
**April 29 to May 1, 2018**

**Presentation to the CPA Commodity Tax Symposium**

**October 2018**

The GST Leaders met from April 29 to May 1, 2018 for its 12th Forum. This is a summary of the discussions, and of submissions to the Department of Finance, Canada, that followed.

Holding Corporation Rules

The Forum discussed the holding corporation rules in section 186 of the Excise Tax Act (Canada) ("ETA").[1] In general, the provisions of subsection 186(1) permit a corporation to claim input tax credits to the extent that the GST/HST incurred was "in relation to" the shares or indebtedness of a related subsidiary corporation that is carrying on commercial activities.

The Forum noted that the CRA historically took a narrow view of what expenses were incurred in relation to the shares and debt of a related subsidiary corporation. This was noted to be particularly problematic in the context of mining corporations with foreign subsidiaries and corporations that had no commercial activities of their own but that acquired and sold shares of other corporations carrying on commercial activities. It was also noted that the CRA was less strict in applying section 186 where the holding corporation was providing management services to the subsidiaries (particularly where management fees were charged).

The Forum was of the view that the jurisprudence concerning subsection 186(1) was consistent in applying a very broad interpretation of the words "in relation to", as illustrated most recently in the *Miedzi Copper* case.[2]

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[1] All statutory references hereinafter are to the ETA unless otherwise noted.

[2] [2015] G.S.T.C. 15 (T.C.C.), informal procedure.

The 2018 Federal Budget announced specific consultations concerning the rules in section 186, in three broad areas: (1) the degree to which the expenses incurred must be in relation to shares and debt of the subsidiary, (2) the degree of relatedness required between the parent and the subsidiary, and (3) whether the rules should be expanded to include partnerships and trusts that met the requisite degree of relatedness or control.

In short, the Forum was of the view that no amendments were required to section 186, other than to expand the provision to apply to associated partnerships, for the reason that the Courts had, to date, adopted a reasonable approach to interpreting these provisions that was consistent with the original stated intent thereof. We have attached hereto the submissions sent by the Forum in relation to section 186, which provide additional reasons and context for the positions advanced.

Investment Limited Partnerships

The Forum also discussed the new investment limited partnership rules that were released in draft in September of 2017. The apparent objective of these new rules is to ensure that certain management and administrative functions related to "investment limited partnerships" attract GST/HST, in a manner similar to mutual funds.

Prior to the introduction of these rules, distributions and amounts payable to partners (including general partners of a limited partnership) generally would not be subject to GST/HST provided that the services rendered were in the course of the partnership's activities. The draft provisions essentially attempt to override this result by deeming any management or administrative service provided by a general partner to an investment limited partnership (1) not to be done as a member of the limited partnership, and (2) not to have been done in the course of the limited partnership's activities. If such services are provided to an investment limited partnership that is not exclusively engaged in commercial activities, the service is deemed to be supplied to the investment limited partnership for the "fair market value" thereof. The draft proposals also deem an investment limited partnership to be a listed financial institution, which could cause onerous reporting obligations, among other complications.

The Forum discussed a number of problematic aspect of the draft rules. These included (1) the very broad and confusing definition of an investment limited partnership, (2) that such definition potentially may include tiered limited partnerships within a corporate structure, even when the bottom tier partnership was engaged exclusively in commercial activities, (3) the difficulty of determining what the fair market value of the services supplied would be, and how such value could be measured, (4) how the rules would be applied if a limited partnership had multiple general partners and (5) when the rules would be applied (i.e., what happens in the event a limited partnership becomes or ceases to become an investment limited partnership).

QST Registration for Non-Residents making Digital and Other Supplies

The Forum discussed the proposed mandatory specified registration system for non-residents of Quebec that do not carry on business in Quebec. The proposals also would prevent the application of the existing rule that provides that a supply made in Quebec by a person that is not resident in Quebec and not registered under the AQST is deemed to have been made outside Quebec (and therefore not subject to QST). Non-residents registered under the specified registration system therefore would be required to collect QST on supplies made to specified Quebec consumers (this is the so-called "Netflix Tax").

Generally, non-residents that would be required to register under the specified registration system would not be entitled to input tax refunds for QST incurred in their commercial activities. Similarly, regular QST registrants would not be entitled to recover the tax paid to the non-resident registrant under the specified registration system.

The specified registration system will also apply to digital property and services distribution platforms where these digital platforms control the key elements of transactions, such as billing, transaction terms and conditions, and terms of delivery.

The technical issues relating to these draft provisions are too extensive to briefly summarize in this communiqué. However, Forum members did question both the constitutionality of these proposed measures as well as Quebec's ability to enforce and collect any amounts owing. Another discussion topic was whether the federal government would use these proposals as encouragement to develop similar rules aimed at non-residents of Canada making digital supplies to Canadian consumers.

The New Voluntary Disclosure Program (VDP) Rules

The CRA introduced the new VDP rules in Information Circular IC00-1R6 and GST/HST Memorandum 16-5, applicable to all voluntary disclosure initiated after March 1, 2018.

The Forum discussed the changes to the old VDP, and the likely chilling effect the new rules will have on taxpayers coming forward to fix errors that likely would have made for a straightforward disclosure under the prior program. The new rules appear to be more applicable to cases of deliberate evasion of income taxes through sophisticated structures or offshore planning.

Significant changes under the new program include (1) the disclosure will not be considered voluntary if the CRA has specific information as to the registrant's non-compliance (even if it had not yet notified the registrant), (2) the disclosure will not

be complete without identification of the advisor who advised on the subject of the disclosure, (3) payment of outstanding amounts is required at the time of the disclosure, and (4) the request for relief must include a waiver of further objection and appeal, (5) the ability to make subsequent applications for relief is extremely limited (must be a different matter and beyond the registrant's control), and no-names disclosures are no longer permitted (although pre-disclosure, non-binding "discussions" are permitted).

Even for those registrants prepared to take on these considerable impediments to coming forward, relief under the program will be more measured, on a "case by case" basis. All disclosures generally will thereafter fall under 3 broad categories.

For eligible wash transactions, complete relief of penalty and interest will be provided (consistent with the old program). For the second category (generally, non-eligible wash transactions, reasonable errors, failure to file information returns, over claimed rebates, with no gross negligence or deliberate avoidance), 100% of penalties will be relieved, but only 50% of interest. For the third category, where there is some element of "intentional conduct", no interest will be relieved, only gross negligence penalties will be relieved, and there will be no criminal prosecution.

One positive element of the new program is that for category 1 or category 2 disclosures, the period covered is limited to four calendar years.

While the new VDP program may still be of use to any registrants deliberately abusing the GST/HST system, the consensus of the Forum was that the utility of the program to large GST registrants struggling with the best way to deal with the discovery of an unintentional GST/HST reporting problem is likely to be greatly reduced.

<u>Pension Plans and Master Trusts</u>

The Forum discussed the application of the pension plan provisions of the ETA to pension "master trusts", both before and after the July 2016 legislative amendments.

Prior to July 22, 2016 draft legislation, section 157 elections were not available for master trusts. Further, rebates were also unavailable to the master trust as it was not considered to be a pension entity. This had the potential to result in double taxation where master trusts were involved in a pension structure. The Department of Finance was aware of the potential issues concerning master trusts for six years prior to the introduction of the 2016 draft legislation.

As a result of the draft legislation, a retroactive amendment was made to exclude from the existing deeming rules an employer's consumption or use of employer resources in the course of either (1) the establishment, management or

administration of a master pension entity; or (2) the management or administration of assets held by a master pension entity.

While the Forum acknowledged that the 2016 proposals likely prevented the prospect of double taxation, it was debatable whether such measures were necessary, given that it was not clear that master trusts could be considered to be a separate person (since, in many master trust arrangements, it is arguable that such trusts act only as bare trustee or agent for other pension trusts).

Contemporary GST/HST Real Estate Issues

The Forum discussed certain contemporary audit issues pertaining to the real estate industry.

First, the Forum discussed circumstances where a builder of a multiple unit residential complex leased out certain of the units prior to the closing of a sale of the complex as a whole. At issue is whether the builder was entitled to a landlord rebate under section 256.2 for long-term residential rentals where the builder enters into a forward sale of the building during the construction phase. The CRA appears to be denying the rebates in such circumstances (resulting in no person being entitled to the section 256.2 rebates). The Forum was of the view that the forward sale should not disentitle the builder to the rebate, as such sale was not closed until after the rental of the applicable units.

Joint venture elections continue to be a practical, and frustrating, problem for real estate developers. The most recent audit issue identified was circumstances where the nominee title holder of the property to be developed holds a small undivided interest in the joint venture (such that it is a "participant" in the joint venture and can elect to account for the GST/HST under section 273). At least some offices of the CRA were having difficulty understanding that a corporation can hold a small beneficial interest in a joint venture but continue to hold title of the property as bare trustee or nominee for the other participants. The CRA had suggested that a true trust (rather than bare trust/nominee) must have been created. The Forum members agreed that there is no basis in law for the CRA's position in this respect.[3] The Forum expressed frustration that the CRA continues to challenge joint venture elections under section 273 that provide an expedient way of accounting for profit and loss and GST/HST, where there is no loss to the Crown.

Cannabis Taxation

The Forum discussed the general framework for the legalization of cannabis, as well as the forms of taxation thereof agreed to as at the time of the meeting. Generally,

[3] Since the time of the meeting, we understand that CRA Headquarters has reconsidered and now adopts the same view as the Forum members.

this included an overview of the Cannabis Act, the cannabis taxation proposals announced in November of 2017 and the Federal/Provincial/Territorial tax sharing framework agreed to in December 2017, as well as the measures introduced in the 2018 Federal Budget applicable to the ETA and the Excise Act (2001).

The general principles emerging from the proposals were that for the first two years of legalization, taxes were to remain low (not to exceed the greater of $1 per gram or 10% of sale price), with revenues to be shared 75% to the provinces/territories and 25% to the federal government. The excise duties are dependent on the type of product (flower/trim/seed/seedling). Further, exemptions are provided for certain low THC and prescription products. Notably absent from the legislative framework are taxes applicable to food and beverages containing cannabis. The Forum was of the view that the different timing and manner of calculating the tax could prove to be problematic.

From a GST/HST perspective, food and beverages containing cannabis and cannabis plants will not be eligible for zero-rating. PST generally will apply to the sale price of cannabis, with the exception of certain prescription items.

Craig M. McDougall, QC
Chair,
2018 GST Leaders Forum