Managing the Objections & Appeals Process

Experiences from a Commodity Tax Perspective

MILLAR
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Presented at the TEI's 2003 Annual Conference

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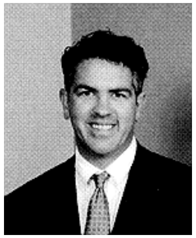
PROFESSIONAL PROFILES

Jack and Rob are partners at Millar Wyslobicky Kreklewetz (MWK) – a boutique tax law firm specializing in all **Commodity Taxes**, **Customs & Trade,** and **Tax Litigation**, and further described below.

W. JACK MILLAR, LL.B., LL.M.

Jack has an LL.M. from Osgoode Hall Law School, and is a member of the Board of Governors of the Canadian Tax Foundation.



ROBERT G. KREKLEWETZ, LL.B., M.B.A.

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

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Specialized Practice Area

MWK's practice area 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. MWK also advises on the application of all other excise taxes, applying to a wide range of goods like tobacco, alcohol, jewellery, gasoline and other motive fuels.

MWK's also focuses on **Customs & Trade** matters, including Periodic Verification Audits concerning Valuation, Tariff Classification, Origin, or Marking issues, and including NAFTA Origin Verification Reviews, Forfeitures, Seizures, and other NAFTA & WTO issues.

Finally, MWK advises on a number of other **Tax-Related Matters,** wherever involving the domestic or international movement of goods, services and labour. These would include advising non-residents on properly structuring Canadian business operations (or on the entry into Canada of business persons), providing Transfer Pricing opinions, advising on the application of the Ontario EHT (and other pay-roll source deduction taxes), and any and all tax or licensing law issues affecting the Canadian Direct Selling Industry.

Extensive Tax Litigation Experience

All elements of MWK's practice include **Tax Litigation**, and both Rob and Jack have acted as lead counsel in many cases before all courts, including the Tax Court of Canada, Canadian International Trade Tribunal, Federal Court (Trial Division), Federal Court of Appeal, Ontario Court of Justice, Ontario Court of Appeal, and the Supreme Court of Canada.

Speaking Engagements / Publications / Memberships

Both Jack and Rob continue to write and speak extensively in all of the above areas, regularly addressing the Tax Executive Institute (TEI) – both at its Annual Conference and Chapter Meetings – and other tax organizations like the Canadian Tax Foundation, Canadian Bar Association (CBA), Canadian Institute of Chartered Accountants (CICA), Canadian Finance and Leasing Association (CFLA), as well as the Canadian Associations of Importers & Exporters (CAIE), Certified General Accountants (CGA), and Direct Sellers (DSA). They also speak frequently at Conferences held by the Strategy Institute, Infonex, Federated Press, and at the Institute for International Research.

MWK is proud to announce as recently described in L'Expert Magazine, MWK has become Canada's

"brand name for Commodity Tax and International Trade work …".

MWK is also proud to announce that in April 2003, the International Law Review ranked MWK as the

Top Canadian Law Firm in
Commodity Taxes – "Indirect & State and Local Taxes"

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THE ROAD MAP

General Focus of the Presentation

Dealing with contentious tax assessments remains a high-focus part of the tax executive's daily life. The Presentation and Materials will outline some experiences that we have had – from our Commodity Tax perspective – in helping our clients manage those tax assessments through the objections and appeals process.

In our presentation today, we will attempt to address our experiences in managing, dealing with, and succeeding in matters at both the "objections" and "court" appeal levels.

The discussion is aimed at sharing our experiences, and allowing the reader to take those experiences back to their own businesses, when managing their own Objections and Appeals process.

The "objections" appeals level refers, of course, to the Notice of Objection stage of proceedings, and is common to income tax, GST, and provincial sales tax disputes. The "court" appeal of course refers to the next level of appeal after an unsuccessful Notice of Objection, and is initiated with either the Tax Court of Canada (for federal income tax or GST matters), or one of the particular superior courts (for provincial tax matters).

We will also briefly discuss additional issues that arise when a taxpayer has been unsuccessful at both earlier levels, and is required to consider appealing its tax matter beyond the Tax Court, to the Federal Court of Appeal (or, in provincial matters, to the provincial Courts of Appeal).

The audience is encouraged to participate !
So feel free to ask questions at any time.

Navigating Through the Materials

The Materials are broken into two main parts.

Part I is a narrative outline of the main topics to be presented today, and begins on the next page.

Part II of the Materials is a fairly comprehensive review of Canada's GST[1] and RST[2] regimes, and is designed to allow readers not completely familiar with these systems to more fully understand the customs and commodity tax systems in which our discussions will often focus. Part II is styled, then, as a "*Building Block*" discussion, and that is what it is.

Obviously many readers will already have a very sophisticated understanding of Canada's commodity tax system will not need to spend much time with Part II. It can remain, however, a handy secondary resource.

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FILING & MANAGING AN OBJECTION

"Shock and Awe" is now required

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PART I – MANAGING THE OBJECTIONS & APPEALS PROCESS

FILING & MANAGING AN OBJECTION

We first turn our attention to the mechanics of filing a Notice of Objection (the "Objection"), and then to what, in our experience, we regard as the key success factors necessary to be successful at the Objections stage of proceedings.

First, the mechanics of the filing of an Objection.

"Shock and Awe" is Now Required

The biggest recent change to the Objection landscape is the gradual shift in the federal and provincial disclosure requirements for (1) federally, any large businesses, and (2) provincially, all taxpayers wishing to dispute their tax assessment.

By this we mean to refer to the recent amendments, in the last 5 years or so, of the Objection requirements in the federal Income Tax Act ("ITA") and Excise Tax Act ("ETA"), and in provincial sales tax legislation like the Ontario *Retail Sales Tax Act* (the "RSTA") or the *Act respecting the Quebec sales tax* (the "QSTA").

While the Objection has always been recognized as an important document in the process of appealing a tax assessment, the legislative changes alluded to above have escalated its importance to the highest possible order or magnitude. The legislative trend has begun to require all issues set out in a judicial appeal to have previously been "clearly described" in the underlying Objection, and with "facts" and "reasons" related to those issues to have been "fully set out" by the taxpayer.

The clear implication for the taxpayer is that unless absolutely *everything* is now set out in one's objection, one may now find that one is precluded from making all of the arguments necessary to bring a successful conclusion to a tax appeal.

The sections below first outline the basic requirements in the ITA, the ETA, the RSTA, and the various other provincial regimes.

We then discuss the practical implications of these provisions.

Excise Tax Act Rules. The basic rule for filing an Objection for GST purposes is found in subsection 301(1.1) of the *ETA*, which provides as follows:

> 301 (1.1) **Objection to assessment** — Any person who has been assessed and who objects to the assessment may, within ninety days after the day notice of the assessment is sent to the person, file with the Minister a notice of objection in the prescribed form and manner setting out the reasons for the objection and all relevant facts.

Under subsection 301(1.2), however, a "full disclosure" principle applies to certain "specified persons", which are basically defined to be large taxpayers, like certain listed financial institutions, and other fairly large corporations. (One basic threshold, for example, is $6 million in annual taxable supplies, including the supplies of one's associates: see sections 225 and 249 of the *ETA*.) .

These "specified persons" are required to include in an Objection, a reasonable description of each issue to be decided, the specific relief sought for each issue (in terms of the change in any amount relevant for the purposes of the assessment), and the facts and reasons being relied on with respect to each issue.

If these requirements are not met, subsection 306.1(1) precludes an appeal to the Tax Court of Canada with respect to that issue, and also precludes the revision of the relief sought.

The inclusion for "specified persons" – which likely includes most people representative in the room today – may be somewhat surprising for the income tax practitioner, because for income tax purposes, the "full disclosure" rule usually applies to a much narrower base – that being companies subject to the "large corporations tax" or "LCT".

Quebec – Quebec Sales Tax Rules. The rules for Objections in respect to assessments made under the QSTA are virtually identical to those found in the ETA, and readers are urged to compare the provisions set out above, with subsections 93.1.1, 93.1.2 and 93.1.10 of the QSTA.

THE SHOCK & AWE DOCTRINE

- All Facts and Reasons Now Required (GST / RST)
- Contrast Income Tax
- More than "Core" Facts & Reasons Required

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Income Tax Act Rules. The basic rule for filing income tax objections is found in section 165 if the *ITA*, which provides as follows:

> 165 (1) Objections to assessment — A taxpayer who objects to an assessment under this Part may serve on the Minister a notice of objection, in writing, setting out the reasons for the objection and all relevant facts.

As alluded to above, the *ITA* rules regarding "large corporations" are generally the same as those in the ETA regarding "specified persons", with the operative provisions being subsection 165(1.1), which requires "large corporations" to "reasonably describe the issues to be decided, specify the amount of relief sought, and provide the facts and reasons underlying the issues".

Subsection 165(1.13) then restricts a large corporation to appealing only of those issues and related relief, which meet the objection disclosure requirements.

As indicated, the definition of "large corporation" is a much more restrictive definition than "specified corporation", leading to the conclusion that the "full disclosure" rule applies much more often for GST purposes than for income tax purposes – sometimes again a surprise for the unwary.

But when it comes to the "breadth" of the "full disclosure" rule, the jurisdiction which takes the cake is Ontario, whose RSTA applies that rule to *all* taxpayers wishing to object to retail sales tax assessments.

Ontario - Retail Sales Tax Act Rules. The Objections Rules in the *RSTA* were amended effective in 1997 and, as indicated, are much broader (and in fact, a bit more stringent) than their federal counterparts. Subsection 24(1.1) of the RST provides the basis rule, which is as follows:

> 24(1.1) **Facts and reasons to be given** — The notice of objection shall,
>
> (a) clearly describe each issue raised by way of objection; and
>
> (b) fully set out the facts and reasons relied on by the person in respect of each issue.

Subsection 25(2.1) then limits a taxpayer's right of appeal to only those issues raised in the notice of objection:

> (2.1) **Limitation** — A person is entitled to raise by way of appeal only those issues raised by the person in a notice of objection to the assessment being appealed <u>and in respect of which the person has complied or was deemed to have complied with subsection 24(1.1)</u>.

Note that the requirement in Ontario is that the Objection requirements have been "complied with" – which presumably allows the Crown to argue that even though the proper issues were identified, since not all of the facts or reasons were set out, the taxpayer can be denied the right to appeal those issues on that basis alone.

Fortunately, there is a special provision for issues raised for the first time by the Ministry of Finance on a subsequent assessment or reassessment, which is provided for in subsection 25(2.2) of the *RSTA*, as follows:

> **25(2.2) Exception** — Despite subsection (2.1), a person may raise by way of appeal an issue forming the basis of a fresh statement or reassessment or of a variation of an assessment or statement under subsection 24(4) if the issue was not part of the assessment or statement with respect to which the person served the notice of objection.

Despite both the federal and Ontario trends, the B.C., Saskatchewan and Manitoba rules do not impose the same limits on evidence presented on appeal that the Ontario and federal rules do.

British Columbia – Social Services Tax Act. A person who disputes an assessment in B.C. may appeal to the Minister, pursuant to section 118 of the *Social Services Tax Act* (the "SSTA") by serving a notice of appeal on the minister. Subsection 118(3) requires that the notice of appeal to set out "clearly the reasons for the appeal and all facts relative to it."

A decision of the minister can be appealed to the B.C. Supreme Court however, unlike the Ontario rules, an appeal to the B.C. court is a considered a new hearing and is not limited to the evidence and issues that were before the minister.

BEDROCK LEGAL ARGUMENTS

- Due Diligence Defences
- Waiver Arguments
- Constitutional Arguments
- Charter Arguments
- First Principle Arguments
- Ultra Vires Arguments
- Estoppel Arguments
- Differential Treatments

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Manitoba - Retail Sales Tax Act. Under section 17.1 of the Manitoba *Retail Sales Tax Act* (the "Manitoba Act"), where a person disputes the amount of an estimate or an assessment, the person may serve on the commission and the director a notice of objection setting forth "clearly the reasons for the objection and any facts relative thereto."

The decision of the commission may then be appealed to the minister by serving a notice of appeal that sets "forth clearly the reasons for the appeal and any facts relative thereto".

In Manitoba, however, there are not any limits on a subsequent appeal to the Manitoba court, since subsection 19(4) provides that the court shall hear evidence adduced by the appellant and the minister, and may affirm, set aside, or vary the decision appealed.

Saskatchewan - The Revenue and Financial Services Act. In Saskatchewan, a taxpayer who receives a notice of estimate may appeal to the Board of Revenue Commissioners. Subsection 61(4) requires a taxpayer to "clearly set out in a notice of appeal served pursuant to this section the reasons for the appeal and all facts that he considers relevant to the appeal."

The decision of the Board may be appealed to the Saskatchewan court. Subsection 21(12) of the *Revenue and Financial Services Act* allows the court "hear and consider the cause based on the material which was before the Board … and on any further material or evidence that the court may, on any terms that it considers appropriate, permit."

Commentary

The clear implications from the federal and Ontario/Quebec "full disclosure" rules is that when it comes to the preparation and filing of an Objection in any of these jurisdictions, a full "shock and awe" battle plan must be adopted.

That is, it will no longer be sufficient for taxpayers to simply recount their basic core facts and reasons for the objection. Rather, some detailed consideration will have to given to the bed-rock legal arguments that are often key to the ultimate resolution of a tax dispute.

Some of these possible arguments / considerations follow.

Due Diligence Defences. If penalties have been raised, is there a "due diligence defence" to these penalties? Since the Supreme Court of Canada's ("SCC") decision in *The Queen v. Sault Ste. Marie*, [1978] 2 S.C.R. 1299, it has been open to suggest that where penalties are issued, a "due diligence" defence is available to the person being penalized, if the penalty in something other than an "absolute liability" offence (i.e., one where no intent is required, and where liability cannot be avoided even by the accused showing no fault).

Unlike "absolute liability" offences, many other offences, called either "strict liability" or *mens rea* offences, do in fact allow for defences. The most common in the tax context, is the "strict liability" offence, which can be rebutted by a defence of "due diligence" – or effectively demonstrating that all reasonable care was taken to avoid the deed, but that the deed arose notwithstanding that due diligence.

The pivotal GST case, *Pillar Oilfield Projects Ltd. v The Queen*,2 GTC 1005 (T.C.C.), was an excellent example of the significance of a finding that a penalty is a "strict liability" penalty. The case resulted in a finding that the imposition of automatic penalties under section 280 of the *ETA* could be challenged by demonstrating due diligence. (This conclusion was later confirmed by the Federal Court of Appeal in a case called *A-G Canada v. Consolidated Canadian Contractors Inc.*, 98 GTC 6303 (F.C.A.)).

Currently, there is some reason to believe that penalties like those for "non-collection" of provincial sales tax may be subject to the same legal defences, making the application, for example, on the Ontario non-collection penalty in subsection 20(3) of the RSTA potentially defensible in reasonable care situations: see for example, the *Kemp* case.

If your Notice of Assessment includes penalties, and you are subject to a "full disclosure" rule, due diligence defences must now be raised at the time of the Objection !

Waiver Arguments. While statutory waivers have been common place federally for a number of years now, their application provincially has always been of some speculation.

How can I present full facts and reasons when I can't understand the #!!&#% Assessment ?

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Our collective view is that where waivers have been issued in Ontario tax matters, and absent express statutory authorization for the same, they are nullities, and they do not allow the Crown to abridge the statutory time limits for assessments.

Recently announced changes to Ontario's RSTA do provide that legislative authority, but if your Notice of Assessment was issued in Ontario subject to a non-statutory waiver, you may have an argument against it, but under "full disclosure", that argument must also be raised at the time of the Objection !

Constitutional Arguments. The application of provincial retail sales taxes are often fraught with constitutional issues. Is the application of the tax within the purview of the provinces powers under subsection 92(2) of the *Constitution Act, 1867* – formerly the *British North American Act* – which limits provinces, constitutionally, to "Direct Taxation within the Province in order to the raising of the Revenue for Provincial Purposes".

Questions often arise as to whether the province is levying a constitutionally sound tax, and if your Notice of Assessment contains that issue, you may be required to raise it in the Objection or the Objection process.

Charter Arguments. There is much debate as to whether the Charter of Rights and Freedoms can assist taxpayers, and especially corporate taxpayers in tax disputes.

The prevailing view by the Courts – fuelled perhaps, by rulings by the SCC which attempt to restrict corporations from pursuing section 7 rights, and which attempt to restrict property disputes like tax matters from the purview of section 7 (i.e., which provides the right to "life, liberty and freedom") – is that Charter arguments are unavailable.

Our collective view, however, is that if the federal government persists in its increasing appetite to retroactively amend the ITA and ETA, there may come a point in the future where the SCC will be forced to revisit that approach.

And at that point, we fully hope that taxpayers – whether corporate or individual – will be granted a right to attack retroactive legislation on Charter grounds, and ask the federal government to defend their legislation under section 1.

Indeed, the federal government's recent budget announced a retroactive GST amendment reaching back some twelve years – taking away vested rights of an untold number of taxpayers, without any judicial checks or balances. How far will this practice be countenanced? Twenty years, retroactively? Fifty years? A hundred years?

The Charter is in an ever evolving state, and when someone sets out to make new law, there is usually little precedent to assist them in their endeavor. Nonetheless, with the right case … .

Accordingly, and with the right set of facts, Charter arguments are still worth making. And if your case is that "right case", "full disclosure" requires that that Charter argument be made a first instance.

First Principle Arguments. Often times, a tax dispute can be only properly understood by properly characterizing the nature of the transaction. The recent *Wil-care* decision, at the SCC is a good example of that. The case was about whether machines that produced asphalt, produced "goods for sale". The problem the taxpayer faced is that the asphalt, at law, passed by way of accession, from the vendor to the customer, and not by sale. (Effectively the asphalt was part of a real property contract, and title to it passed like a fixture passes to the owner of the real property to which the fixture is attached; with no "sale" necessary, or in fact usually occurring).

Often times the proper characterization of a transaction can only be undertaken from a "first principles" analysis, which draws from the basic laws of contract, property, and tort.

Under "full disclosure", all of these arguments and issues must now be included in an Objection.

Ultra Vires Arguments ? An *ultra vires* argument is essentially an argument about jurisdiction. Is the particular law, regulation, or rule "within" the jurisdiction of the person making it. If so, it is legally enforceable, and called *intra vires*. If the particular law, regulation, or rule is "outside" the jurisdiction of the person making it, then it is legally unenforceable, and called *ultra vires*.

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DEALING WITH INDECIPHERABLE & ESTIMATED ASSESSMENTS

- ***Audi Alteram Partem*** **doctrine**
- **Helou Case**
- **Self-Help Remedies**

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An example comes out of the recent Ontario RST case in *Johnson and Johnson*, where the Court of Appeal rightly observed that regulations cannot restrict the exemption provided in a taxing statute. The corollary, of course, is that regulations, and subordinate rules, cannot increase the tax provided in the taxing statute, unless that power has been clearly delegated.

These are, again, bedrock legal concepts, and can often be the turning point in an otherwise dismal tax case.

Under "full disclosure", *ultra vires* arguments now have to be made at the time the Objection is filed.

How can I present full facts and reasons when I can't understand the #!!&#% Assessment ?

(Dealing With Indecipherable and Estimated Assessments)

In the face of "full disclosure", one of the more common complaints one sees – especially in the Ontario context – is the observation that the basis for the Notice of Assessment is indecipherable. (Ontario has even pushed its normal "indecipherable" assessment a bit further, now levying "estimated assessments", which simply name the dollar figure they are assessing, but which are essentially based on blind guesses by the auditor as to what may be going on).

This raises a couple of issues.

The Audi Alteram Partem Doctrine. This is a Latin phrase which essentially means that in terms of procedural due process, "both sides need to be heard". (It is sometimes loosely translated as "no man ought to be condemned before he is heard).

The doctrine, fully developed, suggests that given "full disclosure", which requires a taxpayer to set out his entire position in an Objection, a taxpayer is thus entitled to understand the case against him.

But many times, that is precisely where the rubber hits the road, with many assessments not being entirely clear as to the means by which they are based, and with many assessment "positions" changing over time, especially between the audit and the administrative appeal.

Helou Case. Given the strong procedural undercurrent in the judiciary (which would expect that certain maxims of fairness be applied), it is not surprising that some courts have begun to go "above and beyond the call of duty" in assisting taxpayers that have, through no fault of their own, had difficulties in filing proper objections, because of faulty or indecipherable assessments.

One such recent case was *Helou v. Ontario (Minister of Finance)*, [2002] O.J. No. 3973. While the situation underlying Helou might not have seemed that extraordinary (i.e., an RST assessment made on the basis of a comparison of an unrelated business, followed by a perfunctory consideration by the Minister at the Notice of Objection stage, following by a missed statutory deadline by the taxpayer), the Ontario Superior Court has seemed to take the opportunity raised by the case to issue a wake-up call to Ontario when it comes to dealing with taxpayers.

The substantive RST issue involved an alleged failure to remit RST collected. The assessment was raised, apparently, on scant information, and based on assumptions made in relation to how similar businesses operated. The issue for the Court, however, arose on a motion, and involved whether there was any remedy available for Mr. Helou (the "Appellant"), who had failed to file a notice of appeal within the 90-day time limit provided for in subsection 25(1) of the RSTA – and was bringing a motion to extend the time for filing the same.

The Minister's position was that the notice of appeal was not filed within the statutory time limit, it should be struck out by the Court as an abuse of process, or alternatively, that the Court was without jurisdiction.

The Appellant's position was that only after numerous phone calls to the Ministry of Finance (the "MOF"), requesting further details regarding the already-issued Notice of Decision, could the Appellant finally determine the basis for the actual assessment, and truly understand the Notice of Decision.

WINNING AT THE OBJECTION STAGE

Gun slinging doesn't work here.

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It was at that point that the Appellant determined that the assessment was based on a comparison of how a third party business would have operated, and that, in fact, his business was significantly different, and making the initial assessment was grossly excessive.

Unfortunately by this time, the Notice of Appeal was overdue, and ultimately filed after the 90 day dead-line had expired.

The Court ultimately allowed the Appellant's motion, and ordered the Minister to serve and file a reply to the Notice of Appeal. In order to reach that result, however, the Court had to both interpret the relevant provisions in the Act as affording the Court the jurisdiction to extend the time for appeal, in order to allow justice to be done, and also, by way of alternative analysis, conclude that the Minister's purported Notice of Decision did not constitute a "reconsideration" in any meaningful way of the initial assessment, and thus could not trigger the commencement of the statutory limitation period provided for in subsection 25(1) – treating it, effectively, as a nullity.

As such, the MOF was estopped from raising the regular ninety day limitation period.

This case is interesting first as an indication of the extent to which Ontario Courts may be willing to help out Ontario taxpayers faced with it perceived as high-handed RST audits.

While the "reading in" approach taken by the Court as its primary approach to the case may be a bit suspect, the observation that the Notice of Decision must contain some meaningful consideration of the case at hand is likely an important (and welcomed) conclusion. Trying to decipher the basis for Ontario Notices of Assessment and Decision is a common problem in the RST context, as both can be brutally brief in explaining the facts and reasons on which they are based. They often also lack the information necessary for the taxpayer to truly stake out its factual and legal position (i.e., it's a bit hard to aim at a moving and elusive target) under "full disclosure".

Self Help Remedies. Faced with hard to understand assessments, but obliged to make "full disclosure" in a Notice of Objection, taxpayers are often left to their own devices in terms of how to proceed.

The presentation will include a discussion of some of the self-help remedies available to the taxpayer, and their practical consequences.

SUCCEEDING AT THE OBJECTION STAGE

In preparing for this presentation, we put some hard thought, based on our experiences, as to how and what it takes to be successful at a Notice of Objection stage.

This part of the Presentation will cover the following topics, but we have elected not to commit more than the general bullet points to writing:

- **Gun slinging doesn't work here.**
- **Characterizing the facts is *everything.***
- **Set the table. See who comes for dinner.**
- **Know when to call it a day.**

Because of its nature, however, this section will be subject to oral comment during the Presentation only.

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GUN SLINGING DOESN'T WORK HERE

- **The "end game" is winning; not beating anyone up**
- **Defusing the adversarial relationship**
- **Consideration: "No Egg on Auditor's Face"**

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STRATEGIZING & FILING THE COURT APPEAL

We now turn our attention to the strategies that come into play at the time the Notice of Appeal is to be filed in the Tax Court, or the provincial courts, and then turn our attention to what, in our experience, we regard as the key factors that will be necessary for you, as an in-house tax advisor, to evaluate whether you should be investing the time and resources into tax litigation.

First, we review the basic steps required to fully prosecute a tax appeal in the courts.

What am I getting Into ?

In attempting to evaluate whether a tax dispute should move beyond the objection stage, to a full blown court appeal, an in-house tax advisor needs to have at least a peripheral understanding of the process that he or she is about to get into.

A tax appeal is more than just a trial of the matter before the Tax Court. Often times the "process" leading up to the hearing takes up to 2 years, and amounts to 80% or more of the cost of the entire appeal.

Pleadings. An appeal obviously starts with a Notice of Appeal which, like the Objection, is required to set out all of the issues, facts, and reasons that the taxpayer believes will be necessary to prevail. The crafting of the Notice of Appeal should be a pivotal part of the appeal, in that it is the time that one must really know the case that must be made before the Court. It is a time to fish or cut bait on the various arguments that might have formed part of the Objections process, and to ear-mark the principal and possible alternative issues and arguments that will either make or break the taxpayer's case.

On the other hand, sometimes "less is more" when it comes to drafting the Notice of Appeal, accordingly, until the taxpayer sees what is coming from the new Crown Counsel on the file, it may want to reserve as many possible avenues of pursuit as possible.

Accordingly, there is often a delicate balance to be struck between letting the Crown know the case that it will have to meet at the trial (which it is entitled to know through the pleadings process), and leaving yourself enough "wiggle room" to take different possible tracks in response to the Crown's own position in the case.

As a testament to its importance, it is not uncommon to expend 10 to 20 hours drafting the Notice of Appeal.

Following the filing of the Notice of Appeal, the Crown files a "Reply", and after that, the Appellant is generally able to file an "Answer", to clarify any matter that needs to be clarified, and after that, the pleadings are "closed".

(Note that in Ontario RST cases, the process is slightly different, with a Notice of Appeal filed, then a Reply filed by the Crown – after which the matter is deemed to be an "action" in the Court. Under the Ontario rules, the "answer" is called a "Reply", and may only be filed under specific situations).

Documentary Discoveries. After the pleadings have "closed", each party is required to serve a "list of documents" (sometimes referred to as an "Affidavit of Documents") outlining the documents that will be relied on at the trial.

There are complex rules in the Tax Court (see further below) that determine what type of "disclosure" is required. In the Tax Court's "informal procedure", there is no documentary disclosure.

In the Tax Court's "general procedure", the general rule is that only "partial disclosure is required, which requires each party to disclose only the documents that "might be used in evidence": see Rule 81. That list is required to be filed 30 days after the closing of pleadings.

In the Tax Court's "general procedure", the parties may also "agree", or one party may apply to the Court for "full disclosure", wherein each party serves on the other party a list of all helpful or hurtful documents that are (or have been) in the party's possession, power, or control: see Rule 82. Obviously, a "full disclosure" requirement has far-reaching implications for taxpayers, and is often a critical turning point in the decision whether to appeal a case, or to continue an appeal.

A major exception to the "full disclosure" requirement is in respect of documents to which "solicitor-client" privilege is attached (which will be the subject of more detailed discussion further on in the Presentation).

(Note that in Ontario RST cases, documentary disclosure process is always "full disclosure", and the Affidavit of Documents is required 10 days following the closing of pleadings: see Rule 30.03).

Characterizing the Facts is *everything*.

QUESTIONS ?

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Examinations for Discovery. Following documentary discovery, comes "examinations for discovery" – although under the Tax Court's "informal" procedure there are no examinations for discovery.

The rules for "discoveries" under the Tax Court's "general procedure" rules, start at Rule 92, while the Ontario rules (for RST appeals) start at Rule 31. Without getting into the detail, the "discovery" process can be summarized as follows.

Each party will be required to select a witness to be deposed, and that witness will be required to inform him or herself as to the relevant facts in the case. The person will attend before a court reporter (although the examinations are usually arranged at counsel's offices), be sworn, and be subjected to questions by counsel for the other side. Most questions, (at least the proper one's – the determination of which will be your counsel's job) will have to be answered. If the witness does not know the answer, the opposing counsel will usually ask for an "undertaking", essentially requiring the witness to go back (after the examination) and get the answer, to the best of his or her ability, and then provide that answer in writing. (Generally it is expected that a number of undertakings (e.g., usually in excess of 30) will be given during an examination.

In many tax cases, there is some strategy involved in whether to proceed with discoveries, or whether to attempt to circumvent the discoveries, perhaps by suggesting that an agreed statement of fact is available. In cases where the facts are not controversial, that may be a plausible option – and will be a significant cost savings.

In practice the cost of attending at discoveries, and fulfilling undertakings, can be equal to or as much as double the costs related to the preparation and attendance at the trial. Accordingly, if the case is one where discoveries may not be necessary, there is an obvious incentive towards attempting to avoid the "oral" discovery process.

Settlement Matters. Despite having taken the steps to appeal a matter to court, settlement should remain a viable option, and an important pursuit throughout the process.

Settlement issues will be the subject of more detailed discussion further on in the Presentation.

The Trial. Trial issues will be the subject of more detailed discussion further on in the Presentation.

Further Appeals. Further Appeals will be the subject of more detailed discussion further on in the Presentation.

With that "introductory" discussion, we will now turn to particular issues that, based on our experiences, we believe are of particular note in an in-house tax advisor's efforts to to evaluate whether further time and resources should be invested in tax litigation.

What are we appealing ?

(Hitting the Moving Target)

The first question to be addressed when considering the appropriateness of a court appeal is what is the matter that is being appealed. This sounds like a silly question since, after all, the tax dispute has by this time already been long-standing. But it is a real question, given the Crown's new powers to raise "alternative arguments" at any stage of the proceedings.

Some background discussion is in order.

There has been some question as to just what is being appealed in tax litigation since the SCC's decision in *Continental Bank of Canada v. Canada*, [1998] 2 S.C.R. 358 (SCC). There the Court responded to the Crown's attempts to raise an alternative basis for the assessment, for the first time, at the Supreme Court hearing. (Previously, the only basis given in the Notice of Reassessment was that the amount in question was alleged to constitute a trading gain on the sale of Central Capital Leasing's partnership interest however, at the Supreme Court the Crown argued that bank was liable for recapture of capital cost allowance pursuant to subsection 88(1) of the ITA). The applicable limitation period for assessment had expired, and McLachlin J. (as she then was), writing for the majority, declined to permit the new argument to be advanced, stating simply that "The Minister should not be allowed to advance a new basis for reassessment after the limitation period has expired." (para. 18.)

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FACTS

CHARACTERIZING THE FACTS IS EVERYTHING

- **"There's no law; only the facts"**

QUESTIONS ?

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The issue was discussed in a bit more detail by Bastarache J., with L'Heureaux-Dubé J. concurring, and he commented that:

> It was open to the appellant to assess the respondent on the basis that it was liable for the recapture of cost allowance when it issued its Notice of Reassessment on October 12, 1989 or anytime prior to the expiration of the limitation period for reassessment. The appellant did not choose to do so and cannot now be permitted to change its assessment eleven years later. ...
>
> To accept this characterization [the new basis sought to be advanced] by the appellant would, in effect, create a situation where the Crown is permitted to raise new arguments simply because other arguments failed in the courts below. ...
>
> Taxpayers must know the basis upon which they are being assessed so that they may advance the proper evidence to challenge that assessment. Here, it is not clear that there is the proper factual basis to support a reassessment on the basis proposed by the appellant. ... To allow the appellant to proceed with its new assessment without the benefit of findings of fact made at trial would require this Court to become a court of first instance with regard to the new claim." (paras. 11-13; emphasis added.)

The case is certainly interesting, mainly because it seems to suggest that what is being appealed is the "mental processes" underlying the assessment, or the reassessment, and not simply the amount assessed or reassessed. That issue has been a difficult one historically, with the idea that an "assessment" refers to an amount of tax levied, rather than the mental process by which that amount is determined, being supported by several income tax decisions, most notably *Riendeau v. Her Majesty the Queen*, (1991) 91 D.T.C. 5416 (F.C.A.); *Her Majesty the Queen v. The Consumers' Gas Company Ltd.* (1986) 87 D.T.C. 5008 (F.C.A.); and *Okalta Oils Ltd. v. MNR*, [1955] S.C.R. 824.

Since the *Continental Bank* case, the federal government has attempted to remedy, in part, the effect of the decision, and give itself at least the ability to make "alternative arguments" at any stage of the proceedings – albeit, something a bit short of the ability to raise assessments or reassessments at "any time".

Given the questionable authority for ultimate (procedural) result in *Continental Bank*, it is perhaps not surprising that some Court's have positioned these amendments as amendments made to "overrule" *Continental Bank*: see *Her Majesty the Queen v. Hollinger Inc.*, [2000] 1 F.C. 227 (C.A.) an income tax case. Létourneau J.A. for the majority observed:

> The amendment has no application in the present proceedings because it was not in force when the matter was argued before the Tax Court. But it is indicative of the philosophy that ought to prevail in these matters. <u>It would introduce an unnecessary measure of formalism, unwarranted by the decision of the Supreme Court [in Continental Bank] and the subsequent amendment to section 152, if we were to require that proper notification to the taxpayer of an alternative argument in support of an assessment can only be achieved by the ministerial issuance of a new reassessment</u>. This is not to say that the Minister may change the amount of an assessment in pleadings, but only that arguments in support of an assessment can be made in pleadings, even if not included in a notice of reassessment. Changing the amount of an assessment in pleadings is tantamount to the Minister appealing his own assessment, an avenue which has been clearly rejected by the Courts.

GST Rules. For GST purposes, the Minister's assessment powers are set out in section 296 of the ETA. For most purposes, the Minister is relegated to issuing "assessments", but can issue reassessments in certain limited situations, generally related to activities of financial institutions, certain agent situations, and situations involving overpaid refunds or rebates or interest: see section 296, which appears on its face, to limit reassessment situations. (Also note that other specific provisions increase the Minister's ability to reassess but only in the specific situations with which they are concerned: see for example section 297(2)).

On the other hand, section 301(3) of the ETA seems to provide the Minster with wide-ranging reassessment powers:

> (3) **Consideration of objection** — On receipt of a notice of objection, the Minister shall, with all due dispatch, reconsider the assessment and vacate or confirm the assessment or make a reassessment.

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Set the table.

See who comes for dinner.

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(One wonders whether the Minister's powers under subsection 301(3) might be circumvented by his powers to "assess" or "issue a reassessment" under section 296.)

Where a reassessment has been made for GST purposes, the taxpayer is given the right, if the reassessment relates to a matter already under objection, to appeal the matter directly to the Tax Court:

> 302. **Appeal to Tax Court** — Where a person files a notice of objection to an assessment and the Minister sends to the person a notice of a reassessment or an additional assessment, in respect of any matter dealt with in the notice of objection, the person may, within ninety days after the day the notice of reassessment or additional assessment was sent by the Minister,
>
> (a) appeal therefrom to the Tax Court; or
>
> (b) where an appeal has already been instituted in respect of the matter, amend the appeal by joining thereto an appeal in respect of the reassessment or additional assessment in such manner and on such terms as the Tax Court directs.

The amendment to – as the FCA in *Hollinger* put it – to "overrule" *Continental Bank*, is found in subsection 298(6.1) of the *ETA*, as follows:

> **Alternative argument in support of assessment** — The Minister may advance an alternative argument in support of an assessment of a person at any time after the period otherwise limited by subsection (1) or (2) for making the assessment unless, on an appeal under this Part,
>
> (a) there is relevant evidence that the person is no longer able to adduce without leave of the court; and
>
> (b) it is not appropriate in the circumstances for the court to order that the evidence be adduced.

The Technical Notes to subsection 298(6.1) state that the provision was added, " to clarify that the Crown has the right, on an appeal of a GST/HST assessment, to advance an alternative argument in support of that assessment even if the normal assessment period has expired."

Income Tax Rules. The scope of this Presentation does not call for a complete discussion of the assessment and reassessment powers of the Minister under the ITA – at least not over and above the observations already made above.

That being said, it is worth noting that the recent amendments to "overrule" *Continental Bank* for income tax purposes are found in subsection 152(9) of the *ITA*, which provides as follows:

> The Minister may advance an alternative argument in support of an assessment at any time after the normal reassessment period unless, on an appeal under this Act
>
> (a) there is relevant evidence that the taxpayer is no longer able to adduce without the leave of the court; and
>
> (b) it is not appropriate in the circumstances for the court to order that the evidence be adduced.

The Technical Notes to subsection 152(9) provide that it "is intended to ensure that the Minister of National Revenue may advance alternative arguments in support of an income tax assessment after the normal reassessment period has expired."

Like our observations with respect to the GST amendments, however, subsection 152(9) is subject to other limitations in the ITA, including subsection 152(5), which prevents the Minister from including amounts in a taxpayer's income, which were not included prior to the expiration of the taxpayer's normal reassessment period.

Ontario's Rules. In Ontario RST appeals, it is a bit more clear that the Minister has the power to issue a reassessment at any time within the normal four year assessment period (or at any time involving a misrepresentation that is attributable to neglect, carelessness or wilful default, or a taxpayer that has committed any fraud, in making a return or in supplying any information in omitting to disclose any information): see for example subsection 18(3) of the RSTA.

(Similar powers seem to exist in respect of penalties for non-collection of tax: see subsection 20(9) of the RSTA.)

The Minister is given, seemingly, an unfettered ability to issue reassessments in answer to a Notice of Objection, subsection 24(4) providing as follows:

SETTING THE TABLE &
SEE WHO COMES FOR DINNER

- **While legislatively required, don't expect Appeals to surrender to the "Shock & Awe"**
- **"Salami Tactics" may be a good second best**
- **A partial win may secure a complete victory later**

QUESTIONS ?

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> (4) **Reconsideration** — Upon receipt of the notice of objection, the Minister shall with all due dispatch reconsider the assessment or statement objected to and vacate, confirm or vary the assessment or statement, <u>or reassess or serve a fresh statement</u>, and the Minister shall thereupon notify the person making the objection of his or her action in writing.

These powers are presumably governed by the Minister's assessment and reassessment powers in subsection 18(3), and limited to the same time periods.

Our understanding is that Ontario is reticent to issue reassessments at the Objections stage.

Recent provincial cases have suggested that as the ability of the taxing authority to assess and reassess is founded in their legislative powers, it will be imperative to review the powers that each respective entity is given under the base statutes which apply the tax: see, as a good example of this, *Teck-Bullmoose Coal Inc v Commissioner of Mineral Tax (BC)*, [2002] 5009 ETC (B.C.C.A.).

Hitting the moving target. With all the recent hoopla over assessments, reassessments, and the time or times the Crown is now permitted to make "alternative arguments", it is in a taxpayer's interests to pin down, very soon after a Notice of Decision or a Notice of Reassessment is received, just what is being appealed. The taxpayer may be surprised to find that the battle that was "signed on for" at the Objections stage or proceedings has changed significantly in its complexion, by the time the Notice of Appeal to court is required.

"Onus" and the Crown's Assumptions Also an important point in the decision whether to proceed to Court is the "onus" and Crown assumption issues.

The "onus" refers to the general obligation, in tax matters, to demolish the Crown's assumptions, generally by establishing at least a different version of events.

The whole notion of "onus" really flows from the well-known judgment in *Johnston v. M.N.R.*, 3 DTC 1182 (SCC), where Rand J. described it in the following terms:

> Notwithstanding that it is spoken of in section 63(2) as an action ready for trial or hearing, the proceeding is an appeal from the taxation; and since the taxation is on the basis of certain facts and certain provisions of law either those facts or the application of the law is challenged. <u>Every such fact found or assumed by the assessor or the Minister must then be accepted as it was dealt with by these persons unless questioned by the appellant</u>.

A taxpayer will meet the assumptions of fact made by the Minister by (a) challenging the Minister's allegation that he did assume those facts, and (b) assuming the onus of showing that one or more of the assumptions was wrong – or otherwise by contending that, even if the assumptions were justified, they do not of themselves support the assessment: see, for example, *M.N.R. v. Pillsbury Holdings Limited*, (1964) 64 DTC 5184, 5188 (Ex. Ct.) *per* Cattanach, J..

More recently however, the Tax Court has held that these three possibilities should be taken as exhaustive of a taxpayer's options for overcoming assumptions of fact pleaded by the Minister, and that in the absence of the taxpayer adducing "sufficient evidence" to show that the Minister's assumption is wrong, the assumptions must stand: see *944787 Ontario Inc. (o/a Victoria Tavern) v. The Queen*, (1998) 3 CTC 2293 (TCC) *per* Brule, J.

In *Hickman Motors*, the SCC set out the current law regarding the onus of proof in taxation matters, generally as follows:

- The initial onus of demolishing the Minister's exact assumptions is met where the appellant makes out at least a *prima facie* case;
- Where the Minister's assumptions have been demolished by the appellant, the onus shifts to the Minister to rebut the *prima facie* case made out by the appellant and to prove the assumptions;
- Where the burden has shifted to the Minister, and the Minister adduces no evidence whatsoever, and no question of credibility is ever raised by anyone, the taxpayer is entitled to succeed: see *Hickman Motors Limited v. Her Majesty the Queen*, [1997] 2 S.C.R. 336 (S.C.C.) *per* L'Heureux Dubé, J..

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Know when to call it a day.

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The Crown was recently taken to task by the Tax Court with regard to its use of "assumptions", in a case called *Holm et al. v. The Queen*, unreported as of yet (Tax Court Docket 2002-575(IT)G). Judge Bowman reviewed the recent attempts by Crown lawyers to plead "assumptions" in their Reply that, really, had nothing to do with the assumptions made at the time of the assessment / reassessment.

In Judge Bowman's words:

> It is undeniable that there is a strongly held view in this court that to plea as assumptions facts that were not assumed on assessing is improper and reprehensible. Also it seems the practice is widespread. …

Burden of Proof. The "burden of proof" point deals with the general obligation of the taxpayer to prove its case on a "balance of probabilities" – which is generally take to be the obligation to make a 51% case, and something that is far from the "absolute" or "complete proof" standard adopted by many tax appeals officers at the Objections stage.

I have to disclose *what ?*

(Hitting the moving target)

Another factor that an in-house tax advisor needs to evaluate in determining whether to invest scarce time and resources into tax litigation, is the implications of documentary disclosure.

The basic structure in the Tax Court and the Ontario courts has been described above, and our comments here focus on the implications of "full disclosure".

"Full disclosure" means just that. And tax Appellants will appreciate once the Tax Court or Ontario rules are fully digested, that there is an on-going obligation on the Appellant to provide the Crown with each and every document that could possibly hurt one's case (disclosure of the "helpful" documents is also required, but for the purposes of this discussion, assumed).

Accordingly, a good question for any in-house tax advisor, also very early on in the proceedings, is "what am I going to have to disclose", and will that impact my decision to go forward.

For example, is there a key document that will "sink" the case if it is is disclosed? How about other unhelpful documents ? Are there previous non-privileged advice that calls into question the tax appropriateness of the transaction? Is there previous non-privileged advice that, while not dismissing its appropriateness out-right, effectively damns the transaction through "faint praise"?

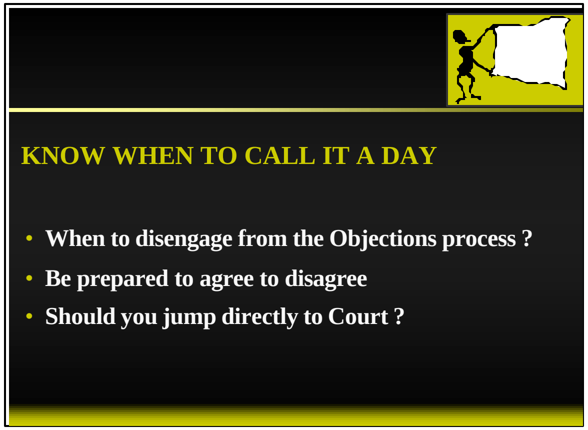
These sorts of questions bring up the issue of solicitor-client privilege.

While a full discussion of solicitor-client privilege is beyond the scope of this Presentation, we do wish to highlight an important legal trend in the development of privilege amongst commercial parties.

This trend is seen in the recent *Fraser Milner* case which dealt with the difficult issue of whether privilege is lost when information is shared with one's commercial or business partners (the word "partner" being used loosely here), and which seems to have expanded on the notion of "common interest" privilege.

Fraser Milner – "Common Interest" Privilege. The *Fraser Milner* case (see *Fraser Milner Casgrain LLP v. Canada (MNR)*, [2002] B.C.J. No 2146 (September 20, 2002) involved an attempt by the CCRA to obtain access to numerous tax and business documents exchanged between negotiating parties for the purpose of obtaining legal advice (and in furtherance of concluding a large business transaction). The documents were disclosed between the parties as part of cross-border tax and commercial work, and given their "common interest" in the business transaction.

The Court ultimately rejected the CCRA's attempts to gain access to the information, finding it to be properly the subject of solicitor-client privilege, and found that the privilege was not waived when the documents were disclosed to the other group. The Court's rationale lay in the fact that there was common interest in completing the transaction. The Court ruled that given the parties' common interest in the successful completion of a commercial transaction, the parties must be free to exchange privileged information without fear of jeopardizing the confidence that is critical to obtaining legal advice.



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Accordingly, the Court found that, in addition to the well recognized common interest/litigation privilege that attaches to legal advice and other information exchanged between those whose interests in a dispute are largely the same, there is also a common interest privilege in respect to documents prepared for the purpose of providing legal advice that are exchanged in the course of commercial transactions.

This is an important expansion, in our view, of the scope of "solicitor-client" privilege, and comes in very handy for many commodity tax transactions, where the vendor and the purchasers have a "common interest" of minimizing, to the best extent possible, the application of the purchaser liability taxes (like the GST, and the various provincial retail sales taxes).

That's right ! Your going to be the witness.

(Managing the Evidentiary Process)

Because of its nature, this section will be subject to oral comment during the Presentation only.

SUCCEEDING AT THE APPEALS STAGE

Because of its nature, this section will be subject to oral comment during the Presentation only.

Topics covered will include as follows:

- **What kind of case do I have ?**
- **Sometimes you can win through settlement.**
- **If all else fails, its hard ball time.**

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STRATEGIZING & FILING THE COURT APPEAL

What am I getting into ?

QUESTIONS ?

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PART II – BUILDING BLOCKS

CANADA'S GST SYSTEM

Overview of the GST System

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]

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WHAT IS REQUIRED FOR AN APPEAL ?

- Pleadings
- Documentary Discovery
- Examinations
- Settlement Matters
- Trial
- Further Appeals
- Cost Considerations

QUESTIONS ?

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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.

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.

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 CCRA.

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.

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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.

Significantly, the CCRA (Excise), in its GST Memoranda Series 2.5 (*Non-Resident Registration*, June 1995) has confirmed that the concept of "carrying on business" ought to focus on the two primary factors above, with the place a contract is concluded being the "place where the offer is accepted".

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.

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 CCRA 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.

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WHAT ARE WE APPEALING ?

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- **The Burden of Proof**
- **Less can be More, at this stage**

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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.

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;

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I have to disclose *what* ?

(Dealing with Documentary Discoveries)

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(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.

CANADA'S RST SYSTEMS

Overview of a Typical RST System

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. (Un)fortunately 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.

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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]

> *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.

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]

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That's right !

Your going to be the witness

(Managing the Evidentiary Process)

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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.

> *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).

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MANAGING THE EVIDENCIARY PROCESS

- Oral Discoveries: Should They be Avoided ?
  - Agreed Statements of Fact
  - Examining the Crown
- Marshalling the Evidence for Trial
  - "There are no Facts; Only Evidence"
- Subpoenas: Effect on Government Officials

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> 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.

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. 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. [15]
>
> *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.

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SUCCEEDING AT THE APPEALS STAGE

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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 includes 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.

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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.

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 resvult 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.

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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.

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. 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.

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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 ...". BC also deems certain people to be carrying on business "in BC" in certain circumstances – making, again, a review of the particular rules essential.

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.

If all else fails, now its hard ball time.

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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.

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.

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.

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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.

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FURTHER APPEALS

What is the Standard of Review ?

QUESTIONS ?

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In Ontario, for example, the Ontario *Retail Sales Tax Act* (the "*RSTA")* 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.*

Finally, Ontario's Retail Sales Tax Branch maintains what I understand to be a formidable collection of "unsanitized" written rulings, issued and catalogued on a number of subjects. Given that the rulings contain "confidential information", Ontario has traditionally resisted publishing them, even in a semi-sanitized form. My understanding is that – again ostensibly for resource reasons – these "headquarters" rulings will not be published in the near future. While some of these ruling are commonly distributed amongst industry, and TEI members, caution should always be taken in relying on them, since the Ontario Ministry of Finance has no compunction in observing that a ruling letter issued to one person is not binding upon the Ministry in respect of the activities of another person – even if very closely related.

Other RST systems also have detailed governmental sources of information, although perhaps BC is the only system that comes close to Ontario in terms of the availability of that information. BC may well have more accessible information, since its own internal training manual ("TIM" - Tax Interpretation Manual) is widely available, and in electronic format.

WHAT IS THE STANDARD OF REVIEW

- Tax Court: Correctness (?)
- CITT: Reasonableness (?)
- Questions of Fact vs. Questions of Law

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ENDNOTES TO INTRODUCTION:

1. 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 entity that administers it is the Canada Customs and Revenue Agency ("CCRA"), which was formerly very well known as "Revenue Canada".

2. For these purposes, consider that there are only five Canadian provinces which still imposed stand-alone RST systems. These are: British Columbia ("BC"), Saskatchewan ("SK"), Manitoba ("MB"), Ontario ("ON") and Prince Edward Island ("PEI"). These provinces may sometimes be referred to in these materials as the "RST Provinces".

ENDNOTES TO PART II:

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, for example, *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.

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Does your case have "Legs" ?

QUESTIONS ?

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ENDNOTES (Continued)

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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DOES YOUR CASE HAVE LEGS ?

- Case is now 50% "policy"; only 50% your "facts"
- Thus considerations have changed; for good or bad
- Dynamic at FCA, at SCC

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