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MEMBER ADVISORY

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May 2003 Roundtable with the CCRA

The annual Canada Customs and Revenue Agency (CCRA) Roundtable Meeting was held in Ponoka on May 22, 2003. A total of 31 CCRA representatives from Calgary, Edmonton, Red Deer and Lethbridge were in attendence along with 27 representatives from the ICAA.

As in previous years, three concurrent roundtable sessions were held focusing on income tax matters and good 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 CCRA contact list appears on the back of this publication. This information can also 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 – Presenter: Ian Gray

Typically, CCRA does not issue assessment notices nor any other communication with respect to capital dividend elections. Taxpayers will often file an initial capital dividend election by not making a "full" election to ensure there has not been an excess capital dividend paid. When no communication has been received taxpayers have assumed their calculation of the capital dividend account balance has been "accepted" by CCRA. Subsequently when an excess election has been filed, CCRA will then correspond with the affected taxpayer and often the calculation error is identified as having occurred in a period prior to the original election. In this case although the taxpayer's calculation did not agree with CCRA's calculation no communication of this difference had been made because the original election had not created an excess election. Will the Department consider issuing Notices of Assessments and automatically confirming capital dividend account balances with every capital dividend election?

Response

We are aware of this concern and have previously taken this suggestion up with our Head Office (Ottawa) to ask for an assessment of this suggestion. A reply will be provided once this is completed.

Question 2 – Presenter: Ian Gray

Recent corporate Notices of Assessments from CCRA

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Call for Tax Questions

The next Roundtable Meeting with CCRA will be in May 2004. If you have a question regarding tax or CCRA 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*** commonly contain the following explanation, "if necessary, we have adjusted subsequent taxation years for carryforward balances, interest, and balance due date." We have seen circumstances where the reference to an adjustment of carryforward balances has occurred as a result of a $1 rounding difference between CCRA and the taxpayer. In other cases the differences have been very substantial. A generic notification that "we have adjusted…….." is extremely frustrating to taxpayers and their advisors. We do not know if future tax filings will be impacted as we cannot tell why a taxpayer's records may not be in sync with CCRA's records. Will the Department consider providing much more detailed and specific carryforward balance information on Notices of Assessment and Reassessments?

Response

Whenever a return is (re) assessed, the system recalculates all subsequent assessed taxation years to determine if the change has any impact on subsequent years assessment or information on record. A generic message is given, "*if necessary, we have adjusted subsequent taxation years for carry forward balances, interest, and balance due date*."

Since any recalculation resulting in a tax change will result in a reassessment notice with an explanation of changes, this message is intended only for those situations, either where the tax change is below the tolerance or there is no tax change, to alert the corporation of the need to complete their own recalculation of carry forward amounts based upon the current notice they receive.

Two changes affect this:

1. Beginning on April 7, 2003, a $5.00 tolerance for GIFI changes was implemented. Prior to this, there was no tolerance and since the old assessing system used dollars and cents and the new one uses dollars only, all income statement items could change for small amounts because of rounding. As such, each time the new system recalculates an amount, last assessed using the old system, the potential exists for changes of $1 or more and a resulting reassessment notices for minor amounts, such as $1.00.
2. In the old assessing system the calculation of tax was programmed to a specific decimal amount. In the new system a larger decimal figure is used in the formula. The new system also has a feature to truncate some calculations which is different than the old system. As a result when the calculations are reprocessed using the new system to update balances we end up with some situations where tax and credits change by more than $1.00. Given the nature of the assessments there is more potential for this, the larger the corporation. Unfortunately, in these situations, since neither net nor taxable income changes and explanation was not provided.

Over time, we will get to the point where all tax years we are working with have been processed in the new system and these notices will no longer be necessary or generated. In the interim we have made some system changes to round amounts to try to limit these occurrences. We will continue with some generic explanations when necessary as this enables the assessment and reassessment actions, which are required to ensure accurate records, to be processed without intervention and to avoid the consequent delays this intervention causes. It should only be necessary to contact the Agency if the tax the corporation differs from those recalculated by the client or representative using the updated amounts.

We are continually investigating possible changes to the system for a later date in order to improve/refine this generic notice verse. In the Winnipeg Tax Centre we have advised assessors to more specific when they are working on accounts to make those where we are involved clearer for the clients and representatives. When possible, generic system generated explanations will be replaced with more specific ones where the assessor feels more detail would improve understanding and eliminate the need for follow-up by the corporation or representative to understand what has occurred. Explanations that provide revised carry forward balances or new credit amounts or revised tax amounts will remain however as this is the only source of this information for use in filing subsequent years' returns. Assessors have been asked to complete a second review all explanations before completing their work to try to identify explanations that could be improved.

Question 3 – Presenter: Maureen MacInnis

Often reorganizations occur in the middle of a calendar year. For example, a business may be transferred to a sister corporation on July 1. In most cases, it would be expected and logical for the employees to cease their employment with the transferor employer and recommence employment with the transferee corporation. Where there has been no change in the beneficial owner of the business (by virtue of direct and indirect control) will the Department accept the transferee corporation to be the same employer as the transferor corporation so as to avoid doubling the employer portion of the CPP and EI contributions? If yes, please explain what procedure should be followed by taxpayers to advise CCRA and request either a transfer or continuation of the employer number on behalf of the transferee corporation. If no, will the Department consider reviewing their position in this type of circumstance?

Response

Canada Customs and Revenue Agency (CCRA) is responsible for the administration of a number of the provisions of both the Canada Pension Plan (CPP) and the Employment Insurance (EI) Act.

Section 9 of the CPP reads as follows:

Sec. 9. Amount of employer's contribution – *Every employer shall, in respect of each employee employed by the employer in* *pensionable employment, make an employer's contribution for the year in which remuneration for the pensionable employment is paid to the employee of an amount equal to product obtained when the contribution rate for employers for the year is multiplied by the lesser of*

a) the contributory salary and wages of the employee for the year paid by the employer, minus such amount as or on account of the employee's basic exemption for the year as is prescribed, and

b) the maximum contributory earnings of the employee for the year, minus such amount, if any, as is determined in prescribed manner to be the salary and wages of the employee on which a contribution has been made for the year by the employer with respect to the employee under a provincial pension plan.

Section 82 of the EI Act imposes similar remittance requirements in relation to EI premiums.

Section 9 of the CPP by its expressed words requires "every employer…in respect of each employee employed by the employer in pensionable employment" to pay an employer's CPP contribution for the year on the contributory earnings paid to that employee. There is nothing in section 9 or elsewhere in the CPP that allows an employer of an employee to take into consideration or look back to or to aggregate with any CPP contribution paid in the year by any other employer, whether affiliated, absorbed or otherwise, of that employee. This is also the case with respect to the EI Act.

If at anytime during a calendar year, an employee is transferred from employment with one legal entity to employment with another legal entity, the second employer who is a distinct legal entity from the first employer, would not be able to take into account amounts already deducted in the year with respect to CPP contributions and EI premiums required to be paid in accordance with section 9 of the CPP and section 82 of the EI Act.

The one restructuring alternative not subject to the above requirements is an amalgamation. An amalgamated corporation is not usually considered to be a new legal entity. Generally, an amalgamation is the union of two or more amalgamating corporations, which continue after the amalgamation as one corporation. That is, the corporations, which amalgamate are not dissolved, and the continuing corporation has all the rights and property, and is subject to the liabilities of, the amalgamating corporations. Legally speaking, the amalgamated corporation is not a new legal entity, but a continuation of the amalgamating corporations. Since the amalgamated corporation is not a new legal entity, it can take into consideration what the amalgamating corporations previously paid in the year in accordance with section 9 of the CPP and section 82 of the EI Act.

In situations where a reorganization results in employees being transferred from one legal entity (one employer) to another legal entity (another employer) and the employer has knowledge and can demonstrate that the employee may have already paid the maximum CPP contributions and EI premiums for the year while employed with the initial employer, relief may be granted by means of a waiver. Tax Services Offices have the authority to grant a waiver to help reduce the financial burden on the employees due to the restructuring and the requirement of the successor corporation to start anew with CPP/EI deductions without regards to what the former employer previously paid in the year. The waiver, if granted, would allow the successor corporation to use the amount of CPP contributions and EI premiums deducted from the individual employees, (in excess of the yearly maximum) to reduce the amount of income tax that would otherwise be withheld for the same pay period, from that individual employee. When the individual employees affected by such a waiver file their individual tax return, the apparent overpayment of CPP contributions and EI premiums will automatically offset their apparent shortage of income tax deductions.

At this time, there are no immediate plans to make legislative changes to section 9 of the CPP or to section 82 of the EIA.

Question 4 – Presenter: Richard Kuna

Subsections 40(3.3) and 40(3.4) of the Income Tax Act contain certain rules which deny the deduction of a loss in certain circumstances where a corporation, trust or partnership disposes of capital property and, generally speaking, the transferor or a person affiliated with the transferor acquires a property that is, or is identical to the property disposed of by the transferor. Would you please confirm that a trust is not an affiliated person with an individual who is a beneficiary of the trust and, therefore, that the stop loss rules contained in subsection 40(3.4) do not apply where a trust realizes a loss on the disposition of a capital property to a beneficiary of the trust.

Response

As defined in Section 251.1 of the Income Tax Act, a person affiliated with a taxpayer does not include a trust. Therefore subsection 40(3.3) and 40(3.4) would not apply to the realization of the loss by the trust on the disposition of capital property to an individual that is a beneficiary of the trust.

Question 5 – Presenter: Bill Waddy

Subparagraph 115(1)(a)(ii) provides that the taxable income earned in Canada of a person who at no time in the year is resident in Canada includes any income from a business or businesses carried on by the non-resident person in Canada.

Article VII of the Canada-U.S. Tax Convention provides, generally speaking, that the business profits of a resident of the United States are taxable only in the United States unless the U.S. resident carries on business in Canada through a permanent establishment situated in Canada. If the U.S. resident carries on, or has carried on, business through such a permanent establishment, Canada may tax such business profits but only so much of them as are attributable to the permanent establishment in Canada. Similarly, Article XIV of the Canada-U.S. Tax Convention provides, generally speaking, that the income of a U.S. resident in respect of the performance of independent personal service may be taxed in Canada if the individual has or had a fixed base regularly available to him in Canada for the purpose of performing his activities, but only to the extent that the income is attributable to that fixed base.

Would you please advise as to whether the concept of a permanent establishment and a fixed base has the same meaning? If there were a different meaning to these terms, would you please distinguish between the meaning of a permanent establishment and a fixed base?

Would you also advise as to whether a non-resident of Canada could be viewed as earning business income which would be subject to tax pursuant to Section 115 of the Canadian Income Tax Act if the non-resident person had neither a permanent establishment of fixed base in Canada during the taxation year in question.

Response

Article 14 was removed from the OECD Model Tax Convention on Income and on Capital (the Model Convention) in April 2000, and the concept of a fixed base no longer exists for purposes of the Model Convention. The decision to remove Article 14 from the Model Convention reflected the fact there were no intended differences between the concepts of permanent establishment (PE), as used in Article 7, and fixed base, as used in Article 14, or between how profits were computed and tax was calculated according to which of Article 7 or 14 applied. Therefore, Article 5 of the Model Convention, which addresses questions of PE determinations, encompasses the fixed base concept.

In discussing issues related to Article 14 of the Model Convention, the OECD Committee on Fiscal Affairs noted suggestions that there may be theoretical differences between the concepts of PE and fixed base that could be interpreted to give the fixed base concept a lower threshold. Notwithstanding any theoretical differences, the Committee stated it could not find any practical examples of a fixed base that would not be a PE or vice-versa.

In the Queen v. William A. Dudney (2000 DTC 6169, [2000] 2 CTC 56) the term fixed base was interpreted to mean essentially the same as PE. Both terms are intended to convey the sense of a fixed place of business of the enterprise carrying on business there, or the person providing personal services there.

In respect of the question concerning business income earned by a non-resident in Canada and the applicability of S.115, the CCRA offers the following comments:

Subparagraph 115(1)(a)(ii) of Income Tax Act requires that a non-resident person include in his taxable income earned in Canada for a taxation year incomes from businesses carried on by that person in Canada. Therefore such income is taxable in Canada subject to the provisions of any applicable Income Tax Convention.

The concepts of fixed based and permanent establishment are not relevant for residents of non-treaty countries.

Question 6 – Presenter: Maureen MacInnis

A corporation, the shares of which would be defined as qualified small business corporation shares, has issued 60 Class "A" shares to one spouse and 40 Class "B" shares to another spouse. The spouse who owns the 40 Class "B" shares transfers those shares to the other spouse on a gift basis utilizing the rollover contained in subsection 73(1) of the Income Tax Act. Within two years from the transfer of shares between spouses, the spouse who is then the sole shareholder of the corporation sells the 40 Class "B" shares to an arm's length person, realizing a capital gain thereon.

On the assumption that the shares in the corporation continue to qualify as qualified small business corporation shares as of the date of the sale and the spouse of the vendor is otherwise entitled to claim the enhanced capital gains exemption, would you please confirm that the spouse who originally owned the 40 Class "B" shares and to whom the capital gain which is realized on the sale of those shares to the arm's length person will be attributed should be entitled to claim the capital gains deduction contained in Section 110.6 of the Income Tax Act.

Response

Yes the spouse who originally owned the 40 Class "B" shares would be entitled to the capital gains deduction as per the provisions of section 110. 6 of the Income Tax Act ("ITA"). Subsection 73(1) of the "ITA" allows for the transfer of the shares at the ACB of the shares. Subsection 74.2(1) then deems that any taxable capital gains that results from the disposition of that property to be that of the transferor, being the original owner of the shares. Subsection 74.2(2) then deems that any taxable gain, for the purposes of section 3 and 111 as they relate to section 110.6, shall be deemed to be a disposition by that individual (the original owner of the shares).

Question 7 – Presenter: Amir Bhaloo

We understand that significant changes have been made in the Vancouver District Taxation office with respect to the Appeals process. We have learned that an efficiency expert has made some recommendations regarding turnaround times. Accordingly:

a) Please describe the recommendations that were implemented?

b) Will such recommendations be implemented into the Calgary and Edmonton District Taxation offices?

c) If yes, will the Agency provide their files immediately to the taxpayer in order that the requested response can be drafted within the stipulated timeline?

Response

We are not aware of any efficiency expert making recommendations on timeliness for the appeals process. We have reviewed Vancouver's new process, and have implemented it with a few local modifications. We have an inventory control unit and upon receiving an objection it is reviewed for validity and to identify the subject matter of the objection. At that time we look at the items under objection to see if the Appeals Officer will need clarification in order to conduct a preliminary review of the accuracy of the assessment. In keeping with the Appeals Renewal Initiative on Transparency, we determine if the objector has received copies of documents that form CCRA's basis for raising the assessment. Our next step, where the situation warrants it, is to send a letter providing copies of documents and/or requesting more representation and/or documents to support the items under objection. A thirty-day time frame is allowed for responding. We are striving to reduce the time required by an Appeals Officer to complete the review of the disputed items; a reduction of this time benefits both the objector and the CCRA.

Edmonton has no knowledge of an efficiency expert making recommendations on timeliness for the Appeals process. Vancouver Tax Service Office has put in place an upfront screening/contact process unit and several offices are using this model.

Question 8 – Presenter: Marcel Martineau

In the past, the CCRA has had a reading room available in its District offices where taxpayers could examine such items as Taxation Operating Manuals ("TOM"). However, we have recently attended a District office and was advised that we would need to complete the appropriate Freedom of Information form to acquire the information and that general access was now denied. Has there been a change in policy? If so, why? Given the electronic age that we live in, could not all of this information be made available through the internet?

Response

CCRA has not made any changes to its policy in this regard. The reading rooms are still available to the public and you are not required to complete a freedom of information form in order to use the room or the information contained in the reading rooms. Regarding the above situation, it could be that there was a misunderstanding with respect to the request or that the reading room was temporarily out of service.

Presently the CCRA is not considering the availability of the manuals on the Internet. Our Information Circulars and Interpretive Bulletins are available on our Web site **www.ccra-adrc.gc.ca**

Question 9 – Presenter: Don Murray

Technical Interpretation 2003-0181705, regarding the definition of "split income" under section 120.4 of the Income Tax Act, contains commentary that interest income received from specified parties could previously be viewed to be split income since such could be viewed to be a financial service. This interpretation is very debatable and seems in contradiction of most tax authors and other people who practice full time in the income tax area. Notwithstanding, is the CCRA planning to revisit files (prior to December 20, 2002 since the December 20, 2002 Technical Amendments now seem to "catch" interest income under the umbrella of "split income" for purposes of section 120.4) and reassess such interest income as split income?

Response

The answer is "no". The technical interpretation referred to (2003-0181705) raised an issue (whether a loan constitutes the provision of a financial service) that has not yet been fully considered by the rulings directorate. Therefore, the rulings directorate has not advised any of the CCRA auditors to revisit income-splitting arrangements involving loans that pre-date the proposed amendment to section 120.4 of the Act contained in the December 20, 2002 technical bill.

Question 10 – Presenter: Phil McCutchan

We note your answers regarding employee profit sharing plans ("EPSP's" as outlined in section 144 of the Income Tax Act) in last year's Roundtable. However, many plans that utilize EPSP's involve planning payments from an operating company to an EPSP such that all of the owner-manager's remuneration is received from the EPSP rather than as salary from the operating company directly. The thought behind this is that if the amounts are received from the EPSP by the individual that no source deductions such as CPP or EI need to be withheld and therefore the owner-manager and the corporation have saved the cost/expenditure of such withholdings. Would the CCRA challenge the reasonableness of payments (pursuant to section 67) to an EPSP where it appears clear that one of the main reasons for payments to an EPSP is to avoid source deductions such as that outlined above?

Response

CCRA reserves the right to review outlays or expenses in respect of which any amount is otherwise deductible under the Income Tax Act, except to the extent that the outlay or expense was reasonable in the circumstances, pursuant to section 67, since this is applicable as a general rule to all expenses.

Whether CCRA will challenge the reasonableness of payments to an EPSP where it appears clear that one of the main reasons for payments to an EPSP is to avoid source deductions, would be determined on a case-by-case basis.

CCRA's comments regarding the payment of the total salary of an employee via an EPSP in recent technical interpretations #2000-0055055 and #2000-0017116 should be noted.

Question 11 – Presenter: Phil McCutchan

Similar to the question as outlined in #10 above, many plans that utilize EPSP's also allocate amounts out to beneficiaries that are minors – some as young as 3 years old. Could you please provide the CCRA's commentary in situations such as this.

Response

CCRA's position is that it would be a question of fact whether a minor, or indeed any person, is an employee of a corporation. Reference to common law and provincial restrictions relating to the employment of children will be necessary to determine whether there is a contract of employment. Should the child not be an employee, then the child could not be allocated amounts from the EPSP.

These situations would be dealt with on a case-by-case basis with consideration given to among other items, the EPSP agreement, the contract of employment and the reasonableness of the allocations.

Question 12 – Presenter: Scott Shelton

Have the District Offices of Edmonton and Calgary levied (or considered levying) the civil penalties under section 163.2 of the Income Tax Act? If no, could you please provide an update for the application of such penalties across Canada.

Response

To date, there have been no cases in Canada of the levying of civil penalties under section 163.2 of the Income Tax Act.

Supplementary Issues

What safeguards does the CCRA have to prevent auditors from discussing the intent to consider civil penalties under section 163.2 of the Income Tax Act in the presence of clients who are being represented by a third party?

Supplementary Response

The confidentiality of tax information for all taxpayers is legislated pursuant to section 241 of the Income Tax Act. Accordingly, an auditor is precluded from discussing tax information, including the consideration of the application of civil penalties under section 163.2 of the Income Tax Act, in the presence of that representative's client without prior authorization from the representative.

Below is an excerpt from IC 01-1 regarding the CCRA process of considering the application of civil penalties under section 163.2 of the Income Tax Act. Paragraph 81 specifically refers to a penalty audit, which would be a separate event than the on-going audit in which the circumstances causing such consideration was discovered.

Process

79. *The CCRA intends to strictly control the application of the penalties. Procedural checks and balances are in place to ensure that no one person can direct the application of the penalties or otherwise inappropriately apply the penalties. In addition, the CCRA will establish a Headquarters review committee, the Third-Party Penalty Review Committee (TPPRC). It will include, for the foreseeable future, senior representatives from the CCRA's Compliance Programs Branch and Policy and Legislation Branch, and representatives from the Departments of Finance and Justice.*

80. *During the course of a regular audit, an auditor may discover circumstances that prompt consideration of the penalties. In such a situation, the auditor must first consult a manager or a senior member designated by management of the field office before a penalty audit is initiated.*

81. *When the management of the field office determines that it is appropriate to conduct an audit of the third party, it will consult orally or in writing with a member of the technical section in Headquarters that supports the TPPRC.*

Question 13 – Presenter: Don Murray

Some private K-12 schools utilize a "creative" formula for the amounts that parents pay for the right for their children to attend such schools and have issued charitable donation receipts for a portion of the amounts that are paid by parents. Given the proposed gifting legislation released on December 20, 2002, could the CCRA comment on the ability of such schools to now issue charitable donation receipts when parents pay amounts to the school in return for the right for their children to attend?

Response

Proposed subsections 248(30) to (33) contain new rules in determining whether a transfer of property to a qualified donee results in a gift for tax purposes where an "advantage" is provided to the donor. Pursuant to proposed subsection 248(30), the eligible amount of a gift is the excess of the fair market value of the property transferred to a qualified donee over the amount of the advantage provided to a donor. Proposed subsection 248(31) provides that the amount of the advantage is generally the value of any property, service, compensation or other benefit received or obtained by the donor as partial consideration for, or in gratitude for, the gift. Given that donative intent must be present for there to be a gift, proposed subsection 248(32) presumes donative intent to exist when the amount of the advantage does not exceed 80% of the fair market value of the transferred property.

Without knowing the full details of the "creative" formula and the schools involved, we are not in a position to provide definitive comments on whether the schools are entitled to issue tax receipts under the current legislation or the proposed gifting legislation. However, in applying the proposed gifting legislation to the situation described, the advantage provided to the parents would include the right for their children to attend the particular school. If the amount of the advantage provided does not exceed 80% of the payment made by the parents to the school and provided that the school is a qualified donee, a tax receipt may be issued for the eligible amount of the gift. We note that the school must be able to support the basis for the determination of the amount of the advantage provided by the school, which would otherwise be assumed to be the amount paid by the parents to the school.

Supplementary Issues

Does proposed subsection 248(32) preclude the issuance of a donation receipt where the value of the advantage to the donor exceeds 80% of the fair market value of the property transferred to the qualified donee?

Supplementary Response

A charity may issue official donation receipts only for donations that are gifts. A gift may be recognized for purposes of the Income Tax Act where it is clear that a transfer of property is made with donative intent on behalf of the donor to enrich the donee. Where the value of the advantage given by a charity exceeds 80% of the value of property it has received, the charity generally should assume that no such intent existed.

The draft legislation provides that there may be exceptional circumstances in which a transfer of property will qualify as a gift for tax purposes notwithstanding that the amount of the advantage to the donor exceeded 80% of the value of the transferred property. This will occur only if the donor is able to establish to the satisfaction of the Minister that there was a clear intention to make a gift. While no formal procedures in this respect have been developed yet a request pursuant to proposed paragraph 248(32)(b) should be directed to the Director of Policy and Communications of the Charities Directorate.

Question 14 – Presenter: Marlene White

Given the recent decision of Manrell released on March 11, 2003 by the Federal Court of Appeal - 2003 FCA 128, can the CCRA inform whether or not they will accept such a decision and accordingly not tax proceeds received from non-competition payments.

Response

CCRA is not seeking leave to appeal to the Supreme Court of Canada on the Manrell decision. Thus this decision is final and binding.

CCRA will follow the finding of this decision that “the right to compete” is not “a right of any kind whatever” and thus not “property” within the meaning of section subsection 248(1) of the Income Tax Act. It follows that non-competition payments are not proceeds of disposition of property; they are non-taxable receipts.

The Manrell decision only applies where there is a sale of shares and the taxpayer did not previously carry on the business. Where a taxpayer sells a sole proprietorship or a company who carried on the business itself received the payments when entering into a non-competition agreement the Crown would continue to argue that the amounts received are “eligible capital amounts”.

The CCRA will continue to review, business sales to ensure there is a proper allocation of proceeds between non-competition payments and other assets.

Question 15 – Presenter: Scott Shelton

CCRA has issued a draft policy relating to the definitions of Canadian Exploration Expenses (“CEE”), Canadian Development Expense (“CDE”), Canadian Oil and Gas Property Expense (“COGPE”) and Canadian Exploration and Development Overhead Expense (“CEDOE”). In light of the revisions to the policy, what changes do you expect to see in the audits of resource companies? How do you expect to implement the changes to the policy for different sized taxpayers?

Response

Background

The draft policy paper deals with the following provisions of the Income Tax Act and Regulations:

1) Subsection 66.1(6) Canadian Exploration Expense definition
2) Subsection 66.2(5) Canadian Development Expense definition
3) Subsection 66.4(5) Canadian Oil and Gas Property Expense definition
4) Regulation 1206(1) Definition of “Canadian Exploration and Development Overhead expense”

The purpose of the draft policy was not an attempt to change the direction the Agency was going but instead was to provide clarification and guidance to both industry and the auditors within the Agency. The policy outlines the provisions noted above and provides interpretation, rationale and jurisprudence to assist in the understanding of these provisions.

The Agency's response to the two questions is as follows

As stated above, there is no change in the policy. However, it is expected that the guidance provided in the policy paper should result in a more consistent application of these provisions across the industry. As with audit of any aspect of the business or transaction, the extent of the audit will largely depend on materiality, risk and professional judgment. The law does not contemplate application based on the size or complexity of the transactions of the taxpayers and therefore we do not envisage significant departure from the policy paper.

Question 16 – Presenter: Jim Simpson

Could CCRA please provide an update on the use of the Pre-claim review process for Scientific Research and Experimental Development ("SRED") Claims as that process has been used in the Alberta Tax Services Offices. Specific information regarding the number and value of claims made and ultimately successful would be useful to our members.

Response

The PCPR service is one of the SR&ED advisory services offered by the CCRA to help make sure you get maximum benefits from the SR&ED Program. It provides an up-front review and a preliminary opinion on the eligibility of projects for SR&ED tax incentives.

The PCPR service is designed to help you in your planning and investment decisions. The service is available before SR&ED tax incentives are claimed and can be provided before work is started. The PCPR service is available to all companies.

Over the past year, 132 PCPR requests were processed in Alberta. Of these 132 requests, 97 (71%) were found to be either fully eligible or partially eligible for the program. An opinion could not be provided for 20 (15%) of the requests, as there was incomplete information available. Only 15 (11%) were determined not to meet the legislative criteria.

The specific dollar value of these requests would not be available as, since all of the work has not been completed, all costs have yet to be incurred. Project costs are not necessarily a relevant part of this eligibility determination and are instead considered once the formal claim is filed. The PCPR process involves a review of the work activities undertaken or to be undertaken and how these activities fall into the eligibility requirements of the program. It also provides education on preparing and supporting a claim, which would include the proper tracking and allocation of costing information. A final opinion on any SR&ED claim must be based on the work done and can only be made after the claim is filed.

Overall, claimants find the PCPR process very positive in assisting them in obtaining certainty of eligibility either before or while the work activities are undertaken.

Question 17 – Presenter: Reid Corrigall

As the CCRA moves towards implementing its "Future Directions", what impact do you see on both the audit and appeals processes in the local Tax Services Offices?

Response

A discussion took place regarding the various CCRA "Future Directions" initiatives. The link below leads to the CCRA "Future Directions" directory of documents for detailed information.

Future Directions link
http://www.ccra-adrc.gc.ca/agency/directions/menu-e.html

Question 18 – Presenter: Diana Gibson

Please describe in general terms the types of transactions that Tax Avoidance is currently reviewing in the Alberta Tax Services Offices.

Response

The types of transactions that the Alberta Tax Services Offices' Tax Avoidance sections are currently reviewing are:

- Art Donations - donations of art in excess of FMV
- RRSP Strips - RRSP acquiring investments with a portion of the proceeds being indirectly returned to the annuitant
- Currency and trading loss straddles - artificial straddles (Friedberg and McGuire types)
- Software shelters - FMV and business use issues
- Film shelters - unverified expenses and sham financing
- Avoidance of Part XIII tax - back to back loan arrangements (rights to interest)
- Slapshot arrangements - Enron type of arrangements
- Offshore Spousal trusts - transfer of assets to offshore spousal trust to bump up ACB
- Treaty Shopping - abusive use treaties to avoid gain on shares
- Subsection 55(2) - standard dividend stripping arrangement
- Circumventing debt parking rules - use of accomodating parting to avoid new debt parking rules
- Surplus stripping - use of asset substitution
- Conversion of income to capital gain by sale of shares - disposition of resource property via sale of shares
- PUC shifts - sale and transfer of shares to bump PUC
- Departure Trades - creation of losses prior to emigration
- Use of Offshore Credit/Debit Cards - use of credit cards and debit card in tax havens to hide accumulation and use of funds
- Use of indirectly held Offshore Bank Accounts - use of untraceable accounts to hided accumulation and use of funds

Question 19 – Presenter: Don Murray

The August 2002 issue of *Taxation of Corporate Organization and Reorganization* (Volume II, Report No. 14), published by Federated Press, claimed that the Canada Customs and Revenue Agency may amend Interpretation Bulletin IT-64R4 *Corporations: Association and Control.*

In that Interpretation Bulletin, paragraph 37 states the Canada Customs and Revenue Agency position that subsection 256(1.4) would not generally be applied solely as a result of the existence of a "right of first refusal" or a "shotgun arrangement" in a shareholder agreement.

The Federated Press publication referred to above indicated that the Canada Customs and Revenue Agency will change its administrative position by amending IT-64R4. As a result, a right of first refusal may cause paragraph 256(1.4) to apply.

1) Is this an accurate description of the Canada Customs and Revenue Agency position? Could you elaborate?
2) What is the reasoning behind this change of policy?
3) Given that shareholder agreements are considered in most private companies, what alternative remedies does the Agency suggest for a right of first refusal that might cause serious hardship if subsection 256(1.4) were to apply?

Response

The Federated Press publication does not accurately reflect the CCRA's position. The CCRA has not changed its administrative position. The CCRA is planning only to amend paragraph 37 of IT-64R4, not to delete it. It is expected that the amended paragraph 37 will read substantially as follows:

Although the wording in subsection 256(1.4) may be broad enough to include almost any buy-sell agreement, this paragraph will not normally be applied solely because of a "right of first refusal" or a "shotgun arrangement" (i.e., an arrangement under which a shareholder offers to purchase the shares of another shareholder and the other shareholder must either accept the offer or purchase the shares owned by the offering party) contained in a shareholder agreement.

At the same time, the wording of paragraph 13 of IT-419R *Meaning of Arm's Length* will also be amended to read much the same, except that the first sentence will refer to paragraph 251(5)(b).

Question 20 – Presenter: Scott Shelton

Please provide an update with respect to CCRA's position on legal fees and success fees paid to investment banks in regards to mergers and takeovers of public companies. CCRA in a few instances, with our clients, has re-assessed and denied expenses paid. The position taken by CCRA is in apparent contradiction to the Tax Court of Canada decisions in both the International Colin Energy and BJ/Nowsco cases. What are CCRA's arguments for their position given the Court's decisions?

Response

The Canada Customs and Revenue Agency's ("CCRA") administrative position is that expenses incurred to produce circulars for shareholders regarding take-over bids to meet obligations imposed under a Securities Act and/or a Business Corporations Act would generally be deductible in computing income pursuant to subsection 9(1) of the Income Tax Act. Expenses applicable to the preparation of circulars such as legal and accounting fees and related fees such as printing and mailing costs would be deductible where reasonable in amount.

The International Colin Energy Corporation case ("Colin") dealt with the deduction of a success fee in a particular fact based situation. The CCRA will review similar expenditures pursuant to subsection 9(1) and subsections 18(1)(a) and (1)(b) on a case-by-case basis.

The Tax Court of Canada's decision in BJ Services Company Canada ("BJ") addressed the GST reassessment only. Since the Tax Court of Canada has recently heard the Income Tax issues for BJ and has not rendered a decision at this time, the CCRA cannot comment on this case.

The CCRA is aware of the situation and Headquarters continues to monitor this important decision.

Question 21 – Presenter: Don Murray

At the May 2000 Roundtable the following income tax question was asked.

Question

It seems practitioners receive a flood of T3's and partnership returns in early April. It causes a crunch. Take the example of a trust investing in a trust – it doesn't get its T3 until past the deadline for filing its own T3. This process creates amendments. What can be done?

Response

Any changes to the legislation requiring T3 slips to be filed earlier might result in the amounts being estimated or incomplete. Consequently, T3 and T1 returns of the beneficiaries would need to be amended. Although the CCRA recognizes that this recommendation could benefit recipients of T3 slips in the case of mutual fund trusts, a consultation process would have to take place with various types of trusts to ensure that a reduced filing period would not impose an impossible deadline on issuers. Our Information Returns Section will be conducting a study on the filing requirements. If results of the study indicate that there is a strong support to change the filing requirements for the T3 information slips, a recommendation can be made to the Department of Finance.

Can you please advise the result of the Departments Information Returns Section study on the filing requirements pertaining to T3's.

Have any recommendations been made to the Department of Finance?

Response

Our response remains unchanged from the May 2002 Roundtable. The study mentioned in 2000 was abandoned. Discussions between the CCRA, the Department of Finance and the Mutual Fund industry did not lead to a consensus regarding these issues. We have no additional information regarding a change in the filing deadline for returns reporting T3 income.

GST Questions

Question 1 – Presenter: Rob Mitchell

Could the CCRA please comment on its position regarding GST audit assessments involving transactions between Canadian registrants and US companies (typically non-registrants).

During a recent GST audit, a CCRA field auditor for GST commented he was specifically instructed by CCRA management to look for cross border transactions". If the CCRA finds cross border transactions where GST is not charged, an assessment is issued to the Canadian resident for the GST plus interest and penalties. The entire amount of the assessment effectively becomes a penalty to the Canadian business as the US company is not entitled to register retroactively to enable the ITC to be claimed.

The net result is substantially different than if the same transaction is found where the purchaser is another Canadian company that is registered – in this case a "wash penalty" of only 4% of the GST is assessed. The level of the wash penalty at 4% is a reasonable amount to penalize a business for failing to charge GST in a "no net tax to the government" situation.

However, a wash penalty can be 20 to 30 times less than the sum of the GST, interest and penalty in the case of a cross border transaction with an unregistered company where wash treatment is allowed.

By focusing on cross border transactions, it appears the CCRA has discovered a very profitable method to collect cash from Canadian business for transactions that would have otherwise been an in-out "wash" where the Agency would have received no net tax. The significant difference in the amount of the audit assessments between "cross border" and "Canada only" transactions seems completely out of line.

Has the Agency considered an alternate treatment to cross border transactions where no net tax would have been collected by the Agency?

Response

The GST/HST is designed to tax the supply of goods and services made in Canada. Generally, where a supply is made outside Canada, or purchased by a non-resident for use or supply outside Canada, it is usually not subject to GST/HST, pursuant to the place of supply rules in section 142 of the Excise Tax Act (the ETA), and the zero-rating provisions in Part V of Schedule VI to the ETA. In addition, where goods are purchased by a non-resident business in Canada for use by the business outside Canada, and the goods are exported within 60 days of their purchase, the non-resident is generally eligible to claim a rebate on their purchase. Where unregistered non-residents purchase Canadian goods and services and use or consume them inside Canada, they are in effect treated the same as any other consumer who is NOT purchasing goods and services to be used to make supplies for which they will ultimately collect GST/HST. They will pay the tax and not have any recourse in recovering that tax. This is the intention of the GST/HST legislation. Only GST/HST registrants acting as agents of the Crown in collecting the tax, are eligible for ITC relief.

Penalty and interest provisions are included in the legislation governing the GST/HST to assist the CCRA in enforcing the above scheme. Where a GST/HST registrant fails to collect the required GST/HST but the supply was made to another GST/HST registrant who would have been entitled to claim an ITC, the CCRA recognizes that there was no net loss to the Crown, and therefore provides administrative relief in the form of the wash transaction policy. Where, however, this is not the case, such as when the supply was made to an unregistered non-resident or any other non-registrant, it would not be appropriate or within the scheme of the legislation for the CCRA to provide such relief, as there is a net loss to the Crown.

Question 2 – Presenter: John Baxter

Would a registrant be entitled to claim ITCs on reimbursements made to part-time help/sub-contractors (not registered for GST/not an employee) for goods and services acquired for use in the registrant's commercial activities. The receipts may or may not be in the name of the registrant?

Response

When a partnership, employer, charity or public institution reimburses a partner, employee, or volunteer, for supplies acquired on behalf of the partnership, employer, charity or public institution, section 175 deems the organization to be the recipient of the supplies. As a result, if the organization is registered for GST, it can claim ITC's to the extent the supplies are used in the organization's commercial and the prescribed documentary requirements are met.

There are no provisions in the ETA allowing ITCs for the reimbursement of expenses incurred by non-registered sub-contractors. Registered sub-contractors can claim ITCs on supplies used in their commercial activities, subject to the limitations and requirements under the ETA.

Question 3 – Presenter: John Baxter

Would the response be different if the part-time help/sub-contractors used the registrant's petty cash to purchase the goods and services rather than pay out of pocket and seek reimbursement from the registrant?

Response

Pursuant to subsection 165(1), GST is generally payable by the recipient of a taxable supply on the value of the consideration for the supply. The CCRA has consistently interpreted the definition of "recipient" of a supply of property or a service to mean, where the consideration for the supply is payable under an agreement for the supply, the person who is liable under the agreement to pay the consideration regardless of whether or not another person actually pays for the supply. Where there is no agreement, the recipient is the person who is liable to pay the consideration.

Where the registrant is liable to pay the consideration for the supply and is therefore the recipient of the supply, the registrant would be entitled to claim an ITC in respect of the GST payable to the extent the property or service is acquired by the registrant for consumption, use or supply in the course of commercial activities (subject to the documentary requirements of section 169).

Question 4 – Presenter: George Hotson

Telecommunication

Scenario

A facility is being used in the United States to connect teleconferencing between cities within Canada. The U.S. Company is a non-resident and non-registered. The U.S. Company does not have a permanent establishment in Canada and they have not supplied any hardware or software to the Canadian users. The process is as follows: the Canadian Company uses the telephone lines within Canada to connect to the facility in the U.S., which connects the conference call within Canada.

Perspectives

1. The US Company could be considered to be pulling business out of Canada and the supply is made outside of Canada.
2. The U.S. Company is considered carrying on business in Canada and the supply is made within Canada.

Questions

1. Is this U.S. Company considered to be carrying on business in Canada?
2. Does the U.S. Company need to become a GST registrant?
3. Does section 143 override section 142 therefore making GST not applicable?
4. If this is the supply of a service coming into Canada, should it be self-assessed by the Canadian Company under Division IV?

Responses

1. As a general guideline, the Canada Customs and Revenue Agency (CCRA) considers that a significant presence in Canada is required for a non-resident person to be considered to be carrying on business in Canada. Policy Statement P-051R (*Carrying on business in Canada*) outlines various factors to be considered when making a determination as to whether a non-resident person is carrying on business in Canada. The factors are based on court decisions and must be applied on a case by case basis to make such a determination. It should be noted that a non-resident person can be carrying on business in Canada even though the person may not have a permanent establishment in Canada as defined in subsection 123(1) of the Excise Tax Act (the "Act").

2. Pursuant to subsection 240(1), every person who makes a taxable supply in Canada in the course of a commercial activity engaged in by the person in Canada is required to be registered unless the person is a non-resident person who does not carry on any business in Canada. Therefore, if the U.S. Company is not considered to be carrying on business in Canada, it will not be required to be registered for GST/HST purposes.

3. A supply of teleconferencing services is considered to be a supply of telecommunication services for GST/HST purposes. Therefore, to determine whether a supply of a teleconferencing service is made in Canada we need to look to section 142.1. However, we do concur that the preamble of subsection 142.1 indicates that this provision is also subject to the deeming provisions provided under section 143 and therefore, if section 143 applies to a particular supply, the place of supply rules set out by section 142.1 will not apply to that particular supply.

However, if U.S. Company's equipment is located outside of Canada, the supply of its services to the Canadian Company would be considered to be made outside Canada regardless of whether U.S. Company is considered to be carrying on business in Canada.

Subparagraphs 142.1(2)(b)(i) and (ii) provide that, in the case of a telecommunication service other than the supply of making telecommunications facilities available, the service is considered to be supplied in Canada where the telecommunication is both emitted and received in Canada or is either emitted or received in Canada and the billing location is in Canada.

Subsection 142.1(1) states that "the billing location for a telecommunication service supplied to a recipient is in Canada if

a) where the consideration payable for the service is charged or applied to an account that the recipient has with a person who carries on the business of supplying telecommunication services and the account relates to a telecommunications facility that is used or is available for use by the recipient to obtain telecommunication services, that telecommunications facility is ordinarily located in Canada; and

b) in any other case, the telecommunications facility used to initiate the service is located in Canada."

Subsection 123(1) defines a "telecommunication facility" as "any facility, apparatus or other thing (including any wire, cable, radio, optical or other electromagnetic system, or any similar technical system, or any part thereof) that is used or is capable of being used for telecommunications".

The bridging equipment used to provide the teleconferencing service qualifies as a telecommunications facility and it is the facility used to initiate the service provided by U.S. Company. Therefore, if the bridging equipment used to provide the teleconferencing service is not located in Canada, the billing location is not in Canada pursuant to paragraph 142.1(1)(b).

Further, based on our understanding of the mechanics of teleconferencing services, the telecommunication service is emitted from where the bridging equipment is located. Therefore, the telecommunication service provided by U.S. Company is not emitted in Canada if the bridging equipment is not located in Canada. Hence, as per subparagraph 142.1(2)(b)(ii), the supply of the telecommunication service by the U.S. Company is not deemed to be made in Canada as the service is not emitted in Canada and the billing location is not in Canada.

4. Under Division IV, recipients of "imported taxable supplies" are required to self-assess and remit the 7% GST, pursuant to section 218, or 15% HST pursuant to section 281.1, if the recipient is a resident of a participating province.

Section 217 defines "imported taxable supply", in part, as

a) a taxable supply (other than a zero-rated or prescribed supply) of a service made outside Canada to a person who is resident in Canada, other than a supply of a service that is

(i) acquired for consumption, use or supply exclusively in the course of commercial activities of the person or activities that are engaged in exclusively outside Canada by the person and that are not part of a business or an adventure or concern in the nature of trade engaged in by the person in Canada".

Therefore, where a supply of teleconferencing service is made to a person resident in Canada, that person would be required to self-assess and remit the 7% GST (or 15% HST, if applicable), if it is not subject to the exclusion under subparagraph 217(a)(i). In conclusion, if the teleconferencing services supplied outside Canada are acquired by a person resident in Canada for consumption, use or supply exclusively in the course of commercial activity of the person, the person would not be required to self-assess under section 218 on the value of the fee paid to U.S. Company.

Question 5 – Presenter: Hanif Amlani

Input Tax Credit - In an August 26, 2002 Tax Court of Canada case (Alexander Nix Group Inc. vs. HMQ, 2001-3361-GST-I), Alexander Nix Group Inc. purchased supplies from 864116 Ontario Ltd. (864). After being provided with a GST registration number from 864, the appellant paid $3,766 GST on $53,874 of services and then claimed the $3,766 input tax credits. The registration number that 864 provided was the company's original number but was invalid as it had been deregistered years earlier.

The court denied the ITC. The primary reason was because it was deemed the appellant's responsibility to obtain a valid GST registration number. (Paragraph 169(4)(a) of the Excise Tax Act)

What is the purchaser's responsibility in checking the registration number of the vendor? Can this be done online or over the telephone?

Response

It is the taxpayer's responsibility to ensure that the vendor's registration number is valid in order to claim the ITC as per paragraph 169(4)(a) of the Excise Tax Act.

A purchaser may call CCRA Business lines to confirm a registrant's number. The purchaser must provide the name and the Business Number (BN) of the vendor and their reason for requesting the information. Once this information is provided the CCRA representative will:

- Confirm that the BN is valid
- That the legal name matches the BN or not (if it does not no name will be disclosed)
- The registration status of the GST account
- The date when the GST/HST account became registered

Question 6 – Presenter: Joe Gruzleski

Voluntary Disclosure - On June 12, 2002 (sic), CCRA issued its revised Voluntary Disclosure Program including the introduction of a policy to make a "no-name" disclosure on Form VDP-1. The no-name disclosure does not identify the name of the taxpayer but includes all relevant information to permit the CCRA officer to review the situation. We understand that the taxpayer could then proceed with a full disclosure by a negotiated deadline, or alternatively choose not to follow the Voluntary Disclosure process.

In GST disclosures which qualify for the 4% wash transaction charge (in lieu of interest and penalties) would the CCRA Appeals Division waive the 4%?

Will CCRA permit a voluntary disclosure that is within a one-year time frame?

IC00-1R *Voluntary Disclosure Program* was issued by the Agency on September 30, 2002. Paragraph 11 of this circular provides information in respect of the no-names policy under the Voluntary Disclosures Program (VDP). The Agency will review information pertaining to a no-name disclosure and provide analysis on the situation as it pertains to the VDP. Upon reviewing the Agency's analysis, the client may chose to continue with the program and provide their name and full disclosure, or in the alternative the client may choose not to follow the VDP process.

Question - Part 1

In GST disclosures which qualify for the 4% wash transaction charge (in lieu of interest and penalties) would the CCRA Appeals Division waive the 4%?

Response – Part 1

Where a voluntary disclosure involving a wash transaction has been made and is accepted by the CCRA as a valid wash transaction and a valid disclosure in accordance with GST Memorandum 500-3-4, *Voluntary Disclosure*, the 4% penalty will not be applied to the transaction identified as a wash transaction and reported in the course of a voluntary disclosure. In such circumstances, only the taxes that should have been collected originally by the supplier for that transaction will be sought by the CCRA.

Question - Part 2

Will CCRA permit a voluntary disclosure that is within a one-year time frame?

Response – Part 2

If the disclosure is less than one year past due it must not be initiated simply to avoid any applicable late filing or instalment penalties. (Income Tax Act and Excise Tax Act)

The Voluntary Disclosure Program (VDP) is not intended to act as a vehicle for clients to intentionally avoid their legal obligations under the acts administered by the CCRA. For example, a client cannot use the VDP to disclose a current year income tax return simply to avoid paying the late-filing penalty.

Paragraph 6(d)(ii) of the revised VDP policy allows discretion in accepting a disclosure of only current information. As expressed in the policy document, the VDP is not intended to generally provide relief from penalties for filing returns late. Acceptance of the disclosure in these circumstances will be based on additional considerations, such as the client's filing history, previous relief granted and the substance of the disclosure. If the client is only disclosing current information, the VDP officer will evaluate the motivation behind the disclosure. The following factors, although not all-inclusive, may be considered.

The CCRA will consider accepting the disclosure if:

- Penalties other than a LFP apply or may be applied or
- The client is trying to correct omissions on filed returns

Question 7 – Presenter: Hanif Amlani

Audit to Net Tax – As of July, 1996, Subsection 296(2) of the Excise Tax Act States that CCRA "shall" on audit allow taxpayers to claim previously unclaimed input tax credits.

It was noted in the June, 2002 issue of Canadian GST Monitor, Number 165, published by CCH Canadian Limited that, unfortunately, certain auditors still do not appear to be aware of this policy. It also noticed a recent CCRA Ruling where CCRA note that it does not allow an ITC that became payable in another period to be included when assessing the net tax for a "particular reporting period". CCRA's position is to allow only ITCs for the "particular reporting period" – ITCs that first became claimable in that same period.

The article notes that this approach does not seem to be supported by subsection 296(2) and may not be found in law.

Response

Subsection 296(2) of the Excise Tax Act (the "Act") provides that the Minister, when assessing net tax for a particular reporting period, shall take unclaimed "input tax credits for the particular reporting period" into account when assessing that net tax. Subsection 169(1) of the Act provides that a person's input tax credit for a reporting period in respect of the supply, importation or bringing into a participating province of property or a service is equal to the **tax that becomes payable or the tax that is paid without becoming payable in the period** (emphasis added) by the person to the extent of the person's use of that property or service in their commercial activities. Further, the definition of net tax for a particular reporting period as defined in subsection 225(1) of the Act distinguishes between an input tax credit for a particular reporting period (i.e. the period in which the tax became payable) and an input tax credit for a preceding reporting period. Provided that all other criteria have been met (e.g. the time limits for claiming an input tax credit under subsection 225(4) of the Act), an input tax credit of a preceding reporting period can be included in the calculation of net tax for the particular reporting period under subsection 225(1) of the Act. However, including an input tax credit of a preceding reporting period in the net tax of the particular reporting period does not transform that preceding period input tax credit into an input tax credit of the particular reporting period.

Consistent with the application of sections 169, 225 and 296, the CCRA considers the "particular reporting period" in subsection 296(2) to be the reporting period in which the input tax credit first became claimable (i.e. the period in which the tax became payable). This position is also supported by the explanatory notes to subsection 296(2) which state, in part, that "the Minister shall, unless the person being assessed requests otherwise, continue to take an input tax credit for a reporting period (i.e., an input tax credit claimed to recover **tax that became payable in the period**) (emphasis added) into account in determining the net tax for that period within the four-year period for assessing that period, even if the limitation period for claiming the credit has expired".

When the net tax for a particular reporting period is being assessed and it is determined that an input tax credit to recover tax payable for another reporting period has not been claimed, it is the CCRA's position that subsection 296(2) does not provide for the allowance of that unclaimed input tax credit in that particular reporting period. If that other reporting period is within the applicable time limit for assessing net tax for that period, as provided for in section 298 of the Act, and the net tax for that period is being assessed by the Minister, subsection 296(2) of the Act will apply to allow the input tax credit for that other reporting period. The provisions of subsections 296(3) and 296(4) of the Act would then apply to determine the amount of that input tax credit that can be applied to prior or subsequent reporting periods or that can be refunded to the registrant.

Question 8 – Presenter: Grant Perry

As an assist for the many part-time GST practitioners in the province, can you identify the ten most common mistakes made by honest registrants that result in assessments under the ***Excise Tax Act***? Roughly how many assessments are made out of each TSO in Alberta in a year and what percentage (in number and in amount) would these 10 issues represent?

Response

We cannot provide statistics for this question. However, we can identify some common areas of concern:

- Completion of the return; transposition errors are made as registrants transfer information from the top of the return to the bottom portion which is sent to CCRA for processing
- Lack of required documentation in the following areas: lack of proper documentation to support ITCs claimed, no export documentation, or no supporting documents verifying the usage of capital personal property
- ITCs are not prorated when the business provides both exempt and taxable supplies
- Registered individuals purchase land, use their GST number to not pay the GST, build a personal residence on the land and then do not self-assess and remit the GST
- Incorrect use of elections, particularly the GST 25 election for Nil consideration for closely related corporations and/or partnerships and the GST 44 election for supply of business assets
- Failure to re-capture 50% of ITCs on meals and entertainment expenses
- Incorrect use of a streamlined accounting method of net tax calculation for charities
- Failure to account for GST on employee and/or shareholder benefits
- Registrants do not believe they have to collect and remit GST if their sales are under $30K, but yet they are registered and claim ITCs
- Generally, there is a lot of confusion and non-compliance in the MUSH sector due to a misunderstanding or lack of understanding of the legislation

Question 9 – Presenter: Grant Perry

General experience has been that no applications under the Fairness Program have been accepted in Alberta. Has any one received waiver of penalty and interest under the Fairness Program in Alberta with respect to a GST assessment and without revealing confidential information, what facts allowed the application to be approved?

Response

When dealing with the issue of fairness waivers under the Fairness Program, one must distinguish between waive and cancel. When we reverse a penalty or interest that has already been assessed, we cancel it. When penalties and interest have not yet been charged, and at the client's request or on our own initiative we determine the amount will not be charged, we waive it.

As the auditor and team leader handle waivers during the course of their audit, the Fairness Team is normally not made aware of the waiver of either penalty and/or interest. Therefore, the remainder of this response would deal strictly with the cancellation of penalty and interest. A notation should be made in the auditor's report indicating that a request has been made or received and the reasons for accepting or denying the request in accordance with the fairness guidelines.

Written requests for the cancellation of penalty and interest on amounts assessed as a result of an audit would be handled by the Verification and Enforcement Division (hereafter referred to as V&E). The requests are reviewed to determine the type of penalties and interest that is accrued to the amounts outstanding. This process is required as there are two types of penalties and interest, which are charged; they would either be system-generated and/or audit generated. If the amount pertains strictly to system-generated amounts, the request would be referred to WTC for their consideration. As for amounts that are made up of both components, V& E would review each request with the additional information provided by the client to determine whether the guidelines and criteria of IC 92-2 and GST Memorandum 500-3-2-1 have been met. A detailed report would be prepared outlining the facts of the case and consideration is given based on the guidelines of either publication as to whether the client would be entitle to fairness under the Fairness Program. A final letter is forwarded to the client advising them of the decision and informing them of any other recourse in the event the decision is not favourable.

There are also requests that are for the cancellation of penalties and interest with reference made to financial hardship. If financial hardship is the only issue the request is referred to Assessment and Collections for their consideration. If there is more that one issue or guideline referred to, a joint response will be issued by V&E and Assessment and Collections.

As the requests are submitted in writing, the information provided by the client would strictly be based on their own initiative. If confidential information is provided it would be at the client's discretion

Question 10 – Presenter: George Hotson

Business Window

Our experience with the Level 2 officers in the Business

Window has been extremely satisfactory. The staff is very competent and they have allowed professionals to quickly bring clients into compliance when GST registration, filing or elections need to be resolved. We believe the general public finds the same great service when they bring requests to the various locations in the province and in the region. We could not ask for better assistance when we contact these officers.

However, our problem is the current process that requires a Level 1 officer to set up GST registrations and then having to submit further information to a Level 2 officer without face to face contact or at least a telephone conversation. There appears to be a shortage of Level 2 officers and by forcing a two-step process, much time and energy is wasted on both sides. Can we set up a direct contact line for professionals to the Level 2 officers (much like the TIS model), so that we may quickly confirm the treatment of a particular situation and determine exactly what information needs to be provided to attain a proper resolution for the client? (The most common example will be the need for a backdated GST registration. Where the client is a "registrant" there are normally outstanding GST returns with debit balances that are attracting penalty and interest every day the process is delayed.)

Response

While this idea has merit, budget restrictions, technical (telephony) considerations and workload distribution are some of the potential problems, which we must consider before; we could make a commitment to this idea.

We will however, consider this idea in conjunction with other initiatives currently underway and with those stemming from the various Future Directions initiatives.

Question 11 – Presenter: Rob Mitchell

The service provided by the regional TIS officers is generally fast and accurate, and delays are not common. Having said that, we have found that delays are generally the result of a query being forwarded to National TIS Headquarters. Business does not wait for the answer to a GST question, but we professionals must be 100 % accurate in the short time we may have to provide advice. Is there some way that we can expedite answers when the questions we must answer are National level?

Response

The main reason queries are forwarded to our headquarters office is that they involve issues that are of a policy setting or precedent setting nature that have national implications. However, we understand the importance of providing our clients with timely responses and are committed to improving our turnaround times. We are currently addressing this issue by making enhancements to the streamlining of our workload, developing industry specialization both at the regional and head office level, as well as introducing new publications such as fact sheets that are more specific to the needs of our clients.

Question 12 – Presenter: George Hotson

Electronic Commerce

In July of 2002, a Policy was issued on eCommerce that set out a standard for website access that is opposite to the position that the CCRA has given in interpretation letters and ruling letters since the GST was instituted. We are finding that auditors are applying the new policy to periods when the published position of the Department was opposite to the policy. Registrants have already made the supplies and have treated them as zero-rated, as they were told by Revenue Canada officials. There is no ability to recover GST from the thousands of customers, and the magnitude of this problem is in the hundreds of million dollars. Is it the intent of the CCRA to apply changes in policy as though they were always in existence (1984- style history as it were)?

Does the CCRA have any suggestions on how a Canadian internet service provider can effectively, to the CCRA's approval, zero-rate website access provided to non-Canadians or are these businesses expected to relocate to countries outside Canada in order to provide these non-residents with the service in a manner that allows them to compete with all other businesses in the world?

Response

Based on the information provided, it is not entirely clear what specific type of supply the question is referring to.

The issuance of GST/HST Technical Interpretation Bulletin B-090, *GST/HST and Electronic Commerce* in July 2002 did not result in a change in position if the "Web site access" to which the question is referring is a supply such as access to an interactive Web site that is characterized as intangible personal property (for example, access by subscription to an interactive Web site that contains various types of digitized content). Pursuant to the *Excise Tax Act*, where such a supply is deemed made in Canada because it may be used in whole or in part in Canada, the supply will not qualify for zero-rating even if the supply is made to a non-resident recipient. The bulletin explains the CCRA's interpretation of key provisions of the *Excise Tax Act* relevant to electronic commerce and outlines how the CCRA's administrative policies pertain to transactions made by electronic means. If a particular registrant has received an interpretation or ruling letter that is contrary to the CCRA's stated position regarding the tax status of the particular type of supplies made by the registrant, this will be taken into consideration on a case-by-case basis at the time of an audit.

The CCRA does not provide suggestions on how registrants can zero-rate a supply of Web site access made to non-residents. The CCRA administers and interprets the GST/HST legislation as enacted by Parliament. The responsibility for any amendments to the legislation that would result in a different tax treatment of the supplies in question falls within the purview of the Department of Finance.

Question 13 – Presenter: George Hotson

A partnership is involved in marketing crude oil and natural gas. ACo is the managing partner and has no business activities other than managing the affairs of the partnership. BCo is involved exclusively in the commercial activity of exploring for and producing crude oil and natural gas. The partnership pays a fixed management fee to ACo that is recorded as an expense by the partnership in determining the profits distributed to ACo and BCo. ACo, BCo and the partnership are registered for GST purposes.

a) Is the management fee a taxable supply under the general rules, or is it not a supply under the provisions of section 272.1(1) which deem anything done by a member of a partnership to be done by the partnership in the course of the partnership's activities, and not to have been done by the partner?

b) Would the answer to (a) be different if ACo did not charge a management fee but instead was allocated a slightly larger share of the profits?

c) Would the answer to (a) be different if Aco also provided management services to BCo and/or unrelated third parties?

Response

For GST purposes, partnerships are treated as separate persons. Anything done by a person as a member of a partnership is deemed to have been done by the partnership. Conversely, where a member of a partnership supplies property or a service to the partnership otherwise than in the course of the partnership activities, the supply is made on account of the member of the partnership.

As a consequence, the *Excise Tax Act* requires a partnership to register and to collect and remit GST and to claim ITCs with respect to the operations of the partnership, and the partners to register, to collect and remit GST and to claim ITCs with respect to their own activities, (assuming that they are both engaged in commercial activities).

With respect to the scenario described in Question #13, the Partnership is engaged in the activity of marketing crude oil and natural gas. ACo earns revenue from two sources: its interest as a partner in the Partnership; and its supplies of management services.

Part (a) of this question asks whether the management fee charged by ACo to the Partnership is a taxable supply? The answer is that ACo and the Partnership are two separate persons, with separate activities. ACo's business activity is the supply of management services. The Partnership's business activity is marketing oil and gas product. The management fee is taxable under the general rules, as the supply of management services is performed by ACo on its own account, rather than in its capacity as a member of the partnership.

Subsection 272.1(3) states that where a partner supplies property or a service to the partnership of which they are a member, and that supply is made *otherwise than in the course of the partnership's activities*, any amount that the partnership pays or credits to the partner in respect of the supply is deemed to be consideration for the supply, due at the time the amount is paid or credited, if the property or service is acquired by the partnership for consumption, use or supply in the course of the partnership's commercial activities. If the property or service is acquired by the partnership for use otherwise than in commercial activities, the supply is deemed to have been made for consideration equal to the fair market value of the property or service at that time.

Part (b): Based on the limited information provided in the question, the answer to (a) may be different if ACo receives a larger share of partnership profits instead of a management fee. However, other factors such as the partnership agreement and the nature of the services would have to be reviewed to make the determination.

Part (c): If ACo supplies management services to other persons, in addition to the Partnership, those services also will be taxable.

Question 14 – Presenter: Rob Mitchell

A financial institution sells a portfolio of mortgages to an investor. The financial institution continues to service the mortgages for the investor. Are the servicing fees subject to GST? Would the answer change if the financial institution retained a 15% interest in the mortgages? Would the answer change if the financial institution provided a guarantee to the investor of repayment of a portion of the principal if the mortgagor defaulted.

Response

Generally the supply of financial services provided in Canada is exempt pursuant to section 1 of Part VII of Schedule V to the *Excise Tax Act* (the ETA). Included in paragraph (c) of the definition of financial service in subsection 123(1) of the ETA is the lending or borrowing of a financial instrument. A debt security, which includes a mortgage, is a financial instrument. Specifically excluded from the definition of financial service in paragraph 123(1)(q) of the ETA is a management, administrative or almost any other service provided to an investment plan (as defined in subsection 149(5) of the ETA), a corporation, partnership or trust, whose principal activity is the investment of funds where the supplier is a person who provides management or administrative services to the investment plan, corporation or trust. Also specifically excluded from the definition of financial service in paragraph 123(1)(t) of the ETA is a prescribed service. Paragraph 4(2)(b) of the *Financial Services (GST/HST) Regulations* (the Regulations) prescribes any administrative service, including an administrative service in relation to the payment or receipt of dividends, interest, principal, claims, benefits or other amounts, other than solely the making of the payment or the taking of the receipt. However, in part, subsection 4(3) of the Regulations states that for the purposes of paragraph (t) of the definition "financial service" in subsection 123(1) of the ETA where the service is supplied with respect to an instrument by a person at risk, the service is not a prescribed service.

In order to answer this question completely, more information is required about the investor and what service(s) the financial institution is providing. If the investor were not an investment plan, a corporation, partnership or trust, the servicing fees would not be excluded under paragraph 123(1)(q) of the definition of financial service in the ETA. We then have to determine if the service(s) are prescribed under paragraph 123(1)(t) of the definition of financial service of the ETA. Where the service(s) are prescribed, the supply of the service is taxable. Where the financial institution retained 15% interest in the mortgages it becomes a person at risk and subsection 4(3) of the Regulations specifically excludes the service from being a prescribed service. Where neither paragraphs 123(1)(q) or (t) apply the fees will be exempt. The answer is unaffected by whether or not the financial institution provides a guarantee to the investor or repayment of a portion of the principal if the mortgagor defaults as that falls within paragraph 123(1)(e) of the definition of financial service and would be a separate supply from the other service(s).

That being said, where all supplies are provided as one package, section 139 of the ETA states that if there is a single consideration for the supply of financial services and other related services where the total consideration for financial services exceeds 50% of the total of all amounts that would be the consideration for each of the financial services and other services, had each been supplied separately, then the entire supply is deemed to be a supply of a financial service.

If the investor is an investment plan, a corporation, partnership or trust we would first have to establish whether or not its principal activity is the investing of funds. If the principal activity is the investing of funds then the servicing fees would be subject to the GST. If the principal activity is not the investing of funds we would then have to look at whether or not it is a prescribed service as explained in the previous paragraph.

Question 15 – Presenter: Rob Mitchell

A partner dedicates certain business assets to a partnership for exclusive use by the partnership in the partnership's commercial activities. The partner does not convey the assets to the partnership, and receives no consideration for either the dedication or the use. Has the partner made a supply to the partnership? If so, is there any consideration for GST purposes.

Response

We assume that what is meant by "dedicating" assets is that the assets remain the property of the partner despite exclusive use by the partnership. For GST/HST purposes, a supply includes the provision of a property or service in any manner. Where property of the partner is used by the partnership, this may be considered to be a supply by way of lease, licence or similar arrangement of the property to the partnership.

Where the partner is making the supply as a member of the partnership, the provisions of subsection 272.1(1) would apply and in effect there would be no supply to the partnership. As outlined in CCRA's draft policy statement, *Draft Policy Statement on the Application of Subsection 272.1(1) of the Excise Tax Act*, whether the supply is being made by the partner as a member of the partnership or not depends on various factors such as:

- The terms of the partnership agreement, whether the partner is responsible for making the supply under the terms of the agreement;
- The nature of the action undertaken by the partner, whether the action taken by the partner relates to the purpose of the partnership's business. Where the partner is making a capital contribution to the partnership, the provisions of 272.1(3) would apply, and it would not be considered to be done by the partnership;
- The partner's ordinary course of conduct, whether the partner is doing the same thing for other persons.

Where the supply is not made as a member of the partnership, the provisions of subsection 272.1(3) would apply. This subsection provides that where the supply is acquired by the partnership for consumption, use or supply exclusively in the course of commercial activities of the partnership, the amount of consideration for the supply of the assets will be considered to be the amount that the partnership agrees to pay to or credit the partner in respect of the property or service. Where this amount is nil, the consideration for the supply would also be nil.

General Questions

Question 1 – Presenter: Randy Mann

The Bonus Plan for Managers

It is now public knowledge that the CCRA has a program to reward managers by paying a cash bonus in addition to their salary as a result of acceptable performance. As with any such program, this is an offshoot of "Management By Objectives". It has long been established that for these types of programs to be successful the objectives must meet certain criteria:

Objectives should be **SMART**. i.e.

S = specific, clear and easily defined

M = measurable and quantifiable targets, tasks etc.

A = achievable, so objectives should be realistic

R = relevant and must not conflict with other objectives

T = time bound, so they need to be within a specified period of time.

A website on business applications (**www.bized.ca.uk**) recently made the following comment:

"However, George Obidone, one of the most astute users and critics of MBO, ***now holds that it is applicable mainly to those jobs which can be measured in numerical outputs*** *- profit, sales figures and so on. Even then, the best sales people argue that it is easy to get good sales figures for one year. It is developing relationships with customers so that one can repeat them year over year that matters. Like many aspects of management, the applicability of MBO depends upon the situation.*

MBO is essentially top down. That is to say, the objectives are set, even when agreed, by a boss and a subordinate, so that the subordinate knows what to do. ***The boss's job is either to set the objectives or at least to ensure that they are consistent with the objectives of the team****, his or her own jobs, the department and company at large." (Weekly Newsletter – February 3, 2003 Biz/Ed)* ***(Emphasis added)***

In light of this, what objectives are set for managers in order that they can earn their bonuses, and how does the CCRA intend on monitoring the performance of managers and the people under them to ensure that no abuse of power occurs when someone misunderstands the purpose of the program. What are some of the typical goals and objectives that are set for managers and do they meet the SMART model? How do you ensure that errors are not deliberately made in an attempt to meet target goals of the program? (For example, putting through an audit assessment in March 2003 knowing that a 1H reversal must be made in April because the assessment is incorrect.)

Response

A discussion regarding the earning of bonuses by CCRA management took place. This discussion emphasized that the bonuses are predicated on effective people management. Effective people management is defined as leading and developing employees, through a process of open, constructive communications and working relationships, toward the achievement of business goals and objectives.

Typical performance factors for Effective People Management include:

- Effective performance management – recognizes and rewards good performance and addresses poor performance;
- Support for employee learning;
- Open, multi-directional communication;
- Teamwork and consultation; and
- Decisions and behaviours based on CCRA values, ethics and principles.

CCRA business goals and objectives evolve from established service standards, which are published and reported on to Parliament. Below is the CCRA link to the 2001-2002 Annual Report to Parliament.

www.ccra-adrc.gc.ca/agency/annual/2001-2002/menu-e.html

Question 2 – Presenter: Maureen MacInnis

Recent experience has seen income tax and GST auditors ignoring the listed representatives when contacting taxpayers and registrants to set up an audit. There is a move towards forcing an instant meeting to commence the audit and interaction with professional accountants seems to be discouraged. The introductory audit letter appears to have been abandoned for a simple telephone call. The 30 day or 15 day proposal to assess letter is not being issued as a matter of course.

What is the current policy for setting up audits and for having professionals represent their clients throughout the audit process and what directives are being given to the field auditors in order that we might do our best to expedite the entire process?

Response

Auditors are advised that initial contact should be made with the taxpayer/registrant by telephone and then a letter sent confirming the details of the telephone discussion.

If the taxpayer/ registrant has indicated a representative via documentation on file, the auditor should still contact the taxpayer/registrant first. Written authorization must be on file or obtained from the taxpayer/registrant prior to any contact with a representative.

Proposal letters are issued to the taxpayer/registrant and a copy provided to the representative, where requested by the registrant. Auditors are instructed that the taxpayer/registrant should be given 30 days response time. The response time can be modified given specific circumstances such as approaching statute-barred dates.

Question 3 – Presenter: Marlene White

What are the reasons in the Voluntary Disclosure process for 6 years of disclosure when the statutory limits are 3 or 4 years?

Response

The Voluntary Disclosures Program (VDP) does not provide for only six years of disclosure. Clients are expected to come forward and provide all known facts and circumstances related to an omission.

The guidelines emphasize that VDP officers can include a statute-barred year when, at a minimum, the officer is satisfied that the omission is attributable to neglect or carelessness. When statute-barred years can be included, VDP officers will consider the facts, including the materiality of the omission.

The guideline is consistent with the recommendations of a private sector consultation group, in particular that omissions involving any of the most recent six years due be included in a disclosure. The group noted that omissions for older years should also be included, in particular when they are material and involve factors that the CCRA has noted in VDP guideline 8.4.4.

Question 4 – Presenter: John Baxter

Assessing Restrictions

We have a concern over the proposed amendment from the February Budget concerning GST and busing school children. The wording in the proposed amendment allows CCRA to ignore the assessing restrictions in the Excise Tax Act and also recent court decisions. This means CCRA can assess for reporting periods back to 1991 and are not required to consider offsets for the periods assessed (like missed input tax credits). How are the Alberta Tax Services Offices responding to this proposed amendment?

Response

The proposed legislation has not yet received Royal Assent. Current audit administrative policies will continue to apply to this industry. Should the legislation pass, CCRA may revisit its administrative policy in this regard.

Additional Questions

Income Tax Issues

Question 1 – Presenter: Edmonton TSO

Opco pays management fees to its three parents (Holdcos 1,2 and 3). Opco has been properly invoiced for these management fees and GST charged accordingly. The Holdcos each pay salaries to their respective shareholders for which source deductions are properly withheld and remitted. T4 slips are prepared by the Holdcos to acknowledge the payment of salaries.

The management fees payable are recorded by Opco in the appropriate intercompany accounts with each of the Holdcos. As a matter of convenience, rather than have Opco pay each Holdco for the management fee and then have the Holdcos each pay their shareholder employee for salaries earned, the Holdcos direct the Opco to make the payment directly to their shareholder employees. All of this is properly reflected in the intercompany / shareholder accounts.

CCRA has stated that these payments could be interpreted as an appropriation of property from Opco and 15(1) may apply to include these amounts as shareholder income in the year that it was received. CCRA has not proposed an assessment for the audit in question but has stated in its letter that it is mandatory that the companies not follow this business practice any longer and that the corresponding payments be made to the entity that is issuing the invoice.

Our Question/Concern

It is our understanding that subsection 15(1) of the Income Tax Act only applies where a "benefit" has been bestowed upon a shareholder. The purpose of this subsection is to bring into income any such benefit that would not otherwise be included in the shareholder's income under another section of the Act. Therefore, it is intended to ensure that a shareholder has not appropriated corporate funds without the proper payment of tax.

In the case at hand, we fail to see why subsection 15(1) would be applied. The Minister suggests that there is an appropriation of funds from Opco by the Holdcos. However, Opco pays a management fee to its holding companies which is properly supported by invoices. The Holdcos are properly recording the management fees in their respective income. The Holdcos pay a salary amount to their respective employees, properly documenting the payment by issuing T4 slips to the employees. The employees report the income on their respective tax returns.

It appears that the Minister has taken exception to the practical business flow that has been adopted by these companies. The payment flows do not appear to be in contravention of any section of the Act. We do not believe it is appropriate for the Minister to direct that a taxpayer change its business practice in a case where there is, and has been, no attempt to avoid taxation by any of the parties involved.

Response

This question appears to involve an ongoing issue and therefore we are not in a position to respond to this situation at this time. In general terms however the Minister does not involve itself in the questioning of a certain business practice if it is not in contravention of the various Acts that it is responsible for. In certain cases the Minister may make a recommendation to the taxpayer that a certain business practice may result in unintended tax consequences and that caution be exercised.

Nothing in the above comments should be construed as relating to the reasonableness of the amounts in question.

Question 2 – Presenter: Barry Rooke

We continue to hear reoccurring concerns from our clients about the time taken to complete CCRA audits. The common theme is that the auditor is quick to set up the audit arrangements, but that once the auditor is on-site, there often appear to be significant lapses in time between completion of the review and issuance of the proposals. It has not been uncommon for clients to receive a proposal six months or more after the auditor has left the client's premises. One recent example was an 18 month audit where the taxpayer did not hear from the auditor until one year after the field audit was completed. Once the auditor presented his proposal, the taxpayer was given 30 days to respond. When the taxpayer requested an extension of time to respond, the auditor advised that the extension could not be granted as he had a deadline to complete the file.

Our Question/Concern

Can you provide reasons why the foregoing might occur and who the taxpayer should consult to discuss delays or extension requests in these circumstances?

Response

The examples in the question appear to be exceptional cases. Without knowing all of the circumstances in those examples we cannot really comment as to why excessive delays were experienced. Having said that, most audits are completed within expected time parameters that are established on a case-by-case basis. Auditors are expected to plan and organize their work so as to minimize elapsed audit times as much as possible.

Initial audit plans are generally based on the assumption the records of a taxpayer are complete and available. Where auditors discover that this is not the case, third parties are sometimes approached to provide copies of missing or incomplete documents. Delays often occur when dealing with other large institutions such as banks.

Delays have occurred because taxpayers may not be available to clear outstanding audit queries due to reasons such as: business cycles (busy season), illness, vacations and consultations with representatives.

Some audits can be quite complex which require them to be referred to other areas. Referrals to areas such as: Valuations, Tax Avoidance, International Audit, Investigations or Head Quarters will cause delays in completing an audit.

Question 3 – Presenter: Barry Rooke

We continue to encounter situations where auditors are not prepared to discuss the issues for which they are proposing assessments. Instead, we are advised that further discussion will be through the Objection process. In the majority of cases, we have been successful in vacating all or portions of the assessment. However, this becomes an added cost to the taxpayer.

We have also encountered a situation where a taxpayer has been reporting its income in accordance with Section 18 (cash basis) consistently over the past thirty years. A CCRA auditor has reassessed to convert part of the taxpayer's income to accrual reporting. This would result in great complexity for the taxpayer. For the sake of a what is essentially a timing adjustment the taxpayer will be forced to incur additional professional assistance to adjust its reporting. Over time the taxpayer will adjust its procedures to effectively bring it back to the same tax position as occurred using the full cash basis. The only thing that has changed is complexity and cost to the taxpayer, and CCRA has charged interest on the original reassessment.

Our Question/Concern

Is there a process within CCRA to make the auditors more accountable for the proposed assessments? Why are supposed limited CCRA resources devoted to this type of exercise?

Response

We cannot comment on the examples provided as the circumstances surrounding them are unknown.

CCRA auditors are expected to conduct themselves in accordance with our core values of Professionalism, Respect, Integrity and Co-operation. Auditors who do not act in accordance with these values are subject to internal disciplinary procedures. Correct interpretations of tax law and fairness in dealing with taxpayers are included in these values. Where a taxpayer or representative feels the auditor has not acted fairly in conducting the audit, he or she should bring the matter to the attention of the auditor's team leader.

The second question appears to relate to the "cash basis" situation. While we cannot address this specific situation without knowing all of the facts, we do offer the following comments.

Taxpayers who are farmers or fishermen may elect to report their income on the cash basis pursuant to section 28 of the Income Tax Act. Taxpayers who are not farmers or fishermen are required to report their income on the accrual basis. The facts of the case will determine their income-reporting basis. Even though a particular taxpayer's final tax obligation may be the same under either approach, the rules governing income reporting have national application under the Income Tax Act. The CCRA would not be fair in its administration of the Income Tax Act if one taxpayer were allowed to adopt an incorrect method of accounting while requiring other taxpayers in the same or similar situation to adopt another.

Question 4 – Presenter: Edmonton TSO

We see CCRA audit situations involving family owned businesses where CCRA appears to be telling taxpayers how to conduct their business affairs. Where family members are the ones incurring the expenses, as employees of the taxpayer, CCRA appears to be overly subjective in disallowing expenses. In one example, three family member employees attended a conference in the U.S. To discuss the taxpayer company activities after the conference, the three members vacated the conference hotel, moved into a less costly hotel, and met for two or three days to discuss the conference issues and to plan the taxpayer activities accordingly. CCRA suggested that it was more appropriate for the employees to travel ten hours back to Edmonton and meet the next day to continue their discussions. We do not see this situation happening if the employees were not family members. It seems that the CCRA attitude is predetermined when family owned businesses are involved, or conversely, that the CCRA auditors believe they have better business judgment than those actually in business.

Our Question/Concerns

How can the taxpayer defend itself from these approaches?

Response

This question appears to be one that involves an ongoing audit issue and therefore we are not in a position to make any comments on this particular situation at this time. However, in general terms it must be noted that expenditures related to the attendance of conventions are limited to two a year as per subsection 20(10) of the Income Tax Act. CCRA's views on the deductibility of expenses incurred in relation to such events may be found in Interpretation Bulletin (IT) 131R2 Convention Expenses. The reasonableness and deductibility of any expenses not related to the actual attendance at a convention must be determined on the basis of the facts. This determination would be the same whether the employees are related or not.

GST Issues

Question 1 – Presenter: Joe Gruzleski

CCRA has advised that the consideration of late-filed elections for GST purposes is beyond the scope of the Voluntary Disclosure Program. However, there has been no clear guidance as to where we should direct requests for consideration of late-filed GST elections.

Our Question/Concern

To whom should concerns be directed with respect to late filed GST election? Is CCRA considering modification of these Voluntary Disclosure rules for GST elections that have been filed late?

Response

The Appeals Division (and specifically the VDP) does not have the delegated authority under the Excise Tax Act to make a decision on a late filed election. The delegated authority resides in the Business Window Unit of the Client Services Division and in Audit.

Concerns about late-filed GST elections should be forwarded to the Business Window Unit of your local Tax Services Office. They can make a determination, based on the particular facts of a situation, as to whether a late-filed election can be allowed. Such determinations are made on a case-by-case basis.

Once the determination whether to allow an election is made, if taxes are still due from a previous period, a voluntary disclosure can be made to cancel penalties.

Question 2 – Presenter: Joe Gruzleski

There have been difficulties in consistent application of the Voluntary Disclosure Program guidelines between offices and even between officers assigned to cases within the same office. Our understanding of the VDP is to bring the taxpayers back on board while minimizing the bureaucracy to accomplish this objective. We have encountered situations where the VDP officers insist on having us perform tasks, that while technically correct, are not productive for the taxpayer, nor for CCRA. This adds cost to the taxpayers for even the smallest of Voluntary Disclosures.

The vast majority of taxpayers choose to carry out their GST reporting within the law. Most voluntary disclosures for GST purposes are the result of errors or lack of understanding of the issues and usually result in an offset of GST liability with recovery of ITCs. As such, taxpayers want to resolve the issues and move on with minimal cost.

Our Question/Concern

What steps is CCRA taking to simplify the Voluntary Disclosure procedures for GST?

Response

The most recent information concerning the Voluntary Disclosure Program is found in income tax Information Circular 00-1R, "Voluntary Disclosures" (September 30,2002), which applies for GST purposes as well. More information on the Voluntary Disclosures Program is available at CCRA offices and on the "Fairness and Client Rights" page of the CCRA's Web site at: **www.ccra.gc.ca**.

In that circular, certain changes were made to the policy; for example, disclosures of less than one year may be accepted, as long as they are not initiated simply to avoid any applicable late filing or instalment penalties.

Question 3 – Presenter: Edmonton TSO

A Section 150 Election is required to be filed before it can be considered to be valid. No retroactive filing of the Election is permitted. We have recently seen a number of examples; including sister corporations that believed they were provincial government entities where the realization of the taxable status (or lack of provincial entity status) occurred well after the transactions took place. In these situations, the Section 150 Election cannot be made retroactively. It is obvious that the taxpayers would have elected under Section 150 if their status was known, or if the status of the supplies was known earlier.

Our Question/Concern

In cases such as the foregoing, what relief is available to the taxpayer, given that the use of the Section 150 Election would have been without question if all the facts had been known?

Response

Section 150 of the Excise Tax Act (the "Act") provides that an election may be made jointly between members of a closely related group of which a listed financial institution is a member. The effect of filing this election is that certain supplies made between these members at a time when this election is in effect will be deemed to be financial services. Subsection 150(3) of the Act provides that the member shall file this election with the Minister on or before the day on or before which a return under Division V for the reporting period of the member in which the election is to become effective is required to be filed.

There are no legislative provisions in the Excise Tax Act that will allow for the late filing of a section 150 election.

Question 4 – Presenter: Edmonton TSO

We have encountered situations where auditors continue to see only black and white in dealing with situations where only the public interest is being damaged by the audit action. A government sponsored not-for-profit corporation is assessed because it supposedly did not meet the appropriate characteristics for ITCs. The taxpayer had attempted to resolve the issue and satisfy CCRA guidelines by forming a separate entity that did satisfy the criteria. The taxpayer ran the same business activities out of the new entity. Since the Province funds the entity and since the entity had corrected the deficiencies through use of the new corporation, why is time and money being spent to reassess? Does it accomplish anything other than cause financial hardship to the community at large?

Our Question/Concern

Is there a process within CCRA to make the auditors more accountable for the proposed assessments? Why are supposed limited CCRA resources devoted to this type of exercise?

Response

The goal of the Department is to encourage and facilitate voluntary compliance with the provisions of the *Excise Tax Act* and its Regulations. The GST, therefore, operates on a self-assessment system in which registrants determine their own liability for tax or net tax and remit or request a net tax refund accordingly. Persons must also determine their entitlement to a rebate and submit the appropriate claim form.

In order to verify compliance and enforce the provisions of the Act, auditors have been given the general authority to inspect, audit or examine any documents, property or process of any person and to assess or reassess any amount, such as tax or net tax, of a person.

The field audit is the main tool in the Department's audit program. It involves a detailed examination of the books and records of the person liable for the tax and is conducted at the person's place of business. Auditors have been designated as a class of officers, pursuant to subsection 275(3) of the Act, who are authorized to exercise the powers or perform duties of the Minister under Part IX of the Act.

The role of the auditor is to determine the correct net tax remittable or tax payable in accordance with the provisions of the Act, verify the information contained in the GST return and prove the accuracy of any rebate claim. As a result of the audit, an auditor may make an assessment, reassessment, or an additional assessment for the following reasons:

(a) to determine any deficiency in the net tax reported by a person for a reporting period; Refer to GST MEMORANDUM 500-2-4, **CALCULATION OF LIABILITY** for more information on net tax.

(b) to determine any tax payable by a recipient of a taxable supply made in Canada (e.g., non-registrant recipient of property in Canada);

(c) to determine any tax payable by a recipient of an "imported taxable supply" as defined in section 217 of the Act;

(d) to determine any penalty and interest payable by a person under Part IX of the Act; and

(e) to determine any amount for which a person became liable under subsection 270(2) of the Act.

When an audit is completed, the auditor will prepare a summary of the proposed audit adjustments. The proposed audit adjustments will be discussed with the person audited or the person's representative. If the person audited is in full agreement with or has not voiced any concerns about the proposal, the auditor may proceed with the process of finalizing the Notice of Assessment (NOA). If the person audited is not in agreement with the proposal or may need an opportunity to analyze the proposal, the auditor will advise the person that the person has 30 days, from the date of the statement of audit adjustments, to make representations at the district or regional level. If the representations are not made within this period, the auditor will proceed with the process of finalizing the NOA.

We currently cannot comment on the outcome of the specific question because it is still under review.

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