Chartered Accountants of Alberta

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March 2006

Member Advisory

May 2005 CRA Roundtable

The annual Canada Revenue Agency (CRA) Roundtable Meeting was held in Ponoka in May 2005. CRA representatives from Calgary, Edmonton, Red Deer and Lethbridge were in attendence along with representatives from the ICAA.

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

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

Income Tax Questions

Question 1—Changes to the Cash Window

With the 2005 Federal Budget, the Minister of Finance has indicated that the Canada Revenue Agency (CRA) will be streamlining the services provided to registrants and taxpayers and their representatives. We have heard rumours that the Edmonton CRA will be closing down its cash window in the near future, forcing people to use the banks or to mail in payments. We have heard that there will be a reduction in the number of forms that will be available in the Tax Services Office (TSO). We have also heard that the Edmonton Business Window will be changed to appointment only. These are disturbing trends for those who regularly interface with Agency staff. The trend to Internet service has not shown itself to be effective, and not everyone has access to the Internet or having access, does not feel confident in its use and confidentiality. Many forms required to file returns and payments are not available on the CRA website, and the banks will not accept photocopies. We have already experienced great difficulty in making payments during the recent strike, which should illustrate the need for the cash windows and personal service.

Please outline the overall program and explain how these changes and others that will be instituted will improve the service that you provide.

Response

In the February 23, 2005, Budget Speech, there were expenditure review initiatives announced that will impact our Enquiries Counter, Cash and Forms operations. The existing counter service will be redesigned to include self-service kiosks, telephones linking to our 1-800 networks and service by appointment for clients who require in-person service. Forms that are not available on the CRA's website may be ordered by calling the 1-800 telephone lines or ordered online through the Internet.

CRA recently announced changes to the planned closing of the payment counters.

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Call for Tax Questions

The next Roundtable Meeting with CRA will be in May 2006. If you have a question regarding tax or CRA procedures you would like the participants to address, please send it to Monika Siegmund CA (c/o ICAA) or Wayne Kauffman FCA at w.kauffman@icaa.ab.ca

Since the budget, CRA has consulted openly and extensively with internal and external stakeholders. These consultations have resulted in a change to our previous proposals.

With the benefit of the input provided, the Agency has been able to further evaluate the impact and feasibility of completely eliminating cash counters. We've concluded that it would be in the best interests of all to continue to allow our clients to make most types of payments in person at CRA offices.

This means that the CRA is maintaining payment counters.

The Agency will still encourage our clients to make payments electronically or through their financial institutions, but CRA will continue to accept cheques and debit card payments at counters. Soon, however, CRA will no longer accept cash. After reviewing some internal processing procedures, and by eliminating the security and handling costs incurred in accepting cash, CRA is confident that efficiencies can still be achieved, while service to Canadians is maintained.

These decisions support the Government's commitment to providing streamlined, cost-efficient and accessible services to Canadians through the innovative use of technology.

Question 2—Auditor Field Resources

We have heard that field auditors across Canada are not being given current printed copies of the *Income Tax* and *GST Acts*. As well, it is rumoured that the electronic copies that each field auditor had on their laptops are being deleted due to licensing issues. Even if the auditors were willing to pay for these resources themselves, they are not allowed to install the software on their government-issued computers. How do you expect your professionals to carry out efficient audits and to educate taxpayers and registrants on the finer points of the legislation without having access to the legislation?

Response

It is true that individual paper copies of *Income Tax* and *Excise Tax Acts* are not distributed to every auditor. It is not true that electronic copies of the Acts are being deleted due to licensing issues. The CRA has a complete and comprehensive system of licensed products for our use.

Currently, we are in a position of transition where our various reference and research tools are in the process of being "certified" for use on the laptops by our Headquarters Information Technology Branch. This recertification was necessary because of a change in the platform on which our systems operate. The security of the information about taxpayers and registrants contained in our laptops is paramount to the CRA—each and every software addition to a laptop must be vetted from a security as well as a functional perspective. Until certification is complete, no product will be added to a laptop.

In respect to an auditor adding their own software, all auditor laptops are only loaded with the CRA approved software, which is managed by the local IT function. We do not permit individual customizing of them.

During this transitional period, all auditors continue to have access to the necessary legislation. Most auditors continue to have current access to the legislation on their laptops. Other sources include paper copies of the Acts, CD copies of the legislation, on-line access through the LAN hook-ups and personal resources of team leaders and technical advisors.

It is expected that the necessary certification process will be completed in the near future. The CRA is also replacing a significant number of auditors' laptops to ensure that auditors can continue to conduct their audits and to educate taxpayers and registrants in an efficient manner.

Question 3—PST Penalty Deductibility and Section 67.6 Proposed Changes

The deductibility of all but a few penalties will be disallowed for income tax purposes with passage of the proposed amendment to Section 67.6 of the *Income Tax* Act. Unfortunately, for taxpayers that operate in jurisdictions with a provincial sales tax, failure of a vendor to collect sales tax as an agent of the province results in the assessment of a penalty equal to the tax not collected. (The province cannot make the vendor pay the tax since the legislation defines the taxpayer as the person acquiring the taxable good or service.)

Assuming the amendment passes, how will these penalties be treated by CRA auditors in the future? Will the expense be denied when the person pays the province?

If the penalty for not charging sales tax is disallowed as a business expense, how will the sales tax be treated for income tax purposes if the person collects it from the customer and, having paid the penalty assessed by the province, does not have to remit that tax to the province? Will this be considered taxable income?

Response

The Department of Finance is responsible for drafting and amending income tax law. In concert with the Department of Finance, our responsibility at the CRA is to administer and to enforce the *Income Tax Act* and other statutes within the scope of our legislated authorities.

The pending amendment to the *Income Tax Act* proposes to add Section 67.6 to the *Act*. The wording of the draft amendment is very clear:

> *Section 67.6 – Non-deductibility of fines and penalties*
>
> *In computing income no deduction shall be made in respect of any amount that is a fine or penalty (other than a prescribed fine or penalty) imposed under a law of a country or of a political subdivision of a country (including a state, province or territory) by any person or public body that has authority to impose the fine or penalty.*

To clarify its intent, the Department of Finance further stated in the explanatory notes that the *"new Section 67.6 of the Act prohibits the deduction of any amount that is in respect of a fine or penalty imposed under the law of a country or a political subdivision of a country (including a state, province or territory) by any person or public body that has the authority to impose the fine or penalty."*

The CRA's current position regarding to the deductibility of fines or penalties is outlined in IT-104R3, which was rewritten to reflect the decision of the Supreme Court of Canada in 65302 British Columbia Ltd. v. the Queen, [2000] 1 CTC 57, 99 DTC 5799.

The income tax treatment of fines and/or penalties imposed under provincial statutes is well established under Canadian income tax law. Dating back to 1930, the case of Clinton W. Roenisch v. Minister of National Revenue is still valid with respect to the treatment of fines or penalties imposed under provincial statute.

With regard to fines or penalties imposed under provincial income tax legislation, paragraph eight of Interpretation Bulletin, IT-104R3, states:

"Any fine or penalty imposed under a province's income tax law is also considered not to be an expense incurred for the purpose of gaining or producing income". (Source: Interpretation Bulletin, IT-104R3, Deductibility of Fines or Penalties)

The preamble to IT-104R3 also provides some insight into what the proposed amendment will mean to taxpayers:

"The 2004 Budget proposes that, with two exceptions, all fines or penalties imposed by federal, provincial or municipal governments in Canada or by a foreign country are not deductible. This includes any fines or penalties imposed by a government, a government agency, regulatory authority, court or other tribunal, or any other person with a statutory authority to levy a fine or penalty. The two exceptions are:

- *Penalty interest imposed under the Excise Act, the Air Travellers Security Charge Act and the GST/HST portions of the Excise Tax Act will continue to be deductible.*
- *There is to be regulated authority to exclude prescribed fines and penalties. The House of Commons Standing Committee on Finance will be consulted with respect to any recommendation put forward.*

Penalties charged pursuant to contracts (e.g., penalties for late performance) are not covered by the proposal. They will continue to be deductible if they meet the general rules under the ITA.

The amendment applies to fines and penalties imposed after March 22, 2004."

This prohibition does not extend to "prescribed fines or penalties" (as indicated above). It is proposed that the following be prescribed for this purpose: penalty interest imposed under any of paragraphs 280(1)(a), 280(1.1)(a) and 280(2)(a) of the *Excise Tax Act*, paragraph 110.1(a) of the *Excise Act*, and Subsection 53(1) of the *Air Traveller's Security Charge Act*. (Department of Finance, Explanatory Notes, Section 67.6, ITA)

With respect to the second part of the question, it would be necessary to review the applicable provincial legislation in order to determine whether the PST liability would be considered extinguished once the penalty was assessed to the vendor. If the tax liability no longer existed, the payment to the vendor could be considered a payment for something other than PST. It is possible the payment could be considered as a recovery of the penalty or it could be treated as something else and taxed accordingly. The facts and pertinent legislation would need to be examined in any given situation.

Question 4—Collections Call Centres

Collection of amounts owed to the government has become an automated process. With the use of collection call centres, there seems to be a lack of continuity in the processing of taxpayers' payments and much less cohesion between the various accounts that a person has with the government. We have seen many situations where collections calls and letters are initiated before Notices of Assessments are mailed out, let alone received by the taxpayer/registrant. The use of a 15-Day Reminder Notice is common for outstanding GST returns, and this ignores the fact that Canada Post is often unable to deliver the mail and the return response in that period of time. Letters sent from call centers indicate a name and telephone number to contact. If this letter is lost, it is almost impossible to obtain the particular officer's name and number by calling the local Tax Services Office (TSO).

Is there any hope that these problems will be addressed in the near future? Is there any chance that we will go back to dealing with the local TSO collection officials who seem to have done a good job in the past and were certainly on top of all activity on the files in their workload?

Response

The use of a call centre for collection of debt is considered to be an "industry best practice", and the CRA, as a result of private industry benchmarking and a re-engineering process, established the National Collection Call Centre (NCCC). This was done in an attempt to improve the timeliness of our collection activities, and to better manage our staffing and workload allocations.

The National Collection Call Centre is accountable for the collection of high volume, low-dollar value, and non-complex accounts. The agents of the NCCC are responsible for:

- Obtaining payment in full or negotiating a mutually acceptable payment arrangement for debts within the established parameters
- Arranging the filing of outstanding GST returns, and payment or any anticipated balance
- Recognizing complex accounts, and referring these accounts to the appropriate Tax Services Office
- Providing information to the client regarding the client's responsibilities
- Locating telephone numbers for clients that do not have correct phone numbers
- Answering general questions regarding current interest, status of T1 and T2 accounts, GST returns, or requests for forms

CRA believes the NCCC will not only make a positive impact on the timeliness and amount of revenue collected, but will also assist clients early in the “collections continuum”, which will encourage increased compliance. Any account that is determined to involve more complex issues as per our established criteria will be the responsibility of the local TSO. These include accounts that have disputed amounts, arbitrary assessments, bankruptcies and estate accounts.

The main function of the NCCC is outbound collection-oriented phone calls. The agents in the NCCC do not send collection letters, and their names do not appear on any correspondence. In fact, no particular individual is assigned to the collection of a specific account. If the client calls the NCCC in response to a letter or a message received, the client will be served by whichever agent has answered the call. If a letter that refers to the NCCC is lost, the client can contact the NCCC via the toll free number (1-888-863-8657) that is listed in the government pages of their local phone book.

If clients are receiving collection letters before a Notice of Assessment is received, the collection letter is system-generated and not the result of the account being the responsibility of the NCCC. This concern has been forwarded to the appropriate division to address the timing issues of the system-generated notices.

In response to your concern regarding the use of the 15-Day Reminder Notice for outstanding GST returns, we can only say that this is a standard timeframe. The CRA believes this is a reasonable timeframe and expects all GST registrants to know the deadline for the filing of their GST returns. In addition, since the Reminder Notice is not sent to the client until at least 30 days after the due date of the GST return, the client should already be aware the return is overdue and outstanding.

The processing of payments does not fall under the responsibility of the NCCC, or any local TSO, and no recent changes have been implemented regarding the processing of payments. All payments continue to be processed at the appropriate Taxation Centre depending on revenue type, and if you have concerns regarding the processing of payments, they will be directed to the responsible Taxation Centre.

To address your final concern regarding the cohesion between the collection activities on multiple accounts, if a client has more than one account and is currently dealing with their local TSO, the NCCC is able to transfer an associated account to the local office once it is made aware of the association. We are conscious of the frustrations of dealing with more than one collection official, and in all cases will attempt to consolidate the client’s accounts when it is appropriate.

Although we are very pleased that the TSO collection officials have previously achieved an excellent standard, the use of the NCCC is an integral part of CRA’s overall strategy to improve the timeliness of our collection activities, and there are no plans at this time to discontinue this practice. We have every confidence that the NCCC will be able to provide the same level of service that you have come to expect from the local TSO.

Question 5—Practitioner Access to Client Information

Where appropriate information cannot be obtained in a timely fashion, taxpayers and their advisors are often forced to make "best guesses" and sort out any discrepancies later. This wastes time and money for advisors, taxpayers and the Agency, and seems to benefit no one. With this in mind, what steps is the Agency prepared to take to better facilitate advisor access to taxpayer information, with a minimum of administrative costs for taxpayers, representatives and the Agency itself.

Response

Currently, taxpayer information is available to authorized representatives via mail, telephone and in person. The authorized representative is required to provide written permission from their client through completion of Form T1013 or a letter containing the same information.

In 2006, the CRA will offer an online service for representatives that will allow them, when authorized, to access information and services for their clients. The following steps will be required:

- The tax professionals, representatives and business owners will go through CRA’s website to register their tax services business and/or themselves and get a Representative Identifier (RepID)
- Once registered, the tax professionals, representatives and business owners will provide their RepID or BN (to authorize the entire business) to their clients.
- Clients will then be able to complete the newly designated T1013, *Authorizing or Cancelling a Representative*, and enter a RepID or BN in the available space to authorize their tax professionals, representatives or tax services business for electronic access. Clients may choose alternatively to login with their epass to electronically authorize their tax professionals, representatives and tax services business through CRA’s My Account.

Question 6—CRA Electronic Forms

Many practitioners use computer software to prepare CRA forms. However, it appears CRA will not permit software designers to include certain forms in their software. One such notable form is the non-personalized GST return. While we appreciate that it would be preferable for taxpayers to use the pre-printed returns CRA provides, the simple fact is that these are sometimes lost, making a non-personalized form essential. Requiring practitioners to fill those out by hand, rather than having them available in a computerized format, does not reduce the likeliness of errors. As well, with a software-generated form, CRA could have better certainty that all relevant information would be included on their portion of the form. Would CRA consider allowing software developers to include GST returns suitable for filing in their packages? If not, please explain the benefits the Agency perceives in requiring these forms to be completed by hand.

Response

Some payment forms and remittance vouchers are not available in a computerized format due to the technical requirements of the Magnetic Ink Character Recognition (MICR) technology used on these forms. Because the ink or toner is magnetized, we can provide these forms only in pre-printed format. If these forms were printed from the Internet or computer software, they would not be acceptable for payments at financial institutions. As a result, various forms including the non-personalized GST/HST return are only available in pre-printed format.

Question 7—Assessments and Income Slips

In recent years, CRA has seemed more and more prone to "reassess first and ask questions later". We have seen this commonly in cases where T slips reflecting a client's social insurance number are added to his or her income automatically, with no questions asked of the taxpayers. In our offices, at least, many such assessments are erroneous. Commonly, the income has been properly reported as divided amongst various individuals, all of whom contributed funds to an investment, or reported on a line other than that expected by CRA. In some cases, the same individual has been reassessed for the same T slip for several years. While the best answer for such clients would be to request the slip issuer to remove their SIN, issuers of slips are understandably reluctant to delete such required information.

Requests for supporting information on personal tax returns suffer a similar problem. Commonly, CRA receives information they consider less than adequate, and reassesses rather than requests further details. For example, we recently had a client who was requested to provide supporting information for his moving expenses, which consisted solely of the commission on sale of his former residence. Copies of the documents reflecting the commission were sent to the Agency. The Agency wrote back that they did not consider the information provided to be sufficient because it did not include the address of the property sold, and the claim was therefore being denied. We also had a client who was requested to provide details to support deductions in a post-assessment review. The client was unavailable for some time due to a vacation and, as such, cancelled cheques were not available. We wrote the Agency with a copy of the support agreement and the name and SIN of the support recipient, and advised the cheques would follow at a later date but could be later than the requested (30-day) deadline as the taxpayer was away from his residence on business for an extended period. The client was reassessed to deny the support payments with no further contact. The reassessment pre-dated even the 30-day deadline in the initial request for information.

Such reassessments are very frustrating to taxpayers and their advisors. They do not, to put it mildly, promote a spirit of co-operation between the Agency and taxpayers. As many of these arise in pre-assessment of e-filed returns, they can also discourage electronic filing. In many cases, these force a Notice of Objection to be filed in order to ensure the deadline for some is not missed, risking loss of the claim due to timing issues.

While the writer realizes that there are costs to the Agency being in continued contact with taxpayers, it does not seem unreasonable to expect the Agency to make the effort to contact taxpayers before reassessing them, and to follow up when partial information is submitted and further information is desired. Ultimately, this would save the Agency the costs of processing numerous unnecessary Notices of Objection and preserve considerable goodwill with taxpayers and their advisors. We would therefore ask whether the Agency would consider revising their policies and practices to request explanations of discrepancies, and provide taxpayers with an opportunity to provide further supporting documents, rather than reassess at the earliest possible stage.

Response

The matching program takes place after the Notice of Assessment has been sent. It is an important element of the CRA's compliance programs that ensure the integrity of Canada's self-assessment tax system. We compare the information on an individual's tax return to the information provided by third-party sources, such as employers or financial institutions. As part of the program, we also administer the Beneficial Client Adjustments Initiative by identifying under-claimed credits relating to tax deducted at source.

The matching program identifies cases where a client has under-reported income received in a year. As part of this process, we also look at spousal returns in situations where there is an indication on a T slip that the account is held jointly. This helps minimize client contact and unnecessary reassessments for clients who have split the income. During the review, most reassessments are straight forward and do not require client contact; however, where additional information or clarification is required, we do instruct assessors to establish client contact. The contact can be done by telephone or in writing. Where the client does not reply or respond, a reassessment is prepared based on the information we have. From a client service perspective, it is in our best interest to ensure that our reassessments are accurate to avoid client frustration and unnecessary reversal adjustments.

Regarding requests for supporting documentation, we can assure you that we want to give individuals every opportunity to respond to our requests before action is taken to reassess the return. For our compliance programs for 2004-2005, we have initiated a second contact policy for cases in which a partial reply was received and in which it was reasonable to believe the contact would result in the missing information being provided to support the claim under review. The expectation was that this process would result in a lower adjustment rate at the review stage. It was also expected to reduce the number of reversals required. The final program data supports our expectations, as both the adjustment rate and reversals requested have been reduced. With respect to granting extensions beyond the

30-day period provided to clients, our policy is also to grant reasonable requests for extensions to the reply period. In the case you have referenced, the fact that you had advised CRA that the client would not have the information for an "extended" period of time, our policy would have instructed the employee to determine whether the length of time was reasonable and if so to allow the extension. In instances where the length of time is not reasonable, our policy would instruct the employee to deny the claim until the client submitted the required documentation. For specific situations where it is apparent the Tax Centre is not following these policies, please bring the matter to our attention, providing the clients SIN.

While we understand that this may cause frustration and may discourage electronic filing, please note that our review processes are the same not-withstanding which filing method an individual chooses for filing his/her T1 return. In additional to similar review processes, the benefits of electronically filing returns include:

- Faster refunds (normally less than two weeks regardless of time of year)
- Paper savings
- No postage
- Confirmation that return has been received by us
- Improved accuracy and ease of payment (file early and pay on April 30)

In the vast majority of cases, additional information can be provided to correct returns without filing a Notice of Objection as long as the information is received within three years from the date of assessment of the return. The filing of a Notice of Objection may in fact add to the length of time required to correct the return.

We continually enhance our policy and procedures in order to make the review process as efficient as possible and cause minimal inconvenience to our clients. Meetings such as this allow us to discuss issues and improve communication and processes. Thank you for bringing your concerns to our attention.

Question 8—International Income Tax Returns

Some years ago, CRA sought to enhance its efficiency in dealing with tax returns of international scope in the International Tax Services Office. While we cannot comment on any efficiencies experienced by the Agency in this regard, it seems clear that improved turnaround was not among them.

Commonly, returns filed with this office take nine or more months to assess. Requests for information go unanswered for similar periods of time without reply or even acknowledgment of receipt. This lack of timeliness causes hardship for taxpayers and does not act to encourage non-resident taxpayers to make every effort to comply with Canadian taxation requirements. We expect it also acts as a disincentive to international business operating (and creating jobs and economic activity) in Canada.

While we appreciate that international tax matters are, almost by definition, considerably more complex than tax matters confined within our borders, this does little to alleviate the frustration of both taxpayers and their advisors when refunds are delayed for months, requests for clarification of calculations cannot be processed within the time period in which a Notice of Objection must be filed, and time-sensitive matters such as requests for reductions of withholdings at source cannot be resolved, or even acknowledged, for extended periods of time.

These issues do not only affect non-residents of Canada (many of whom are themselves citizens of this country). Many Canadians deal with non-residents of Canada and need guidance on how to comply with their related tax obligations. Taxpayers eligible for the Overseas Employment Tax Credit, who must be residents of Canada, have their returns processed by the International Tax Services Office.

These delays are frequently acknowledged by the Agency representatives; however, there seems to be no plan of action for improving service in this area. These delays seem to increase each year, with no sign of any improvement. What, if any, plans does the Agency have for enhancing its ability to provide timely service to taxpayers who are faced with tax issues that are international in scope?

Response

At the International Tax Services Office, income tax returns are usually processed within the timeframes published in our guides and on our website. In some cases, a return may be selected for a more detailed review resulting in a delay before the assessment is finalized. Therefore, to be able to address the concerns raised with respect to delays in processing returns, we would need information on specific returns where delays were encountered.

Fair and consistent treatment, high-quality service, reduced compliance costs, easier access, faster response times, and simplified tax administration are the fundamental elements of service delivery for the Agency. In this regard, we have committed ourselves to a process of continuous innovation and service improvements.

Question 9—Small Business Deduction and Partnerships

Income tax law currently applies to restrict corporate partners to a proportionate share of the small business deduction limit based on their overall partnership interest. This effectively restricts the partnership income eligible for the small business deduction to a single business limit.

However, in some cases, partnerships are structured as a partnership of corporations (referred to as "PartnerCo's") each owned by a second corporation (referred to herein as "HoldCo's"). This structure is commonly adopted to permit payment of dividends from PartnerCo to HoldCo in order to protect accumulated equity from business risk arising from the partnership operations on a tax-effective basis.

For illustrative purposes, assume an equal partnership of three PartnerCo's each owned by a HoldCo. Each HoldCo is owned by an individual. The three individuals are unrelated and Act at arm's length. Consequently, while each HoldCo is associated with the PartnerCo it owns, no HoldCo-PartnerCo group is associated with any of the other HoldCo's or PartnerCo's. All entities are assumed to have a June 30, 2005, fiscal year end, such that the relevant business limit is $300,000.

Assume the partnership earns $3 million of income, $1 million of which flows to each Partner Co. The PartnerCo's have no employees but have a contract for management services to be provided by their respective HoldCo's. Each PartnerCo pays management fees of $900,000 to its respective HoldCo, which are deducted leaving $100,000 of income in PartnerCo. This income is eligible for the small business deduction.

Each HoldCo pays salaries to its shareholder in the amount of $700,000, which leaves $200,000 of taxable income in HoldCo. As HoldCo is not a partner in any partnership, and is not associated with any corporation other than its PartnerCo, this $200,000 is eligible for the small business deduction, which HoldCo claims. While HoldCo could be viewed as a personal services business, because it is associated with the PartnerCo from which its fees are received, its income is deemed not to arise from a personal services business.

Can CRA comment on its views in respect of such a structure? In particular, would CRA seek to apply the General Anti Avoidance Rule to such a structure?

Response

The management fees would be subject to the general limitations for deductibility pursuant to paragraph 18(1)(a) and Section 67. The determination of whether management fees represent active business income is a question of fact. Where appropriate, we would consider the application of Subsection 256(2.1). GAAR would most likely not be applied.

Question 10—Small Business Corporation

A corporation has, as its sole asset, a limited partnership interest. The limited partnership carries on active business in Canada. Is the corporation considered to meet the 90% test required under the definition of "small business corporation", or does CRA feel that a limited partner does not carry on active business for this purpose?

Response

It is our view that where a corporation has a partnership interest as one of its assets, it is the underlying partnership's assets (to the extent of the corporation's interest therein) that are used in determining whether all or substantially all of the corporation's assets are used in an active business for the purpose of the definition of "small business corporation" under Subsection 248(1) of the *Income Tax Act* (the *Act*). Provided that these assets are used in an active business carried on primarily in Canada by the partnership, they will qualify as being used by the partner in an active business carried on primarily in Canada by the corporation. This position has been reaffirmed in the case of Robinson v. the Queen (98 DTC 6065, FCA).

Section 253.1 of the *Act* provides an exception to some specified trusts and corporations[1], which hold interests as a limited partner, from being considered to carry on any business or other activity of the partnership solely because of the holding of that interest. A proposed amendment to Section 253.1 extends the application of this provision to an RESP trust.

[1]Unit trusts, mortgage investment corporations, mutual fund corporations, mutual fund trusts, pension corporations, private holding corporations, small business investment corporations and master trusts

Question 11—Tsiaprailis Decision

The Supreme Court decision in Tsiaprailis provided that settlement payments in respect of arrears disability insurance benefits that would have been taxable had they been paid on time, are taxable, but payments in settlement of future obligations were not. Can the CRA please comment on the following issues raised by that case?

Question 11(a)

In the Tsiaprailis case, the allocation of the total settlement between payment in respect of arrears benefits and payment in lieu of future benefits was very clear. It is common, however, for a single lump sum to be paid, with no allocation between past and future benefits. What is the CRA's position in respect of such circumstances? Do they consider the entire amount to be non-taxable, the entire amount to be tax-free, or believe a reasonable allocation must be made by the taxpayer? In the last case, it seems likely that few taxpayers possess the expertise to make such an allocation. What factors would the CRA expect will be used in making such an allocation?

Response

Whether a settlement payment of a disability insurance claim includes a component that is in respect of a payment of accrued periodic amounts payable to the date of settlement, of an amount that is in lieu of future benefits under the disability insurance plan, or of an amount that represents non-taxable damages, is a question of fact.

In the case of HMTQ v. Antonija Siftar [2003 FCA 137], the FCA found that a lump-sum settlement made without an allocation between its components is not determinative of the nature of the payment, nor does it preclude an inquiry into the makeup of the settlement amount.

As Canada has a self-assessment system of taxation, the onus rests with the taxpayer to report the amounts of the settlement subject to tax. Significant consideration should be given to the nature of the underlying claim and the intention of the parties. The reasonableness of the amounts declared should reflect the reality of these factors.

Where the Minister is not satisfied that the taxpayer has reasonably allocated the settlement to its component parts, the Minister may reassess the taxpayer to reflect his understanding of the underlying claim and the nature of the settlement. Such determination would include consideration of the terms of the disability insurance plan, correspondence of the parties during negotiations, and other relevant factors.

Question 11(b)

Will the CRA require insurance companies to issue reporting slips showing the taxable component of such settlements, requiring them to make their best estimate of a reasonable allocation where no allocation is included in the settlement agreement?

Response

Regulation 200(2)(f) requires any person who makes a payment as or on account of an amount that is taxable pursuant to paragraph 6(1)(f) of the *Income Tax Act* to make an information return in prescribed form in respect of such payment. Therefore, insurance companies should be making a reasonable allocation between taxable and non-taxable components of lump sum settlements. The taxable component should be reported on a T4A.

Question 11(c)

Where the parties to a settlement agreement allocate the settlement proceeds between past and future benefits, will the CRA abide by such allocation, or will they challenge allocations which, in their view, are not reasonable? Given the insurance company will have a deduction for the full settlement amount, it seems likely they would be biased to over-allocate to the tax-free component in order to achieve a lower-cost settlement by reducing the insured's income tax costs.

Response

As indicated in our response to (a), the Minister will not challenge allocations that reasonably reflect the values of the different heads of the settlement. This determination is supported by the underlying claim of the taxpayer, the intentions of the parties, the terms of the disability insurance policy, correspondence of the parties during settlement negotiations, and other relevant factors.

Question 11(d)

The terminology for taxation of support payments is similar to that used in the taxation of disability benefits. In fact, the Supreme Court of Canada (SCC) commented on the Armstrong case (56 DTC 1044) in the Tsiaprailis decision. Is it the view of CRA that settlements of support are taxable (and deductible) on the same basis as disability insurance benefits, or does the CRA feel that "pursuant to" an insurance policy for disability benefits differs sufficiently from the term "under" an order or agreement for support to adopt a different interpretation? The CRA's comments in respect of (a) and (c), above, as they relate to support payments would also be appreciated.

Response

The Tsiaprailis decision does not change our position in respect of the deductibility and the requirement for income inclusion of a lump sum support payment. The CRA's position with respect to this issue is set out in paragraphs 21 and 22 of Interpretation Bulletin IT-530R.

Question 12—Canadian Resident Trusts

Pursuant to Section 248(1) a "capital interest in a trust…resident in Canada" is a "taxable Canadian property".

Section 116 requires Clearance Certificates when disposing of a taxable Canadian property by a non-resident. This requires the completion of form T2062 and all of the related paperwork that comes therewith.

While we appreciate and understand the policy related to this matter when and if a non-resident beneficiary were to sell his/her interest (if possible), or if there were a final distribution being made from a trust, the technical provisions appear to require completing form T2062 even when there are regular monthly or quarterly distributions to a non-resident beneficiary. For example, we have several circumstances where the capital of a trust resident in Canada has approximately $5 to $10 million in a portfolio of Canadian marketable securities. The terms of the trust do not provide for any income payments to beneficiaries but do establish monthly distributions of a capital of $10,000 per month. It seems to us a very onerous requirement for both CRA and the taxpayer to complete the form T2062 procedures each month. Are we correct in understanding that CRA's interpretation is that monthly distributions described above do in fact require compliance with Section 116 and the filing of form T2062 each month? If yes, are there any relieving procedures that are administratively available to reduce and eliminate a significant paper flow for both CRA and the taxpayer?

Response

A capital interest in a trust resident in Canada is taxable Canadian property. Any payment out of a trust that can reasonably be considered to have been made because of the capital interest will result in a disposition of all or part of the beneficiary's capital interest in that trust. Thus, a distribution of capital to a non-resident beneficiary will normally result in a disposition of taxable Canadian property by that non-resident beneficiary. Monthly distributions to a non-resident beneficiary are considered payments to non-residents, and Section 116 is applicable. Form T2062 is required when a monthly distribution is made to a non-resident beneficiary. The monthly distributions described above fall under the requirements of Section 116. *However, only one Form T2062 is required at the beginning of each year as long as a payment schedule is provided with the submission.*

Question 13—Extension to Filing Deadlines - T1 Returns

Many tax practices are now seeing 60% or more of their T1 clients not able to take their information to their accountant to have their personal income tax returns prepared until after the end of March—many holding back because they do not yet have all their information slips. Returns for many clients who bring some of their material in earlier are often only partially completed by the end of March, and have to be held while waiting for more slips.

The government seems to have understood the pressure on taxpayers to determine their income and file appropriate tax returns—in most cases—

• Corporations	6 months
• Self-employed individuals	5.5 months
• Employees	4 months

- Individuals with interests in trusts, receiving T3 slips **2-3 weeks**

The IRS has a system (which seems to work well) whereby taxpayers can pay their estimated tax due on the normal filing date, and obtain an automatic two-month extension in the due date to file their personal income tax return to allow them time to organize their affairs or to gather up missing information. In fact, they can in most cases get a second or even a third extension without major difficulty. Has the CRA or the Department of Finance considered extending this type of courtesy to Canadian taxpayers? Clearly, it does not need to result in a delay in collecting revenues.

Response

The April 30 filing deadline applies regardless of the individual's sources of income, and regardless of whether or not all information slips and receipts have been received. If the return is not filed by the due date, a late-filing penalty may be charged.

The CRA encourages individuals who have not yet received all of their information slips to file their returns on time, including an estimate of any amounts for which they have not received the relevant slips. Providing that the return is filed by the individual's filing due date, no late-filing penalty will be charged. If the individual's estimate does not agree with the amounts reported on the slips, the individual can request an adjustment after the missing slips have been received.

As comments concerning the filing extensions granted by the IRS relate to tax policy, it is suggested that they be addressed to the Department of Finance.

Question 14—Medical Expenses - Massage Therapy

Currently massage therapists are only recognized/regulated in BC and Ontario and are only viewed by the CRA as meeting the definition of medical practitioner in those two provinces, for the purpose of s.118.2(2)(a) (medical and dental services), so in only those two provinces may a taxpayer walk into a wellness centre or clinic and order a massage knowing it will be allowed as a medical service expense.

However, massage therapy is becoming increasingly recognized as a legitimate course of treatment following various injuries and accidents, and is often prescribed by taxpayers' physicians. Is the CRA prepared to accept the cost of massage therapy as a medical expense under s.118.2(2)(e) where this therapy is a course, or part of a course, of treatment ordered by a doctor or other qualified person?

s.118.2(2)(e) for the care, or the care and training, at a school, institution or other place of the patient, who has been certified by an appropriately qualified person to be a person who, by reason of a physical or mental handicap, requires the equipment, facilities or personnel specifically provided by that school, institution or other place for the care, or the care and training, of individuals suffering from the handicap suffered by the patient.

Response

In order for a payment to qualify as medical expenses for a particular individual under paragraph 118.2(2)(e) of the *ITA*, it must meet the following criteria:

- The individual must be suffering from a physical or mental handicap.
- The individual must be receiving care or care and training at a school, institution or other place. The term of "other place" is part of the phrase "a school, institution or other place" and should take its meaning from the words preceding it according to the interpretative principle ejusdem generic.
- An appropriately qualified person must certify that the individual, because of the nature of that handicap, requires the equipment, facilities or personnel specially provided by the particular place mentioned above.

It is the CRA's opinion that an "appropriately qualified person" includes a medical practitioner as well as any other person who has been given the required certification powers under a provincial or federal law to diagnose that particular handicap.

The CRA agrees with the Federal Court of Appeal's view in the case the Queen v. Title Estate that the certificate under paragraph 118.2(e) must at least specify the mental or physical handicap from which the individual suffers, and the equipment, facilities or personnel that the individual requires in order to obtain the care or training needed to deal with the handicap. In addition, the CRA must be satisfied that the equipment, facilities or personnel provided by a particular place meets the requirements specified. Please note that the pending amendment of paragraph 118.2(2)(e) requires the certification be provided in writing.

The severity of an injury varies from individual to individual and may not always constitute a handicap. Therefore, the totality of the evidence of each particular case must be analyzed in order to determine whether all the criteria of paragraph 118.2(2)(e) have been met. Please refer to paragraph 29 and 30 of IT-519R2 (Consolidated) for further comments.

Question 15—My Account

This was a welcome improvement to the personal tax system. However, in an attempt to improve security, it appears that for 2005 the CRA has made this feature extremely difficult to access, and impossible to do so on a timely basis. An individual who wants to just look at their account, instead of just being able to sign on with some personal data contained in their Notice of Assessment and tax return, now must:

- Make a decision if they want to log in or register for a Government of Canada epass if they try to log in, thinking they don't want an epass (all they want to do is look at their account), they are directed to epass Canada anyway and odds are will get a message stating "Java applet unable to load."

- Then have to figure out what the problem is, go to the Sun Microsystems website to download the latest Java software and install same, then configure their internet browser to allow Java to operate properly with the CRA system.
- Then start again at the CRA website and go through a half-hour exercise to (partly) register for a Government of Canada epass, only to find that this process is only partly on the Internet. After filling in several questions and answers (hopefully they will remember the answers later), they find that the epass code/password will be sent by mail and they have to wait for a week or so.
- Then, after they have the information by mail, they have to sign on and finish the process—and this part is time sensitive—if they wait too long to activate their epass after it is mailed to them, it is outdated and they have to start over again.

We are dealing in many cases with people who only know the basics of how to deal with their computer, and many will be simply unable to navigate these steps.

Hopefully, taxpayers who just want to let their professional advisors act for them will not be forced to go through this procedure to give professional access to their electronic record when third party access comes about later in 2005. In other words, will taxpayers be able to just sign the new T1013 or equivalent, which will be sent to the CRA, and not themselves have to register for an epass in order to allow practitioners electronic access?

Response

The security and protection of confidential client information is one of the CRA's highest priorities when we offer electronic services. To that end, CRA uses the best commercially available encryption technology to ensure the integrity of information transmitted to us electronically. Public Works and Government Services Canada (PWGSC) sponsors this technology.

Effective February 14, 2005, we have made more services and information available with My Account. Accordingly, we have enhanced our procedures for accessing My Account and included registering for a Government of Canada epass. The use of Java Virtual Machine provides enhanced security measures the epass Canada uses to protect a client's privacy. If the client does not have this software installed and enabled on their computer, it must be downloaded.

The CRA activation code is also a new feature of the identity proofing process and has been added to increase security. The activation code takes approximately five business days to receive (15 days outside Canada or the U.S.). The code is valid for 35 days for Canada and U.S. addresses, and 50 days for addresses outside Canada and the U.S. Should the activation code expire, the client can obtain a new activation code by either re-registering online or calling the e-service Helpdesk at 1-800-714-7257 or (204) 984-0120 (collect) if outside Canada or the U.S.

The initial registration-based process is a one-time event. Subsequent access to My Account will be based on a user ID and password of the client's choice. The epass will remain valid indefinitely if it is used at least once a year.

In early 2006, CRA will introduce an electronic service for tax professionals, representatives and owners of tax services businesses to get access to their clients' tax information online. The following steps will be required:

- The tax professionals, representatives and business owners will go through CRA's website to register their tax services business and/or themselves and get a Representative Identifier (RepID).
- Once registered, the tax professionals, representatives and business owners will provide their RepID or BN (to authorize the entire business) to their clients.
- Clients will then be able to complete the newly designated T1013, "Authorizing or Cancelling a Representative," that will have a space to enter a RepID or BN to authorize their tax professionals, representatives or tax services business for electronic access. Clients may choose, alternatively, to login with their epass to electronically authorize their tax professionals, representatives and tax services business through CRA's My Account.

Question 16—Taxpayer Consent Forms

It seems that the CRA is dealing with the problem of too many consent forms that never seem to expire by: (1) flushing out the system and "losing" consents that have been there for some years, and (2) transforming the standard T1013 and T183 consent forms to automatically expire three years after they are transmitted. What's the rush? A professional preparing a 2004 tax return in early March and sending in a consent, then three years later preparing a 2007 tax return late in April, would find that he/she could not check back on the 2004 return, even though it would not be statute barred, because the original consent form would now be more than years old. This means CRA will get hundreds of thousands of consent forms being sent all over again every **two** years, to ensure coverage. Could a more reasonable period (like five years) not have been set?

Response

The response to Question 16 is included in the response to Question 22.

Question 17—Late T3 Slips for Individual Taxpayers

More and more trusts are themselves investing in other trusts. Where this is not the case, investments in trusts are often held by taxpayers in nominee form, via broker or investment management accounts. This results in T3 slips for the individual taxpayer being delayed substantially beyond the end of March, as the information must go through two or more levels prior to being passed on to the individual taxpayer late in April. Anecdotal evidence from tax professionals would seem to infer that slips are getting later and later, putting more and more pressure on taxpayers and tax return preparers to respond in an ever-shrinking tax preparation season. Is the CRA monitoring the situation and taking steps to address the problem?

Response

There are a number of reasons why individuals may be missing certain information slips, including the situation mentioned. However, individuals still need to file their income tax returns by their filing due dates (June 15 in the case of self-employed individuals and their spouses, otherwise April 30) to avoid the possibility of late-filing penalties being charged.

The CRA encourages individuals in this situation to file their returns on time, including an estimate of any amounts for which they have not received the relevant slips. If the estimate does not agree with the amounts reported on the slips, an adjustment can be requested after the missing slips have been received.

Question 18—Disability Expense Flowchart

Would Canada Revenue Agency consider developing a flowchart to map out the Disability Tax Credit, Medical Expenses and the new Disability Supports Deduction and the interrelationships between these credits/deductions? This would be a most helpful addition to their publications on the rather complex criteria for these credits/deductions.

Response

We appreciate your concern in this area. Your suggestion has been forwarded to Head Office (Ottawa) for their consideration.

Question 19—T1 Preparation Software and RRSP Contributions

Question 19(a)

At the request of CRA, changes to the 2004 versions of T1 preparation software does not enable RRSP contributions to be entered for January/February 2004. CRA has advised that RRSP contributions for that time period should have been entered on the 2003 T1 return and treated as a non-deductible carry forward if the client chose not to claim on the 2003 T1. Taxpayers/tax practitioners now have to go through extensive and expensive machinations to obtain the 2003 or 2004 deduction for the client.

This new RRSP “rule” does not appear to be based on legislation and is a very costly exercise for practitioners to administer. Why was the change to the software programs considered necessary and why were practitioners not advised of this change at least one year in advance of the change so that our clients could be educated? It is understood that CRA will insist for all future years that any contributions made within the first 60 days following the current tax year, must be reported on the current year’s return.

We have a situation where our client did not include the Jan/Feb 2004 RRSP contribution receipts on his 2003 tax return. We have attempted to remedy the situation by filing a 2003 T1 adjustment to include RRSP contribution receipts previously omitted from the 2003 return. Since receiving the T1-Adjustment Request, CRA has requested that we go back to each preceding year to prove that no duplication of contributions has occurred. Instead of an inexpensive T1 adjustment, our client has now incurred significant costs required to research RRSP contributions over the last four years and to communicate with CRA to satisfy them that the T1 adjustment for 2003 and all deductions for prior years are in order.

Response

There have not been any new requirements for the reporting of RRSP contributions provided to T1 preparation software since 1999. Any change made to last year’s software programs would have come from the software developers.

Although there is no specific provision in the *Income Tax Act* (the *Act*) that states how RRSP contributions are to be reported, Subsection 150(1) of the *Act* does require that *“a return of income that is in prescribed form and that contains prescribed information shall be filed with the Minister, without notice or demand for the return, for each taxation year of a taxpayer.”* Because of the flexibility the *Act* allows in the deduction of RRSP contributions made during the first 60 days of a year, the Agency determined that the best way to track these contributions was to capture them on the first return on which they could be deducted (regardless of whether or not a deduction was actually claimed). Beginning with the 1994 tax year, the Agency decided that RRSP contribution information would be tracked using the Schedule 7. The 1994 Schedule 7 was the only year that provided a line to report RRSP contributions made in the first sixty days of the year or in prior tax years. Line 244 was used to record the contributions made from January 1, 1991, to March 1, 1994, that were not deducted on the 1990, 1991, 1992 or 1993 returns. Subsequent years’ Schedule 7s allowed only contributions made in the last 10 months of the year and the first 60 days of the following year to be reported.

In the Client Requested Reassessment (CRR) workload, if a client submits a request to adjust their RRSP contribution for a given year, we verify the file to ensure that the amount was not previously reported. This will ensure that no duplicate claims are reported. We further ensure that the return only contains contributions based on the last 10 months of the current year and the first 60 days of the following year. This method of processing (reporting) RRSP contributions was adopted by CRR with the introduction of the Schedule 7 in 1994.

The Agency’s review programs play an important role in client education and in the integrity of the self-assessment system. The ultimate result of the RRSP contribution slip matching program will be the validation of amounts reported by clients and increased accuracy of the Agency’s records.

While the RRSP contribution slip matching is a new initiative, based on the information provided above, the method of reporting unused contributions has not changed for the 2004 tax year.

Question 19(b)

Please explain the reason for this change in RRSP contribution administration. Is the ultimate result of the RRSP contribution slip matching program to be that CRA will be able to prepare the T1-OVP forms for taxpayers in the future and include this on the Notice of Assessment in the RRSP section?

Response

No, CRA would not prepare T1-OVPs in advance for our clients and include them on the T1 Notice of Assessment. The T1-OVP Individual Tax Return for RRSP Excess Contributions is a separate tax return with its own Notice of Assessment. The Canadian taxation system is based on a principal of client self-assessment. The RRSP contribution receipt filing information will allow CRA to identify clients who should be filing a T1OVP return. If a client fails to file a tax return when requested to do so, CRA could assess tax in accordance with Subsection 152(7).

Question 20—Farm Audits

We have noticed an increase in the number of farm audits this year among our client base. Audits place an additional financial burden on farmers at a time when cash is short, as they typically want their accountants to assist them during an audit. Over the past couple of years, with the BSE crisis and drought, many of Alberta's farmers have reported losses (and typically offset with the optional inventory adjustment) from farm operations and many are living on their lines of credit.

What are the typical screening criteria for farm audits? Does CRA taken into consideration the recent economic hardships that Alberta farmers have encountered when selecting a file for audit? As most of the farmers report on a cash basis, they have used the mandatory and optional inventory adjustments to include in income a portion of their inventory to offset losses. If any audit adjustments are proposed as a result of the audit, it is likely that there will not be any cash taxes owing by the farmer as the optional/mandatory inventory adjustments will just be adjusted to absorb the audit adjustments.

Response

In the audit selection process, CRA employs sophisticated methods to help determine where the risk of non-compliance is greatest. Files are reviewed on the basis of the facts on a case-by-case basis.

CRA is aware of the challenges being faced by the agriculture industry. Selecting audits from this industry is being done in a manner respectful of their difficulties.

Question 21—Contract Payment Reporting System

Question 21(a)

Why is the financial burden and time commitment for the completion and filing of the Contract Payment Reporting System (CPRS) imposed upon individual and corporate taxpayers?

Question 21(b)

Is the CPRS the most effective tool to identify the target taxpayers?

Question 21(c)

What is the purpose of the CPRS?

Question 21(d)

Is the CPRS achieving its objectives in a cost effective manner?

Taxpayers are investing significant time and money into assembling information to report payments made to subcontractors so that CRA has a list of entities from which to determine if income is being reported. However, taxpayers are given the option to report payments to subcontractors based upon the taxpayer's fiscal year end or based upon a calendar year.

If the intention is to confirm whether individuals and sole proprietors are reporting income, would it not be prudent to require calendar year reporting as with T4s? Based upon the information provided on the T5018 slips, if the recipient is an entity other than an individual or sole proprietor, it would be virtually impossible to agree the amounts received to the amounts reported based upon varying year ends of the recipients.

We also note that there is no requirement for the taxpayer to distribute copies of the T5018 slips to the recipients of the payments. It appears that our self-assessment tax system has gone well beyond what the legislation originally intended. With the introduction of the CPRS an unwarranted financial burden has been placed on the taxpayer.

It would appear that CRA already has access to this target taxpayer group through the GST system.

If this is so, why should the taxpayer bear the financial hardship to provide CRA with information that is solely used to reduce CRA's audit costs without receiving some form of compensation, such as a non-refundable tax credit of $X per slip submitted?

Response 21(a)

The requirement to file an information return under the Contract Payment Reporting System (CPRS) is found in Section 238 of the *Income Tax Regulations*. Consultations with the construction industry were undertaken to ensure that the system was effective, and particular attention was paid to minimizing the administrative costs of compliance. Industry's suggestions have resulted in features to help reduce time including—providing the address of the subcontractor is optional and instead of preparing the T5018 slips, contractors may report the information on a line-by-line basis in a column format with the appropriate summary information.

Response 21(b)

The objective of the CPRS is to assist the CRA in addressing activity in the underground economy in the construction sector by promoting voluntary compliance and providing a basis for strengthening the CRA's enforcement programs. Third party reporting systems are used by many tax administrations to encourage voluntary compliance. Consultations with the construction industry were undertaken to determine the most effective approach for reporting payments to subcontractors. The T5018 was a modified T4A slip, a form already known and recognized by business and considered the most cost-effective method for businesses to comply.

Response 21(c)

The CPRS is but one initiative to address underground economic activity in the construction industry. The CPRS was developed by the CRA in consultation with the construction industry to encourage compliance in that industry. The CPRS also provides information on contractors that allows the CRA to undertake enforcement action against those who have unreported or under-reported income.

Response 21(d)

With respect to enforcement action, the objectives of the CPRS are being achieved. An evaluation of the CPRS was completed and is posted on the CRA website at **www.cra-arc.gc.ca/agency/internal/cprs-e.html**. In summary, the CPRS has exceeded its expectations. It has resulted in $650 million in tax assessments over the past four years at an annual cost of $30 million. Just as measuring the size of the underground economy is difficult, so to is measuring voluntary compliance. The CRA has not yet measured the extent to which the CPRS has influenced voluntary compliance in the construction sector.

Reporting—In CRA's original discussion paper, the reporting period was for the calendar year and the deadline for filing was the last day of February. After consultation with the construction industry, the reporting period was established to be either on a calendar year basis or a fiscal period basis, and the return is now due within six months after the end of the reporting period.

Distributing—In CRA's original discussion paper, it was stated that the provision of a copy of the information to the subcontractor is a statutory requirement of information returns. After consultation with the construction industry, there is no mandatory requirement to provide information slips to subcontractors, as the industry was concerned about possible increased administrative costs. However, from the point of view of fairness and transparency, we encourage contractors to provide them to the subcontractors.

We do have access to this target taxpayer group through the GST system; however, it is through third-party information that we can then effectively check for compliance on GST returns as well as income tax returns. As this was a joint initiative with the construction industry to encourage compliance in that industry and ensure a level playing field, which is a benefit to both the industry and CRA, compensation for preparing the slips was not considered.

Question 22—Third Party Authorizations

- The CRA recently amended form T1013, used to grant third party authorization. Two key changes were made, in the writer's view:

a) Two tiers of authorization now exist. Other than providing another opportunity for a client to make an error and provide a level of authorization lower than actually desired (both levels were previously subsumed in the form), this seems to have little real impact. Was there a significant demand for reducing the authority given to representatives?

b) A three-year time limit has been imposed. Again, we are uncertain what purpose this serves, other than imposing a further impediment and administrative cost to taxpayers who wish their professionals to have general access to their information. The previous form already provided the option of selecting a specific year or providing ongoing access.

What is the reasoning behind these changes?

Would it not be possible to make these changes, assuming they are essential for some reason, in a fashion more friendly to taxpayers who wish to provide long-term authorization to their representatives (e.g. retaining the option for authorization which remains in effect until revoked)? The three-year limit, in particular, seems to impose extra costs on all parties, for no significant benefit we can perceive.

The new form came as a complete surprise to the writer. Why would the Agency not consult with tax professionals before changing a system that we rely upon to obtain information necessary to serve our clients in a timely fashion?

Will the Agency continue to respect previously-submitted authorizations and, if so, for what period? For example, if a Notice of Objection is filed by a taxpayer's representative who was previously authorized, will it be rejected?

Response

The changes brought into effect on the *Authorizing or Cancelling a Representative Form* T1013 were made to ensure clients are more informed of what they are allowing their representative to see and do. A client can either authorize the CRA to disclose information to their representative (Level of Authorization - 1) or to disclose and make changes (Level of Authorization - 2).

Advice from our legal department indicated there should be a time limit on the validity period for authorization. Three years was selected as the validity period as it matched the time limit for reassessments. All previously authorized representatives that were on our system will remain on the system until December 31, 2008. We will continue to accept the older version of the T1013 form; however, when you use the old form your authorization will be at a Level 1 only. To avoid problems with authorization levels, it will be necessary to begin using the revised form.

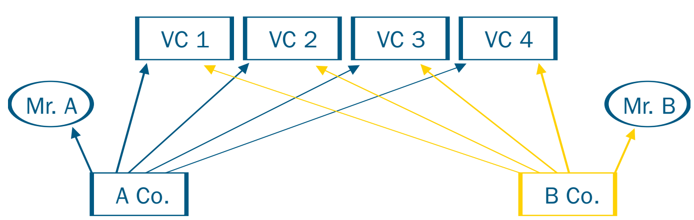
The new form, as well as the new time limit, was focus-tested with clients and tax preparers and the feedback indicated an overall comfort with the form and what it is intended to do. Since the new form was distributed, there has been feedback that indicates the three-year period is problematic. Headquarters is in the process of reviewing this and would welcome feedback from your association.

The form T183 Part E when signed and transmitted to CRA will automatically be assigned a level 2. The decision to assign the highest level was made in this case because electronic filers are, for the most part involved in both our pre- and post-assessment verification processes and with these often ensue requests for adjustments.

The RC 59 *Business Consent Form* will be revised later this year. One of the changes being considered is the ability to designate a representative for Other Levies and Charities. A change to the time limit of the validity period will not be included in this year's revision. However, the issue is being reviewed for subsequent revisions. Your suggestions for future revisions to this form would also be welcomed.

Question 23—SR&ED

We seek clarification of the situations in which the provisions of the March 24, 2004, budget, as outlined in paragraphs 7 and 8 of the related Notice of Ways and Means, will be effective in not requiring the sharing of the SR&ED Expenditure Limit, and related questions about the application of the new provision. The following scenarios are for illustration, and we'd appreciate clarification as to how CRA would, or would not, apply the new provision.



Scenario 1

A Co. and B Co. are startup technology companies, each of which would qualify to earn Investment Tax Credits (ITCs) at the 35% refundable rate but for the involvement of the Venture Capitalists (VCs). Neither of A Co. nor B Co. is taxable, and therefore would have no ability to utilize any non-refundable ITC earned. In the above diagram, assume Mr. A and each of VC1, VC2, VC3 and VC4 own 20% of A Co., and Mr. B and each of VC1, VC2, VC3 and VC4 own 20% of B Co. Mr. A, Mr. B, and each of VC1, VC2, VC3 and VC4 are otherwise unrelated and would not normally be associated with each other. *ITA* 256(1.2)(a) would allow for the formation of several different groups, each of which would be deemed to control both A Co. and B Co. In the absence of the budget provision, A Co. and B Co. would be associated and would need to share the SR&ED Expenditure Limit with each other and each of VC1, VC2, VC3 and VC4, which could result in all of the ITC being earned at the 20% non-refundable rate.

Would the budget provision be effective in this situation, allowing each of A Co. and B Co. to have a full SR&ED Expenditure Limit? Would the above companies still need to share a single Small Business Deduction Limit? Would the Large Corporation Capital Tax exemption need to be shared by all of A Co., B Co. and the VCs? Will the disassociation be a question of fact that occurs automatically with no disclosure to CRA, or will there be a new association code added to Schedule 9 to reflect that the corporations would be associated but for the new budget provision, or will there be an election required to allow this provision to be applied?

Scenario 2

Assume the same fact situation as in Scenario 1, except that Mr. B is removed from the picture, and the VCs each own 25% of B Co.

Does the provision require that each of A Co. and B Co. have at least one "non-group" investor, or would the new scenario still allow the disassociation of A Co. and B Co. for expenditure limit purposes? Would A Co. be disassociated, but B Co. associated with the VC group, and any other corporations that they are collectively associated with and which have no "non-group" investors?

Scenario 3

Assume the same fact situation as in Scenario 1, except that there is a common investor in each VC, Ms. V, who owns a minimum of 51% of VC1, VC2 and VC3, and 25% of VC4. VC1, VC2 and VC3 would then be associated with each other, and related to VC4.

Would the budget provision still allow for the disassociation of A Co. from B Co., or would the indirect control by Ms. V make this provision ineffective? Would Ms. V be deemed to control 60% of A Co. and B Co., or would Ms. V be deemed to control the pro-rata portion (35.6%) of each? Would this interpretation change if the balance of the investors in the VCs were, or were not, related to Ms. V? Would a s.256(2) election made by each of VC1, VC2 and VC3 be effective in restoring full SR&ED Expenditure Limits and Large Corporation Capital Tax exemptions to each of A Co. and B Co.?

Scenario 4

Assume the same fact situation as in Scenario 1, except that VC1 now owns 65% of A Co. and 5% of B Co. VC2 and VC3 each own 5% of A Co. and 5% of B Co. VC4 owns 5% of A Co. and 65% of B Co. The VCs are not related or associated with each other.

Would the budget provision be effective in disassociating A Co. from B Co.? If not, would a s.256(2) election filed by each of VC1 and VC4 be effective in restoring the SR&ED Expenditure Limits to A Co. and B Co.?

Scenario 5

Assume the same fact situation as in Scenario 1, except that VC1 now owns 65% of A Co. and 65% of B Co. VC2, VC3 and VC4 each own 5% of A Co. and 5% of B Co. The VCs are not related or associated with each other. VC1 would therefore have direct control of both A Co. and B Co., and they would be associated with each other as a result of *ITA* 256(2).

Would the budget provision be effective in disassociating A Co. from B Co.? If not, would a s.256(2) election filed by VC1 be effective in restoring the SR&ED Expenditure Limits to A Co. and B Co.?

Response

Unfortunately, we cannot provide any definitive comments on the application of these proposed provisions to the situations presented without reviewing all of the facts surrounding each case. However, we will provide some general comments that may be of assistance.

Subsection 127(10.1) of the *Act* provides an additional ITC for certain Canadian-controlled private corporations (CCPCs), calculated as 15% of the least of three amounts, one of which is the corporation's "expenditure limit" for the year. A CCPC's expenditure limit for a taxation year is calculated under Subsection 127(10.2) of the *Act*, and is generally $2 million, subject to certain reductions. However, where the CCPC is associated with other corporations, it must share the annual $2 million expenditure limit among the associated corporations. In addition, the phase out of the expenditure limit is based on the combined taxable income and taxable capital of a group of associated corporations.

CCPCs that are controlled (in law or in fact) by the same person or group of persons are considered to be associated corporations. Common investors in a CCPC that do not form a "group of persons" under the jurisprudence may nevertheless be considered to be a group of persons under the extended definition of that phrase in paragraph 256(1.2)(a) of the *Act*, which provides that a group of persons in respect of a corporation means any two or more persons each of whom own shares of the capital stock of a corporation.

Proposed Subsection 127(10.22) provides a special relieving rule that can apply for the purpose of calculating a corporation's expenditure limit for a particular taxation year under Subsection 127(10.2). Proposed Subsection 127(10.22) will, subject to proposed Subsection 127(10.23), apply to a particular corporation if the following three conditions are met:

- The particular corporation is associated with another corporation, but would not be so associated if the *Act* were read without reference to paragraph 256(1.2)(a).
- The particular corporation has issued shares to one or more persons who were also issued shares by the other corporation.
- There is at least one shareholder of the particular corporation who is not a shareholder of the other corporation, or one shareholder of the other corporation that is not a shareholder of the particular corporation.

If proposed Subsection 127(10.22) applies to a particular corporation in respect of another corporation, the particular corporation will not be considered to be associated with the other corporation for the purpose of determining the particular corporation's expenditure limit under Subsection 127(10.2) and for the purpose of determining the particular corporation's business limit under Section 125 (as applied for the purpose only of determining the particular corporation's expenditure limit under Subsection 127(10.2)). This relief from the application of paragraph 256(1.2)(a) for the particular corporation vis-à-vis its association with another corporation for SR&ED ITC purposes is to be determined on a corporation-by-corporation basis.

According to the technical notes issued by the Department of Finance, the purpose underlying proposed Subsection 127(10.22) does not extend to shareholding structures that are intended to multiply the expenditure limit of corporations. Therefore, proposed Subsection 127(10.23) of the Act provides that the relieving rule in Subsection 127(10.22) will apply only if the following two conditions are met:

- The Minister of National Revenue is satisfied that the particular corporation and the other corporation would not otherwise be associated under the *Act*, ignoring the extended meaning of "group of persons" in paragraph 256(1.2)(a).
- The Minister is satisfied that the existence of one or more shareholders of the particular corporation, who are not shareholders of the other corporation, is not for the purpose of fulfilling the requirements of Subsection 127(10.22).

The following points should be noted with respect to the application of these provisions:

- The draft provisions only affect the determination of whether a particular corporation is associated with another corporation for the purpose of determining the particular corporation's SR&ED ITC. The provisions do not impact whether corporations are associated for other purposes in the *Act*.
- In order to determine whether a particular corporation is associated with another corporation in situations where the draft provisions may apply, it is necessary to determine whether the corporations would otherwise be associated. The draft provisions only affect the determination of association by ignoring the extended meaning of "group of persons" in paragraph 256(1.2)(a) of the *Act*. Without applying paragraph 256(1.2)(a), it is a question of fact whether two or more corporations would otherwise be associated. For example, if a group of persons own shares in two corporations, and the group acts in concert to exercise control over each corporation's policy and affairs, then the two corporations would likely still be considered associated, even without considering paragraph 256(1.2)(a) of the *Act*.
- The determination of whether the draft provisions would apply must be made on a corporation-by-corporation basis. Therefore, in analyzing a particular set of facts, each particular corporation's association with another corporation should be considered separately in determining whether the draft provisions would be applicable.

Please note that our above comments would similarly apply in considering the application of proposed

Subsections 127.1(2.2) and (2.3) with respect to refundable ITCs for SR&ED.

We trust that our comments will be of assistance.

Supplemental Question 1—Purchase Price Allocation

As a result of changes in the *CICA Handbook* and increasingly sophisticated valuation practices on the acquisition of commercial revenue properties, part of the purchase price may be identified to relate to assets other than the land and the building and include intangibles such as customer relationship values and above and below market value leases.

The provisions in the *CICA Handbook* concerning business combinations (HB 1581, EIC 140) require that for purposes of allocating the purchase price in a transaction that meets the criteria for an acquisition of a business, that the acquiring entity identify and recognize intangible assets that meet certain criteria. Generally Accepted Accounting Principles (GAAP) have evolved resulting in this requirement recognizing intangible assets, such as customer relationship values and above and below market leases, regardless of whether or not the individual assets have been assigned a value as part of the legal purchase and sale agreement. Further *CICA Handbook* guidance (EIC 124, EIC 140) sets out that the criteria for a definition of a business is broader than an acquisition of an equity interest in an incorporated entity, in that it includes situations where a group of net assets is acquired that represents a self-sustaining integrated set of activities.

In light of this, could the Agency provide guidance with respect to the proper allocation of these intangible costs for income tax purposes? Is the Agency's position influenced if the purchase and sale agreement allocates the selling price among the assets including intangibles? It should be noted that under GAAP, the in-place lease value portion of the purchase price, for example, is amortized over the term of the lease.

Response

For income tax purposes, CRA will generally not view the purchaser in a real estate transaction as having purchased eligible capital expenditure based solely on the accounting requirements to allocate a portion of the purchase price to intangible assets as recommended by EIC 140 and EIC 137.

Normally, appraising the fair market value and determining the purchase price of an income-producing property will include a calculation of the present worth of the rental income to be earned in the future from the property. This holds true regardless of whether the property is fully leased or empty of tenants (in which case other anticipated outlays like lease-up costs and time delays would be factored in). Hence, the rental income based on leases in-place or not in-place would have been an integral component in determining the cost of the tangible assets in a purchase.

Supplemental Question 2—Property Transfer and Subsection 85(1)

As you know, Subsection 56(2) applies, interalia, where a taxpayer transfers property or makes a payment to another person for the benefit of the taxpayer or as a benefit that the taxpayer desired to have conferred on the other person. Could the CRA comment in what situations they will consider that a payment to another person will be for the benefit of the taxpayer/transferor. Specifically, if a taxpayer makes a tax-deferred transfer of property (perhaps by utilizing the provisions of Subsection 85(1)), does the CRA include in its analysis of whether a benefit was conferred the fact that the transferor did not pay any tax on the transferred property because of the utilization of Subsection 85(1)?

Response

When considering in what situations the Agency would consider that a payment to another person would be for the benefit of the taxpayer/transferor, we can make the following general comments:

Whether a taxpayer desires to confer a benefit on a related party is a question of fact that can be determined only after consideration of all the facts and circumstances. Generally, where the facts show that the parties to the transaction intended to transfer the property at its fair market value and their efforts to establish that value are based on a fair and reasonable method, the Department will not consider that a taxpayer desired to confer a benefit. The existence of a price adjustment clause, in and of itself, will not be enough to negate the conclusion that a benefit was desired to be conferred. The concurrence or participation of the taxpayer in the conferring of the benefit need not be active. It may be passive or implicit and can be inferred from all the circumstances of a particular situation (for example, the degree of control which the taxpayer is entitled to exercise over the corporation conferring the benefit).

Within the context of a tax deferred rollover, such as that utilizing the provisions of Subsection 85(1), it is possible that benefits and/or deemed dividends can result, from the application of provisions such as Subsections 15(1) or 84(1). In this context, the most specific provision addressing the conferral of benefits is paragraph 85(1)(e.2), as alluded to below.

However, these types of provisions are generally dependant upon a discrepancy between the consideration given and received, or the paid up capital in the case of Section 84. For example, in a rollover of an asset utilizing Subsection 85(1), where the fair market value of the consideration given back to the shareholder exceeds the value of the asset transferred, a benefit could be assessed pursuant to Subsection 15(1). In the converse situation, in a rollover utilizing the provisions of Subsection 85(1), where the fair market value of the property transferred by a shareholder to a corporation exceeds the fair market value of the total consideration received by the transferor[1], a benefit could be assessed pursuant to paragraph 85(1)(e.2)[2].

In the context of a tax deferred rollover, the Agency generally will not consider that a benefit has been conferred simply by virtue of the proceeds being transacted at less than fair market value such that the transferor does not pay any tax.

[1] Actually the greater of the FMV consideration received and the agreed amount

[2] Assuming the excess FMV was a benefit the taxpayer desired to have conferred upon a related person

Supplemental Question 3—Voluntary Disclosure Program

Recent statistics published by the CRA indicate that the voluntary disclosure program has had great success in terms of utilization by taxpayers and their advisors in bringing forward situations that have not been handled correctly in the past. However, recent experience indicates that turning around a voluntary disclosure file can sometimes take one year or more. Is the CRA committed to improving the turnaround time for a voluntary disclosure file? Are more people intended to be hired to service the voluntary disclosure sections?

Response

The CRA is committed to reducing overall inventories, as well as reducing the elapsed time that a file is held until completion, in the Voluntary Disclosure Program (VDP). To that end, a review of the VDP workload is conducted each year in order to commit an appropriate level of resources.

Turnaround times for specific files must be viewed in the context of the particular file. For example, additional days can be added to files when the original information on the disclosure is incomplete, where a no-name disclosure is involved, when specific tax rulings are required, or when an audit is required to ensure completeness.

At any time where you believe that a particular file should be completed, or has been unnecessarily delayed, you are invited to contact the VDP officer or their team leader to discuss the file.

Supplemental Question 4—T1 Return Line 104

We understand that the CRA during the last year commenced a “line 104 project” whereby amounts that appeared on line 104 of an individual taxpayer’s income tax return were queried. Was this measure or audit partially targeted at identifying employee profit-sharing trust allocations? If so, is it fair to assume that many Employee Profit Sharing Plan (EPSP) allocations will be reviewed for reasonableness?

Response

The Winnipeg Tax Centre worked in partnership with the St. John’s Tax Centre for four months to review the income reported on line 104 of the T1 individual tax returns. The purpose of the project was to ensure employer compliance and appropriate remittances to the Crown in a timelier manner. We verified the nature of income (such as management fees, director’s fees and bonuses that are subject to deductions at source) and identified amounts where no required payroll deductions were withheld and remitted. Failure to remit assessments were raised accordingly and requests sent to T1 Enquiries and Adjustments to re-assess T1 returns where and when applicable.

During our review, many of the amounts reported at line 104 were identified by the clients as income from EPSPs. Referrals were made to the Trust Exam areas of the TSOs as these types of allocations were not within the scope of the line 104 project.

Supplemental Question 5—Pending Legislation

As you are aware, certain legislation has been in draft form for quite some time with proposed effective dates that, if passed, would have a retroactive effect. For example, the non-resident trust draft legislation and foreign investment entity draft legislation have an effective date of January 1, 2003, while such legislation is not yet passed. In addition, the “reasonable expectation of profit” draft legislation as proposed in new Section 3.1 has a proposed effective date of January 1, 2005. Such retroactive legislation appears to be more and more common. While this has its fundamental issues that are more appropriately dealt with by The Department of Finance, a question arises as to how taxpayers and their advisors should deal with such retroactive legislation. For example, to the extent that the legislation is passed with retroactive effect, and to the extent that a taxpayer has not considered such effect on his or her income, such retroactive legislation may require a taxpayer to amend their prior filings. What advice, if any, could the CRA provide with respect to taxpayers who are presently faced with such situations? Will the CRA look to impose interest and penalties on any tax payable as a result of such required amendments?

Response

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 results in an increase in benefits (e.g. Canada Child Tax Benefit) to the taxpayer or a significant amount of rebate or refund is at stake, generally, the CRA’s past practice has been to wait until the measure has been enacted.

With respect to the existing legislative proposals concerning non-resident trusts (NRTs) and foreign investment entities (FIEs) that have been made public by the Department of Finance, when deciding whether or not to file based on the wording of the existing law rather than the wording of those legislative proposals, taxpayers should be conscious of the proposed application dates for those legislative proposals. Taxpayers that choose to file based on the wording of the existing law rather than the wording of the existing legislative proposals are expected to bring their tax affairs up-to-date, in a timely manner, once the legislative proposals become law. In this case, the CRA may waive penalties as appropriate.

Supplemental Question 6—High-Low Stock Dividends

As you are likely aware, the Alberta Government has released draft legislation (Bill 16) to amend its corporate law to make it clear that high-low stock dividends are allowed under Alberta corporate law. Specifically, proposed Subsection 44(2) appears to contemplate a situation where a preferred share may be paid as a stock dividend that may have a high redemption value but a stated capital (i.e. paid up capital for income tax purposes) of a nominal amount. Accordingly, can the CRA now confirm that the "amount" would be the nominal amount chosen by the corporation that will dictate the taxable amount to the recipient and therefore not challenge the validity of such high-low stock dividends assuming that such legislation is passed by the Alberta Government?

Response

For the purposes of the *ITA*, the "amount" of a stock dividend is defined in Subsection 248(1). On the assumption that neither of paragraphs (a) or (b) of the definition of "amount" is applicable in the circumstances, the "amount" of the stock dividend for the purposes of the *ITA* will be the amount by which the stated capital of the corporation, which paid the dividend, is increased by reason of the payment of the dividend.

Subsection 44(2) "Amendment of the *Business Corporations Act* (Alberta)" provides that if shares of the dividend are issued in payment of the dividend, the directors may add all or part of the value of these shares to the stated capital account of the shares issued in payment of the dividend. Accordingly, if the *ABCA* allows AlbertaCo to declare a dividend of any amount including up to the FMV of the shares issued or to some lower amount, which is then added to the stated capital account as outlined above, the amount of the stock dividend as defined in Subsection 248(1) of the *ITA* would be the declared amount.

In general, CRA would not challenge the legal validity of the stated capital of shares of a corporation incorporated under the *ABCA*, where a nominal amount has been added to the stated capital of the shares issued by the corporation, as in the situation above.

Supplemental Question 7—Forward Foreign Currency Contracts

Does the CRA consider a forward contract to buy or sell foreign currency at a specified price in the future to be the "right to receive an amount" within the meaning of "disposition" under Subsection 248(1) "disposition" (b)(ii)?

Response

The meaning of "disposition" under subparagraph 248(1)(b)(ii) of the *Act* includes any transaction or event by which a "property" that is a debt or any other right to receive an amount is settled or cancelled.

Accordingly, pursuant to that definition, when the right to receive the amount is settled or cancelled, the "property" that consists of the right will be considered to have been disposed of.

Supplemental Question 8—Contract Disposition

Question 8(a)

Is there a "disposition" of a contract when the contract (such as a lease or non-compete covenant) reaches its term?

Question 8(b)

Is there a distinction to be drawn when the lease or contract is cancelled prior to its term (as occurred in the Queen v. Compagnie Immobiliere BCN 79 DTC 5068)?

Response 8(a)

Whether there is a "disposition" will depend on the nature of a particular contract.

Where a contract is an operating lease, generally, there is no tax implication at the end of the lease term. Payments received from an operating lease would have been on account of income and should be recognized over the term of the lease.

Where a contract contains a non-compete covenant, the payments received may be taxable or non-taxable depending on the facts of the case.

For example, where a vendor sells shares of a corporation and receives payment for a covenant not to compete with the corporation's business, the Federal Court of Appeal held the receipt to be non-taxable in both Fortino (2000 DTC 6060) and Manrell (2003 DTC 5225). In response to these court decisions, the Department of Finance issued a press release on October 7, 2003 announcing its intention to amend the *Income Tax Act*. The general rule under the proposed amendment, Section 56.4, is to treat any amount received or receivable in respect of a restrictive covenant as current taxable income. There are three exceptions to this general rule which could have the payments treated as income from office or employment, eligible capital expenditure (ECE) receipts, or proceeds of disposition.

Response 8(b)

The case of Compagnie Immobiliere deals with a very specific set of facts involving emphyteutic leases, the disposition of leasehold interest (Class 13) by the lessee upon its acquisition of the lease property prior to the lease term, and the disposition of a building (Class 3) by the lessor when it conveyed the right to demolish the building to its lessee.

In circumstances where a lease or contract is cancelled prior to its term, the lessor/vendor would normally be compensated. The CRA's position for non-performance of business contracts is outlined in paragraphs 8 and 9 of IT-365R2.

GST QUESTIONS

GST Question 1—Municipalities

The GST legislation as it affects municipalities was drastically altered in 2004 as a result of technical amendments introduced with the Federal Budget. To this date, no written guidance has been issued to existing municipalities, the general public or even to the CRA officials in the TSOs. The amendments were retroactive in their effective dates, but no provision was made for administrative fairness with respect to transactions that occurred after the announced changes but before the amendments were passed into law. When can we expect to see something concrete to inform municipalities on the effect of the changes on their operations? Is there a general administrative policy in place to deal with penalty and interest created by the retroactive nature of the changes?

Response

We note that at the time these amendments were announced, officials from Excise and GST/HST Rulings conducted a conference call with representatives of the Federation of Canadian Municipalities to discuss the amendments and address any questions their member municipalities had. More recently, our GST/HST Rulings Centres have been conducting outreach activities for municipalities to discuss the effect of the technical amendments on their operations and entitlements under the *Excise Tax Act* (*ETA*), and are available to conduct others. Should you have specific enquiries or concerns, you may contact officers in GST/HST Rulings Centres.

The following information is currently available and can be used along with the *ETA* when discussing amendments with clients.

1. Department of Finance—Notice of Ways and Means Motion (March 9, 2004). (This document provides a narrative of the amendments.)
2. Department of Finance—Notice of Ways and Means Motion (March 29, 2004). (This document provides the legislative amendments.)
3. Department of Finance - Explanatory Notes Regarding the Municipal Amendments (March 31, 2004).

In addition to the above, we are currently updating our guide *GST/HST Information for Municipalities*, which will include information about the 100% public service body rebate and the other technical amendments to the *ETA* affecting these entities. This guide is expected to be available in the near future.

The CRA will not make assessments based on proposed amendments until such time as those amendments are enacted. However, when a proposed amendment is enacted, Subsection 124(3) of the *ETA* requires interest to be calculated retroactively on any resulting amount that is payable or remittable by a person, as if the amendment had been enacted before its effective date. This Subsection also requires the retroactive calculation of interest on amounts becoming payable by the CRA as a result of a retroactive amendment being enacted. Although interest applies retroactively, Subsection 124(4) of the *ETA* provides that penalty will not be applied retroactively when a proposed amendment is enacted.

The CRA's policy on the cancellation or waiver of interest and penalties is set out in GST/HST Memorandum 500-3-2-1 entitled "Cancellation or Waiver of Penalties and Interest."

GST Question 2—New Housing Rebates

On December 20, 2002, the Minister of Finance announced amendments to Subsection 256(3) of the GST legislation that would allow the Minister to accept GST/HST New Housing Rebates after the normal two-year period provided in that Subsection of the *ETA* for filing such claims. This came largely as a result of the large number of remission orders that have been granted by parliament on late-filed applications. This amendment has still not been passed after more than two years. Assuming the amendment will be passed, it will be effective as of the date of announcement, December 20, 2002.

What is the administrative position of the CRA on accepting late-filed applications—is discretion being shown or must people file Notices of Objection until the legislation is amended?

Response

The proposed amendment to Subsection 256(3) permits the Minister of National Revenue to accept an application for the rebate of an owner-built home after the period otherwise allowed for making an application. The amendment recognizes that exceptional circumstances may prevent an owner-builder from filing the rebate application by the due date. Rebate claims filed beyond the two-year period, which are accompanied by a letter from the claimant indicating the reason(s) for the delay, will be reviewed by a Fairness Committee for Rebates at the Summerside Tax Centre. If the request for fairness is approved by the Fairness Committee, the related rebate will be held in abeyance at the Summerside Tax Centre until the proposed amendment to the legislation has passed in the House of Commons and becomes law. These rebate claimants will receive a letter and/or phone call confirming that their rebate has been received and that it will be held in abeyance until the proposed amendment becomes law. If the request for fairness is not approved by the Fairness Committee, Summerside Taxation Centre will deny the claim in full.

Any rebates filed on or after December 20, 2002, that had been denied for being filed past the two-year deadline will be reconsidered if the claimant submits a letter explaining the exceptional circumstances.

GST Question 3—Section 259 Amendments

What is the intended impact of the proposed amendments to Section 259 that were introduced with the 2005 federal budget?

Response

Under the public service body rebate, hospitals are entitled to a rebate of 83% of the GST and the federal component of the HST that they pay on their purchases used to provide exempt health care supplies, while charities and government-funded non-profit organizations are entitled to a 50% rebate.

In recent years, the restructuring by provinces and territories of the delivery of health care services has resulted in some services formerly provided by hospitals being performed by other non-profit institutions entitled to claim the lesser 50% rebate. In recognition that this restructuring might affect the application of the GST/HST rebate for health care, the 2003 budget announced a review of the rebate to assess and improve its application with respect to health care functions moved outside of hospitals.

Further to extensive consultations with provincial and territorial health and finance authorities since that time, the 2005 budget proposes to extend, effective January 1, 2005, the application of the 83% rebate to eligible charities and non-profit organizations that provide health care services similar to those traditionally performed in hospitals. This proposed measure accommodates the significant variations in health care delivery models across the country.

GST Question 4—Tax Paid in Error

What is the CRA's view with regard to a company's eligibility for an ITC or a "tax paid in error" rebate claim where the company inadvertently pays the same invoice twice (assuming a taxable purchase was made)? We are aware of CRA auditors contemplating denying the second ITC claim (where it was made at the time of the second payment) on the basis that there was no supply. In this case, it would seem that a tax paid in error rebate would be available to the company as they have in fact "paid an amount on account of tax" as detailed in Section 261 (where the payment can be linked back to the original invoice that charged tax—i.e., the same invoice provides documentation for both the first ITC and the rebate).

Response

It is our position that in a circumstance where the recipient of a taxable supply pays an invoice more than once, an input tax (ITC) will only be available once. However, a rebate of the amount paid as tax in error may be available under Section 261 of the *Excise Tax Act* (the *ETA*).

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

Section 165 requires a person, who is a recipient of a taxable supply, to pay tax in respect of that supply calculated on the value of the consideration of the supply. Pursuant to Subsection 221(1), a supplier is required to collect the tax payable by the recipient of the supply.

Subsection 123(1) defines "tax" as tax payable under Part IX of the *ETA*, and "consideration" to include an amount that is payable for a supply by operation of law.

Therefore, it is the supply of the property or service for consideration that creates the incidence of tax, and not the payment of the consideration for the supply. The second payment of the invoice is not consideration for the supply of the property or service, and the amount paid as "tax" in this second payment is not tax payable under Part IX of the *ETA*. Accordingly, making multiple payments in respect of one invoice issued for a particular taxable supply will not entitle the recipient to further ITCs.

In situations where an invoice has been paid twice by the recipient, the additional amount paid by the recipient as or on account of tax, constitutes an amount paid as tax in error. The recipient would be eligible to claim the amount as a rebate under Section 261, as long as the application for the rebate is filed within two years after the day the amount was paid.

Also note that the supplier, having collected the amount as or on account of tax, is required under Subsections 222(1), 225(1), and 228(2) to include the amount as part of its net tax calculation, which must be remitted to the Receiver General. As an alternative to the recipient filing a rebate application under Section 261, the supplier could refund or credit the amount to the person under Section 232 within two years after the amount was collected from the recipient. The supplier would be required to issue a credit note containing prescribed information. After such a credit note is issued, the supplier would be entitled to claim a credit for it

GST Question 5—Input Tax Credit Eligibility

What is the CRA's position with regard to a GST-registered entity's entitlement to claim ITCs where their only sources of income are interest and oil & gas royalties? It is our understanding that certain CRA auditors are of the opinion that no ITCs are available, as there is only GST-exempt financial income (interest), and that even though the royalties would be considered commercial activity, there is no supply for consideration (as required by Subsection 141.01(2)) due to the deeming provisions of Section 162. In this case, it would clearly seem that Subsection 141.01(7) would apply such that the deeming under Section 162 is ignored for purposes of applying Subsection 141.01(2) with the result being that in the least a pro-rated ITC would be available.

Response

Subsection 162(2) provides that certain supplies are deemed not to be a supply and any consideration paid or due, or any fee or royalty charged or reserved, in respect of the right is deemed not to be consideration for the right.

Even though Section 162 deems supplies not to have been made, the person may still be able to register pursuant to paragraph 240(3)(a) if the person's activities meet the definition of commercial activity.

If registered, the person can claim ITCs to the extent the inputs are used for the purpose of making taxable supplies, even though Section 162 deems there to be no supply, because Subsection 141.01(7) overrides the deeming provision in Section 162 for the purposes of Subsections 141.01(1) to (4).

GST Question 6—Closely Related Election

Has Finance given any consideration to widening the scope of the closely-related corporations (and partnerships) elections to sister corporations and/or to significant (90% or greater ownership) shareholders of corporations?

Response

Although we are uncertain as to the exact scope of the question, we have brought the matter to the attention of the Department of Finance. You may wish to follow up with Finance on this issue. Note: On November 17, 2005, the Department of Finance announced proposed changes to *ETA* Section 156.

GST Question 7—GST Account Reconciliation

We are seeing what appears to be an increase in the incidence of GST auditors "reconciling", or being unable to reconcile GST remittances, including instances where the auditor provides his/her own reconciliation with no support as to how or why it differs from returns filed or the company's books and records. Collection of any GST so reassessed is, of course, not stayed by an appeal. Our clients can be out many thousands of dollars, which, months later, are returned as the reconciliation assessment is overturned on appeal. Comments from Verification and Enforcement on this practice?

Response

It is a mandatory audit step to reconcile the posted GST Collected and ITCs claimed on a registrant's GST account to the accounting records. Variances identified during this reconciliation will be brought to the attention of the registrant at or before the proposal stage. The registrant will be required to provide information to identify the reasons for the variances. The auditor will provide the source/calculation of their variance to the registrant if and when requested. It is up to the registrant to analyze the variances to determine how the posted amounts were determined and included on the GST return, and why they differ from the amount identified by the auditor in the accounting records as the correct GST Collected or GST Paid.

GST Question 8—Credit Return Audits

We are concerned with the amount of time taken in some instances for auditors to complete reviews where large refunds are outstanding. Most recently, a client had a refund of more than $150,000 due. The Prepayment Unit referred the refund to audit. Due to many delays on the part of the auditor and the auditor's supervisor, the refund was not cleared for more than nine weeks. Does CRA have guidelines in place with respect to how long a file can be outstanding?

Response

The CRA strives to audit credit returns and rebates on a timely basis. Efforts are made to address refunds within the first 21 days of receipt of the claim in the TSOs workload.

When a refund is received in the local TSO and selected for an audit the nature and complexity of the issue may affect the amount of time required to conclude the review. The refund may be audited from CRA's offices or at the registrant's place of business. The circumstances may require the review of a large number of documents or the need to undertake technical research or consultation that could add to the time required to compete the file.

The registrant or their representatives are encouraged to ask the auditor or his/her team leader about the status of the audit and any delays that are occurring.

GST Question 9—GST Registration Verification

Similar to last year, we are still encountering many situations where CRA staff will not confirm whether a GST number is valid. It was announced in the recent budget that a business number registry will be put into place. We trust that this may solve some of these problems for us. Can CRA confirm when this registry is expected to be available to the public and what types of information we will be able to confirm through the registry? As well, in the meantime, what can we do when we encounter a CRA staff member who is unwilling to provide us with the validation information?

Response

A GST/HST Web Registry is currently in the preliminary stages of development by the CRA. It is anticipated that the GST/HST Web Registry will be available through the CRA public website and will have real time responses to queries. It is expected that the GST/HST Web Registry users will need to input a supplier's business number and name from an invoice, as well as the date they wish to confirm (i.e., the effective date of the supply). Updates to the GST/HST Web Registry are expected to be made on a daily basis. Finally, it is expected that the GST/HST Web Registry will only confirm or deny the validity of a registration number for a specified date (the date of supply) and that no other information about a registrant will be available. In the interim, we will clarify current CRA policy and procedures with respect to the confirmation of a GST/HST registration.

Although there is no obligation for a purchaser to verify the GST/HST registration of a supplier, a registrant may be denied an input tax credit if it turns out that the supplier was not a registrant.

GST Question 10—Partnerships

Consider a situation where a partnership is formed but the partnership itself is not registered for GST. Instead, the general partner is registered for GST and reports and remits the GST for the partnership. (This is the general partner's only activity.) In order to remedy this situation, will CRA accept retroactive registration for the partnership and a transfer of the filings to the partnership? If not, what would CRA do to remedy this situation with minimal financial impact to the partnership?

Response

The definition of a registrant includes any person who is or is required to be registered. Based on requirement to register as outlined in Section 240, registration of the partnership can be backdated to the point in time where the partnership was required to be registered.

Where a partnership makes a valid voluntary disclosure in accordance with CRA's published policy, the CRA will apply the WASH Transaction Policy, if the transactions otherwise qualify as a wash transaction, before the VDP Policy will be applied.

The WASH Transaction Policy will waive interest and penalty as stated in the *GST/HST Memoranda Series* Chapter 16.3.1. If there is any remaining penalty after this application the VDP Policy will apply, if there is a valid voluntary disclosure, thus removing the remaining penalty.

GST Question 11—Real Property

Assume a GST registrant pays GST when he/she purchases real property. In order to recover the GST, is the registrant required to file for a rebate for tax paid in error or, to simplify, can the registrant claim an ITC on its next GST return?

Response

In circumstances where Subsection 221(2) applies in respect of a particular taxable supply such that the person who made the supply is not required to collect the tax under Division II of the *Excise Tax Act*, any amount so paid by the recipient and collected by the supplier in respect of such a supply is not considered to be "tax paid" in accordance with the *ETA*.

Because an input tax credit (ITC) entitlement only arises with respect to tax paid or payable in accordance with the *ETA* and not with respect to any other amount paid as, or on account of tax, the recipient would not be entitled to claim an ITC in this case.

Note that any amount collected as or on account of tax is to be remitted in accordance with Subsections 222(1) and 225(1) of the *ETA*. Therefore, where a supplier has collected an amount as tax in respect of a taxable supply of real property to which Subsection 221(2) applies, the supplier is required to remit the amount collected to the Receiver General even if it has been collected in error.

Where it is determined that a supplier has collected an amount as, or on account of tax in error, the supplier may refund or credit the tax paid in error to the recipient, within two years of the day the amount was so paid. Where the supplier refunds or credits the recipient with the amount of tax paid in error, the supplier is required to issue a credit note to the recipient (or the recipient may issue a debit note) within a reasonable time, containing the prescribed information.

Where the supplier does not refund or credit the GST paid in error to the recipient, the recipient would be entitled to claim a rebate pursuant to Subsection 261(1) of the *ETA* in respect of such an amount paid, provided there is sufficient evidence to substantiate that the purchaser had in fact paid an amount as or on account of tax, or that was taken into account by the parties to the transaction as tax. The application for the rebate must be filed within two years after the day the amount was paid.

GST Question 12—Account Payment Holds

We have encountered many situations where CRA has a "hold" on a client's GST account and thereby many actions stall, resulting in our frustration to clear the holds. Several examples are cited below:

(a) A client became inactive several years ago but remained in existence due to a legal dispute. After five years with no apparent contact from CRA, we received notification that GST returns were outstanding. After several discussions with CRA, we determined that the client had a balance of over $25,000 being held by CRA for more than five years. Despite filing NIL returns for these years, we had significant difficulties in convincing CRA to release the credit on the account. Once released, we had to then convince CRA that interest was due and payable on the credit. Does CRA have a mechanism in place to identify large credits being held and to periodically follow up on the credits?

(b) We are aware that CRA will write-off large credits periodically without contacting the taxpayer to confirm. Is CRA responsible for ensuring that final contact is made with the taxpayer prior to writing off a significant credit on the account?

(c) We are still encountering difficulties with old "holds" on GST accounts that are not released properly and therefore cause problems when we try to have refunds released. A recent example is an audit hold not released after the audit was completed. Does CRA not have a mechanism to ensure that these holds are reviewed periodically or to ensure that they are released as soon as possible after they are no longer valid?

(d) Recently, we encountered a situation where a significant GST refund was being held until a payroll audit was completed. Can CRA confirm what the link would be between the payroll audit and GST account and whether there is a formal policy with respect to the holding of refunds in this situation?

(e) Subsection 229(2) of the *ETA* requires that all GST returns for the reporting period and prior periods must be filed before the GST refund is paid to the registrant. We have encountered situations where refunds relating to prior periods are held because GST returns for periods subsequent to the refund periods are outstanding. Can CRA confirm its policy with respect to the holding of refunds under Subsection 229(2)?

Response

(a) The GST system monitors for overdue returns and will release the overpayment refund once all outstanding returns are received and processed; or the account is otherwise brought into compliance. Client contact and enforcement action can also result in credits being released as a result of information received. Reports can also be generated of system sweeps to identify credits for resolution. Refund hold reports are generated on a regular basis on accounts where a refund hold has been manually set on an account, and the division setting the hold is contacted to determine the disposition of the hold.

(b) A dormant credit that is not subject to a system inhibit or a manual refund hold, can be written off if they have an effective date greater than two years. They may also be written off if the effective date is greater than one year, and two written requests for information have gone unanswered. Otherwise, they must be sent to the client. If the resulting refund cheque is returned as undeliverable, we will proceed to write off the credit. Credits will be reinstated if the new address or new information is obtained.

(c) A refund hold may be placed on a registrant's account for a variety of reasons due to activity on the account by various areas of CRA's operations. There is no mechanism within the GST system that identifies and releases holds when a refund is established. As noted previously, refund holds must be released manually and generally by the party that originally placed the hold on the account.

If a registrant is experiencing delays in the release of a refund, they should contact the Agency to determine why their funds have not been received.

(d) When a trust exam is completed, both the Payroll and GST accounts are reviewed to ensure compliance with the applicable legislative provisions. Refund holds may be placed on a GST account where it is apparent that a debt exists or will be assessed on a related payroll account.

(e) Section 229 provides the rules for the payment of a net tax refund to a person. Under Subsection 229(1), where a net tax refund is claimed by a person in a return filed by the person, the Minister shall pay the refund to the person with "all due dispatch" after the return is filed. However, under Subsection 229(2), a net tax refund for a reporting period of a person shall not be paid under Subsection 229(1) until such time as all returns required to be filed by the person for the reporting period and all preceding reporting periods have been filed with the Minister.

Where the conditions under Section 229 have been met, a net tax refund is to be paid with "all due dispatch." When determining whether to pay a refund amount, it is both fiscally responsible for the CRA to examine the potential liability of the claimant where other amounts may be due and payable, and fair to both parties such that we are not put in the position of paying a refund and at the same time taking independent collection action to recover other amounts. For example, in the situation where returns are overdue for subsequent reporting periods and the person is likely to have net tax remittable for those reporting periods.

Since the CCRA is committed to the responsible administration and enforcement of the *ETA*, requesting the subsequent returns that are due prior to paying a refund negates the somewhat stronger action of assessment and offset. Exercising the above enforcement provisions would require the Minister to take care in paying any refunds.

Therefore, Subsection 229(1) provides discretion of the Minister to be exercised, for the good administration of the *ETA*, with reason, justice and legal principles. As a result, a refund balance may be left on a registrant's account where returns for subsequent reporting periods have not been filed by their due date and there is potential that the registrant will have net tax remittable for those reporting periods.

GST Question 13—Other Bodies Established by Government Draft Policy

Several of our clients made submissions with respect to the draft policy on what constitutes an "other body established by a government." Is there any news as to the progress of this draft policy?

Response

As of April 15, 2005, the Public Service Bodies and Governments Division had received several submissions on the draft policy statement on what constitutes an "other body established by a government." Others have discussed with us the need for additional time to submit their comments on the draft policy. We have agreed to provide the additional time. Once all of the submissions are received, we will undertake our review of the draft policy in the context of the representations.

Note: On November 4, 2005, CRA issued GST/HST Policy Statement P-247: "What Constitutes An "Other Body Established by a Government" for Purposes of the *Excise Tax Act* (the *Act*)?"

GST Question 14—Cost of Audits

In the course of their training, are auditors made aware of the financial cost borne by taxpayers in responding to audit queries? We note many examples where the costs to respond are disproportionately high in relation to the audit amount at issue. Will CRA consider implementing a formal policy that taxpayers and/or practitioners can call upon someone at CRA to address and mediate these situations at less cost?

Response

Auditors, as professionals, are aware that there is a cost, both in time and money in the work they perform. One of the primary focuses of audit is compliance. If an issue arises and the auditor believes further analysis is required, a query will be issued to gather additional information. The quantum of the issue usually cannot be determined without the query being issued. If a registrant believes a query issued by an auditor is unreasonable, they should discuss this with the auditor and/or with the auditor's team leader. It is the registrant's prerogative whether the query should be researched or the amount at issue be assessed, depending if the costs disproportionately outweigh the assessed amount. To summarize, at this time CRA is not considering implementing a formal policy to address and mediate these situations at less cost.

GST Question 15—Voicemail

We recommend that CRA staff ensure that their voicemail messages accurately reflect their availability. It is very frustrating when attempting to contact an auditor or other CRA staff with a generic voice message that does not indicate if they are in the office that day or are away for an extended period. The standard in our office follows common business courtesy by ensuring that our voice messages are updated daily. This means that anyone attempting to contact us is well aware of the potential time before a call will be returned, or is given the option for another action such as contacting an alternative person.

Response

Local TSOs have established guidelines regarding the type of greeting that CRA staff should use in their voicemail system. Generally, these guidelines provide that only personalized greetings are to be used and in addition to including the person's name, these greetings are also to include a message telling the caller whether the person is in or out of the office.

CRA Staff have been encouraged to change their voicemail greetings on a daily basis and to include the current date in those greetings. Callers encountering voice mail at the local TSOs should also be presented with the identified option of dialing "0", if available, in order to reach a "live person" during operational hours.

In addition to the established guidelines regarding the format of greetings our guidelines also provide that all messages left on voicemail systems are to be responded to at the earliest possible time. Given that our voicemail system generally allows CRA staff to access their messages when working away from the office, it would be expected that these messages would be responded to within a short period of time.

GST Question 16—Natural Gas Importation

Natural gas delivered to a pipeline by all shippers is completely commingled such that a particular shipper does not receive back the same molecules that it delivered. In this physical context, large volumes of natural gas are shipped from Western Canada to Eastern Canada via continuous pipeline systems situated in part in the United States. Canadian-sourced gas is commingled en route in the American pipeline system with American-sourced gas. Consequently, the gas that is imported into Canada, and delivered in Eastern Canada, is a combination of Canadian- and American-sourced gas. Please provide your views on the application of Section 144.01 of the *Excise Tax Act* in the following circumstances.

(a) A Canadian shipper enters into a transportation contract with an American pipeline carrier to transport 1,000 units of gas acquired in Canada from the point where the gas is exported from Canada to the point where the gas is imported back into Canada. The shipper does not trade gas in the United States.

(b) The situation is the same as in (a) except that the Canadian shipper sells the gas to an American affiliate at the export point and repurchases the gas at the import point. The American affiliate enters into the transportation contract with the American pipeline carrier. A shipper exports 1,000 units of gas from Canada and imports 600 units back into Canada for sale in Canada. The shipper, or its American affiliate, conducts active trading operations in the United States, with sales exceeding purchases by 400 units.

Response

The intended purpose of Section 144.01 of the *Excise Tax Act* was to address cross-border in-transit pipeline shipments of continuous transmission commodities (CTCs) taking into account the fungible nature of such commodities. As a result of various assessments that have been raised by the Cross Border Services Agency (CBSA), we have just recently been made aware of the extent to which this provision and other provisions that apply to CTCs may or may not apply to fully reflect the practical aspects of cross-border in-transit pipeline shipments of continuous transmission commodities such as natural gas. The issue has therefore been under review by headquarters officials of the CRA.

The Canadian Association of Petroleum Producers also provided an information session in April to headquarters personnel from the CRA, the CBSA and the Department of Finance on cross-border pipeline shipments of natural gas. Headquarters officials of the CRA are currently considering the information provided at the session as part of their review and are discussing the issue with headquarters officials of the CBSA.

GST Question 17—Natural Gas Importation

Natural gas imported into Canada is, for practical reasons, not released by the Canada Border Services Agency (CBSA) under the provisions of the *Customs Act*. Most of this imported gas is burned as heating fuel or used as an industrial raw material within 48 hours of entering Canada. It is not reported or accounted for under the provisions of the *Customs Act* until the 25th day of the following month. Much of this imported gas would be sold numerous times between the point of importation and consumption. Some of these sales may occur immediately after entering Canada, conceptually before the gas commences being transported in Canada.

We would appreciate you providing your views on the following.

(a) Are the sales occurring between the point of entry into Canada and the point of consumption deemed to occur outside Canada under Section 144 of the *Excise Tax Act*?

(b) If nobody accounts for the gas as importer of record under the combination of Section 212 of the *Excise Tax Act* and Section 32 of the *Customs Act*, who is liable for payment of GST as owner of the gas at the point of release under Subsection 17(3) of the *Customs Act*?

(c) If a person does pay the GST as importer of record, who is entitled to claim the input tax credit, if available, as constructive importer under proposed Section 178.8 of the *Excise Tax Act*?

Response

As a result of various assessments that have been raised by the CBSA, we have just recently been made aware of the extent to which Section 144.01 of the *Excise Tax Act* and other provisions that apply to continuous transmission commodities (CTCs), including those referred to in the question, may or may not apply to fully reflect the practical aspects of cross-border in-transit pipeline shipments of continuous transmission commodities such as natural gas. The issue has therefore been under review by headquarters officials of the CRA and is being discussed with headquarters officials of the CBSA.

The Canadian Association of Petroleum Producers also provided an information session in April to HQ personnel from the CRA, the CBSA and the Department of Finance on cross-border pipeline shipments of natural gas. HQ officials of the CRA are currently considering the information provided at the session as part of their review and are discussing the issue with Headquarters officials of the CBSA.

Supplementary GST Question 1—GST 44 Election

Would the following be considered to qualify for the GST 44 election available under Section 167?

(a) A 40% working interest in one property is supplied by Vendor

(b) A 100% working interest in one property is supplied by Vendor

(c) Working interests, all less than 100%, in 10 properties

In all three scenarios, Vendor and Purchaser are both incorporated companies that are registered for GST purposes. The properties constitute only a portion of the producing properties held by both companies.

Response

The question does not contain sufficient facts to give a detailed response. It is a question of fact as to whether or not the election in Subsection 167(1) of the *ETA* is available in a specific situation. If you require a ruling with respect to a particular transaction, please provide full details of the transaction, including the nature of the business or part of a business, the structure of the business (e.g., in the case of a partial interest in a business, whether the business is a joint venture), the total property used in the business and what property is to be supplied under the agreement.

In order to determine whether the election in Subsection 167(1) of the *ETA* is available for the supply of the 100% working interest referred to in part (b) of the question, please refer to Policy Statement P-188, "Supply of a Business or Part of a Business for the Purpose of the Election" in Subsection 167(1), which provides some information on the interpretation of Subsection 167(1) of the *ETA*.

Policy Statement P-103R, "Transfer of an Undivided Interest in a Joint Venture," provides information on the interpretation of Subsection 167(1) of the *ETA* where an arrangement described as a joint venture meets certain conditions. This policy may be relevant, depending on the facts, with respect to the supply of a 40% working interest referred to in part (a) of the question, or the supply of less than 100% interests in 10 properties referred to in part (c) of the question.

Supplementary GST Question 2—Bare Trusts

Regarding bare trusts and the acquisition of real property, could the department please clarify and explain the procedures that should be followed when a GST registered entity makes a disposal of commercial real property to a "bare trust" or a nominee corporation? Please clarify the impact of Section 221 on this transaction and who is responsible to charge, collect and remit the GST?

Response

The Agency's position regarding the application of GST to transactions involving bare trusts is detailed in Technical Interpretation Bulletin B-068 and Policy Statement P-015. A bare trust is considered to exist where a person (the trustee) is merely vested with the legal title to a property and has no other duty to perform, responsibilities to carry out, or powers to exercise as trustee of the trust property. Where a bare trustee engages in a transaction, it is considered that the principal or beneficial owner is the person who engages in that transaction for GST purposes and is therefore the recipient.

Under Subsection 221(1), a supplier is required to collect tax on all taxable supplies as an agent for Her Majesty in right of Canada. Paragraph 221(2)(b) provides that a supplier who makes a taxable supply of real property is not required to collect that tax in those situations where the recipient is registered for GST (and the supply is not a residential complex being supplied to an individual). It is the Agency's position that in order to meet the exclusion under paragraph 221(2)(b), it must be demonstrated that the beneficial owner (and not the bare trustee) meets the relevant conditions in that provision.

Supplementary GST Question 3—Section 296

Question 3(a)

With respect to *Companies Creditors' Arrangement Act (CCAA)* protection whereby a monitor is in place, receiverships and bankruptcies—please explain to us the current policy of CRA as to when Section 296(1)(b) assessments will be issued. Is this procedure consistently applied throughout Canada?

Question 3(b)

Does the CRA consider the amounts assessed under 296(1)(b) to be trust funds as provided under Section 222 of the *Excise Tax Act*?

Question 3(c)

Could the department please clarify and explain the potential for double taxation when there is an assessment raised under paragraph 296(1)(b) and the person who is assessed subsequently makes a payment to the supplier(s) on which the original input tax credit was claimed?

Question 3(d)

Could the department clarify where a person is in receivership, and the receiver identifies that a credit is available under 231(1), to what extent is the CRA able to offset this amount with an amount assessed under 296(1)(b)? Could the department also elaborate on their views of "offset" in general?

Question 3(e)

Where an assessment is raised under paragraph 296(1)(b), what collection procedures are being followed on these amounts with respect to the receivers?

Question 3(f)

Could the department also provide us with clarification surrounding the timing and procedures to obtaining a "Clearance Certificate" under Section 270 of the *Excise Tax Act*?

Response 3(a)

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

Response 3(b)

The amounts assessed under paragraph 296(1)(b) of the *ETA* are assessed as Tax Payable under Division II and not as net tax. As such, there is no deemed trust under Section 222 of the *ETA* with respect to these amounts.

Response 3(c)

The Agency will not generally assess a purchaser under paragraph 296(1)(b) unless it is evident that the related tax amount will not be paid to the supplier. In theory, though, the subsequent payment of any GST payable to a supplier would reduce the amount the Agency could have assessed pursuant to 296(1)(b) and this would therefore enable the registrant to request an adjustment to the assessment. However, in practice it is highly unlikely that any adjustments would be requested since it is highly unlikely that an insolvent or bankrupt registrant would ever be able to fully satisfy the GST payable via the combined payments to it's creditors and via the amount recovered by the Agency.

Response 3(d)

Pursuant to Subsection 266(2) of the *ETA*, a receiver is deemed to be an agent of the registrant and is jointly and severally liable for amounts payable or remittable with the registrant. As such, the Agency has the right to offset any credits resulting from a pre- or post-receivership period against any assessment under paragraph 296(1)(b). Additionally, pursuant to Section 318 of the *ETA*, the Minister may require the retention by way of deduction or set-off, of any amount that may be or become payable to that person by Her Majesty in right of Canada.

The Agency may choose to apply credits from a pre- or post-receivership period to an assessment under paragraph 296(1)(b) in preference to a pre- or post-receivership period leaving a liability for net tax for which the registrant and potentially the receiver may be liable.

Response 3(e)

Generally, the right of offset and set-off is undertaken to collect amounts assessed under paragraph 296(1)(b).

Response 3(f)

In order to request a "Clearance Certificate," the form GST352 "Application for Clearance Certificate" should be completed and forwarded to the Estates and Trusts Section of the respective Tax Services Office. The turnaround time for the issuance of a certificate will depend on the status of the account, such as outstanding balances, audits, reviews, returns, or other compliance issues. Generally, a response should be expected within eight weeks from the date of the request. It should be noted that a clearance certificate will not be issued as long as amounts remain payable to the Crown.

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