The GST Leaders met from April 28 to April 30, 2019 for the 13th GST Leaders’ Forum. This is a summary of the discussions, and subsequent conversations with the Canada Revenue Agency.

Threat of and Use of the Gross Negligence Penalty by the CRA

The Forum discussed concerns regarding the increased frequency with which the possibility of the application of a penalty, most notably the gross negligence penalty pursuant to section 285 of the Excise Tax Act, is brought up by auditors in the course of GST/HST audits. In the Forum’s experience penalties are increasingly mentioned as a matter of course. Specific concerns are as follows:
— The gross negligence penalty is raised routinely during an audit as a matter being considered, and
— The threat of applying a gross negligence penalty being brought up as a negotiating tool when the auditor wants the taxpayer to sign a waiver or provide information beyond the limitation period for assessment.

In an overwhelming majority of the cases, the Forum’s experience is that the auditor has not been able to substantiate the grounds for proposing a gross negligence penalty should apply. The threshold for gross negligence is high. Section 285 states that the penalty applies to a person who “knowingly, or under circumstances amounting to gross negligence” makes false statements on a return. The Tax Court of Canada in Fourney v R (2011 TCC 520) held that the test for applying the penalty is not “ought to have known”. The Court stated that for the gross negligence penalty to apply the registrant must have known there were false statements on the return, or there must be evidence of intent or recklessness.

A reasonable, but erroneous, view of the law does not constitute gross negligence and a gross negligence penalty is not justified simply because the auditor and the taxpayer disagree. However, in many cases auditors may threaten to apply gross negligence penalties simply because the taxpayer takes a different position on the application of the law. In some cases auditors have threatened to apply the gross negligence penalty to taxpayers acting in accordance with CRA rulings or previous CRA appeals decisions on the same matter, because the auditor has a differing view on the issue.

1 All statutory references hereinafter are to the ETA unless otherwise noted.
Finally, pursuant to section 28.1.7 of the CRA GST/HST Audit and Examination Manual, where a gross negligence penalty has been considered, even if it is not ultimately applied, the auditor is required to prepare a Penalty Recommendation Report that summarizes all of the facts considered in the decision to apply (or not apply) the penalty. In many cases these reports do not appear to be completed, leaving the taxpayer in the dark as to the facts and basis for the application of this onerous penalty.

**Increased Use of Waivers**

Under subsection 298(7), a person may, within the general limitation period for assessment, waive the application of the general limitation period (under subsection 298(1) or (2)) by filing a waiver in the prescribed form\(^2\) specifying the matter in respect of which the person waives the application of that subsection. It is noted that CRA accepts waivers that are not given in the prescribed form. Under subsection 298(8), the waiver may be revoked on six months’ notice\(^3\). A revocation cannot be withdrawn or cancelled after it is filed.

According to the CRA GST/HST Audit and Examination Manual, waivers should not be used to give an auditor more time to finish his/her audit or as a substitute to manage the audit. They are there to allow a registrant to delay the issuance of a notice of reassessment, or to allow the auditor more time to consider information provided and/or give the registrant time to make any additional representations. Implicit in this commentary is that there be a mutual agreement between the parties to put a waiver in place.

Considering the above, the Forum has the following observations regarding the misuse of waivers by the CRA:

- Proposing a waiver as a way to give the auditor more time to complete the audit.
- Using a waiver for a reporting period that is already statute barred (and insistence on providing such a waiver despite, representations that it is not valid, as a waiver can only be given for a reporting period that is still open for reassessment),
- Threatening reassessment if a waiver is not provided, despite the audit ongoing for a lengthy period of time, often when a reporting period is about to go statute barred,
- Threatening to reassess under subsection 298(4) (i.e., misrepresentation due to negligence or carelessness), if a waiver is not provided.
- Rejection of a waiver where CRA auditor found it to be too narrow, requesting a new broader waiver.

**Requirement to Audit to Net Tax**

Subsection 296(1) outlines that the Minister may assess the net tax of a person for a reporting period of the person. Subsections 296(2) and (2.1) state that where, in assessing the net tax of a person for a particular reporting period, the Minister determines that an amount would have been allowed as an input tax credit (or a deduction to net tax) or a rebate to the person, the

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\(^2\) GST Form 145

\(^3\) GST Form 146
Minister shall take the allowable credit or rebate into account in assessing the net tax of the person.

These companion subsections appear to imply that the Minister has a positive obligation upon it to not only determine any increases to net tax when auditing a taxpayer, but also to determine any potential decreases to net tax when auditing a taxpayer. However, in practice the Forum notes that only the former is typically what occurs, with the latter only rarely applied. Specifically, in the Forum’s experience, unless the Minister is presented with potential unclaimed allowable credits or rebates by the taxpayer itself, the Minister does not actively audit or bring to the attention of the taxpayer any potential unclaimed allowable credits or rebates. Moreover, effort is often required to educate the auditor on this statutory requirement.

This appears contrary to the wording and spirit of the Excise Tax Act, which provides a requirement for the Minister to generally audit to net tax. The CRA, as the representative of the Minister when it comes to performing audits, should reflect this wording and spirit by ensuring that taxpayers are audited to net tax completely and transparently, on both sides of the ledger.

**Challenges with Fair Market Valuations for Self-Supply Purposes**

The Forum has observed that the CRA is undertaking to review and often challenge the fair market value (FMV) on which the GST/HST liability for builders on a newly constructed or substantially renovated multiple use residential complex (“MURC”) is determined.

Unlike other forms of new housing constructed by builders for sale or rental where the GST/HST applies on a unit-by-unit basis, the GST/HST applies on the entire property (including all units) generally at the time of the first unit’s rental, and this can represent a substantial upfront liability for builder-landlords before they have earned any rental revenues. While not a legislative requirement per se, builders of rental apartments often hire professional appraisers to determine the FMV on which they must pay GST/HST under the self-supply rules. This is done to lessen the risk that the CRA will challenge their GST/HST remittance. However, it is the Forum’s experience that CRA does not often handle FMV issues in a fair and reasonable manner consistent with the self-supply rules and even their own administrative policy.

**Object of the Valuation**

A MURC is often not the same as the actual property, such that the appraiser is required to make certain adjustments to the actual property to ensure that the valuation is limited to that of the MURC. Typical examples of such required adjustments can include the exclusion of non-residential parts of the property, exclusion of excess land, apportionment of shared common areas with adjacent multi-unit rental buildings that are not part of the subject property, additions to a pre-existing multi-unit rental building, and ensuring the valuation is for the freehold even in cases where the builder holds only a leasehold interest.

**Timing of the Valuation**

The self-supply rules require that the FMV be determined at the later of: (1) the date of substantial completion and (2) the date of possession or use of the first rental - referred to as
the Valuation Date (VD). However, in the Forum’s experience the appraisal is often on the
property as fully complete, often resulting in over-valuation as there is no adjustment (discount)
to the value of the property where the VD is at substantial completion.

Valuation Methodologies

The CRA’s administrative policy requires that none of the three commonly used valuation
methodologies (Income Method, Direct Comparison Method and the Cost Method) be excluded
without a reasonable justification for doing so. Given the inherent strengths and weaknesses in
all methods, it is preferred that all three valuation methods with the aforementioned
adjustments be undertaken. However, despite this approach there is much uncertainty and
inconsistency regarding the CRA approach to reviewing appraisals utilized for self-supply
purposes.

Based on the Forum’s experience, it is likely that the CRA will undertake a review of a valuation
used for the self-supply of a MURC and will increasingly challenge the valuation as being too
low. Frequently this results in proposals to increase the GST/HST liability with little or no
supporting rationale.

The Forum is concerned that the appraisers used by CRA audit do not have a full understanding
and appreciation of the Excise Tax Act requirements with regards to fair market value
calculations. As a result, the Forum has seen large (re)assessments without having an informed
basis on which to dispute the increased GST/HST liability, either at the audit or appeals stage.

The Forum is also concerned that there is lack of an independent review when an assessment
pursuant to a FMV is disputed. CRA Appeals will find itself often in a position of seeking the
assistance of the same appraisal group that supported Audit in the initial appraisal, with the
result simply a confirmation of the disputed FMV amount. This lack of independent review often
results in matters ending up in the Tax Court of Canada.

Other FMV issues has arisen from the positions taken by the CRA in their audits, as follows:

— CRA has shown a tendency to ignore prices fixed in forward purchase agreements for
landlords purchasing MURCs and instead require the purchaser to self-assess at FMV at the
closing date. Conversely CRA has shown a tendency to allow prices set in builder-landlord’s
subsequent sale agreements to inflate the FMV at valuation date. It seems that the CRA
either ignores such prices or is heavily influenced by them, when it suits its purpose to justify
an upward adjustment to FMV.

— CRA has taken the position that in many cases condominium purchasers are “builders” and
subject to self-supply where they enter into lease-back arrangements with builder/sellers,
who in turn sublease the condominiums to individual tenants. Based on this position, the
CRA requires purchasers to pay GST/HST at FMV on the lease-back, which may be
considerably higher than the GST/HST payable on the condominium purchase itself.
Training Discussion

Finally, it is the view of the Forum that many of the above matters can be addressed to some degree through enhanced training. Such training will help increase the efficiency and effectiveness of audits and ultimately benefit the overall functioning of the GST/HST system. In this regard the Forum has reached out to the CRA to open a dialogue.

John Bain
Chair
2019 GST Leaders Forum