GST & RST Issues on

Professional Corporations

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Rob is a partner at MILLAR KREKLEWETZ LLP, with an LL.B. from Osgoode Hall Law School, and a M.B.A. from York University.

Extensive Commodity Tax, Customs & Trade Experience. Rob's practice focuses on **Commodity Taxes**, which encompasses all issues involving Canada's Goods and Services Tax (GST) and Harmonized Sales Tax (HST), as well the various other provincial sales taxes, including Ontario RST and Quebec QST. Rob's practice area also focuses on **Customs & Trade** matters, including Periodic Verification Audits and Voluntary Disclosures concerning Valuation, Tariff Class Origin, or Marking issues, and NAFTA Origin Verification Reviews, Forfeitures, Seizures, and other NAFTA & WTO issues.

Tax & Trade Litigation. Tax & Trade Litigation is an integral element of Rob's practice, and Rob litigates tax and trade matters before all relevant bodies, tribunals and courts, including the Tax Court of Canada, Canadian International Trade Tribunal, Federal Court, Federal Court of Appeal, and Canada's various provincial Superior Courts and Courts of Appeal, and the Supreme Court of Canada. At MILLAR KREKLEWETZ LLP, we believe our "hands-on" tax and trade knowledge, combined with our litigation skill, gives us a competitive advantage. Rob's practice also includes planning and representation work before all government levels.

Client Base. MILLAR KREKLEWETZ LLP has some of the best tax and trade files in Canada, and Rob advises blue chip corporate clients who are international leaders in:

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- Banking
- Financial Services
- Leasing
- Publishing
- Public Sector
- Manufacturing
- Wholesaling
- Retailing
- Direct Mail
- Direct Selling

Speaking Engagements / Publications / Memberships. Rob has published over **400 articles and papers**, and spoken at over **150 conferences and seminars**.

Accordingly, Rob regularly addresses the Tax Executive Institute (TEI) – at its Annual Canadian and International Conferences, and at various provincial Chapter Meetings – and also speaks frequently before other organizations on like the Canadian Tax Foundation (CTF), Canadian & Ontario Bar Associations (CBA/OBA), Canadian Institute of Chartered Accountants (CICA), Certified General Accountants Association (CGA).

Rob also regularly addresses industry-specific associations like the Canadian Corporate Counsel Association (CCCA), Canadian Association of Importers & Exporters (CAIE), American Petroleum Institute (API), American Toy Industry Association (TIA), Canadian Finance and Leasing Association (CFLA), and the Canadian and U.S. Direct Sellers Associations (DSA). Rob is also a frequent speaker at other professional conferences held by organizations like the Strategy Institute, Infonex, IIR and Federated Press.

Rob is a regular contributor to the Tax Foundation's Tax Highlights publication, writing exclusively on commodity tax, customs & trade matters, and also contributes regularly to a number of other publications like Carswell's GST and Commodity Tax Reporter, the OBA's Tax Newsletter, Federated Press's Sales and Commodity Tax Journal, and the CAIE's Tradeweek publication.

Rob is a member of the OBA's Tax and International Law Executives, a member of the CFLA's Tax Committee, and Chair of the DSA's Taxation Committee. Rob is also a member of several federal and provincial consultation groups, consulting both with the federal Department of Finance, and the Ontario Ministry of Finance.

The Real Important Stuff – Unfortunately Left to the Bottom. Rob is married to Franceen, has a beautiful 8 year-old boy named William (the "Conqueror"), who has a 3 year-old little brother named Richard (the "Lion-Hearted").

While Rob concedes that Tax & Trade is truly scintillating, what he really enjoys is spending time with his family, playing golf with his boys, and attempting to finish at least one household project he starts.

We are proud to announce that the International Tax Review has ranked us as the top Canadian law firm in our field for three consecutive years – "Indirect & State and Local Taxes".

We are also recognized as a leading Canadian law firm by World Tax 2007, and noted as commodity tax specialists.

QUESTIONS ?

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THE ROAD MAP

General Focus of the Presentation

Implementing a professional corporation structure will have clear income tax benefits, but often entail some important GST issues that cannot be overlooked.

This presentation will focus on some basic GST issues to be considered on the implementation of a professional corporation, as follows:

- **Operational Issues** including
  - an assessment of what is taxable and exempt in the current business structure
  - GST registration requirements
  - ITC allocation between taxable and exempt supplies
- **Implementation Issues**, including
  - Understanding the application of s. 167 of the ETA
  - Assessing other business assets on a stand-alone basis
  - Understanding the RST related party rules

Please note that the issues discussion is not meant to be exhaustive, and that the GST issues inherent in any particular structure will be dependent, in many respects, the form of structure developed.

There is no substitute for specific advice on specific structures.

Navigating Through the Materials

On the assumption that at most, the reader will have only a rudimentary understanding of Indirect Taxes, these Materials are broken into several parts, as follows.

Part I is a narrative outline of the basic GST (and sales tax) considerations in most Professional Corporation Structures, and summarizes the points to be made during the Presentation.

Part II of the Materials is a comprehensive introduction to Canada's Commodity Tax Systems, including introductions to the GST, and the provincial sales tax systems in place in Ontario, British Columbia, Saskatchewan, Manitoba and PEI.

Questions ?

Questions are welcomed at any point during the presentation.

If you would like to discuss your question in private, please see me after the session, or contact me at the telephone or e-mail set out in the bottom left-hand corner.

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Part I

GST & RST Issues in Professional Corporations

Half of Professional Corporations' are GST Unique

As Colin Smith's paper notes, the marketplace for Professional Corporations in Ontario is mainly, from a income tax splitting perspective, professional doctors and dentists – with accountants and lawyers excluded from having family members involved in their share ownership.

This current legislative reality leads to an important GST reality, and that is that the marketplace for Professional Corporations is very unique, and will mainly involve GST exempt suppliers like doctor's and dentists.

The "exempt" status of these groups is important from cradle to grave for GST purposes, and affects everything from the GST registration obligations, to special rules on ITC allocation, to special rules on recovering GST paid on real property.

Recognizing this special GST status is the starting point for GST purposes.

Operational Issues

Health Care – What's Exempt; What's Taxable

The GST exemptions for "health care" services are found in Part II of Schedule V of the *Excise Tax Act* (the "ETA"). Not all, but some of the more applicable to "Professional Corporations" are as follows: *

"**medical practitioner**" means a person who is entitled under the laws of a province to practise the profession of medicine or dentistry;

"**practitioner**", in respect of a supply of optometric, chiropractic, physiotherapy, chiropodic, podiatric, osteopathic, audiological, speech-language pathology, occupational therapy, psychological or dietetic services, means a person who

(a) practises the profession of optometry, chiropractic, physiotherapy, chiropody, podiatry, osteopathy, audiology, speech-language pathology, occupational therapy, psychology or dietetics, as the case may be,

(b) where the person is required to be licensed or otherwise certified to practise the profession in the province in which the service is supplied, is so licensed or certified, and

(c) where the person is not required to be licensed or otherwise certified to practise the profession in that province, has the qualifications equivalent to those necessary to be so licensed or otherwise certified in another province.

…

5. A supply made by a medical practitioner of a consultative, diagnostic, treatment or other health care service rendered to an individual (other than a surgical or dental service that is performed for cosmetic purposes and not for medical or reconstructive purposes).

…

7. A supply of any of the following services when rendered to an individual, where the supply is made by a practitioner of the service:

(a) optometric services;

(b) chiropractic services;

(c) physiotherapy services;

(d) chiropodic services;

(e) podiatric services;

(f) osteopathic services;

(g) audiological services;

(h) speech-language pathology services;

(i) occupational therapy services; and

(j) psychological services.

8. A supply of a dental hygienist service.

9. A supply (other than a zero-rated supply) of any property or service but only if, and to the extent that, the consideration for the supply is payable or reimbursed by the government of a province under a plan established under an Act of the legislature of the province to provide for health care services for all insured persons of the province.

* Note that portions of the provisions above are subject to announced amendment, but which have not, at the date of writing, been enacted. The "announced" versions have been used in this text.

Understanding what is "exempt" and what is "taxable" will be important for determining the GST registration requirements on the newly formed Professional Corporation entity.

For example, while much that a medical or dental practice may do will be wholly exempt, there may be instances where the activities of the business are "taxable" for GST purposes.

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What is "taxable" ?

The most notable example of "taxable" health care services would include surgical or dental service that is performed for *cosmetic purposes*.

Other situations could include taxable business activities not covered by the exemptions above, like *teaching*, *research* or *administrative services*. For example, a supply made by a medical practitioner of overseeing the delivery of clinical, academic or research services is not considered to be exempt by the CRA.

There are also special considerations related to inter-practice payments between exempt medical practitioners, which ought to be taken into account. See for example: GST/HST Policy Statement P-238: *Application of the GST/HST to Payments made between Parties within a Medical Practice Organization*, November 7, 2000).

Similarly, the GST treatment of Medico-legal Reports has been a focal point in recent years. See for example GST/HST Policy Statement P-080, *Medico-legal Reports*, June 30, 1993), *Riverfront Medical Evaluations Ltd. v. The Queen*, [2002] 2959 ETC (FCA), and CRA Notice 181R (2004/02), *For Discussion Purposes Only – Discussion Paper: The Application of the GST/HST to Independent Medical Evaluations and Other Independent Assessments*, February 2004).

Are the same exemptions available to Professional Corporations ?

The CRA has confirmed that where a medical professional incorporates a professional corporation, the GST status of the supplies made by the professional (albeit now *through* the corporate vehicle) will still maintain their exempt or taxable status, notwithstanding the corporate vehicle. Accordingly, where a professional corporation invoices a patient directly for a tax-exempt supply provided by the medical professional, that supply will remain exempt. See for example, CRA GST Question & Answer 3d.73 (June 1993).

More recently, the CRA has also confirmed that it would view the "professional corporation" to meet the definition of "medical practitioner" in Part II of Schedule V of the ETA: See Headquarter's Ruling Letter 0001960 (RITS/No: 8354), March 24, 2000.

When will GST be required to be Charged ?

Where "taxable" services are rendered, one must then consider whether the professional or the professional corporation is required to charge GST.

Generally speaking, the GST will be required to be charged where the professional or the professional corporation is either *registered* for GST purposes, or *required to be registered* for GST purposes.

These persons – namely persons either registered or required to be registered – are known as *registrants* for GST purposes.

What are the GST Registration Requirements ?

Registration for GST purposes of provided for in section 240 of the ETA as follows:

> 240. (1) **Registration required** — 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 for the purposes of this Part, except where
>
> (a) the person is a small supplier;
>
> (b) the only commercial activity of the person is the making of supplies of real property by way of sale otherwise than in the course of a business; or
>
> (c) the person is a non-resident person who does not carry on any business in Canada.
>
> …
>
> (2.1) **Application** — A person required under subsection (1) … to be registered shall apply to the Minister for registration before the day that is thirty days after … the day the person first makes a taxable supply in Canada, otherwise than as a small supplier, in the course of a commercial activity engaged in by the person in Canada.

Notably, the "small supplier" exception relieves persons making *de minimis* taxable supplies from being *required* to register for GST purposes, although the $30,000 threshold comes with some specific requirements.

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What are the Small Supplier Requirements ?

Specifically, under section 148 of the ETA, in order to be considered a "small supplier" during any particular quarter and the following month, the total value of all consideration for world-wide taxable supplies made by the person (or by an associate of the person) that became due or was paid without having become due, in the preceding four calendar quarters does not exceed $30,000 (or $50,000 in the case of a public service body).

The calculation of this small supplier threshold includes zero-rated supplies but excludes consideration attributable to the goodwill of a business, supplies of financial services, and supplies by way of sale of capital property.

Note also that the calculation includes consideration paid to an associate. "Associate" means a person "associated" with another person. Under subsection 127(1) of the ETA, corporations are associated with one another for GST purposes if they are associated for income tax purposes under subsections 256(1) to (6) of the Income Tax Act (the "ITA"). Essentially, the test for determining whether corporations are associated focuses on corporate control. The general rule under subsections 256(1) and 256(2) of the ITA is that two corporations are associated with each other if one of them is controlled, directly or indirectly, by the other, or if they are both controlled, directly or indirectly, by the same person or group of persons.

What is Voluntary Registration ?

For persons not otherwise *required* to register, section 240(3) provides for *voluntary registration* in the following situations:

> 240(3) **Registration permitted** — An application for registration for the purposes of this Part may be made to the Minister by any person who is not required under subsection (1) … to be registered and who
>
> (a) is engaged in a commercial activity in Canada;

Thus even though a "small supplier", a medical or dental professional (or his or her "professional corporation") will be entitled to voluntarily register for the GST just by virtue of carrying on commercial (i.e., taxable, but not exempt) activities.

This may be a useful strategy where the GST costs are easily passed on (e.g., cosmetic surgery), and the practitioner or professional corporation desires to recover GST paid on expenses related to the taxable supplies by way of input tax credits ("ITCs").

What is "ITC Allocation" ?

Generally speaking, GST ITCs are only available where the GST was paid in respect of inputs that are for "consumption, use or supply in the course of commercial (i.e., not exempt) activities": see for example sections 169 and 141.01 of the ETA.

Where a business involved in both "commercial" and "exempt" activities, it will be required to allocate ITCs between those activities. Thus a medical practitioner that provides both exempt and taxable activities would be required to make a reasonable allocation of expenses between those supplies.

The basic legislative rule is found in section 141.01(5) of the ETA, which while plain enough, does not give much guidance in terms of just how ITC allocation is to practically occur – all that must be used is a "fair and reasonable" approach, which is "used consistently by the person throughout the year":

> 141.01 (5) **Method of determining extent of use, etc.** — The methods used by a person in a fiscal year to determine
>
> (a) the extent to which properties or services are acquired, imported or brought into a participating province by the person for the purpose of making taxable supplies for consideration or for other purposes, and
>
> (b) the extent to which the consumption or use of properties or services is for the purpose of making taxable supplies for consideration or for other purposes,
>
> shall be fair and reasonable and shall be used consistently by the person throughout the year.

Jurisprudence does suggest that the method need not be the best possible method, only a "fair and reasonable" one: see *Ville de Magog v The Queen*, [2001] 3030 ETC (F.C.A.).

Given the rules in section 141.01 of the ETA, however, it is notable that ITC Allocation will not apply where there is a direct link between the purchase and the commercial or exempt use.

For example, a specialized patient chair is acquired for a particular exempt medical procedure, and is only used for the medical procedure. Even though the medical professional may be engaged in 50% commercial activities, it is not eligible to claim any ITC for the GST paid on the chair: see section 141.01(3) of the ETA.

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RST Registration and Considerations

Unlike the GST, the Ontario *Retail Sales Tax Act* has no "small supplier" threshold. Thus any medical practitioner selling taxable goods or services in Ontario would be required to register.

Thankfully, most medical practitioners will either *not* be selling goods at all, or will *not* be selling taxable goods. For example, exemptions apply in Ontario for most drugs and medicines sold on prescription, and most goods and equipment sold to hospitals.

Implementation Issues

Other than day-to-day GST or Sales Tax compliance that will follow any health care practitioner engaging in a professional practice (whether individually or through a professional corporate entity), there are one-time "implementation" issues that arise on the incorporation and start-up of a professional corporation.

These issues generally track the "transaction" that is implemented to stock the professional corporation with the goods, services, and intangibles necessary to carry on business.

The GST and sales tax issues inherent in this implementation phased can be understood in the following terms, and would be treated not unlike the transfer of a business from one person to another.

Characterization of Transaction

The first thing to consider is whether the transaction that is being contemplated involves the transfer of goods, services or intangibles, or merely contemplates a "share" transaction.

If all that is involved is the transfer or issuance of "shares" (i.e., with no legal transfer of the underlying ownership of the assets, which remain owned by the entity whose shares are being dealt with), then there will, generally speaking, be no GST or RST issues.

The reason is that for GST purposes, the transfer or issuance of shares is an exempt financial service, and no GST applies. For RST purposes, there is no sale of any "tangible personal property" on which to trigger RST, so no RST applies either.

Generally speaking, the GST and the RST will apply, however, where there is the transfer of legal ownership of assets, as for example, on the transfer of a medical practices physical and non-physical assets to a professional corporation.

GST Issues on the Transfers of Assets

Sale of Business ?

When if comes to the transfer of business assets, the first question for GST purposes is whether the transfer is a sale of a business or a part of a business.

Special GST relief may be available to a person who acquires "a business" or a "part of a business", as set out in section 167 of the ETA. The rules are subject to some stringent conditions, however, each of which must be met in order to take advantage of the GST relief.

Section 167 applies where there is a (1) sale of a business, or part of a business, and the (2) purchaser is "acquiring ownership, possession or use of all or substantially all of the property that can reasonably be regarded as being necessary for the recipient to be capable of carrying on the business or part of the business as a business".

If that test has been met, and the provision is otherwise available, a joint election must be made by the vendor and purchaser (in Form GST 44).

Note the following potential traps with respect to the application of section 167.

First, the rule requires the purchaser to acquire a "business".

Second, the purchaser must also be acquiring ownership, possession or use of "all or substantially all" of the assets which are reasonably necessary for the purchaser to be capable of carrying on the business or part of the business. The CRA considers "all or substantially all" to mean 90% or more. However, this 90% threshold would not seem to apply to assets which are not necessary to carrying on the business like, for example, accounts receivables, working capital, bank accounts, etc. Further, recent case law has also confirmed that the CRA's 90% arbitrary test for "substantially all" is only a guideline at most. (Irrespective of what percentage amounts to "all or substantially all", there is no requirement on the purchaser to purchase "all or substantially all" of the vendor's assets. The ETA specifies that the purchaser must obtain, under the agreement of purchase and sale, only use to "all or substantially all" of the vendor's assets and, as such, some of the assets may be leased instead of purchased.)

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Third, there are special limitations to the relief that is available under section 167. For example, relief under section 167 will not extend to taxable services that "are to be rendered by the supplier", taxable supplies of property by way of "lease, licence or similar arrangement", or sales of real property (unless the purchaser is a registrant) – even though these assets will count in the "all or substantially all" calculation.

Finally, note that the section 167 election is <u>not</u> available where the vendor is a GST registrant, but the purchaser is not.

Trap: In the context of professional corporations, note the exclusion in section 167 for situations "where the supplier is a registrant and the recipient is not a registrant". Where this situation exists, the election is NOT available, and in practice this could be a common situation, and would arise where a GST registered medical practitioner (or a medical practioner with over $30,000 in annual taxable supplies) incorporates a new professional corporation, that has not undertaken any activities to date. In that instance, the newco would not qualify as a registrant. Steps would have to be taken to engage the newco in commercial activities, and register it for GST purposes, prior to the transfer of the business.

Goodwill

The sale of goodwill may be non-taxable under s. 167 as part of the supply of the assets of a business, provided the requirements of that provision are met and provided an election is made.

The sale of goodwill may <u>also</u> be exempt under s. 167.1, which may apply where the s. 167 election is not made or is not available (the Technical Note for s. 167.1 explains that s. 167.1 "need only apply where the general roll-over provision does not, namely on sales of businesses by registrants to non-registrants or where the supplier and recipient choose not to elect under section 167").

Section 167.1 provides as follows: *

> 167.1 Goodwill — For the purposes of this Part, where a supplier makes a supply of a business or part of a business that was established or carried on by the supplier or that was established or carried on by another person and acquired by the supplier, the recipient is acquiring ownership, possession or use of all or substantially all of the property that can reasonably be regarded as being necessary for the recipient to be capable of carrying on the business or part as a business, and part of the consideration for the supply can reasonably be attributed to goodwill of the business or part, that part of the consideration shall not be included in calculating the tax payable in respect of the supply.

* Note that this section is subject to announced but as yet unenacted amendments. The version above does not take the announced amendments into account.

Sales of less than a Business

Where section 167 is not available or does not apply, the application of the GST to the assets being transferred will apply on an asset-by-asset basis.

Some of the more important, are as follows.

Note that all situations described below are in the context of assets previously used in an exempt health care practice.

Physical Assets & Inventory. The rules in section 141.1 of the ETA provides some helpful rules for dealing with the disposition of personal property. The rules allow a person that has previously acquired (or manufactured or produced) personal property for consumption or use in an exempt business, to sell the same to another person free of GST.

The rules are complex, however, and advice should be sought.

Whether the rules can be used to apply to "inventory" of an exempt business is also complex, although there would appear to be some basis for considering the one-time sale to the professional corporation (on a "non-profit, at cost basis), to be an instance where similar non-taxable treatment could be obtained.

Where section 141.1 does not provide relief, also consider subsection 200(3) of the ETA.

Note that absent reliance on special rules like section 141.1 and section 200(3), most transfers of business asset would generally be taxable.

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Customer Lists. According to CRA Policy P-242, *Whether a customer list is personal property that can be produced by a person for the purposes of paragraphs 141.1(a) and (b) of the ETA* (July 13, 2003), the sale of a customer list may be exempt under paragraph 141.1(1)(b) of the ETA as personal property "produced" in the course of exempt activities exclusively for consumption or use in exempt activities.

Note that according to CRA interpretation No. 7496 HQR0001102, "The Sale of a Customer List of an Insurance Business," (March 31, 2000), customer lists are considered intangible personal property and can be sold separately, unlike goodwill, which may only be sold with the business. This appears to be consistent with CRA's income tax bulletin IT-143R3, "Meaning of Capital" (August 29, 2002) which states that "Goodwill cannot be divorced from the business itself. It follows the business and may be sold with the business, but it cannot be sold separately. (Generally, goodwill arises as a recognizable business asset only where a business is acquired at a price in excess of the value, as a going concern, of its net assets".)

Land or Other Capital Real Property. "Capital real property" is taxable for GST purposes, although a special remittance rule usually applies. The special remittance rule is found in subsection 221(2) of the ETA and relieves the purchaser from having to pay GST to the vendor on purchases of real property where (a) the vendor is a non-resident or is considered a resident only because of special deeming rules (for example, by maintaining a permanent establishment in Canada); or (b) where the purchaser is registered.

Where subsection 221(2) applies, the vendor is relieved from its obligation to charge GST, and the purchaser is specifically required not to pay the GST to the vendor. Subsection 228(4) then imposes a corresponding obligation directly on the purchaser, and provides that when the purchaser falls under the special non-collections rule in paragraph 221(2)(b) (e.g., because the purchaser is a GST registered corporation), and provided that the purchaser is acquiring "the property for use or supply primarily in the course of commercial activities", then the purchaser must self-assess the amount of the GST owing, and report and remit the GST with its regular GST return.

In this process, the purchaser would be able to offset the GST required to be remitted with an ITC claim, all in the same return.

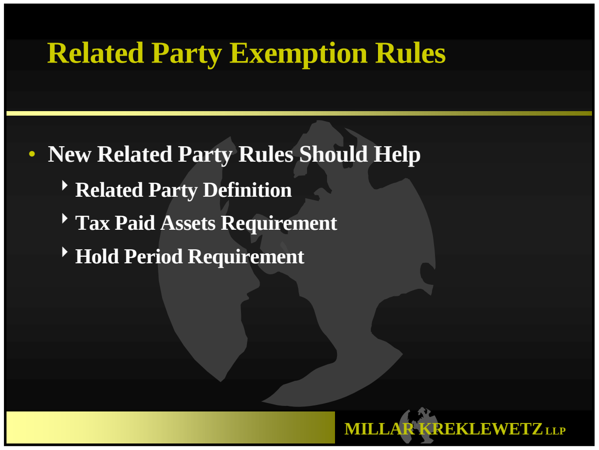
If the purchaser falls within the special non-collection rule in paragraph221(2)(b), but is <u>not</u> acquiring "the property for use or supply primarily in the course of commercial activities", then paragraph 228(4)(b) is applicable, and requires the purchaser to prepare and file Form GST 60 "on or before the last day of the month following the month in which the tax became payable".

Thus even if a purchaser of real property is "registered" and able to defer payment of the GST on the purchase date, the GST may be payable in the end result if the use of the real property is going to be for "exempt" activities. Thus the practical effect of this rule for professional corporations involving health care practices may be short-lived, and only allow for the tax free rollover to the next required reporting period.

Note also that that sections 193 and 257 of the ETA may allow the recovery by the individual professional or any embedded GST in the real property conveyed. That section is aimed at ensuring that the GST does not cascade in real property. Thus, if there is embedded GST, and the subsequent sale is taxable, the vendor is afforded a GST ITC if a registrant, or a GST rebate otherwise.

Accounts Receivable. When accounts receivable are acquired, some special GST considerations arise. While the acquisition is generally exempt (i.e., a financial service), the real issues arise when collection attempts fail, and the transferee is left with a bad debt.

Bad debts, of course, contain an element of the GST – since the original vendor would have been required to charge, collect and remit the GST on the "credit sale", and should technically have remitted the GST some time prior to its assignment of the accounts receivable. While the ETA has some rules for recovering bad debts, they do not work in the context of an assignment since bad debt relief is only available to the person who made the supply from which the account receivable arose (i.e., the original vendor). Accordingly, where accounts receivable are assigned, there is a real risk that any resulting bad debts would carry unrecoverable GST – both to the assignee and the assignor. Despite recent changes to these rules, this problem has not been addressed.



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Fortunately, the CRA does make an exception where accounts receivable are assigned on a full recourse basis. In its Policy P-029R (Assignment of Accounts Receivable, January 4, 1999), the CRA indicates that the vendor of the accounts receivable can claim a reduction in net tax if re-purchasing the bad debt.

Where Tax is Payable

Where tax is payable by a professional corporation on the acquisition of business assets, special rules may also apply to govern ITCs that are available.

If the business will be wholly exempt, no ITCs will be available as a general rule.

Where there is at least some "taxable" supplies, the ETA's change of use rules will have to be consulted to determine if any ITCs are available.

These rules will have application to "capital" real and personal property.

A Word on Cost Sharing Arrangements

While cost-sharing agreements have been in place some time in respect of medical practices, it is interesting to note that one of the most desired benefits is the non-GST status of "employee" costs.

For example, consider A, B, and C, all medical professional corporations, not operating in partnership. Consider Diane and Eugene, two employed administrative staff. If A, B and C all contribute equally to Diane and Eugene's employment costs, the desire is often to "cost-share" these amounts with no GST effect. The problem is that GST-free treatment will only follow to the extent A, B and C can each be said to be the employers of Diane and Eugene. While easily formulated in principle, such "co-employment" situations are, in the author's view, much more difficult (if not impossible) to implement in practice. See for example, the Federal Court of Appeal's views on co-employment situations: *Glengarry Bingo Association v. Canada*, [1999] G.S.T.C. 15 (F.C.A.).

Before blindingly entering into "cost sharing" agreements in the professional corporation context, some consideration ought to be given to these issues.

These issues are generally avoided where the medical practice or the group of professional corporations amounts to, at law, a partnership. However, in these instances, special GST registration and reporting issues may arise where the partnership's activities include taxable supplies, and the "small supplier" threshold is surpassed.

RST Considerations

Unlike the GST, there is no special "roll-over" for the sale of business assets in the Ontario *Retail Sales Tax Act.*

In the context of the establishment of professional corporations, however, there are special related party rules that should allow for the RST free rollover of business assets, provided those assets are RST paid, and the shares in the professional corporation meet certain other requirements.

The exemption will apply so long as the professional corporation is wholly-owned by the medical professional, which is defined to mean the beneficial ownership of shares representing less than 95 per cent of the sum of the stated capital of all classes and series of shares of the corporation, being held directly or indirectly, by the person or one or more individuals who are members of his or her family.

A new rule in the proposed regulations will now require a 180-day holding period with respect to the "relatedness" of the parties. Specifically, the wholly-owned relationship between the related parties must continue for a period of at least 180 consecutive days following the date of the transfer. The likely purpose of the 180-day rule is to ensure that the asset transfer occurs between bona fide related parties, and the rules are not used in tax avoidance schemes. It is also fairly clear that the 180-day requirement is the trade-off for the expansion of the rules beyond "one-time-use".

PART II

CANADA'S COMMODITY TAX SYSTEMS

OVERVIEW OF GST SYSTEM

Introduction

Canada's federal value-added taxation system is called the Goods and Services Tax (the "GST") and is provided for in Part IX of the *Excise Tax Act* (the "*ETA*"). The GST, while commonly considered to be a single tax, is actually imposed under three separate taxing divisions, on three distinct types of transactions. Together, the three taxing divisions create a comprehensive web of taxation.

Its basic design is aimed at taxing virtually all (1) supplies of *domestic* goods, services, and intangibles,[1] all (2) supplies of *imported* goods, services, and intangibles, and (3) relieving from tax a number of *exported* goods, services, and intangibles.

Under Division II of the *ETA*, for example, GST is imposed on domestic supplies, or "taxable supplies made in Canada". In turn, Division III imposes GST on most "importations" of "goods", while Division IV imposes tax on "imported taxable supplies", which amount to certain services and intangibles acquired outside of Canada, but consumed, used or enjoyed in Canada. The "zero-rating" of exports from Canada (both goods, services, and intangibles) is facilitated through various enumerated categories in Part V of Schedule VI of the *ETA*.

What this means is that taxpayers engaged in cross-border transactions can find themselves subject to GST under any one of Divisions II, III or IV (and, in some instances, subject to a "double-tax" under more than one division).

Not surprisingly, then, determining how the GST applies to a particular transaction, and determining how the impact of the GST can be minimized, requires an understanding of how each of these taxing divisions operates, as well as an appreciation of a number of other special rules in the *ETA*. That includes the rules regarding "zero-rated exports" in Part V of Schedule VI of the *ETA* (the "Export Schedule"), and the rules regarding "non-taxable importations" found in Schedule VII of the *ETA*.

With the fairly recent addition of an 8% "harmonized sales tax" ("HST") to transactions involving Canada's Atlantic provinces, businesses with exposure in those areas will see that what was once a 7% risk, is now a 15% risk – all usually measured on gross revenues (i.e., the "consideration" for the supplies).

Division II & "Taxable Supplies Made in Canada"

When Canadians speak of the GST, they are most often referring to the GST that is imposed under Division II of the *ETA*. Division II is entitled *Goods and Services Tax,* and imposes tax on "every recipient of a taxable supply made in Canada": s. 165(1).

While applying only to domestic supplies (e.g., taxable supplies "made in Canada"), Division II affects a large number of cross-border transactions, including supplies made in Canada by registered non-residents,[2] unregistered non-residents who carry on business in Canada, and supplies which are drop-shipped in Canada on behalf of unregistered non-residents. Division II can also affect certain goods exported from Canada. Having said all of this, there are a number of general rules governing when a "taxable supply" will be regarded as having been made "in Canada", and forcing a supplier to register and begin charging and collecting GST.

There are also some other special rules applying to unregistered non-residents who do not carry on business in Canada, all of which will be touched on further below.

What is a "Taxable Supply". Before engaging in a consideration of whether a supply is made "in Canada" or "outside Canada", it is usually a good "first step" to assess whether the supply is "taxable" or "exempt". (This is because the Division II GST only applies to "taxable" supplies made "in Canada".) A "taxable supply" is defined in subsection 123(1) of the *ETA* to be a supply that is made in the course of a "commercial activity". Since "commercial activity" is quite broadly defined, a taxable supply would generally include most supplies made in the course of a business, or in an adventure or concern in the nature of trade.

Significantly, however, a "taxable supply" specifically excludes the making of "exempt" supplies enumerated in Schedule V of the *ETA*.[3]

Supplies Made "in Canada". If a supply is "taxable", one can then proceed on with the issue of whether that supply is made "in Canada", such that the taxing provisions in Division II impose the GST on it. As indicated, the *ETA* contains a number of general rules for determining when a supply is made "in Canada",[4] and these are found in s. 142. For example, if the supply under consideration is a "sale" of "goods", the applicable rule is that the goods will be supplied "in Canada" if "delivered or made available" in Canada. Other rules apply for other types of supplies (e.g., a supply of leased goods, a supply of services, intangibles or real property like land). Understandably, some of these rules can be quite complex, and require some detailed consideration.

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Special Non-Residents Rule. The general "place of supply rules" found in s. 142 of the *ETA* must always be read in context with a number of other rules which affect the determination of whether a particular supply is made "in Canada" for purposes of the Division II GST.

For non-residents, the most important of these rules is found in s. 143 of the *ETA*, which deems all supplies of property and services made in Canada by non-residents to be made outside Canada, unless:

(a) the supply is made in the course of a business carried on in Canada; or

(b) at the time the supply is made, the person is registered.

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What this means is that for most unregistered non-residents, the general "place of supply" rules found in s. 142 of the *ETA* are unimportant: as long as the unregistered non-resident is not "carrying on business" in Canada, it is kept outside the GST system; accordingly, it is neither required to register for the GST, nor charge, collect and remit GST on its supplies to Canadians.[5] The significance of that rule obviously brings up the meaning of terms like "non-resident", "registered", and "carrying on business in Canada".

Residents & Non-Residents. While a complete discussion is outside the scope of this presentation, the *ETA* does have some complex rules regarding the meaning of "non-resident" and "resident".[6] For example, s. 132 of the *ETA* provides that a corporation will be considered a "resident" of Canada if it has been "incorporated" or "continued" in Canada, and not continued elsewhere. While this might suggest that all corporations incorporated or continued outside of Canada would qualify as "non-residents" of Canada, there are other rules which may impact like, for example, the *ETA*'s "permanent establishment" rules.

Permanent Establishments. A special rule in s. 132(2) of the *ETA* provides that where a person who is otherwise a "non-resident" (e.g., a corporation incorporated in the U.S.) has a "permanent establishment in Canada, the person shall be deemed to be resident in Canada in respect of, but only in respect of, activities of the person carried on through that establishment". The effect of this rule, of course, would be to deem the non-resident to be a "resident" in respect of any activities carried on through a Canadian permanent establishment, which has the ancillary effect of *excluding* the "non-resident" from use of the special "non-resident's rule" referred to above. Accordingly, a non-resident with a Canadian permanent establishment might (unhappily) find that its activities in Canada have effectively brought itself *into* the GST system, requiring it to take positive steps to register for the GST, and to begin charging, collecting, and remitting the GST to the Canada Revenue Agency ("CRA" – formerly the "Canada Customs and Revenue Agency", or "CCRA").

CRA has recently released its new interpretation on the meaning of permanent establishment in GST Policy P-208R, *Meaning of Permanent Establishment in Subsection 123(1) of the Excise Tax Act (the Act),* (March 23, 2005).

Carrying on Business. As we saw, the other main requirement for use of the "non-residents rule" in s. 143 was that the non-resident not "carry on business" in Canada. The concept of "carrying on business" is not defined in the *ETA*, and falls to be determined by the facts of the situation, and a number of tests developed largely from income tax jurisprudence. That jurisprudence suggests that to "carry on" a business is a factual-based analysis, focused on a couple of primary factors, and an inexhaustive set of secondary factors. The two primary factors are:

(a) the place where the contract for the supply was made; and

(b) the place where the operations producing profits take place.

In terms of the "place where a contract is made", the jurisprudence generally accepts that the important elements of the contract are its offer, and its subsequent acceptance, and that the place the contract is "accepted" is the place it was made.

The CRA has recently re-vamped its interpretation of the phrase "carrying on business", and the attendant registration requirements in the ETA, effectively discarding any reliance on the traditional jurisprudential position referred to above, and imposing multi-faceted tests of its own. Readers are accordingly cautioned to approach the meaning of "carrying on business" with caution, and seek professional advice. The CRA's views are set out in GST Policy P-051R2, *Carrying on Business in Canada.*

Summary of Application of Division II Tax. For non-residents, most will want to ensure that they are "unregistered" and "not carrying on business" in Canada – so as to ensure the proper application of the "non-residents rule" in s. 143. The application of that rule will "exonerate" non-residents from charging, collecting and remitting the GST in respect of transactions with Canadian residents.

On the other hand, for most readers, the Division II tax will usually be payable (e.g., you will be a resident Canada, or a non-resident carrying on business in Canada) – which raises a contemporaneous requirement to register for the GST.

Even where Division II tax is payable, that is not usually the end of the "GST story". Depending on your business activities, there may be additional GST imposed on your business under either Division III or Division IV, as discussed below.

Division III & "Imported Goods"

Division III is entitled *Tax on Importation of Goods* and imposes tax on "every person who is liable under the *Customs Act* to pay duty on imported goods, or who would be so liable if the goods were subject to duty": s. 212.[7]

Accordingly, the Division III GST applies to most goods imported into Canada. Here, the supplier is under no obligation to charge or collect tax. Rather, the importer of the goods is required to pay the tax when clearing them with Canada Customs.

As indicated above, even if a person (like an unregistered non-resident, not carrying on business in Canada) has successfully shielded itself from any Division II GST obligations (i.e., because of the special non-residents rule in s. 143), the Division III tax can still apply to any goods imported by the non-resident. And many other taxpayers and consumers now fully know, from their personal cross-border shopping experiences, the GST also applies to imported goods. The surprising element here, however, is that since there is no provision in the *ETA* creating a mutual exclusivity between Division II and Division III taxes, "double-taxation" can happened in many cross-border transactions. In those situations, *both* the Division II and Division III tax will apply to a particular movement of goods from outside of Canada, to inside of Canada. The key to minimizing tax in these situations, then, is to understand when and how this can occur, and how to either avoid it, or how to unlock one or both of the taxes that have been paid.

Newly proposed rules in s. 178.8 of the ETA (proposed by Notice of Ways and Means Motion on October 3, 2003) will significantly change the manner in which importers of goods to Canada will be entitled to claim ITCs for the GST paid under Division III of the ETA and, accordingly, importers are cautioned to seek professional advice on this question.

Interplay of Division III Tax with Customs Valuation Rules. As mentioned, the GST's Division III tax is payable on the "duty paid value" of the imported goods, as determined under the *Customs Act*. Significantly, then, the provisions in the *Customs Act* and *Customs Tariff* which affect the "value for duty" of imported goods are still important for GST purposes – even if the goods being imported are otherwise "duty free". This means that even those duties on imported goods may have long-since been removed, the CRA will still be interested in a proper valuation of the imported goods, for GST purposes, and will continue to focus on issues like whether dutiable royalty payments, assists, "subsequent proceeds", and "buying commissions" have been included in the "value for duty" of goods. Where these additions are left out, GST will be regarded as having been short-paid, and customs assessments (or other positive "voluntary correction" obligations – see *infra*) will arise.

This effectively means that when combined with its "customs cousins", Division III can have the effect of taxing more than simply goods, but also certain payments for intellectual property or services. While GST registrants carrying on commercial activities will only experience cash-flow strain (e.g., between the time GST paid and the time it is recovered via ITC), persons involved in partially or wholly exempt activities (e.g., financial institutions, municipalities, universities, schools, and hospitals) would find these amounts to be "hard costs", and not all recoverable.[8]

Division IV & "Imported Taxable Supplies"

The third taxing division under which GST might be payable is Division IV, which is entitled *Tax on Imported Taxable Supplies Other than Goods*, and which imposes tax on "every recipient of an imported taxable supply": s. 218(1). Since an "imported taxable supply" is defined quite broadly, Division IV captures most transactions not otherwise taxable under Divisions II or III and, as indicated above, can catch a number of international transactions involving services or intangibles. The rules defining "imported taxable supplies" are remarkably complex, and to the extent taxpayers are again involved in somewhat less than "exclusive" commercial activities, special attention should be paid to these rules: they will create a self-assessment obligation equal to the 7% GST, multiplied by the amounts paid abroad for the ultimate use, in Canada, of intellectual property, other intangibles or services.

Zero-Rating Provisions

Even if Division II tax somehow applies to a transaction involving a good, service or intangible (i.e., because the supply was made "in Canada"), there is a general intention in the *ETA* that if the supply is for consumption, use or enjoyment *outside* of Canada, it should be free of GST.[9]

This intention is manifested in Part V of Schedule VI of the *ETA*, which sets out a number of zero-rating rules for *export situations*, some of the more important ones of which are as follows.

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Zero-Rated Goods. Some of the rules for zero-rating exported goods are provided for as follows:

Section 1: Exported Goods. A supply of tangible personal property (other than an excisable good) made by a person to a recipient (other than a consumer) who intends to export the property where ...

(b) upon delivery of the TPP to the recipient, the TPP is exported "as soon as is reasonable" having regard to the "circumstances surrounding the exportation", and having regard to the "normal business practice of the recipient",

(c) the TPP is not acquired by the recipient for consumption, use or supply in Canada before the exportation,

(d) after the supply is made, the TPP is not further processed, transformed or altered in Canada, "except to the extent reasonably necessary or incidental to its transportation".

(e) the supplier of the TPP maintains evidence satisfactory to the Minster of the exportation by the recipient (or the recipient issues the supplier with a special s. 221.1 export certificate – see *infra*) indicating that all the conditions above have been met.

Section 12: Supply via Common Carrier. A supply of tangible personal property where the supplier delivers the property to a common carrier, or mails the property, for export.

Dovetailing with these rules are special "Export Certificate" rules aimed at certain registered persons whose business consists of export trading activities. These persons would include "export trading houses" who export goods which are not manufactured by them. The bulk of their business activity is purchasing domestic goods for export (e.g., a transaction likely subject to GST), warehousing them, and then exporting them.

Zero-Rated Services. Some of the rules for zero-rating exported services are provided for as follows:

Section 5: Agents' and Manufacturers' Rep Services. Agents' services are zero-rated when provided to a non-resident under s. 5 of the Export Schedule. Also zero-rated are services "of arranging for, procuring or soliciting orders for supplies by or to the person" -- which would seem to cover the "manufacturers' representatives" situation. In both instances, however, the services must be in respect of "a zero-rated supply to the non-resident", or a "supply made outside Canada by or to the non-resident".

Section 7: General Services. A supply of a service is zero-rated when made to a non-resident person, but not in the case of the following services:

(a) a service made to an individual who is in Canada at any time when the individual has contact with the supplier in relation to the supply;

(a.1) a service that is rendered to an individual while that individual is in Canada;

(b) an advisory, consulting or professional service

(c) a postal service;

(d) a service in respect of real property situated in Canada;

(e) a service in respect of tangible personal property that is situated in Canada at the time the service is performed;

(f) a service of acting as an agent of the non-resident person or of arranging for, procuring or soliciting orders for supplies by or to the person;

(g) a transportation service; or

(h) a telecommunication service.

Section 8: Advertising Services. The supply of advertising services is zero-rated if meeting the following conditions: a supply of a service of advertising made to a non-resident person who is not registered under Subdivision d of Division V of Part IX of the *ETA* at the time the service is performed.

Section 23: Advisory, Professional or Consulting Services. A supply of the following services is also zero-rated, A supply of an advisory, professional or consulting service, made to a non-resident person, but not including a supply of

(a) a service rendered to an individual in connection with criminal, civil or administrative litigation in Canada, other than a service rendered before the commencement of such litigation;

(b) a service in respect of real property situated in Canada;

(c) a service in respect of tangible personal property that is situated in Canada at the time the service is performed; or

(d) a service of acting as an agent of the non-resident person or of arranging for, procuring or soliciting orders for supplies by or to the person.

Zero-Rated IPP. Zero-rated IPP is currently limited to the following supplies of *intellectual* property – which is notably a smaller subset of IPP, and which would be expected to exclude things like "contractual rights":

Section 10: Intellectual Property. A supply of an invention, patent, trade secret, trade-mark, trade-name, copyright, industrial design or other intellectual property or any right, licence or privilege to use any such property, where the recipient is a non-resident person who is not registered under Subdivision d of Division V of Part IX of the *ETA* at the time the supply is made.

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OVERVIEW OF RST SYSTEMS

Introduction

Who Still Has Them. Only 5 of Canada's provinces still levy a stand-alone provincial RST (i.e., BC, SK, MB, ON and PEI).[10] Québec ("QB") has a system (the "QST") which is partially harmonized to the GST, while the Atlantic provinces of Nova Scotia ("NS"), New Brunswick ("NB"), and Newfoundland & Labrador ("NF") have a fully harmonized system, incorporated into the *ETA* (the "HST").

Alberta ("AB") and Canada's two territories do not presently employ retail sales taxing systems.

Broad Comparisons. If broad comparisons can be drawn, these RST systems are "old generation" systems, and ancestors of the more recent attempts by Québec and the Atlantic Provinces (NS, NB, and NF) – to implement partially and fully harmonized systems. To understand how the "old generation" RST systems work, it is useful to consider both where they came from, and why they evolved the way they did.

Where did they Came From ? – The Historical Background. Retail sales taxes grew out of the economic depression of the 1930s, and were a product of the needs for greater tax revenues to fund increasing need for social programmes.

Interestingly enough, the first RST system was neither federal or even provincial: it was a municipal sales tax initiative, implemented by the City of Montreal, on May 1, 1935, which applied a 2% tax on tangible personal property ("TPP"). Within the year, however, Canada's provinces followed suit, with Alberta being the first to enact a provincial system, on May 1, 1936. (Unfortunately for Alberta, its RST system proved so unpopular, it was repealed less than two years later, and never replaced). Other provincial initiatives were somewhat more successful, with Saskatchewan implementing a system on August 2, 1937, Québec imposing a 4% tax on July 1, 1940, BC imposing a tax on July 1, 1948, New Brunswick on June 1, 1950, and Newfoundland by November 15, 1950. PEI and Nova Scotia waited until January 1, 1959 and July 1, 1960, respectively. Ontario and Manitoba became the last provinces to implement RST systems, with Ontario's tax applying on September 1, 1961, and Manitoba's applying on June 1, 1967.

Why Did They Evolve the Way They Did ? – Some Constitutional Limitations. In understanding how current RST systems operate, it is useful to observe that each system evolved within constitutional limitations imposed on the provinces by s. 92(2) of the *Constitution Act, 1867* – formerly the *British North American Act.*

Constitutionally, provinces are limited to "Direct Taxation within the Province in order to the raising of the Revenue for Provincial Purposes".

Understanding the scope of the limitation is useful. "Direct taxation" is generally accepted as a tax imposed on the person who will ultimately bear it, and was set out by the economist John Stuart Mill's as follows:

> Taxes are either direct or indirect. A direct tax is one which is demanded from the very persons who, it is intended or desired, should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another: such as the excise or customs ... Direct taxes are either on income or on expenditure ...

While a number of constitutional decisions were taken on a number of provincial attempts to tax such things as fuel and tobacco, one of the more important was the Privy Council's decision in *Atlantic Smoke Shops Ltd. v Conlon*, (1943) A.C. 550. The Court had to consider the constitutionality of New Brunswick's tax on purchasers of tobacco, and then set out the following standard for assessing an indirect or direct tax:

> It is a tax which is to be paid by the last purchaser of the article, and, since there is no question of further resale, the tax cannot be passed on to any other person by subsequent dealing. The money for tax is found by the individual who finally bears the burden of it. It is unnecessary to consider the refinement which might arise if the taxpayer who has purchased the tobacco for his own consumption subsequently changes his mind and in fact re-sells it. If so, he would, for one thing, require a retail vendor's licence. But the instance is exceptional and far-fetched, while for the purpose of classifying the tax, it is the general tendency of the impost which has to be considered.

Thus the crux of the matter fell to determining whether the "general tendency" of the tax was such that it would be borne by the person on whom it was imposed. Not surprisingly, the constitutional validity of a "retail sales tax" was eventually upheld by the Supreme Court of Canada ("SCC").[11]

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Example. A simple example of a "indirect tax" would be one imposed on a good that was purchased *for resale*. Since the initial purchaser (e.g., a wholesaler) would be taxed, but would also be generally expected to resell the TPP, and recover that tax in its purchase price, there could be seen to be a general tendency that the tax imposed on the wholesaler would be passed and borne by a another person (i.e., the retail purchaser). That fact makes the tax an "indirect" one – and one which none of the Provinces are constitutionally capable of levying.**12** It was probably with this concern in mind that Quebec – when making the transition from its *Retail Sales Tax Act* to its now partially harmonized QST – decided to employ the concept of "non-taxable supplies" for the purpose of recognizing instances where a provincial tax ought not be the charged on purchases acquired by businesses for purposes of resale. The concern was likely that if the QST were imposed on these purchases, it might well be considered a indirect tax – even though businesses would be entitled to a refund of the tax paid on most of their inputs.

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Inter-Jurisdictional Comparisons

The following description discusses in general how the existing RST systems operate. While an attempt has been made to canvass all existing RST systems at every stage, there is an obvious focus on the RST system currently in place in Ontario.

What are their Common Concepts ? It was only with reference to this base constitutional jurisprudence that Canada's "old generation" RST systems were formulated. Accordingly, it is not surprising that each of the remaining five RST systems have a number of very common elements – many of which can be directly related to their constitutional antecedents. What are some of the common elements ?

First and foremost, one sees that all of the RST systems are (1) aimed at imposing taxes on *the final consumer or user* of the property or services being taxed. Thus while there may well be significant differences between the structures of the taxing systems,[13] or the tax bases or the tax rates, each RST system can be seen to apply a tax at the "consumer" and "user" level .[14]

If other generalizations can be made, most RST systems also (2) apply only if the TPP or taxable services are acquired within the province for "consumption" or "use" within the province, or acquired elsewhere, but brought into the province for consumption or use therein; (3) levy the tax directly on the retail purchaser/consumer, but require "collection" of the tax by vendors, as "agent" of the province, and under threat of "penalty" for non-collection; (4) contain either special exemptions for purchases for "resale", or leave these untaxed in the first place; and (5) contain special rules for determining other applicable exemptions.

How do they differ from the QST & GST/HST ? – Some Principal Differences. While the RST systems have some commonality, there are two main differences between these systems and their QST or GST/HST counterparts: the *comparatively narrow* tax base used by the RST systems, in comparison to their QST or the GST/HST counterparts; and over-all focus of the tax and provisions made for universal credits for business inputs.

Narrower Tax Bases. The most obvious is the differences in the respective tax bases. While the QST and GST/HST are all-encompassing taxes, the RST systems are aimed at comparatively narrow tax bases. For example, the GST/HST is levied on virtually all tangible personal property ("TPP"), intangible personal property ("IPP"), real property, and services.

On the other hand, the various RST systems are usually aimed at levying tax on transactions involving only TPP, and certain specially defined "taxable services". (Saskatchewan's recent expansion of its tax base to include a large number of specifically defined "taxable services" has now become the exception to this general rule).

Having said that, these provinces generally employ an all encompassing definition of TPP (see *infra*) which is capable of not only capturing virtually all TPP, but what might otherwise be conceived of as a service, and even some IPP.

For example, each RST system now attempts to tax computer software. In terms of the specially defined "taxable services", most provinces attempt to tax services related to TPP (e.g., like services to install, assemble, dismantle, repair, adjust, restore, recondition, refinish, or maintain TPP), as well as certain other special-nature services.

Focus of the Tax & Treatment of Inputs. The second difference between the QST/GST/HST model and the various RST systems lies in the overall focus of the taxes, and the consequent treatment of business "inputs".

While the GST/HST, for example, is a multi-stage value-added tax, with a comprehensive system for taxing the value-added at each stage of the production process, and crediting tax paid at earlier stages of that process (e.g., through ITCs), the RST systems are aimed at (theoretically) imposing the RST only on the ultimate consumer of the taxable good or service. In other words, these systems attempt to create a "single incidence" tax. This poses a problem for business inputs, since situations arise where a business may be paying the RST on its business inputs, and then charging and collecting the RST again on the value of its production. Absent rules to "remove" this cascading of tax, the final manufactured product may well bear double and triple layers of tax.

While each RST system has some rudimentary rules providing for some limited exemptions (e.g., an exemption where TPP is purchased for "resale"), these rules are nothing like the "universal" ITC system available for commercial businesses paying the GST. Thus while the GST system ensures that every Canadian consumed good, service or intangible bears, at the most, a 7% GST component, the effective rate of RST imposed on fully manufactured Canadian TPP may be much higher than the stated provincial rate. Even more troubling, to the extent there is RST imbedded in manufactured TPP, the TPP will carry that RST even when exported from Canada.

While all the taxes are at least theoretically aimed at imposing the tax burden on the ultimate consumer of a taxable item, the manner in which that is accomplished is much different across the various systems.

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Example of Cascading RST. Consider Kco, an Ontario woodworking business, which builds and sells custom-made children's beds – miniature four-posters, in fact. Assume 10 beds are produced each year and sold for $1000 each, ultimately yielding $800 in Ontario RST (8% times $10,000).

To manufacture the beds, Co purchases a number of raw materials, which can be purchased exempt of Ontario RST, as well as a taxable desk and computer for $5,000, paying an additional $400 in Ontario RST. Assuming that the RST paid on the inputs is reflected in the final selling price of the beds, the effective rate of Ontario RST on the beds is much higher than 8%, perhaps approaching 12% in this simplistic example. One effect of this "cascading" of tax is to make Kco susceptible to competition from manufactures in other jurisdictions (e.g., the Harmonized Provinces) who might be entitled to ITCs for the RST paid on their business inputs, enabling them to sell their beds on a cheaper basis.

This is markedly different than the GST/HST system – and, for that matter, the QST system – which generally affords universal input tax credits/refunds for most business inputs.

Imposition of the Tax – The "Charging Provisions". RST is generally imposed by virtue of an all-encompassing "charging provision", like that found in s. 2(1) of the Ontario Act:

> 2.(1) *Tax on Purchaser, of [TPP]* — Every *purchaser* of *tangible personal property*, except the classes thereof referred to in subsection (2), shall pay to Her Majesty in right of Ontario a tax in respect of the *consumption* or *use* thereof, computed at the rate of 8 per cent of the *fair value* thereof.

Charging provisions in the other RST systems are found in ss. 5 and 6 of the BC Act; s. 5 of the SK Act; s. 2 of the MB Act; and s. 4 of the PEI Act.

While not entirely obvious, the addition of specially defined words, like those in *italics* above, make such charging provisions incredibly encompassing. In Ontario, s. 1 of the Ontario Act defines, among others, the following words:

> *TPP*, to mean just about anything that can be touched: "personal property that can be seen, weighed, measured, felt or touched or that is in any way perceptible to the senses and includes computer programs, natural gas and manufactured gas".
>
> *Purchaser*, to mean not only (a) a "consumer or person who acquires [TPP] anywhere", but also persons (b) acquiring TPP for the benefit of some other person, and (c) certain persons acquiring TPP for purposes of promotional distribution. Until recently, "purchaser" also included persons acquiring a taxable service at a sale in Ontario in order to fulfil warranty or guarantees or other contract for the service, maintenance or warranty of TPP.
>
> *Consumption* and *use*, to include all concepts of use, and the incorporation of something into another thing.
>
> *Fair Value*, to capture virtually every type of payment that could be expected to pass from a purchaser of TPP or services to the person from whom the TPP or services were acquired.

Sometimes definitions of certain words are contained in regulations underlying the particular legislation. Thus, for example, Ontario's Reg. 1013(1) helps define TPP by excluding things like gold and silver in their primary forms. Ontario is particularly notorious for hiding important definitions in regulations, and one can also find special definitions for "manufacturer", "contractor", "food products", and a number of other important terms.

Treatment of Certain "Taxable Services" & Specially Taxed Items. Each RST system taxes more than simply TPP. Some define a whole host of "taxable services", which in Ontario include, for example, most (i) telecommunication services, (ii) labour provided to install, assemble, dismantle, adjust, repair or maintain TPP, (iii) contracts for the service, maintenance or warranty of TPP. These are taxed at a rate of 8%, while "transient accommodation" is also defined as a "taxable service", but taxed at a special rate of 5%.

There are a number of other "specially taxed" items as well, with tax rates often much higher than the general 8% rate.

For example, each of the following is subject to a special Ontario RST: liquor, beer and wine – s. 2(2); places of amusement – s. 2(5); "insurance premiums" – s. 2.1; "brew-your-own" beer and wine – s. 3.1; "new passenger vehicles or sport utility vehicles" – s. 4.1; "used motor vehicles" – s. 4.2; and the acquisition of a taxable service for the purpose of repairing, replacing, servicing or maintaining TPP under a warranty or guarantee or similar contract – s. 2.0.1. Like the case in BC and Manitoba, Ontario has now legislated a mandatory collections system for the RST exigible on items of non-commercial TPP accompanying returning residents to Ontario, as they cross the Canada-U.S. border.

In terms of the other RST systems, virtually all tax things like wine, spirits, and beer, telecommunications, and transient accommodation, but there are still some significant differences.

BC and PEI tax "legal" and "professional" services, respectively, and Manitoba taxes certain types of "electricity".

As mentioned previously, Saskatchewan has recently taken this approach to an extreme, and now applies its RST against a wide variety of professional services.

Timing of the Tax. A pre-requisite of every valid tax is some indication as to when a validly imposed tax is *payable*. The general rule in most RST systems is that the tax is payable at the time of the sale, and Ontario's rule is found in s. 2(6) of the *RSTA*:

> 2(6) *When Tax Payable* — A purchaser shall pay the tax imposed by this Act at the time of the *sale*, or the promotional distribution of an admission.

> *Timing provisions in other RST systems are s. 5 of the BC Act; s. 5 of the SK Act; s. 2(2) of the MB Act; and s. 7(1) of the PEI Act.*

Sale is, like the other terms defined in s. 1 of the Ontario Act, defined in the broadest sense, and includes, in the case of TPP, "any transfer of title or possession, exchange, barter, lease or rental, conditional or otherwise, including a sale on credit or where the price is payable by instalments, or any other contract whereby at a price or other consideration a person delivers to another person [TPP]".

In the case of a "taxable service", *sale* is the "provision of any charge or billing, including periodic payments, upon rendering or providing or upon any undertaking to render or provide to another person a taxable service". Thus the general rule becomes as follows: tax is usually payable up-front.

Timing of RST on Leases. A special "timing" rule is usually found for leases of TPP which, by their very nature, do not involve the up-front acquisition of property. In most RST systems, the rule is like that found in s. 2(7) of the Ontario Act, with tax payable at the time of the rental payment, or other consideration paid under the lease as, for example again in Ontario, the payment on the exercise of a "purchase option".

Amounts Included in the Tax Base. The existing RST systems use one of three measures for determining what amounts are taxed: the "fair value" standard in MB, ON, PEI; "value" in Saskatchewan; and "purchase price" in BC.

While there are a number of legislative "additions" to each of these terms (usually making it necessary to review each definition), some generalizations can be drawn.

GST. First, unlike the situation in Quebec – where GST is included in the QST tax base – GST is not generally included in any sales tax base in existing RST systems (the only exception being PEI). Each RST system does include all other federal customs or excise duty in its tax base, however.

Financing Charges. So long as financing charges are broken out (e.g., "unbundled") in the price or invoice for taxable TPP or services, they are not required to be included in the sales tax base in any of the existing RST systems. Where bundling of financing charges is occurring, tax will generally apply on the whole amount being charged for the taxable TPP or services, including the bundled financing charges.

Delivery Charges. The tax status of delivery charges across the RST systems is rather complex. Most other RST systems (e.g., BC, SK, MB) will require RST to be charged on any delivery charges made in respect of TPP sold on a "delivered basis" (i.e., "FOB purchaser"), but allow for some relief for delivery charges in respect of TPP sold on an "FOB vendor" basis. (In some cases, as in SK and MB, delivery charges for FOB "vendor" sales are taxed if the TPP originates from outside of the particular province). Ontario taxes virtually all types of delivery charges, whether or not broken out, and whether or not the sale is made FOB "purchaser" or "vendor".

Installation Charges. Most RST systems tax installation charges, whether bundled with contract prices for taxable TPP, or broken out separately. This is generally accomplished by defining such installation to be a "taxable service" in its own right. Saskatchewan, which was once the only province not to include installation as a "taxable service", recently moved to close that loop-hole, and now defines "repair and installation services" among the various "taxable services" that it began to tax as part of its 2000 budget.

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Treatment of "Trade-ins". A number of RST systems, like that in Ontario, Manitoba and PEI allow "trade-ins" of TPP to reduce the tax base of the new TPP sold. BC and Saskatchewan do not allow for that treatment, although BC does allow limited "trade-in" treatment on purchases of "passenger vehicles." Where relief is available, some special rules and conditions would generally apply.

For SK's administrative prohibition for Trade-In see s. 8(14) of the SK Administrative Guides.

Temporary Imports. Most RST systems have special rules for TPP that is temporarily imported to the province. Since the general importation rules would require a self-assessment of RST on the full value of the imported TPP (see *infra*), these "temporary import" rules are relieving in nature, and usually result in a partial taxation of the imported TPP.

While the rules may differ, each of the other RST systems offer this same type of relief, and generally tax the TPP by applying 1/36 of its value to the regular tax rate, for each month the TPP is employed in the province.

In Ontario, for example, if TPP is imported for less than 12 months, tax is payable on a tax base equal to the "net book value" of the TPP, divided by 36, and is payable each month the TPP is present in Ontario.

Where equipment is leased, the RST systems generally attempt to tax the equipment on the basis of the lease payments being made.

Temporary importation rules for other RST systems are in s. 11 of the BC Act and Reg. 2.38; s. 5(9.1) of the SK Act and Reg. 1(17.3); s. 17 of MB Reg. 75/88R; s.2(21) of the Ontario Act and Reg. 1012(15.4); and s. 37 of PEI Reg. EC262/60.

Most of the RST systems also deal expressly with the temporary importation of "big ticket" items like aircraft, railway rolling stock, and inter-provincially used transportation equipment. (In some systems, some of these items are completely exempt).

Exemptions. Each RST system imposes its own distinct set of exemptions. There are some commonalties among the exemptions afforded by the various RST systems, with the two most important ones being for *TPP purchased for resale* and *TPP delivered outside of a province by a vendor.*

These exemptions exist for obvious constitutional reasons since in the absence of a "resale" exemption, the general tendency of the RST might well be interpreted as an "indirect" one; and in the absence of an exemption for TPP delivered "outside" a province, there might be some issue as to whether the RST was a direct tax "within the province". Some other exemptions that are generally common across each of the existing RST systems are as follows: [16]

Books; food and beverages for human consumption; children's clothing and footwear; most motive fuels (for reason only that they are taxed under separate provincial systems); fuel oil; wood; certain pharmaceuticals and medical supplies (usually if prescribed); agricultural feeds and certain purchases by farmers; raw materials and components for use in manufacturing; and catalysts and direct agents.

Some notable exemptions specific to particular provinces are:

BC: human organs, tissue, and semen; portable buildings manufactured and sold in the province for non-residential use; prescribed energy conservation equipment and materials; prototypes; repossessed TPP on which tax has been paid; 2-wheel bicycles; vitamins and dietary supplements; and, since 2001, production and manufacturing equipment.

SK: beer, wine, and spirits; mail order records, cassettes, and tapes when purchased by subscription; and prototypes for R&D purposes.

MB: flood control sandbags; private purchases of used TPP (except snowmobiles, aircraft and registrable vehicles); used furniture valued at $100 or less; and prototype equipment for mining

ON: Gifts of cars between family members; liquor, beer, or wine purchased for consumption at a special event; R&D TPP; and production and manufacturing equipment.

PEI: anti-pollution TPP; electricity production equipment; equipment to produce telephone service by telephone utilities; and production and machinery equipment.

Notably present in Ontario and British Columbia is an exemption for "production machinery and equipment". While Ontario was historically the only province to have afforded such an exemption, British Columbia announced a similar exemption as part of its 2001 budget, which change was effective July 1, 2001.

Exemptions by Nature of the Purchaser. Most RST systems have special exemptions by nature of the purchaser, although these are diverse. For example, the federal government (or related departments) is RST exempt in Saskatchewan, but taxable elsewhere. Similarly, provincial and municipal governments (including all departments, boards, and commissions) are generally taxable in all RST systems.

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Some provinces, like Ontario, have special exemptions for certain TPP purchased by certain hospitals, and certain additional exemptions for certain types of hospital equipment, when purchased by a hospital.

Exemption Permits. Most RST systems require "purchase exemption certificates" ("PECs") to be provided by purchasers seeking to claim an exemption, whether the exemption be for "resale" or otherwise. In Ontario, the PEC can be included in the purchase order, letter or on Ontario's prescribed form, but must be signed by the purchaser. A customer may submit a single or blanket PEC, with blanket PECs valid for up to four years from the date of issue. The purchaser would make reference to the blanket PEC when making subsequent purchases of items which it covers.

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The customer's vendor permit number should generally be shown on the PEC. (Ontario does have the concept of a "G" permit holder, who are not required to issue PECs; all that is required is the G Permit holder provide the vendor with the G Permit number, although it might well be advisable for the vendor to obtain a copy of the permit.)

Vendor Registration & Collection Requirements. Each RST system creates a vendor-registration and vendor-collection system. Under these systems, a vendor selling taxable TPP or taxable services in the province is usually required to register for the system (i.e., obtain a "RST licence", often called a "vendor permit"), and thereafter to begin charging, collecting and remitting RST in respect of its taxable supplies. In Ontario, for example, the relevant rule is found in s. 5 of the Ontario Act, which provides as follows:

> 5.(1) *Vendor Permits* — No vendor shall sell any taxable [TPP] or sell any taxable service or own or operate any place of amusement the price of admission to which is taxable unless the vendor has applied for, and the Minister has issued to the vendor, a permit to transact business in Ontario and the permit is in force at the time of such sale.
>
> *Collection requirements in other RST systems are s. 92 of the BC Act; s. 4 of the SK Act; s. 5 of the MB Act; and s. 13 of the PEI Act.*

Issues with Non-Resident Collection. The traditional issue relating to vendor collection requirements under RST systems is when and why a non-resident vendor, with little or no connection to a particular province, needs to register under that province's RST system. The answer comes, in part, from the definition of "vendor" employed in each RST system.

In BC, for example, the definition of "vendor" provides as follows:

> "*vendor*" means a person, including an assignee, liquidator, administrator, receiver, receiver manager, trustee or similar person, who, in the ordinary course of the person's business, in British Columbia, sells [TPP] to a purchaser at a retail sale in British Columbia.
>
> *"Vendor" is defined in s. 3(o) of the SK Act; s. 1 of the MB Act; s. 1 of the Ontario Act; and s. 1(t) of the PEI Act.*

With the exception of Ontario, all other RST systems contain a similar "carrying on business in the Province" wording. Ontario's provision does not require the vendor to be carrying on business "in Ontario", but that requirement is administered in practice – as it would probably have to be in order for Ontario's registration requirement to be within its constitutional authority. The Ontario Act defines "vendor" to mean, among other things, "a person who, in the ordinary course of business, (a) sells or licenses [TPP], [or] (b) sells or renders a taxable service ...".

Extra-territorial Registration Provisions. Some provinces (like BC, Manitoba and Quebec) have recently employed extra-territorial registration requirements, which effectively deem out-of-province vendors to be "vendors" required to be registered for local provincial sales taxes, on the basis of certain activities related to the province (e.g., soliciting goods for sale, and sending those goods into the province). As the constitutional (and practical) effects of these measures are uncertain, readers are cautioned to seek professional advice on these matters.

Carrying on Business. As indicated above, whether one "carries on business" in a particular jurisdiction falls to be determined by the facts of the situation.

A number of legal tests have also been developed, largely from jurisprudence under the *Income Tax Act* ("*ITA*"), as reviewed above. As most readers will already appreciate, that jurisprudence suggests that to determine whether a person is "carrying on business" in Canada requires a factual-based analysis, focused on a couple of primary factors, and a inexhaustive set of secondary factors.[17]

The two primary factors are: (a) the place where the contract for the supply was made; and (b) the place where the operations producing profits take place. In terms of the "place where a contract is made", the jurisprudence generally accepts that the important elements of the contract are its offer, and its subsequent acceptance, and that the place the contract is "accepted" is the place where it was made.

Voluntary Registration. Each RST system allows non-residents selling TPP or taxable services into a province to *voluntarily* register, which sometimes, is the path of least resistance for persons wishing to carry on business on a national scale, although located in one particular province (or, indeed, located outside of Canada).

Collection Provisions. Once registered, each RST system imposes a *collections* obligation on vendors of the TPP or taxable services, always imposing this obligation as an "agent" of the Crown. In Ontario, this requirement is found in s. 10:

> 10. *Vendor to be Collector* — Every vendor is an agent of the Minister and as such shall levy and collect the taxes imposed by this Act upon the purchaser or consumer.
>
> *Vendor collections obligations are s. 93(1) of the BC Act; s. 8.1 of the SK Act; s. 9(2) of the MB Act; and s. 19 of the PEI Act.*

While constitutionally limited to imposing "direct taxes" on consumers, the RST systems generally enforce a vendor's obligations to collect tax by imposing penalties for non-compliance. Ontario's "vendor non-compliance" penalty is found in s. 20(3) of the Ontario Act, which provides as follows:

> 20(3) *Penalty for Non-Collection of Tax* — The Minister may assess against every vendor who has failed to collect tax that the vendor is responsible to collect under this Act a penalty equal to the amount of tax that the vendor failed to collect, but, where the Minister has assessed such tax against the purchaser from whom it should have been collected, the Minister shall not assess the vendor.
>
> *While sometimes only imposing a "deemed amount of tax collected by not remitted", similar provisions can be at s. 116(1) of the BC Act, s. 58 of the SK Revenue And Financial Services Act; and s. 22 of the PEI Revenue Administration Act.*

There is a general four year limitation on s. 20(3) penalties – see s. 20(5) – although there is no limitation period in cases where the vendor's non-compliance is attributable to neglect, carelessness, wilful default or fraud. (In such cases, an additional 25% penalty can also apply: see s. 20(4)).

There is currently some issue in my mind as to whether a penalty assessed against a vendor can be "recovered" as tax by a vendor from a purchaser. There is also currently some issue whether such penalties lie where the vendor has been duly diligent.

Ontario generally takes the position that a vendor can pursue a purchaser for such recovery, but there are technical problems in the Ontario Act suggesting that anything collected from a purchaser on account of "tax" would have to be remitted to the Ontario Ministry of Finance in any event. Additionally, contract law principles would seem to make it difficult for a vendor to pursue a purchaser for a "penalty" imposed on it by statute. Accordingly, there have been occasions where I have suggested to purchasers that vendors seeking recourse for "penalties" levied under section 20(3) may be without valid claims against the purchasers.

Assessments & Appeals. Each RST system is based on voluntary compliance, as enforced by substantive audit activity. Assessments are, as would be expected, limited by statutory limitation periods, generally at least 4 years in length in Ontario and PEI, but up to 6 years in BC, Saskatchewan and Manitoba – although in some cases there is a 3 year limitation imposed on assessing vendors for failure to collect tax. In cases of wilful default or fraud, the statute of limitations is always extendable, and in some RST systems (most notably, Ontario), the limitations period can be extended to instances only of misrepresentation that is attributable to "neglect, carelessness or wilful default".

> *Statute of limitations rules are found at s. 115 of the BC Act; s. 18 of the Ontario Act; and s. 38 of Revenue Tax Act Regulations made under the PEI Act. While the SK and MB Act's do not specify a period of time after which a Notice of Estimate or Assessment for a particular year may not be issued, In SK, Estimates are generally assumed to be limited to a six-year period under SK Limitation of Actions Act. In MB, Assessments are generally limited by administrative practice to "two years" prior to the commencement of the audit, although the Assessments may be up to 6 years for "own use" situations.*

Appeal Rights. All RST systems provide for appeal rights to assessments issued, both at the administrative level, and to the provincial superior courts.

> *Timing for the appeals ranges from 90 days in BC (s. 118(2)); 30 days in SK (s. 61 of the SK Revenue and Financial Services Act; 60 days in MB (s. 18(1)); 180 days in Ontario (s. 24); and 60 days in PEI (s. 9).*

Generally speaking, RST assessed is payable on issuance of the Notice of Assessment, and must be paid irrespective of administrative or judicial appeals. Under some RST systems (e.g., SK), a notice must first be issued (i.e., after the appeal is commenced) before payment becomes mandatory. Where an appeal is won, the amounts paid are repaid, with interest.

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Directors & Officers Liability. Each RST system contains a special provision by which a director (or sometimes officers or mere agents) can be made personally liable for a corporation's tax debts. In a number of instances, however, there are either limitations placed on the administration's ability to pursue directors (e.g., unsuccessful attempts must first be made to collect the tax liability from the corporation), and/or the director's are given the ability to make out complete "due diligence" defences.

Directors' Liability provisions are found at s. 48.1 of the SK Revenue and Financial Services Act; s. 22.1 of the MB Revenue Act and s. 24.1 of the MB Act; s. 43 of the Ontario Act; and s. 22.1 of the PEI Revenue Admin. Act.

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Voluntary Disclosure Programmes. A number of RST systems have voluntary disclosure programmes, aimed at allowing taxpayers or vendors with RST exposure to come forward on a voluntary basis and, in return, to avoid civil penalties or criminal prosecutions in respect of the liability. In effect, then, all that would be payable would be the net tax owing, plus statutory interests charges. In all instances, the voluntary disclosure is required to be "voluntary" – in the sense that it is not in any way prompted by a contact by a particular provincial administration – and "full", with most systems requiring full payment of the tax and interest. Currently, all RST systems with the exception of PEI have some form of voluntary disclosure or another. Saskatchewan is currently the only jurisdiction which waives *both interest and penalty* on a voluntary disclosure.

Waiver of Interest and Penalty. Like the federal situation under the GST/HST legislation, some RST systems are beginning to be augmented with legislative provisions allowing for the waiver of interest and penalties. For example, s. 58.1 of the SK *Revenue and Financial Services Act* allows Saskatchewan to waive or cancel all or any part of any interest or penalty otherwise payable by a vendor or consumer. Absent these sorts of provisions, the only relief would be tax remission, which is generally done at the Executive Level of government, by Order of Council.

GAAR. Currently Manitoba is the only RST system with any semblance of a "general anti-avoidance rule" (see s. 245 of the *ITA*).

Self-Assessment Obligations. A hallmark of each RST system is a series of rules regarding self-assessment obligations in certain instances. While many RST systems now incorporate international collections agreements for the collection of RST on non-commercial importations, the RST payable on commercial importations is generally left up to the importer, both in terms of TPP imported from another country, and TPP imported from another Canadian province or territory. Generally speaking, however, the self-assessment obligation is imposed only on persons who ordinarily reside in the particular province.

Self-assessment is also required in most cases where TPP is "manufactured" for "own use", or otherwise acquired on an exempt basis (e.g., for "resale"), but thereafter committed to a different use. When such TPP is permanently put to a taxable use, the user generally falls into the definition of "purchaser", and is required to self-assess and remit tax based on the fair value of the TPP at the time of the change in use. Accordingly, vendors who permanently withdraw TPP from inventory for business or personal use must account for tax on the fair value of the TPP at that time. Special valuation rules apply to printed matter and certain other TPP manufactured for own use.

Treatment of Business Organizations and Reorganizations. The treatment of business organizations and reorganizations is also particularly complex. Bear in mind here, that the focus is on the treatment of certain sales of TPP resulting from such transactions, since the transfer of 'shares' would never generally be expected to give rise to RST liability, since such a transaction would amount only to a transfer of an "intangible". The issue arises, then, in the context of TPP, usually situated in a province, and usually tax-paid, that is to be transferred to another corporation as a result of a business organization or reorganization. While I have summarized some of the treatments across RST systems below, there are often a number of exceptions and additional conditions and requirements to the "general" rules. Accordingly, the rules in each particular RST system ought to be consulted before considering the full RST treatment afforded to any of these transactions.

Amalgamations. As a general rule, the transfer of TPP by virtue of an *amalgamation* is generally either legislated to be exempt, or treated as exempt through administrative practice.

Wind-Ups. The transfer of TPP by virtue of a *wind-up* is generally either legislated to be exempt, or treated as exempt through administrative practice in every RST system other than Ontario. Ontario has a special rule which taxes the transfer unless the particular corporation being wound-up has previously paid tax in respect of its consumption or use of the TPP.

Related-Party Transfers. Each RST system has rules aimed at relieving tax from TPP transferred between related parties. The rules, however, can often be quite difficult to meet. For example, most RST systems require at least a 95% shareholding between corporations before they can be considered to be related.

Bulk Sales Transactions. Most RST systems have provisions aimed at ensuring that purchasers of TPP "in bulk" (e.g., a business being acquired through the acquisition of "assets") obtain a retail sales tax clearance certificate from the vendor indicating that all sales taxes have been paid by the vendor. The vendor is then required to obtain the same from the particular provincial tax administration, thereby ensuring that in the "sale by way of assets" situation, the particular province does not suffer tax leakage because a tax debtor divests itself of all its assets.
(Normally, the only time a purchaser would acquire a vendor's liabilities – for taxes or otherwise – would be in the instance where it purchased a business by way of shares, thereby acquiring all assets and all liabilities). Where "bulk sales certificates" are not obtained, the purchaser is made personally liable for any sales taxes due. Currently, the RST systems in all of the RST Provinces have bulk sales requirements.

> *Bulk sales provisions can be found in s. 99 of the BC Act; s. 51(2) of the SK Revenue and Financial Services Act; s. 8 of the MB Act; s. 6 of the Ontario Act; and s. 56 of the PEI Act.*

Government Structure & Resources. The last point in terms of the structures of the various RST systems is the structure of the bureaucratic agencies overseeing the systems, which can often play an important part in the informal resolution of assessment and appeal matters.

In Ontario, for example, the Ontario Act falls under the auspices of the Ministry of Finance, and within that Ministry, the Retail Sales Tax Branch, administers retail sales tax policy set by the Ministry. Although the Retail Sales Tax Branch has input into legislation, largely through its Tax Advisory section (and in view of its practical experience), there is another body, called the Tax Design and Legislation Branch of the Office of the Budget and Taxation which has the primary input into the drafting of legislation and the wording of exemptions.

In terms of the day-to-day administration of the Ontario Act, the Audit Branch, Appeal Branch, and Collections Branches all have separate parts to play, as does the Special Investigations Branch. Separate from each of these branches, is the Office of Legal Services.

Needless to say, it can sometimes get quite involved determining just who in the Ministry of Finance has the "call" on even the most simple of audit, assessment or appeal issues.

Often times, in order to resolve matters at the Appeals or Court stage of the assessment process, consensus is need from up to 3 or 4 separate branches (e.g., the Office of Legal Services, Appeals, Tax Advisory, and possibly the first-line Audit Branch). When Branches disagree, the Deputy Minister and his ADM are often required to sign-off on the final decision.

Resources. While secondary resources for determining the application of RST systems are notoriously lacking, most RST administrations attempt to publish at least their view of how the particular legislation is to be administered. In Ontario, for example, this is done through separate series of *Sales Tax Guides* and *Information Bulletins* and through the limited public dissemination of a RST Handbook called *UOST* – short for the "Understanding Ontario Sales Tax" Handbook.

While *Sales Tax Guides* are published as needed, on a topic by topic basis (e.g., Ontario Sales Tax Guide No. 210: *Partnerships*), *Information Bulletins* are usually published after an Ontario budget, or on changes to regulations, outlining changes in the law and administrative practice. *UOST* is a handbook initially compiled by the Retail Sales Tax Branch as a training aid, and as an internal reference manual for the application of Ontario RST. In many respects, the manual is the most detailed piece of "general" information available in terms of specific Ontario administrative policies. While UOST was once available in electronic form, Ontario has since made it "unavailable", ostensibly on the basis that it was "out of date".

My understanding is that an electronic version continues to be updated and in use at the Retail Sales Tax Branch, and it may well be that an electronic version of UOST is available – albeit, only to those willing to avail themselves of Ontario's *Freedom of Information Act.*

QUESTIONS ?

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ENDNOTES

TO PART I1

1. For "domestic" supplies, the principal exceptions are goods, services, or intangibles enumerated in Schedules V or VI of the *ETA*. For "imported" goods, the principal exception is goods enumerated in Schedules VII of the *ETA*.
2. "Registered" or "registered under the *ETA*" is used to refer to persons who are registered in accordance with subdivision d of Division V of the *ETA*, which establishes who must be registered for the GST, and how they must register.
3. Bear in mind that a "taxable" supply will include the sorts of "zero-rated" supplies that are enumerated in Schedule VI of the *ETA*. The difference between the two is that a simply "taxable" supply is taxed at a rate of 7%, while a zero-rated supply is taxed at a rate of 0% (effectively removing the GST from the zero-rated supply).
4. In reviewing the general and specific rules discussed below, and in determining whether a particular taxable supply is made "in Canada" or "outside Canada", remember the significance of these rules: (1) Where a taxable supply is made "inside" Canada it will be taxable under Division II, and not generally taxable under any other provision in the *ETA* (although there are some exceptional situations where double-tax can occur); (2) If, on the other hand, the taxable supply is made "outside Canada", it will be outside the purview of Division II tax, and would only be subject to GST, if at all, under Division III (imported goods) or Division IV (imported services and other intangibles).
5. Note the distinction between charging, collecting and remitting the Division II GST on supplies made by the non-resident "in Canada", and the non-resident's obligation to pay GST at the border on goods imported to Canada under Division III. Many non-residents incorrectly assume that the "special non-residents rule" referred to just above somehow relates to the Division III obligations regarding imported goods. It does not. Accordingly, one could have a situation where, as a non-resident, one is entitled to deliver goods to Canadian customers *without* charging GST to the Canadian customer (i.e., because of the application of the non-residents rule in s. 143), but still required to pay the GST at the border because of the application of Division III.

   Many non-residents are confused in the application of the GST in these situations, increasing the likelihood that the GST rules are either not being fully complied with, or that some of this "double" GST is not being fully unlocked (see *infra*).
6. Also outside the scope of this presentation is a full discussion regarding the "registration" requirements in the *ETA*. Suffice to say that s. 240 of the *ETA* requires every person making taxable supplies in Canada in the course of a commercial activity to register for GST. Limited exceptions exist, including exceptions for certain "small suppliers" making less that $30,000 of supplies annually, and for non-residents who do "not carry on any business in Canada" – which dovetails with the special rule in s. 143 discussed just above.
7. Section 214 provides that Division III tax shall be paid and collected under the *Customs Act* as if the tax were a customs duty levied on the goods. In turn, the *Customs Act* provides that the person who "reports" the goods in accordance with that Act (i.e., the importer of record), is jointly and severally liable, along with the owner, for the duties levied on the imported goods. Accordingly, Division III tax is often applied to persons not actually owning imported goods, but merely reporting them for customs purposes.
8. Persons engaged in "commercial activities" are generally entitled to claim full input tax credits ("ITCs") for the GST paid, under s. 169 of the *ETA*. As this can only be done on the regular GST return following the day on which the GST became payable, there is often only a cash-flow issue involved in the payment of the GST. On the other hand, persons engaged in "exempt activities" are generally precluded from claiming ITCs, making the GST they pay unrecoverable, and a "hard cost". (In certain instances, where the exempt person is also a "public service body", limited rebates may be available for the GST paid – these would include, for example, municipalities, universities, schools, hospitals and charities, but not financial institutions).
9. This is consistent with the general policy in the GST legislation of removing all taxes and artificial costs from the cost base of Canadian exports, in order to eliminate the competitive disadvantages that would face Canadian exporters in the international markets as a result of these artificial costs.
10. The existing RST systems are as follows: in BC, the *Social Services Tax Act* applies at a general rate of 7%; in SK, the *Provincial Sales Tax Act* applies at a rate of 6%; in MB the *Retail Sales Tax Act* applies at a rate of 7%; in ON the *Retail Sales Tax Act* applies at a rate of 8%; and in PEI, the *Revenue Tax Act*, 1988 applies at a rate of 10%.1

    The Ontario *Retail Sales Tax Act* will be referred to here as simply the Ontario Act. Other provincial legislation referred to above will be referred to in the same way (e.g., the BC Act, the SK Act, etc.).
11. See *Cairns Construction Ltd. v. Government of Saskatchewan*, [1960] S.C.R. 619.
12. The logical result of this is the creation of purchase exemptions in every RST systems which, one can see, are not so much a matter of provincial generosity as they are a constitutional imperative.
13. The structures of the taxing systems in ON, PEI and MB tend to be very similar perhaps due to the timing of their respective taxes (all enacted within about 7 years of each other in the early 1960s). BC and SK, with somewhat older systems, tend to be quite different in structure, although containing each of the (constitutionally required) elements described just above.
14. While QB's QST is a sales tax system levied on purchases at all levels of the production and distribution chain, business purchasers are usually afforded refunds on business inputs, helping confirm that the QST is intended to be borne by the ultimate consumer or purchaser.
15. The recent addition of a separate charging provision in section 2.0.1 of the Ontario Act has recently obviated the need for defining purchaser in this manner, and these words were removed from the definition: see s. 2.0.1 of the Ontario Act, as added by 2000, c. 10, s. 24, effective May 3, 2000.
16. Please note that a number of exceptions and conditions apply to some of these exemptions, meaning that in each case, the actual legislative rules ought to be consulted prior to determining if a particular supply is an exempt one.
17. According to the jurisprudence, other factors could include: (a) the place where the TPP was delivered, (b) the place where the payment was made, (c) the place where the TPP in question was manufactured, (d) the place where the orders were solicited, (e) the place where the inventory of the TPP is maintained, (f) the place where the company maintains a branch or office, (g) the place where agents or employees, who are authorized to transact business on behalf of the non-resident person, are located, (h) the place where bank accounts are kept, (i) the place where back-up services are provided under the contract, and (j) the place in which the non-resident person is listed in a directory.

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