduction or elimination of water, soil or air pollutants that are attributable to producing personal property,*
>
> *(ii) the transportation of refuse or waste derived from producing personal property,*
>
> *(iii) the quality control of personal property being produced or of production equipment, and*
>
> *(iv) the cleaning, screening, sifting, wrapping, packing or putting into containers of property.*

"Specified production energy" means the part of specified energy acquired in, or brought into, a specified province by a selected person for consumption or use by the selected person in the production of tangible personal property intended for sale or in the production of production equipment used to produce such tangible personal property, but does not include the part of the specified energy acquired in, or brought into, the specified province for consumption or use by the selected person in equipment for the air conditioning, lighting, heating or ventilating of the production premises or in other equipment if that consumption or use is not integral to that production.

Question #2:

Practitioners are experiencing difficulties with getting assistance with non-routine, complex GST registrations and other related administrative matters and are experiencing difficulties in getting acknowledgements from the CRA that it has received requests and other filings and where/to whom the documents have been assigned. For example:

- After three months of faxing documents into CRA, the response received from the 1-800 number is "…I am sure it will be processed in time and NO there are no human beings that you can speak to."
- A Notice of Objection that was faxed to the CRA on December 11, 2009 was not acknowledged until March 3, 2010.

1. Will CRA provide a contact person in each TSO to help practitioners with non-routine, complex GST registrations and other administrative matters?
2. Can CRA provide an over-all commitment to acknowledge receipt of our requests on a timely basis?

Response (Example 1)

CRA has provided a toll-free telephone number to call if accountants have sent correspondence to our Processing Centre in Regina/Saskatoon and they have not had a reply within around 30 days. The number is **1-866-218-4847** and is only for the Taxpayer Services area where we register, deregister or respond to complex GST correspondence (as well as other correspondence). It is not to be used for GST accounts that are in the Audit area to be audited.

Telephone agents are also instructed to write up a team leader referral when a taxpayer or rep calls in and says they have not received a reply within 30 days to correspondence sent to our processing centre.

We will not be sending acknowledgements of receipt of correspondence due to the large volumes that we process and based on the fact that the Regina and Saskatoon Correspondence centres generally process our correspondence well within our turn around times.

We do not have a TSO contact list for our correspondence area as we have the 1-866 number for accountants to call. A copy of the notice relating to correspondence procedures is attached.

In the near future, it is anticipated that the call-centres will have view only access to our inventory system which will allow them to provide more information on the status of correspondence sent to our processing centre. HQ is *anticipating* this will happen within the year.

Response (Example 2)

The second example involves a Notice of Objection, and these are not processed through the Prairie Regional Correspondence Centre, but rather through the WIC (Western Intake Centre). The WIC has a mandate to acknowledge receipt of incoming Notices of Objection correspondence within 30 days. The WIC is still in its infancy, and while the process is becoming more stream-lined and efficient, there are exceptions to normal processing times and procedures. These are addressed on a case by case basis.

When you have not heard from the WIC within the 30 day acknowledgement time frame, you may call 1-800-959-5513 to request confirmation of receipt of the Notice of Objection.

In certain cases, for example, where files are identified as coming from Large Case Audit, the acknowledgement letters are issued by the Appeals Division at the local TSO. Where this is the case, you may contact the local Chief, Team Leader or Appeals Officer to confirm receipt of the Notice of Objection.

Copy of Notice Relating to Correspondence Procedures

Attention Tax Professionals

For individuals and businesses resident in Alberta, Saskatchewan, Manitoba, and the Northwest Territories, the following written requests should be sent to our centralized Prairie Region Correspondence Intake Centre in Regina:

Individual

Address Changes
Deregistrations
Requests for Printouts to a BN
Correspondence
Individual Account Specific Enquiries
Income Tax Waivers
Old Age Security Waivers
Residency

Business

RC1 Business Number (BN) Registrations and
T2054 Election
Request to add a Program Account General
Elections
Change of Fiscal Year-end Requests
Destruction of Records Requests
Letters of Good Standing (comfort Certification of
letters)
Employer Enquiries
Business Contact Updates (telephone,
address, ownership)
Name Changes
Capital Dividend Account
Verification

All other requests for the Prairie Region continue to be processed at the appropriate local Tax Services Office or Tax Centre.

Although instructions included on the various forms and in the guides indicate to send the requests to the taxpayer's local TSO, to avoid processing delays, tax professionals are encouraged to advise taxpayers from the Prairie provinces/territory to submit requests directly by mail or by fax to:

Prairie Regional Correspondence Centre
P.O. Box 557
Regina, SK
S4P 3A3

Fax number: **1-306-757-1412**

Our aim is to meet a turnaround time of 30 days for responding to most types of correspondence and up to 5 business days for RC1 Business Registration requests.

If you feel there has been an undue delay in the processing of correspondence submitted, you may call us at: **1-866-218-4847**

In addition, our Website (www.cra-arc.gc.ca) offers 24 hours a day, seven days a week access to a wide range of CRA electronic products, including forms.

Question #3

We are still finding joint ventures where bare trusts are registered for the GST and are reporting the tax collected and claiming ITCs in respect of the commercial activities of the joint venture participants/beneficial owners of the real property. The reported Net Tax is correct but is simply reported by the wrong person (i.e.

should be reported by the participants or the operator of the JV under a section 273 election). Has the government figured out a way to deal with these situations without forcing the re-filing of all prior periods in the technically proper legal entities? There is literally no risk to the government and yet hundreds of hours are currently being spent in resolving these situations by the CRA and representatives alike.

Response

It is the CRA's position that in a bare trust situation, the beneficial owners are considered to be engaged in the commercial activities relating to the trust property. They would be required to account for the GST/HST to the extent of their share of the trust property, to file GST/HST returns, and generally to comply with the obligations placed on registrants under the Act.

In the case of a bare trust with several beneficial owners, it may be possible for them to elect one of the beneficial owners to be responsible for accounting for the GST in respect of the trust property under the joint venture election pursuant to section 273 of the Act.

We realize that there may have been some inconsistency between the Edmonton and Calgary offices in dealing with the issue of Bare Trusts where the wrong entity is reporting the net tax. We are currently discussing the issue in order to develop some consistency in the treatment between the two offices. Situations of this nature will be handled on a case-by-case basis.

Question #4:

GST/HST registrants that are required to recapture ITCs and certain builders will be required to file an electronic return using GST/HST NETFILE effective for the first reporting period that ends on or after July 1, 2010. Will registrants that currently file electronically through their financial institution be required to switch to GST/HST NETFILE or will they be able to continue to use net filing through their financial institution?

Response:

All registrants that are required to recapture ITCs for the provincial part of the HST on certain inputs must file their GST/HST returns using GST/HST NETFILE only.

These inputs are:

- energy, except where purchased by farms or used to produce goods for sale;
- telecommunication services other than Internet access or toll free numbers;
- road vehicles weighing less than 3,000 kilograms (and parts and services) and (in Ontario only) fuel to power those vehicles; and
- food, beverages and entertainment.

In addition, builders that are affected by transitional housing measures for Ontario or British Columbia would be required to file a GST/HST NETFILE return if they have to report any of the following information in their return:

- The number of grandparented housing units sold during the reporting period where the purchaser was not entitled to claim a GST/HST new housing rebate or new residential rental property rebate and the total of the sale prices of those units;
- The number of newly constructed or substantially renovated housing units sold by the builder during the reporting period that are subject to the HST where those units were previously purchased by the builder on a grandparented basis and the total of the purchase prices of those units;
- The total amount of the transitional tax adjustment that is required to be included in the builder's net tax calculation for the reporting period; and

- The amount of all RST or PST transitional new housing rebates claimed for the reporting period (including the transitional new housing rebates that were assigned to the builder).

Most of this information will be reported in separate information fields on a schedule to the GST/HST NETFILE return.

More information can be found on the CRA website at "*Mandatory electronic filing for most GST/HST registrants"*, located at:

http://www.cra-arc.gc.ca/tx/bsnss/tpcs/gst-tps/bspsbch/rtrns/rqrmnts/menu-eng.html

Also for your information and reference, the CRA has recently released a video on filing and paying your GST/HST return electronically. It can be viewed at http://www.cra-arc.gc.ca/gncy/hrmnztn/wbcsts/wtchwbcsts-eng.html?clp=wc20100326-06-eng.

In addition, information on GST/HST NETFILE is available at http://www.cra-arc.gc.ca/esrvc-srvce/tx/bsnss/gsthst-tpstch-ntfl/menu-eng.html.

If it is not mandatory for a registrant to use GST/HST NETFILE to file their return, there are a number of filing method options available, including filing your return through a financial institution or third party provider. Your financial institution or third party service provider may offer the service of creating and transmitting GST/HST returns and payment information on your behalf using GST/HST EDI filing and remitting. EDI is a computer-to-computer exchange of information available to eligible registrants across Canada, with the exception of Quebec, to file GST/HST returns and remit GST/HST payments electronically.

Additional Question

Will the two year restriction continue to apply on electronic filing as specified by the Minister in Chapter 7 of the GST/HST Memoranda Series?

Response

As announced by the Minister of National Revenue in a press release on January 4, 2010, all the existing restrictions on electronic filing will be removed. The proposed changes came into effect on July 01, 2010.

For further information on New Reporting Requirements for GST/HST Registrants, please refer to Notice 249, issued in January 2010.

Question #5:

CRA Guide P-184 had administrative guidelines with respect to claiming input tax redits using the simplified method on reimbursement of credit cards. It notes that for HST provinces the ratio is 12/112. Would this also apply to British Columbia, which has a 12% HST as opposed to the 13% in Ontario and the Maritimes?

Response

The CRA will be updating policy P-184, *Credit Card Expenses and the Registrant's Use of Factors for Claiming Input Tax Credits.* It is expected to be published by mid May. The revised policy will reflect the rates applicable to HST in Ontario and British Columbia and were determined using the same methodology used for the rates currently published in the policy.

***Additional Question**:*
What would be the factor used to determine the amount of the RITC attributable to specified property and services on allowances?

***Response**:*

GST/HST Technical Information Bulletin B-104, Harmonized Sales Tax-Temporary Recapture of Input Tax Credits in Ontario and British Columbia, issued in June 2010, addresses allowances and reimbursements.

Question #6:

On May 30, 2006, a non-resident, non-registrant corporation (NR2) enters into an agreement to supply TPP to a Canadian Company, B, on May 30, 2008 for $15M. As part of the contract, NR2 agrees to provide certain installation and testing and warranty services in Canada once the TPP is delivered. The contract calls for progress payments; however, the contract price does not specifically allocate amounts to the installation, testing and warranty services. When the TPP is delivered in May, 2008, NR2 will have more than 20 employees in Canada for unspecified amounts of time for a combined period of more than three years. NR2 is considered to have a PE for income tax purposes as of May 2008 (when the employees are in Canada for installation purposes).

1. Is the supply of TPP made under the contract deemed to be made outside of Canada and not subject to GST/HST because, at the time the agreement is entered into, NR2 was a non-resident that was not carrying on business in Canada? (Section 133 of the ETA provides that, where an agreement is entered into to provide a property or service, the entering into the agreement shall be deemed to be a supply of the property or service at the time the agreement is entered into.)
2. Is there a risk that some of the progress payments will be subject to GST/HST on the basis that NR2, as of May 2008, is carrying on business in Canada and that each progress payment thereafter will be treated as taxable supply?

Response:

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

Part 1

The characterization of a particular supply and the determination of whether a person is carrying on business in Canada is a question of fact to be determined based on all the relevant facts of the scenario. We are unable to provide a definite conclusion regarding the characterization of the supply, whether the non-resident person is carrying on business in Canada or whether the particular supply or supplies are made in Canada in this scenario based on the limited facts provided.

If it is determined based on all the relevant facts that the supply at issue is a supply of installed tangible personal property whereby the installation of the TPP is merely ancillary, as in example 11 in GST/HST Policy Statement P-051R2 – *Carrying on business in Canada*, NR2 would not be considered to be carrying on business in Canada for GST/HST purposes pursuant to either entering into the agreement for the supply and installation of the TPP or for fulfilling their obligations pursuant to the agreement. In this circumstance, the supply of the TPP by NR2 would be deemed to be made outside Canada pursuant to subsection 143(1).

If it is determined based on the facts that there are multiple supplies made pursuant to the agreement with one being a supply of a service or that the entire supply is a single supply that is characterized as a supply of a service, NR2 would likely be carrying on business in Canada and required to be registered for GST/HST purposes. Where this is the case, and based on the fact that NR2 will have more than 20 employees in Canada for a combined period of time of more than 3 years, NR2 would be considered to be carrying on business in Canada for GST/HST purposes effective the day on which they entered into the agreement.

Assuming NR2 is not a small supplier when the supply is made (May 30, 2006), NR2 would be required to register under subsection 240(1) and would be considered to be a registrant at that time. NR2 would be required to collect GST/HST at the appropriate rate on all consideration for taxable supplies that it makes in Canada from that time forward.

Part 2

See the response to 1.

Question #7:

We have been hearing for a number of months that the Voluntary Disclosure Program is being revamped. What is the timeline of announcing the changes, and what do the changes entail?

Response:

Regionalization of the Prairie Region Voluntary Disclosures Program Pilot Project

The Canada Revenue Agency is always evaluating methods to improve the effectiveness and efficiency of this program to meet the needs of Canadians and the Agency. It is anticipated that Voluntary Disclosures Program (VDP) requests will increase as the Agency continues to promote this program.

In the Prairie Region, the Voluntary Disclosures Program was delivered by the Enforcement Divisions within the five Tax Services Offices, with each office responsible for the processing of these files. The Prairie Region is currently undertaking a pilot project to regionalize the program under the management of the Enforcement Division of the Edmonton Tax Services Office. The pilot project is not expected to go beyond March 31, 2011, at which time the results of the pilot project will be evaluated.

The intent of our model is to:

- Improve processing times to enhance service and help lower inventory levels;
- Improve consistency in the treatment of voluntary disclosures;
- Share best practices in an integrated unit with consistent supervisory expertise; and
- Realize economies through specialization, automation and technology.

The pilot project model entails one Team Leader in Edmonton, with VDP officers in Edmonton, Calgary, Regina and the Winnipeg Taxation Centre. Workload from the Saskatoon and Winnipeg TSOs will be assigned to the other three offices. The Tax Centre will perform as an intake centre and process lower risk disclosure files. The remaining files will be forwarded to the Edmonton TSO for assignment.

For the duration of this pilot, VDP requests must continue to be sent to the respective TSO where the taxpayer or representative is located, VDP requests should not be sent to the Taxation Centre directly. This will ensure the timely delivery of VDP requests for processing by the Taxation Centre. Telephone inquiries should be directed to the VDP line at 1-877-741-0095.

The Agency's Voluntary Disclosures Program policies, procedures and guidelines are not changing as a result of this pilot project. The pilot project will assess a structure to enhance the efficient processing and review of voluntary disclosures received by the Agency.

Changes to the GST/HST WASH Transaction Policy

A change to the GST/HST WASH Transaction Policy was effected to allow for additional interest relief when these transactions are disclosed by GST/HST registrants through the Voluntary Disclosures Program (VDP).

This change applies to any reporting period where net tax is due after March 31, 2007.

GST/HST WASH Transactions – Net Tax Due prior to April 2007

For periods prior to April 2007, the late remitting penalty (LRP) was 6% where a disclosure of a GST/HST wash transaction was made.

The GST/HST WASH Transaction Policy reduces the interest to zero and the LRP to 4% of the transaction amount. With a valid disclosure, the 4% penalty will be waived.

The registrant will pay only the net tax up to the date of the (re)assessment. The normal interest rules will apply to any unpaid amounts after the date of the assessment.

GST/HST WASH Transactions – Net Tax Due after March 2007

Effective April 1, 2007 the 6% penalty does not apply to amounts owing after March 31, 2007. Instead, a new interest rate applies, which is the Basic Rate plus 4%. Therefore there is no penalty per se. Technically this would not qualify as a valid disclosure as the penalty condition under the VDP criteria would not be met; however, the Agency has decided to administratively consider these types of disclosures under the VDP.

If the wash transaction is considered to be a valid disclosure, except for the penalty condition, the interest will be reduced to 0% up to the date of the (re)assessment. The registrant will be assessed only for the applicable net tax.

If it is not considered a valid disclosure (e.g., if the transaction is discovered by Audit or any CRA enforcement action), the interest may be reduced to 4% of the transaction amount. The VDP will not be administering this portion of the WASH Transaction Policy because of existing compliance action being undertaken. Audit will have sole jurisdiction and responsibility for administering the policy when they discover a WASH Transaction.

Additional information can be found in GST Memoranda Series, Chapter 16.3.1, which has been amended and posted on the CRA Web Site

Additional Question

The Calgary VDP officers' phones do not appear to have voicemail. Is it possible to leave a phone message with a Calgary VDP officer?

Response

For approximately 10 days in early April the VDP phones in the Calgary TSO were disabled while the Prairie Region made the transition to a regionalized program under the management of the Enforcement Division in the Edmonton Tax Services Office. Phone service has now resumed in Calgary and all VDP officers have voicemail.

Question #8

A vacation property is used personally but also in rental pool. It was purchased before GST, and therefore, no GST was paid when it was first purchased. The owner is an individual who is not a registrant and has never claimed any ITCs. The percentage of personal use of the condo is 8% to 12% per year. The property has appreciated since the time of purchase.

1. What would be the GST implications if the owner decides to convert the vacation property to a personal use only property?
2. Would GST apply on the fair market value of the real property?

Response:

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

Tax status of the vacation property

The sale of a vacation property is taxable where the property is not used primarily (more than 50%) as the vendor's place of residence and all or substantially all (90% or more) of the rentals of the property are for periods of less than 60 days (i.e., the property is operated like a hotel-type establishment, for example, it is included in a rental pool). As a result, most sales of previously occupied vacation properties that were placed in rental pools are taxable.

Change in use

A GST/HST liability is triggered if a change-in-use of a property that was being used in commercial activities results in the property being used primarily for other purposes or personal use. In this case, there is a deemed sale of the property that was used in commercial activities and, except where the supply is an exempt supply, the individual registrant is deemed to have paid and collected GST/HST on the sale.

Property appropriated for personal use

Pursuant to subsection 190(2), an individual must pay tax on the fair market value of the property (i.e., there is a deemed sale) in circumstances where:

- the individual appropriates real property for the personal use and enjoyment of the individual, a related individual, a former spouse or, effective January 1, 2001, a former common-law partner of the individual,

- the property was held for supply, or was capital property for use in a business or a commercial activity of the individual, immediately before the appropriation, and

- the property was not a residential complex.

Fair market value

According to Policy Statement P-165R, Fair Market Value for Purposes of Part IX of the *Excise Tax Act*, when self-assessing on the fair market value of real property under section 191, three aspects of the fair market value are relevant:

- the factors affecting measurements of value;

- the methods used to arrive at a value; and

- the objects of fair market value appraisals.

Professional appraisers have recognized practices on how to take into consideration the factors and the methods. Policy P-165R describes the Canada Revenue Agency's (CRA's) view of the correct object of the appraisal.

Collecting and remitting the GST/HST

Subsection 221(1), in part, requires a person making a taxable supply of real property by way of sale to collect the GST payable from the recipient of the supply, unless the recipient is a GST/HST registrant. Where the supplier is not a GST/HST registrant, the supplier is required to collect and remit the GST using the form GST62, *Goods and Services Tax/Harmonized Sales Tax (GST/HST) Return (Non-personalized)*. The GST/HST return and any amount of GST owing are due by the end of the month following the month in which the sale takes place.

Real property credit

Pursuant to subsection 257(1), upon making a taxable sale of real property, including a deemed taxable sale, an individual is entitled to reclaim some or all of the GST/HST, if any, which is embedded in the cost of the property. If the individual is not a GST/HST registrant, a rebate of tax may be available under section 257 (see Section 19.3.6, Rebate on Non-Registrant's Sale of Real Property).

Question #9:

Under the proposed amendments to the HST place of supply rules for services and intangible personal property, the place of supply of a service will be determined by reference to the home or business address of the recipient obtained by the supplier in the normal course of business. Where the supplier obtains more than one address, the place of supply is generally the province of the address most closely connected with the supply. Can the CRA provide some guidelines as to how it will interpret the phrase “most closely connected with the supply”?

Response:

On April 30, 2010, the Department of Finance released draft regulations in respect of the place of supply rules regarding the proposed rules announced on February 25, 2010**.** A supplier can obtain multiple business addresses of the recipient in the ordinary course of its business. To the extent that the obtained addresses of the recipient do not vary, the address of the recipient that is most closely connected with the supply for purposes of the place of supply rule should also not vary. However, if the addresses of the recipient vary from supply to supply, so too can the relevant address for purposes of the place of supply rule.

The determination of “the address… that is most closely connected with the supply” under the place of supply rules is based on the facts taking into account the ordinary business practice of each supplier with respect to each supply. The business address of the recipient from which the supplier is hired pursuant to the agreement for the supply (the "contracting address") will generally be the address that is most closely connected with the supply. This address will therefore determine the province in which the supply of the service is made where it is in Canada and is obtained by the supplier in the ordinary course of business. The determination of the place of supply can therefore be made with certainty at the time the supply is first made where the contracting address is identified in the agreement for the supply. Where the recipient is a corporation, the contracting address could be the corporation’s head office.

If the contracting business address of the recipient is not obtained, the address most closely connected with the supply would be the business address of the recipient that the supplier has the most contact with and that is most used by the supplier in connection with the supply.

Technical Information Bulletin B-103*,”Harmonized Sales Tax Place of supply rules for determining whether a supply is made in a province*”, dated June 2010, has been updated to reflect the recently released draft regulations (below).

DRAFT REGULATIONS IN RESPECT OF THE PLACE OF SUPPLY OF PROPERTY AND SERVICES

PART 3
SERVICES

Application

11. This Part does not apply to a service to which any of sections 4 to 5 of Part VI or Part VII or VIII of Schedule IX to the Act applies.

General rule for services — address obtained

12. (1) Subject to sections 13 to 15, a supply of a service is made in a province if, in the ordinary course of business of the supplier, the supplier obtains an address (in this subsection referred to as the "particular address") in the province that is

(*a*) if the supplier obtains only one address that is a home or a business address in Canada of the recipient, the home or business address in Canada obtained by the supplier;

(*b*) if the supplier obtains more than one address described in paragraph (*a*), the address described in that paragraph that is most closely connected with the supply; or

(*c*) in any other case, the address in Canada of the recipient that is most closely connected with the supply.

General rule for services — no address obtained

(2) Subject to subsection (1) and sections 13 to 15, a supply of a service is made

(*a*) in a participating province if the Canadian element of the service is performed primarily in participating provinces and

(i) an equal or greater proportion of the Canadian element of the service is not performed in another participating province, or

(ii) if subparagraph (i) does not apply, the tax rate for the participating province is the highest among the participating provinces for which no greater proportion of the service is performed in another participating province; and

(*b*) in a non-participating province if the Canadian element of the service is not performed primarily in participating provinces.

Question #10:

Please refer back to Question #9. If under the place of supply rules for services the place of supply cannot be determined by reference to the home or business address of the recipient, the supply will be deemed not to be made in a participating province where the supply is made over 50% in the non-participating provinces; and where 50% or more of the service is in the participating provinces, the supply will be deemed to be made in the participating province in which the largest portion of the service is provided.

For example: If legal services are provided by a national law firm out of its offices in Calgary, Vancouver and Toronto and the break-down of the invoice is as follows:

Vancouver	20 hours	$3,000
Calgary	10 hours	$7,000
Toronto	10 hours	$3,500

1. Will the GST apply, or will the HST apply and at what rate?

Response

See the answer to #2.

2. Can the CRA provide some guidelines as to what methods are acceptable to determine the percentage of the service that is supplied in a particular province?

Response:

On April 30, 2010, the Department of Finance released draft regulations in respect of the place of supply rules regarding the proposed rules announced on February 25, 2010.

Subsection 12(2) of the draft regulations provides that, subject to subsection 12(1) and sections 13 to 16, a supply of a service is made:

(a) in a participating province if the Canadian element of the service is performed primarily in participating provinces and

(i) an equal or greater proportion of the Canadian element of the service is not performed in another participating province, or

(ii) if subparagraph (i) does not apply, the tax rate for the participating province is the highest among the participating provinces for which no greater proportion of the service is performed in another participating province; and

(b) in a non-participating province if the Canadian element of the service is not performed primarily in participating provinces.

Determining the percentage of the Canadian element of a service that is performed in a participating province is a question of fact to be determined in a fair and reasonable manner. In some cases, it may be fair and reasonable to use the number of hours worked as a basis for determining the proportion of a service performed in a particular province.

Although it would always depend on the facts, based on the limited information provided, it would appear that using the number of hours worked in each province is a fair and reasonable manner for determining the place of supply of the service in the above example. Pursuant to paragraph 12(2)(a) of the draft regulations, the service would therefore appear to be supplied in British Columbia and subject to HST at the rate of 12%.

This assumes that no other specific place-of-supply rule in the draft regulations applies, such as section 26 which provides a place-of-supply rule for certain services rendered in connection with criminal, civil or administrative litigation.

Question #11:

Proposed amendments to the definition of a "financial service" exclude a faciliatory service that is preparatory to an actual or intended financial service from that definition. The services of financial intermediaries such as investment dealers, mortgage brokers and mutual fund sales organizations have in the past been generally regarded as exempt under paragraph 1 of the above definition as "arranging for" services. Each of these intermediaries would typically provide faciliatory services (as defined) prior to executing the purchase or sale of the underlying financial instrument on behalf of its customer.

1. Is it the CRA's view that, unless section 139 of the *Excise Tax Act* were to apply, these faciliatory services would constitute a separate taxable supply, such that the intermediary would be required to collect tax on a portion if its fee?
2. If so, is it the CRA's view that section 139 would generally apply to the services of these financial intermediaries such that the entire service would be deemed to exempt?

Response:

Financial services, as defined in subsection 123(1) of the *Excise Tax Act*, are generally exempt from GST/HST. However, services in the nature of management, administration, marketing or promotional activities, or "facilitatory" services, as referred to in the question, are intended to be taxable, as they are used as inputs into financial services, but they are not themselves financial services.

The proposed amendments to the definition of a financial service are set out in Bill C-9, *The Jobs and Economic Growth Act*, which has not yet received Royal Assent. Determining the GST/HST treatment of services provided by financial intermediaries under the proposed amendments would involve, first, determining whether a single supply or multiple supplies are being made, and then characterizing the nature of the supply or supplies for GST/HST purposes, determining whether they constitute a financial service in the context of proposed changes to the definition of financial service as set out in Bill C-9, as well as considering the potential application of other sections of the Act such as section 139 if there are multiple supplies. These determinations involve questions of fact, and would depend on the specific aspects of the agreement between the parties. GST/HST Policy Statement *P-077R2, Single and Multiple Supplies,* provides additional information on determining whether a single supply or multiple supplies are being provided. There are also a number of examples which may help clarify a particular situation, again, depending on the facts. If it is determined that multiple supplies are being provided by a person, the possible application of sections 138 and 139 should be considered.

If you have particular transactions that you would like guidance on, you can send your written enquiry to the following address:

Director
Financial Institutions and Real Property Division
Excise and GST/HST Rulings Directorate
14th Floor, Place de Ville, Tower A
320 Queen Street
Ottawa ON K1A OL5
Telephone: 613-952-9248
Fax: 613-990-3602

It is important to include with your written enquiry sufficient details of the transactions so that the nature of the supply or supplies can be determined. This will generally require the submission of the related written agreement(s) with respect to the particular transactions.

For further information regarding these proposed changes, please see GST Notice 250, *Proposed Changes to the Definition of Financial Service.*

Question #12:

Where a registered person pays GST on a purchase of real property, the person must self-asses the tax pursuant to subsection 28(4) of the *ETA* and is prohibited by subsection 169(4) from claiming an ITC until that tax has been reported by the purchaser.
However, where the person has paid the tax to the vendor in error, the person is eligible for a section 261 rebates that would have been allowed if filed in the reporting period under audit and assessing the section 261 Rebate and forcing the person to apply for this Objections have been filed. Please

explain the requirements that must be met for the CRA to assess the rebate during the audit and under what circumstances the person would be required to apply for the rebate outside the audit period?

Response:

Currently, due to system limitations, CRA auditors are unable to make adjustments to take into account a non-existing rebate. However, CRA will be advising its auditors to have the registrant complete a GST189 for tax paid in error and will submit it for processing and it will be applied against the audit assessment.

We understand that there may have been a discrepancy in the way this issue is handled between the Calgary and Edmonton offices; however, this inconsistency will be addressed in future auditor training.

Question #13:

There are a number of reasons why a GST/HST registration would be cancelled and reinstated. The CRA computer system appears unable to track when retroactive changes have been made. This creates an issue where an auditor finds a person is registered on that actual day. This is particularly problematic for the vendors and purchasers of real property creating situations where people have followed the requirements of the law only to be assessed by an auditor using information that did not exist when a transaction occurred. Is the CRA able to track the actual date of account activation/deactivation, as well as the effective dates of registration?

Response:

As a result of a major system upgrade implemented in April of 2007, there is an audit trail for any changes made to the GST registration/deregistration status.

All CRA staff have access to GST/HST registration/deregistration information.

Question #14

It is our understanding that it is CRA's policy to issue a proposal letter and discuss all assessments prior to the issuance of the GST/HST assessment. Are there situations where this protocol is not followed as we are seeing GST/HST assessments without a discussion of the assessment or a proposal letter being issued?

Response

The Agency's policy differs depending on whether the audit is pre or post-payment.

With respect to post-payment audits, it is the Agency's policy to issue a proposal letter outlining potential adjustments as soon as possible after completing the audit. The registrant is normally given 30 days from the date of the proposal letter to provide any response, rebuttal, explanation, or further documentation relating to the proposed adjustments. Depending on the circumstances, the proposal letter may be presented to the registrant during a meeting held to explain the proposed adjustments or sent to the registrant suggesting that a meeting be held to discuss the proposed adjustments. Following receipt of any representations and/or submissions, any outstanding issues are addressed with the registrant, either by phone or in person in a final meeting. This protocol is outlined in the CRA publication, *What You Should Know About Audits* which is generally provided to the registrant at the commencement of the audit.

If the registrant fails to respond within the 30 day time period, the (re)assessment may be processed. The auditor should contact the taxpayer/registrant to ensure that a response is not "in the mail" or to determine whether the taxpayer/registrant needs more time to complete their response to the proposal letter.

If a GST audit period for which adjustments are proposed will become statute-barred shortly after the 30-day response period, the proposal letter should state that no extension of the 30-day period for representations will be provided without a signed waiver having been received prior to that time. If the registrant refuses to sign a waiver, the file will be processed without delay at the conclusion of the representation period.

With respect to prepayment audits, where the registrant has agreed to the proposed adjustments over the telephone, a proposal letter is not required. Where no agreement or only partial agreement has been obtained, a proposal letter detailing all potential adjustments will be sent to the registrant. The proposal letter allows 30 days for the registrant to respond unless a specific timeframe for a response has been agreed to. If the registrant fails to respond to the proposal letter, the audit will be finalized after allowing an additional five days for potential mail delivery.

If this policy has not been followed, it is recommended that the auditor's Team Leader or Section Manager be contacted.

Question #15:

On more than one occasion recently, we have been advised that the Appeals Officer has not communicated with the representative before a Notice of Confirmation has been issued.

1. What instructions have been given to Appeals personnel regarding discussions with the representative?

Response

Appeals officers are instructed, after a preliminary review of the file, to contact the taxpayer or authorized representative either by phone or by letter. At that time, the Appeals officer will determine if the taxpayer fully understands the disputed (re)assessment and if the taxpayer requires copies of any of the audit working papers that support the (re)assessment. The Appeals officer may request additional information that he/she has determined to be needed from the taxpayer to support his/her arguments.

Appeals officers are also instructed to contact the taxpayer (or representative) and advise him/her of the preliminary decision. If the taxpayer/representative agrees with the preliminary position, the Appeals officer disposes of the objection. If the taxpayer wishes to present rebuttal evidence or arguments, the Appeals officer will allow a reasonable time for him/her to make a submission in writing and establish a deadline for the documents to be provided. The Appeals officer will review any additional submissions and will advise the taxpayer whether the preliminary decision has changed in light of the new arguments or evidence.

In either situation, a period of 30 days is usually given for the taxpayer to submit the additional information. If the Appeals officer does not receive a response within the required timeframe, a follow-up letter will be issued 10 days after the agreed date. If the taxpayer does not reply within 10 days of the follow-up letter, the Appeals officer will consider the objection and make a determination based on the available information.

2. What can the taxpayer do to remedy the situation, other than to commence a costly court appeal?

Response

There is no provision or authority under the ETA that allows the Minister to withdraw/cancel or otherwise ignore a Notice of Confirmation once mailed to the taxpayer. The only recourse to a taxpayer is to file an appeal to the Tax Court of Canada. Where the Notice of confirmation was issued prior to the taxpayer providing information or documentation in support of the objection, the CRA will review the information and/or documents and will consider resolving the appeal by way of settlement. In such a scenario, the appeal may be resolved without the matter proceeding to a hearing.

3. Are there any changes being considered for GST/HST Objections where Collections takes aggressive actions against the taxpayer who has little recourse to the collection action?

Response

GST/HST is due and payable forthwith upon (re)assessment. The collection restrictions do not apply to GST/HST in the same way that they do not apply to source deductions under the *Income Tax Act*. Currently there are no planned or anticipated legislative changes to provide for collection restrictions for GST/HST.

Where an Objection is filed and payment in full is not possible due to financial reasons, taxpayers are encouraged to immediately contact Collections to negotiate a suitable payment arrangement or provide acceptable security. If payment or a suitable arrangement, including the provision of acceptable security, is not forthcoming, collection action may ensue to protect the Crown's interests. Should there be concerns about collection action that is taken, please contact the Collections Officer to discuss the situation.

Question #16:

The passage of the proposed amendments to subsection 248(16) of the *Income Tax Act* has not occurred since they were announced in 2002. These changes were proposed to prevent registrants from deliberately delaying ITCs to take advantage of dropping corporate tax rates.

1. If the government does not pass this proposed legislation, does that mean the CRA cannot assess using the changes announced in 2002?
2. Where the changes pass and a large vendor fails to recapture ITCs as a result of having missed claiming the underlying ITCs, will the CRA assess both ITCs and the recapture in the original period?

Response

Proposed amendments do not have the force of law and as such, the CRA cannot assess based on proposed amendments. However, parliamentary convention establishes that tax proposals take effect as soon as the Minister of Finance tables the Notice of Ways and Means Motion, even though the Government of Canada's tax plans have not yet been officially adopted through legislation. CRA Administrative Position is to ask taxpayers to file on the basis of proposed legislation which is consistent with Parliamentary convention and eases both the compliance burden on taxpayers and the administrative burden on the CRA.

As outlined in GST Technical Bulletin B-104: *Harmonized Sales Tax – Temporary Recapture of Input Tax Credits in Ontario and British Columbia*, large businesses cannot simply forego claiming ITCs in order to fulfill the RITC requirement (even if the effect on net tax would be the same). This approach to reporting and accounting for recaptured ITCs is necessary in order to allow administrators to properly allocate GST/HST revenues to HST provinces and to the federal government.

Where the Minister assesses the net tax of a large business for a particular reporting period, subsection 296(2) of the Excise Tax Act authorizes the Minister to take into account any allowable credits. An allowable credit includes an input tax credit or deduction that was not previously claimed by the person.

Question #17:

Effective July 1, 2010, HST will be paid by the Province of British Columbia, including all Ministries, agencies, and provincial crown corporations. This would include all parts of the BC government, such as the Ministry of Finance, the Public Affairs Bureau, BC Rail and BC Hydro and Power Authority.

1. Will the entire BC government be considered a "large business" and therefore subject to the "restricted ITC" rules that begin July 1, 2010 as the taxable supplies made by the BC government as a whole would exceed $10,000,000 per year?
2. If so, could CRA explain the "behind the scenes" processes for the getting the 7% provincial component of the HST into the BC government general revenues? Specifically, could CRA comment on whether BC and CRA have considered the effects of imposing the restricted ITC rules on the BC government that will lead to additional reporting and accounting requirements that may make compliance by the BC government more onerous and complex?

Response:

The questions raise tax policy issues that fall within the purview of the Department of Finance Canada.

It is our understanding that tax policy considerations regarding the recapture of input tax credits by the British Columbia government entities is currently under consideration by Finance Canada officials. As such, CRA is not in a position to comment on this matter at this time.

The allocation of HST revenues to the Government of British Columbia is made pursuant to the terms of the Comprehensive Integrated Tax Coordination Agreement (CITCA) between Canada and British Columbia. As the Canada Revenue Agency is not a party to the CITCA, it is not in a position to comment on this question.

Question #18:

The notes to the definition of the term "municipality" in subsection 123(1) state:
"*Local authorities designated under para. (b) are typically entities such as transit Commissions and public libraries."*
The term "municipality" is also defined in section 259 to include persons that are "designated" as such, but only for purposes of claiming rebates under that section.

1. What is CRA's interpretation of the phrase "other incorporated municipal body however designated"?

Response

A municipality is defined in subsection 123(1) of the *Excise Tax Act* (ETA) to mean "(a) an incorporated city, town, village, metropolitan authority, township, district, county or rural municipality or other incorporated municipal body however designated, and (b) such other local authority as the Minister may determine to be a municipality for the purposes of this Part."

Paragraph (a) of this definition lists specific types of bodies that have similar characteristics. They are all entities commonly identifiable as municipal bodies that serve a governing function within a limited local jurisdiction. For example, a city and a metropolitan authority govern within a specifically identifiable metropolitan area. Similarly, a town or village govern within a specifically identifiable, more geographically limited local jurisdiction, as does a township, district, county or rural municipality.

Applying the ordinary (i.e., commonly understood) meaning of these terms and the limited class rule of statutory interpretation, the general term used in paragraph (a)—"other incorporated municipal body however designated"—must be interpreted to mean an incorporated municipal body with the same characteristics as those bodies listed in paragraph (a)—i.e., that serve a governing function within a limited local jurisdiction.

2. Is it possible that an entity designated under section 259 to be a municipality may be neither a "municipality" nor a "public service body" under subsection 123(1)?

Response

Yes, a person designated as a municipality under section 259 may be neither a "municipality" nor a "public service body", as defined in subsection 123(1).

The Minister of National Revenue may designate an organization to be a municipality for the purposes of section 259, but only in respect of activities, specified in the designation, that involve the making of exempt supplies of municipal services by the organization. Generally this will include organizations established and operated on a not-for-profit basis that are performing the type of municipal activities mentioned in sections 20, 21 and 24 of Part VI of Schedule V to the ETA.

However, in consultation with the Department of Finance, special provisions have been made to CRA's administrative policy for the designation of organizations undertaking certain specific activities in limited circumstances. As a result, for-profit water haulers can be designated as a municipality under subsection 259(1) in respect of their exempt supplies of unbottled water. While for-profit water haulers may be designated as municipalities for purposes of section 259, they are neither municipalities nor public service bodies as defined in subsection 123(1).

3. Can a municipality that is designated under section 259 that is also a large business (or were associated with one) be subject to the restricted ITC rules for the provincial component of the HST?

Response

It is proposed that public service bodies will be excluded from the requirement to recapture input tax credits (ITCs) for the provincial part of the HST in Ontario and British Columbia.

A public service body (PSB) is defined in subsection 123(1) to mean a non-profit organization, a charity, a municipality, a school authority, a hospital authority, a public college or a university. The term "municipality" used in the definition of PSB is the one defined in subsection 123(1).

The definition of "municipality" found in subsection 259(1) only applies for the purposes of section 259. Where an organization is designated as a municipality under subsection 259(1) and is also a charity or a non-profit organization as these terms are defined in subsection 123(1), the organization qualifies as a PSB in its own right and as such will not be subject to the requirement to recapture ITCs.

If an organization is designated as a municipality, the designation only applies in respect of the activities described in the designation. An organization designated as a municipality for purposes of subsection 259(1) meets the definition of "selected public service body" also found in subsection 259(1) as it is a municipality for

the purposes of section 259. However, that does not make the organization a municipality or a PSB for the purposes of Part IX of the ETA. Where the organization does not otherwise qualify as a PSB, for example a for-profit water hauler, the organization will be subject to the requirement to recapture the ITCs.

An organization can be designated as a municipality in respect of certain supplies such as those described in section 22 of Part VI of Schedule V (e.g., installing, repairing, maintaining or interrupting the operation of a water distribution, sewerage or drainage system). However, the designation only applies for the purpose of the particular section and does not qualify the organization as a municipality for the purposes of the definition of PSB in subsection 123(1).

The foregoing comments should not be taken as a statement by the Canada Revenue Agency that the proposed recapture of ITC rules will be enacted in their current form.

Question #19:

A large business acquires motor fuel which is subject to the point of sale exemption in BC and the motor fuel is later diverted for use as "specified energy".

Will the large businesses be subject to the restricted ITC requirements for the motor fuel and be required to recapture or self-assessment the provincial component of the HST?

Response:

Based on the British Columbia Ministry of Finance Tax Information Notice #4, *Temporary RITC Recapture of Input Tax Credits* dated February 19, 2010, the large business would not be subject to the RITC rule for the provincial part of the HST.

Question #20:

In the taxation year the taxpayer receives and retains receipts for business expenses. These expenses are recorded in the taxpayer's books for tax purposes, with the GST paid being recorded in the same books for GST ITC purposes. The taxpayer has the receipts at hand when the GST return is filed.

The Department is proposing:

a. To allow for tax purposes the expenses recorded in the taxpayer's books which are supported by both suppliers' statements and by either a cancelled cheque or a credit card payment.
b. To disallow for GST purposes the ITC on these same allowed expenses because the taxpayer could not produce the receipt at the time of audit.
c. To prohibit the recording of the disallowed ITCs as business expenses.

Does the DTC audit proposal correspond with the CRA normal assessing policies?

Response

We are offering general comments in light of the CRA policies and the application of law.

a. Whether a particular expense is deductible in computing the income for the year of a taxpayer is a question of fact that can only be determined by reviewing all of the circumstances applicable to a particular situation.

b. Documentary requirements are very important for GST/HST because it is a transaction based tax, as opposed to Income Tax, which is an income based tax. Accordingly, there may arise a situation where an auditor is willing to accept (as reasonable evidence) an expense based upon proof of payment. In general, ITCs claimed by Registrants that are not supported by the required documentation pursuant to subsection 169(4) of the Excise Tax Act are not allowed. However, first consideration is given to the persuasiveness of the audit evidence gathered.

c. The payment of GST by a purchaser of goods or services is deductible in computing income if it has been made for the purpose of gaining or producing income from a business or property, pursuant to the general rules of paragraph 18(1)(a) of the Income Tax Act. However, it should be pointed out that if the registrant subsequently recovers the missing documentation and claims the ITC on a future GST Return (within the 4 year time limit), a claim of Input Tax Credits in respect of the GST/HST paid or payable on deductible business expenses is deemed by subsection 248(16) of the Income Tax Act to be assistance from a government. As such, paragraph 12(1)(x) of the Income Tax Act requires that this government assistance be included in income.