Ryan
Innovative Solutions to Taxing Problems.

Canadian Hot Tax Topics

September 24, 2013

www.ryanco.ca
Follow us on Twitter @RyanTax_CA

Canadian Tax Hot Topics

Contents	**Page number**

June 2013

Ryan Innovative Solutions to Taxing Problems.

Canadian Tax Hot Topics

Glossary of Terms

CBSA:	Canada Border Services Agency
CRA:	Canada Revenue Agency
ETA:	*Excise Tax Act*
GST:	Goods and Services Tax
HST:	Harmonized Sales Tax
ITA:	*Income Tax Act*
ITC:	input tax credit
ITR:	input tax refund
PSB:	public service body
PST:	Provincial Sales Tax
PVAT:	provincial component of HST
QST:	Quebec Sales Tax
QSTA:	*an Act respecting the Quebec sales tax*
RITC:	recapture of input tax credits (provincial component)

Canadian Tax Hot Topics

Income Tax
Clyde Seymour, CA, CPA, MACC
Principal, Income Tax

www.ryanco.ca

AGENDA – INCOME TAX

Contents

- Non-Residents Providing Services in Canada
  - Regulation 105
  - Regulation 102
  - Permanent Establishment
- Voluntary Disclosure Program
  - New Information Circular

Ryan

NON-RESIDENTS PROVIDING SERVICES IN CANADA

CANADIAN TAX HOT TOPICS

Audit – case example

- CRA audit examines cross-border activity (Form T106) with concentration on "Management Fees" and other services by U.S. parent corporation
- Where services provided in Canada, Regulation 105 withholding may be assessment to the Payor – Canadian Subsidiary
- Where Parent employees providing services in Canada, Regulation 102 assessment considered
- Nexus examined for U.S. Parent
- Compliance requirements
  - T2 for U.S. Parent
  - T1 for U.S. employees working in Canada
  - Transfer Pricing – unreasonable fees can be denied & deemed dividend

Ryan

CANADIAN TAX HOT TOPICS

Regulation 105

- Regulation 105 applies to payments made by a Canadian corporation to a non-resident individual or corporation for services provided by the non-resident in Canada
- Where such payments occur, the Canadian corporate payor must withhold 15% and remit to the Canada Revenue Agency. The non-resident contractor will receive a net payment
- NR (Non-Resident Reporting) required annually. [T4A-NR]
- If the Non-Resident is exempt from Canadian Taxation under Treaty (e.g., Article VII if no permanent establishment exists), the non-resident can apply to CRA for a Regulation 105 Withholding Waiver
- Upon receipt of a Waiver Certificate, the Canadian Payor need not withhold under Regulation 105 prospectively

CANADIAN TAX HOT TOPICS

Regulation 102

- Where a Canadian resident (or non-resident) corporation pays remuneration to a non-resident employee, the corporation must withhold employment taxes pursuant to Regulation 102 where such employee reports for work in Canada
- If the non-resident is exempt from Canadian taxation (e.g., Treaty Article XV), they can apply for a Regulation 102 Waiver Certificate
- Where such waiver is provided to the employer, Canadian payroll withholding under Regulation 102 can cease prospectively
- If a non-resident employee is exempt from Canadian personal taxation and does not obtain a waiver, the employer can still be held liable for payroll withholding taxes even though the employee was technically exempt

CANADIAN TAX HOT TOPICS

Cross-border services – nexus

- Article V(9) of the Canada/US Income Tax Treaty deems a U.S. enterprise that does not otherwise have a Permanent Establishment ("PE) in Canada to have a PE if it provides services in Canada and it meets either of :

a) **Physical Presence Test**:

The services are performed in the host country (i.e., Canada) by an individual who is physically present there for one or more periods totaling 183 days or more during any 12-month period, and the income derived from the services performed in the source country by that individual amounts to more than 50 percent of the enterprise's gross active business revenues during the183+ day period; or

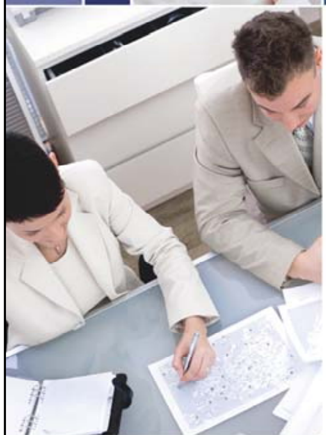
b) **Work Day Test:**

The services are provided in the host country for an aggregate of 183 days or more in any 12-month period with respect to the same or connected projects for customers either who are host-country residents or who maintain a host-country PE in respect of which the services are provided

CANADIAN TAX HOT TOPICS

Cross-border service checklist

- Identify non-resident service providers (related or third party)
- Regulation 105 Waiver
- Regulation 102 Waiver
- No Waivers – Withholding Tax & Compliance
- Nexus Assessment
- Secondment Agreements to mitigate nexus concerns
- Transfer Pricing – Contemporaneous Documentation for related party transactions.
- Consider Voluntary Disclosure where historical risk exists



VOLUNTARY DISCLOSURE PROGRAM

CANADIAN TAX HOT TOPICS

Overview

- New IC IC00-1R3- Voluntary Disclosure Program ("VDP"), March 21/13 provides information on the VDP
- VDP promotes compliance, encourages taxpayers to voluntarily come forward and correct prior omissions (par. 8)
- VDP applies to disclosures for income tax, excise tax, excise duties, source deductions, GST/HST and charges under the ATSCA and SLPECA (par. 6)
- Taxpayers who make a valid disclosure will have to pay taxes or charges plus interest, but no penalty or prosecution (par. 8)
- Submission must be in writing and mailed or faxed to appropriate tax centre (par 23).

CANADIAN TAX HOT TOPICS

Administration

- In 2013, the CRA changed the administration of the VDP
- Henceforth, the VDP is administered by 3 tax offices.
- Taxpayer submissions should be filed with the CRA office based on the taxpayer or advisor's location (par 23)

1. *Atlantic, Quebec and Ontario*- Shawinigan-South Tax Centre, Quebec
2. *Pacific Region*- Surrey Tax Centre, B.C.
3. *Prairie Region*- Winnipeg, Manitoba

CANADIAN TAX HOT TOPICS

Examples of VDP

- Relief from penalty and prosecution provided under the VDP may be considered if a taxpayer (par. 18)
- Failed to fulfill their obligations under the applicable act
- Failed to report taxable income
- Claimed ineligible expenses on a tax return
- Failed to remit employee source deductions
- Failed to report GST/HST (including undisclosed liabilities, improperly claimed refunds/rebates, unpaid tax)
- Failed to file information returns
- Failed to report foreign source income that is taxable in Canada

CANADIAN TAX HOT TOPICS

Exclusions from VDP

- The following would not be eligible for the VDP (par. 19)
- Income tax returns with no taxes owing or with expected refunds
- “Elections”- these are governed by the various acts administered by the CRA
- “Advance Pricing Arrangements”
- “Rollover Provisions”
- “Bankruptcy Returns”
- Post-assessment requests for penalty and interest relief

Ryan

CANADIAN TAX HOT TOPICS

Types of disclosures

- VDP allows either a "Named" or "No-Names" disclosure (par 25)
  - both are same except identity provided later
- "Named" disclosure identifies the taxpayer upfront
- "No-Named" disclosure (par 26-28)
- Gives taxpayer opportunity to have informal, non-binding, general discussions with VDP officer before identity is revealed
- VDP officer may advise that taxpayer should qualify for VDP but cannot provide a final determination until identity revealed and all information provided
- "No-Names" Disclosures- must identify the taxpayer within 90 days of the Effective Disclosure Date ("EDD") (par 28)
- If taxpayer cannot immediately submit all information (i.e., meet the 'Complete' condition in the submission sent to the VDP), the CRA may allow an extension. If granted, the CRA would normally allow the taxpayer 90 days from the EDD

CANADIAN TAX HOT TOPICS

Valid Disclosure

- If the CRA accepts that the disclosure meets all the following 4 conditions, it will be considered a valid disclosure- no penalties, no prosecution (par. 11):

1. ***Voluntary*** (pars 32-34)
   - taxpayer not aware of an audit, investigation, enforcement action
2. ***Complete*** (pars 35-37)
   - taxpayer must provide full and accurate facts and documentation for all tax years in question
3. ***Penalty*** (par 38)
   - disclosure must involve application or potential penalty
4. ***One Year Past Due*** (pars 39-42)
   - the disclosure must include information at least one year past due. Note- can include current year only if other years meet this test


Ryan
Innovative Solutions to Taxing Problems.
Canadian Tax Hot Topics
Indirect Tax
Jeffrey Shaw, CMA
Senior Manager, Client Support Services
www.ryanco.ca

AGENDA – INDIRECT TAX

Contents

- GST/HST Voluntary Disclosures
- Manitoba PST Rate Increase
- Nova Scotia HST Rate Reduction
- ITC Recapture Exposures
- Intercompany transactions/sales
- Pension Plans
- ITCs and Auditing to Net Tax
- Quebec Audit Tactics
- Documentary Requirements for ITCs

- The CRA voluntary disclosures program was created to promote compliance by allowing taxpayers who discover errors, inaccuracies or omissions in the reporting of their tax obligations to disclose such issues to the CRA on a voluntary basis. In exchange for this disclosure, subject to certain conditions, the CRA will exercise its authority to provide the taxpayer with relief from penalties or prosecution.

- In summary, for a disclosure to be accepted as valid by the CRA, it must be:
  - Voluntary – a disclosure will not be accepted if the taxpayer is aware that the CRA or another authority has commenced an investigation or enforcement action, such as an audit;
  - Complete – full and accurate facts and documentation must be provided for all reporting periods impacted by the issue;
  - Subject to a penalty – a disclosure will only be accepted where a penalty is applicable as a result of the issue; and
  - One year past due – the CRA typically requires a voluntary disclosure to include information that is at least one year past due.

- Unfortunately, effective April 1, 2007, the CRA adopted Standardized Accounting Rules which, in effect, eliminated the 6% penalty previously assessed for GST/HST amounts owing and replaced it with an assessment of interest only, calculated based on the 90-day T-Bill rate plus 4%. The removal of this penalty has diminished the potential use of the voluntary disclosure program for omissions occurring after April 1, 2007. Note that disclosures related to periods prior to this date may still be beneficial, since the penalty provisions still apply to assessments preceding the standardized accounting changes. However, these changes are likely to inhibit the use of the program.

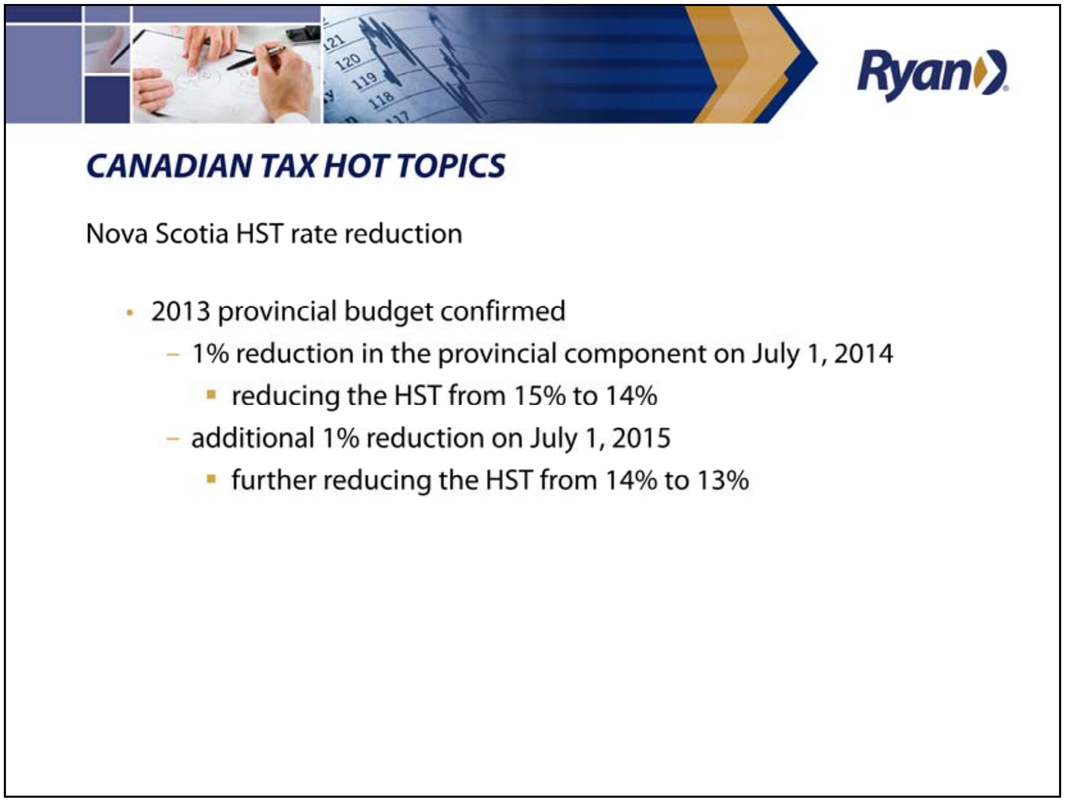
- In the latest version of GST/HST Memorandum 16.3.1, "Reduction of Penalty and Interest in Wash Transaction Situations", the CRA clearly indicates that, where a valid voluntary disclosure involves a wash transaction, the CRA will reduce the interest to 0% of the amount identified as a wash transaction. Where this is the case, only the taxes that should have been collected by the supplier or ITCs not accounted for correctly will be assessed by the CRA.

- In its 2013 provincial budget, the province of Manitoba announced a number of significant tax changes, effective July 1, 2013.

- To assist in funding its infrastructure, the province will increase its retail sales tax rates for a period of ten years, ending June 30, 2023.

- The most significant impact on consumers will be a 1% increase in the general sales tax rate, from 7% to 8%.

- The province, in conjunction with this rate change, has also issued guidance on the transitional rules to be used to determine the correct rate of tax to apply to transactions straddling the effective date of the rate change.
  - The 7% sales tax rate applies to taxable goods purchased before July 1, 2013, including:
    - goods purchased on credit or by deferred payment arrangements where payment is made after June 30, 2013.
    - goods that are fully paid for prior to July 1, 2013, but delivery is taken on or after that date.
  - The 8% sales tax rate applies to goods purchased after June 30, 2013, including goods for which the purchaser has made only a deposit on the purchase.



- In its 2012 provincial budget, the Nova Scotia government announced that, due to its fiscal discipline, it will have a large enough surplus to allow it to reduce the provincial component of the HST in the province by 1% on July 1, 2014 (reducing the HST from 15% to 14%) and then by another 1% on July 1, 2015 (further reducing the HST from 14% to 13%).

- The Nova Scotia government confirmed its intention to reduce the current HST rate of 15% by 1% in each of 2014 and 2015 in the 2013 provincial budget.

- Effective July 1, 2010, large businesses in Ontario and British Columbia were restricted from claiming a full input tax credit ("ITC") on the provincial portion of the HST charged on specific categories of expenses. The restricted expenses are telecommunication services (excluding internet access and 1-800 numbers); meals and entertainment expenses; energy not used to manufacture goods for sale or in farming operations; licensed road vehicles under 3,000 kilograms (and associated parts and certain services); and fuel for licensed road vehicles (restricted in Ontario only). At the time, these ITC recapture requirements were new under the GST/HST legislation and did not apply to HST paid in the initial HST provinces of Nova Scotia, New Brunswick and Newfoundland and Labrador. If the recapture requirement was not confusing enough, as of April 1, 2013, this concept has been eliminated in British Columbia due to the reimplementation of the PST and has commenced in Prince Edward Island when they adopted the HST. These rules are similar to the input tax refund restrictions currently in effect in Québec.

- Areas of potential tax exposures that may result from the requirements to recapture the provincial portion of the HST on restricted expenses include the following:
  - misunderstanding of the term "large business";
  - incorrect application of recapture to telecommunication services;
  - establishing the amount of restricted energy and the use of the production proxy; and
  - The fact that the CRA has only recently commenced auditing for compliance in this area.

- With the elimination of HST in British Columbia, large businesses in the province will no longer have to deal with recapture on specified expenses incurred in the province and paid directly. However, they may continue to be required to calculate recapture on employee reimbursements for restricted expenses related to British Columbia and incurred before April 1, 2013, and on specified expenses incurred in Ontario and Prince Edward Island.

- Without a proper understanding of the term "large business", it is possible for an organization, subject to the ITC recapture requirements, to incorrectly claim full ITCs on restricted expenses.

- A "large business" is defined as a business with annual taxable sales in excess of $10 million in the fiscal year immediately preceding the recapture period (July 1 to June 30), that are made through a Canadian permanent establishment or associated Canadian permanent establishment (including zero-rated sales). Certain financial institutions, not including selected listed financial institutions, and persons associated with certain financial institutions are considered to be large businesses.

- A person or organization is not required to have a permanent establishment in Ontario, British Columbia or Prince Edward Island to qualify as a large business. Therefore, a large business with a permanent establishment outside these participating provinces will be subject to the ITC recapture requirements on expenses incurred in Ontario or British Columbia on or after July 1, 2010.

- It should be noted that public service bodies are not considered to be a large business. Similarly, a person involved in the business of farming, based on the federal *Income Tax Act*, is also excluded from the definition of a large business. A business with annual taxable sales significantly less than $10 million may be considered a large business by virtue of its relationship to an organization with annual taxable sales in excess of $10 million and, therefore, may be subject to the recapture requirements.

- Where a business, qualifying as a large business at the beginning of a recapture period, has annual taxable sales of less than $10 million at a fiscal year end occurring during the recapture period, the business will continue to be considered a large business and subject to ITC recapture until the end of that recapture period.

- Although large businesses must generally recapture ITCs on the provincial component of HST in respect of telecommunication services, they are not restricted from claiming ITCs on the HST paid in respect of internet access services and web-site hosting services.

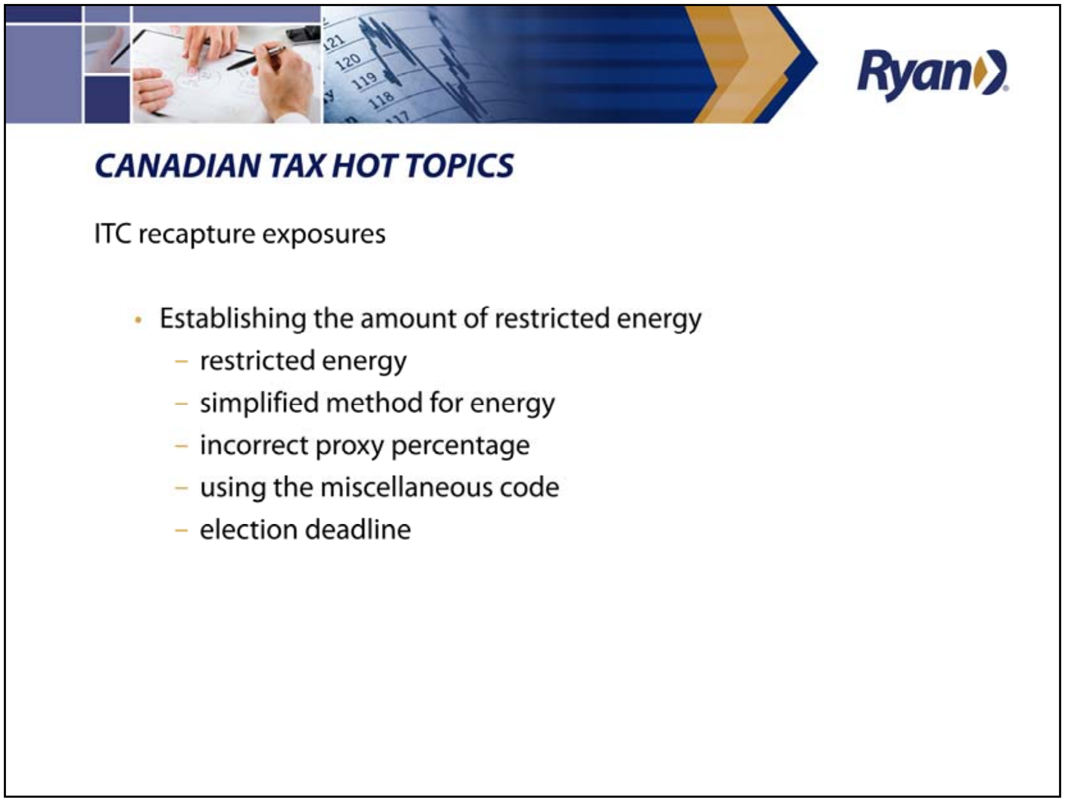
- Telecommunication services that are provided wirelessly and include internet access or access to electronic mail are not considered to be “internet services” and, consequently, are subject to ITC recapture. Common examples of these services include intranet, Blackberry or similar featured services.

- ITCs will be available to all GST/HST registrants for the purchase of a "1-800" toll-free service (which includes the related line rental) as well as optional services such as long distance call routing, overflow routing, interactive voice response and calling number identification.

- The HST paid on the purchase, lease and rental of telephone systems, paging equipment and any associated installation, parts, and repairs for such equipment, are eligible for ITCs even though telephone and telecommunications services acquired by large businesses are generally subject to recapture.

- The purchase of non-telecommunication services, including directory advertising, building surveillance or protection services, news services offered by press agencies, telephone order management services, database access services, services provided through 1-900 lines and directory assistance services, is also not subject to recapture.

- Currently, telecommunication suppliers, as experts in telecommunication services, often indicate on their invoice to customers the recoverable and non-recoverable portions of the QST charged on their services and the portion of HST subject to recapture.

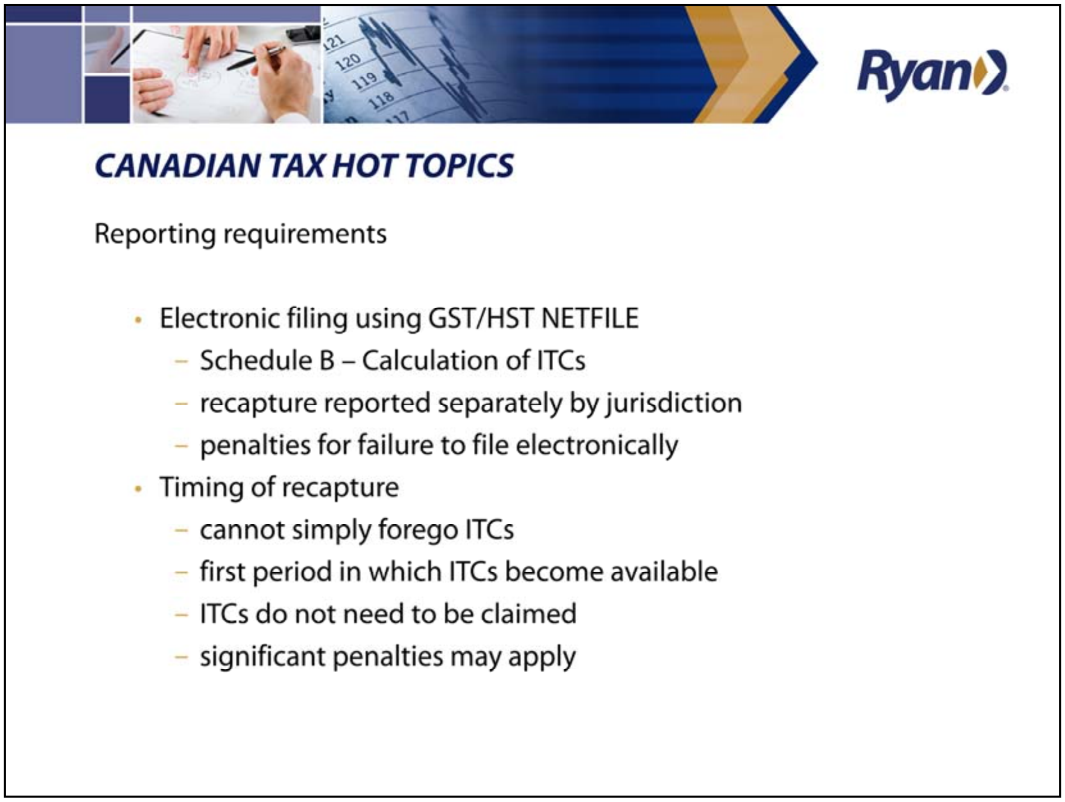


- Large businesses are not eligible to claim ITCs on the provincial component of the HST paid in Ontario, British Columbia (from July 1, 2010 to March 31, 2013) or Prince Edward Island to acquire electricity, gas and steam unless it is used for manufacturing purposes or farming. However, for large businesses that produce tangible personal property for sale, the portion of specified energy that can be attributed directly to the manufacturing process would not be subject to the ITC recapture requirements.

- Where energy is used for dual purposes, it is permissible to have the HST paid on the purchase of this energy apportioned between the different uses. For instance, a manufacturer can separate the costs of energy used in production from the cost of energy used for non-production purposes to make an ITC available on the HST incurred for unrestricted manufacturing purposes. An engineering study may be required to apportion the costs between the restricted and unrestricted uses if separate metering capabilities are unavailable. In many cases, the amount of specified energy used directly in production can be difficult to determine. Therefore, a large business with production activities primarily in Ontario, Prince Edward Island or at least 10% in British Columbia, may elect to use the 'production proxy' as a simplified method to determine the specified energy attributed directly to the production process, if its most significant business activity falls into one of 24 categories based on the North American Industry Classification System for 2007 (NAICS Canada 2007).

- The choice of which production proxy to use should be made carefully so as not to apply a proxy percentage that does not accurately reflect the manufacturing operation of the large business. The assumption should not be made by a large business that it is entitled to use a 30% production proxy under the "miscellaneous manufacturing" code if it is unable to identify its most significant business activity on the NAICS Canada 2007 listing.

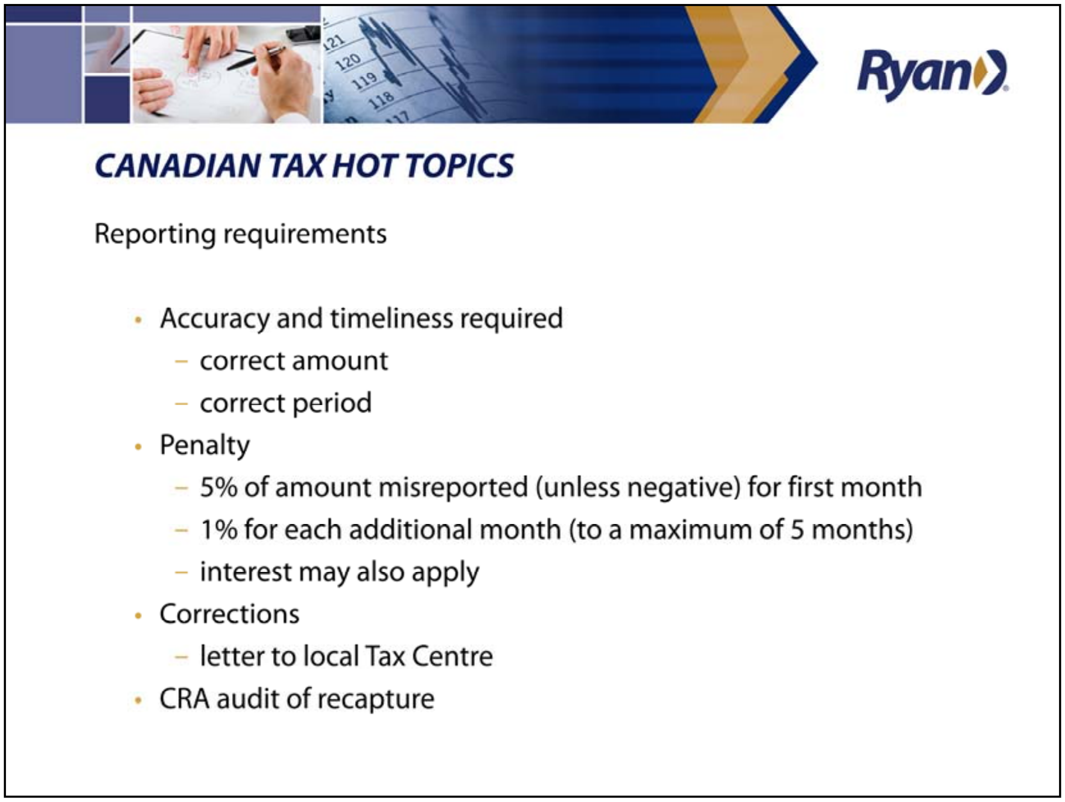
- In order to be entitled to use the production proxy, a large business must generally file an election with the CRA before the due date of the GST/HST return for the first reporting period of a particular recapture period. For the 2013 recapture period, this deadline is August 31, 2013. Large businesses who do not file this election on time may not be entitled to use the proxy method. Therefore, these business would be required to track their actual energy usage. Unlike the telecommunication proxies, the production proxy may not be used without first filing an election with the CRA.



- Registrants who are subject to the RITC requirements are required to file their GST/HST returns electronically using GST/HST NETFILE, and report their gross ITCs on one line, with separate recapture fields to be populated for the provincial component of the HST paid or payable in respect of specified property and services in British Columbia and Ontario. This is accomplished by completing Schedule B – Calculation of ITCs.

- Large businesses should report gross ITCs on Line 1400 of Schedule B, and the required recapture amounts (RITCs) on Line 1401, which consists of two fields: one field for the restricted 7% provincial component of HST in British Columbia; and a second field for the restricted 8% provincial component of HST in Ontario. When the user clicks the "Calculate" button, the electronic return will calculate the net ITCs to be reported on Line 108 of the GST/HST Return by using the information entered in Lines 1400 and 1401 of Schedule B. The justification for this added complexity appears to be the CRA's need to properly allocate GST/HST revenues among the RITC participating provinces. Obviously, these fields have changed with British Columbia's withdrawal as a participating province and Prince Edward Island's adoption of the HST on April 1, 2013. Failure to file an electronic return is subject to a $100 penalty for the first instance, and $250 for each subsequent occurrence.

- A large business cannot simply forego claiming an ITC on the provincial portion of the HST incurred on purchases subject to the RITC requirements, as can be done when dealing with the similar QST input tax refund restrictions. Subject to a few exceptions, a large business is required to recapture the provincial component of the HST paid or payable on specified property or services by jurisdiction (i.e., in British Columbia, Ontario or Prince Edward Island) in the first reporting period in which the ITCs become available, or the following reporting period, provided that the associated ITCs have not been claimed in a preceding period. Furthermore, since there is no requirement for a large business to have first claimed the ITCs, it is possible for a large business to be required to report the recapture associated with available ITCs before they are actually claimed. While net tax might not be assessed against a registrant who fails to report the recaptured portion of input tax credits in this manner, due to the CRA's obligation to audit to net tax, a significant penalty may still be applied for failing to recapture the provincial component of the input tax credits in the correct reporting period.

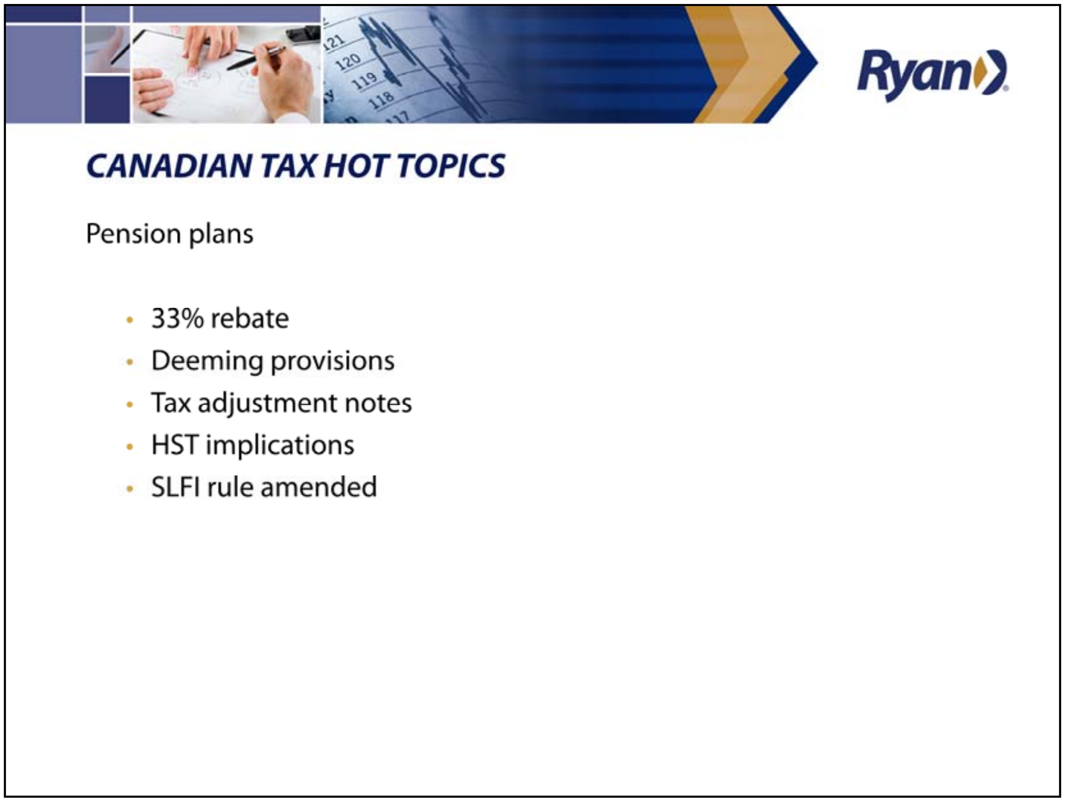


- Recording RITCs accurately for Ontario, British Columbia and Prince Edward Island HST is crucial. The CRA has indicated that where a taxpayer fails to report its recaptured ITCs in the proper period, a penalty may be applied.

- In fact, the Regulations call for a penalty of 5% to be applied to a misreported recapture amount for the period in which the error is made, followed by an additional 1% penalty to be applied for each month that the amount remains misreported, to a maximum of 5 months. In effect, a misreported recapture amount could, within 6 months, be subject to a 10% penalty. Interest may also be applied to any amounts owed to the CRA.

- Where a large business has incorrectly reported its RITCs in a particular period, the CRA requires that a letter be sent to the local Tax Centre requesting an adjustment to its GST/HST Return(s). It should be noted that the filing of the letter to request an adjustment to a recaptured amount may trigger the assessment of the above noted penalty and, more importantly, may prompt the CRA to initiate an audit of the organization, particularly where adjustments to RITCs are relatively common occurrences.

- Taxpayers should be aware that the CRA has only recently started auditing taxpayers on their compliance with the RITC requirement. Our discussions with CRA auditors has led us to believe that most auditors are very knowledgeable about the specific requirements of this concept. Only time will tell whether or not the CRA is able to turn this scheme into a significant audit issue for Canadian businesses.



- Legislation has passed to implement measures that were previously announced in January 2007, September 2009, and some additional measures in respect of pension plan trust expenses. These measures include the replacement of the previous ITC and rebate rules for pension trusts with a single rebate system (i.e., a pension entity will be entitled to claim a rebate equal to 33% of the GST paid or deemed to have been paid) to ensure that pension plan GST relief accrues to pension plan entities.

- These new rules contain three deeming provisions that force employers to make taxable supplies to their pension plans and remit GST/HST related to these deemed supplies. Deemed supplies are required where an employer: consumes goods and services to be used in making supplies to the pension; consumes its own property, labour or resources in making supplies to the pension; and consumes its own resources in the course of pension activities other than making a supply to the pension. This will shift these expenses and any associated GST/HST to the pension, where the pension will be permitted to claim the 33% rebate on the deemed GST/HST.

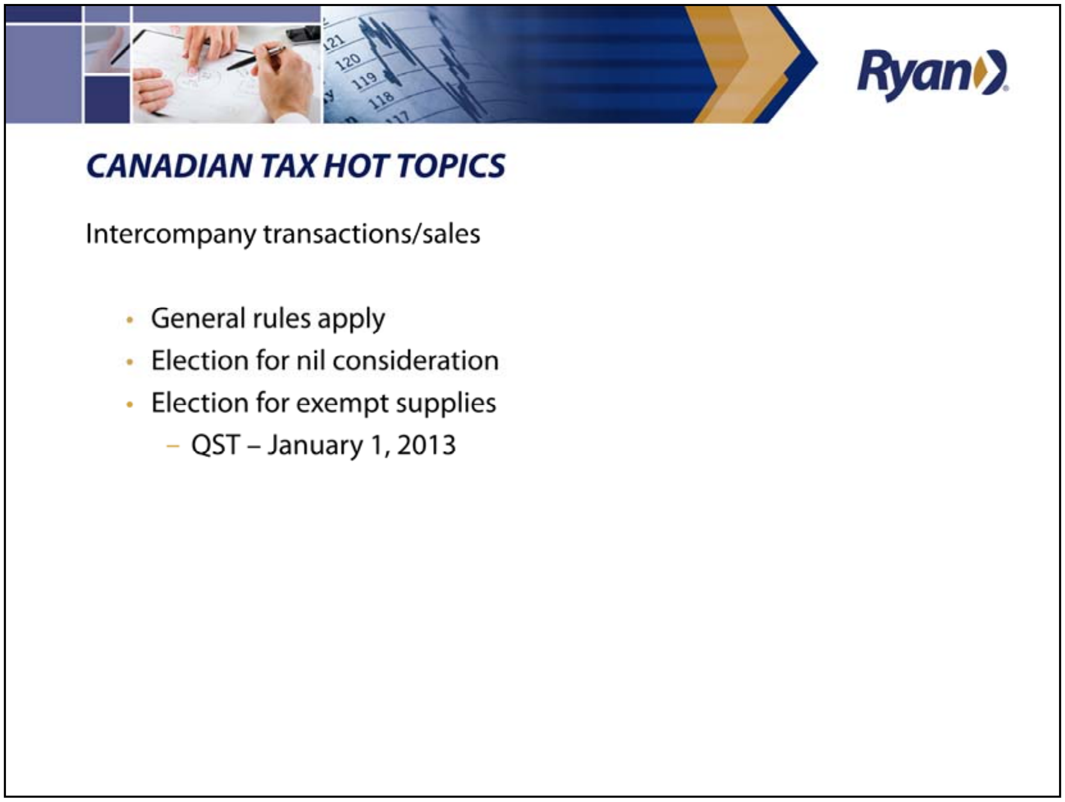
- An employer may issue a tax adjustment note to a pension entity in respect of certain deemed supplies. To avoid double counting in cases where the employer does actually invoice and collect GST/HST on a supply to the plan, the legislation provides for a tax adjustment note to be issued to cancel out the duplicate remittance of tax.

- In addition, pension plan transitional rules for the HST that came into effect on July 1, 2010 in Ontario and British Columbia and on April 1, 2013 in Prince Edward Island are now in place. Transitional rules have also been created to address British Columbia's exit from the HST system. Further, the rules for SLFIs have been amended and a pension will be considered an SLFI where its members are located in both a participating and at least one other province. This may place new reporting and tax calculation requirements on pensions.

- Many taxpayers and tax practitioners have struggled with these rules as they are hard to interpret and quite complex. In addition, the logic behind many of the requirements is not always clear. It should also be noted that some of these rules remain in draft format as they have not received Royal Assent. Despite this fact, compliance with these rules is still required and it can be difficult to understand which rules are actually to be followed.

- The recent sales tax changes that have occurred in British Columbia and Prince Edward Island have impacted the complex calculations required by organizations affected by these new pension plan rules, making them even more complicated. This is due to the fact that any calculations for activity in British Columbia will have to be prorated for the number of days in 2013 where it was a participating province (prior to April 1, 2013). Similarly, calculations for activity in Prince Edward Island will have to be prorated for the number of days in 2013 where it is a participating province (after March 31, 2013).

- Recognizing the complexities of the deemed supply rules, which often require the remittance of tax twice on some transactions, the 2013 budget is proposing the following two simplification measures. First, a participating employer that accounts for and remits tax on a deemed taxable supply will be permitted to jointly elect with a pension entity of its registered pension plan to treat an actual taxable supply as if it were made for no consideration. Second, employers may be entitled to full or partial relief from accounting for tax on deemed taxable supplies where the employer's activities in relation to a registered pension plan fall below certain thresholds. This relief would be available where the amount of GST (including the federal component of the HST) that the employer was (or would have been, except for this relief) required to account for and remit under those rules in its preceding fiscal year is less than $5,000 and 10% of the total net GST (and federal component of HST) paid by all pension entities of the pension plan in that preceding fiscal year.

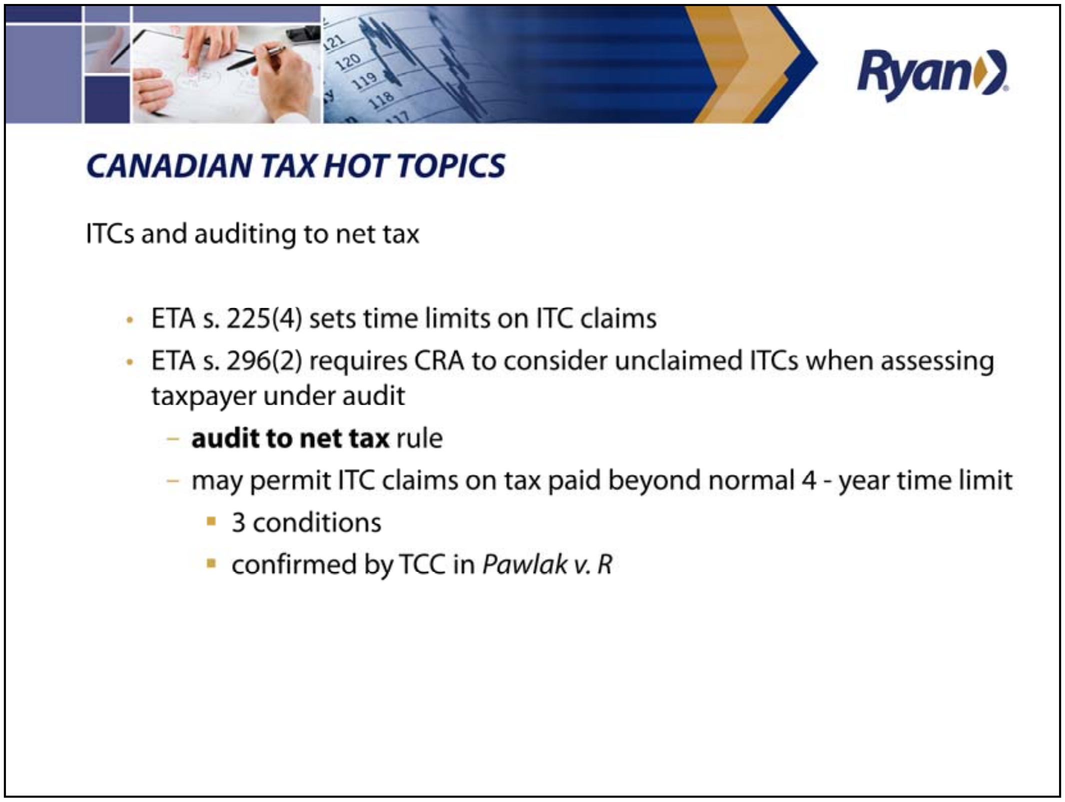


- Intercompany sales are treated the same as sales made to third parties, and are subject to tax if the goods or services are taxable. It is important to note that previously exempt costs may lose their exempt status (i.e., become taxable) when resupplied by a registrant to a separate legal entity. For example, employee wages, property taxes and insurance may be exempt when incurred by a parent company, but if a portion of these costs is billed to a subsidiary, the resupply will generally become taxable (at 5%, 13%, 14%, 15% or 9.975%) where the parent company is a GST/HST and/or QST registrant and the supply is made in Canada/Quebec.

- The CRA will assess registrants for tax not collected in these circumstances, plus interest, even though the recipient may be eligible for ITCs or partial rebates. If the recipient is eligible for full ITCs, the application of the CRA "wash transaction" policy may reduce the interest to a flat 4%. Note that the administration of penalties and interest provisions changed effective April 1, 2007. Full details concerning how wash transactions will be treated after that date have been recently released by the CRA. Quebec will also apply "wash transaction" relief where these same circumstances exist for QST purposes.

- An election for nil consideration is available between closely-related Canadian companies and partnerships resident in Canada engaged exclusively in commercial activity to relieve intercompany transactions from tax by deeming the supply to have been made for "nil consideration". This election is not required to be filed with the CRA, but must be completed and retained for inspection on audit. An Act respecting the Quebec sales tax ("QSTA") has a similar election; in order to make this election, each party to the election must be a resident of Québec.

- A similar election, one for exempt supplies, is available for members of a closely-related group, one of which is a listed financial institution. This election must be filed with the CRA. An election for exempt supplies is now available for QST purposes, effective January 1, 2013. This election became necessary due to the further harmonization of the QST with the GST that took effect on the same day, which made financial services exempt, rather than zero-rated supplies. Prior to this date, this election was not necessary for QST purposes.



- Under section 225(4) of the *Excise Tax Act* ("ETA"), for persons other than specified persons, the time limit for claims for ITCs is generally four years — the claim must be made at the latest in the return for the period that ends within four years of the period when the tax was payable. For specified persons, the claim for ITCs must be made in the return for the last period that ends within two years of the end of the fiscal year that includes the period when the tax was payable. A person is a specified person if it is a listed financial institution, other than a corporation deemed to be a financial institution by virtue of an election for GST-exempt supplies between closely related corporations and includes a person whose threshold amounts, for each of the fiscal year that includes the period the tax was payable and the previous fiscal year, exceed $6 million.

- If the Minister determines in assessing net tax or an overdue amount, as the case may be, that a person is entitled to an unclaimed ITC, deduction, refund, or rebate to which the person would have been entitled if the amount was claimed in the return, if timely filed, for the period, the Minister must take the allowable amount into account in the assessment for the particular reporting period. This requirement provided under section 296(2) of the ETA — often referred to as **auditing to net tax** — applies even where the time limit for claiming the amount had expired before the day the notice of assessment is mailed to the taxpayer for that period.

- The missed ITCs should be taken into account by the CRA, provided: (1) there is an "allowable credit" had it been claimed on a GST return and supported by proper documentation; (2) the "allowable credit" has not been claimed; and (3) the "allowable credit" would be allowed if it were to be claimed now, or, if not, it is only being denied because the period for claiming the ITC has expired. Recently (in 2012), the Tax Court of Canada ("TCC") has confirmed the application of this provision when making a decision in the *Pawlak v. R.* case.

- In an effort to recover lost revenue and ensure all taxpayers pay their fair share of income tax and consumption taxes, Quebec has announced a commitment to increase prevention and carry out more tax audits. In addition, they will review the legislative framework applicable to aggressive tax planning and establish the means to prevent such practices.

- Resources will be allocated to Revenue Quebec on a cost-benefit basis and clear tax recovery targets will be established to measure the increased auditing efforts. Several budget announcements noted that they anticipate stepped up audit activities and efforts to stem tax avoidance to result in increased revenues of $600 million for 2012-2013 and $900 million for 2013-2014.

- In order to meet these tax recovery targets, the QST auditor is beginning to resort to the use of some very aggressive tactics during an audit that can lead to substantial assessments for taxpayers. As a result, some audit procedures that are typically reserved for taxpayers that are evading tax are now being applied to organizations that would not be considered to be evading taxes.

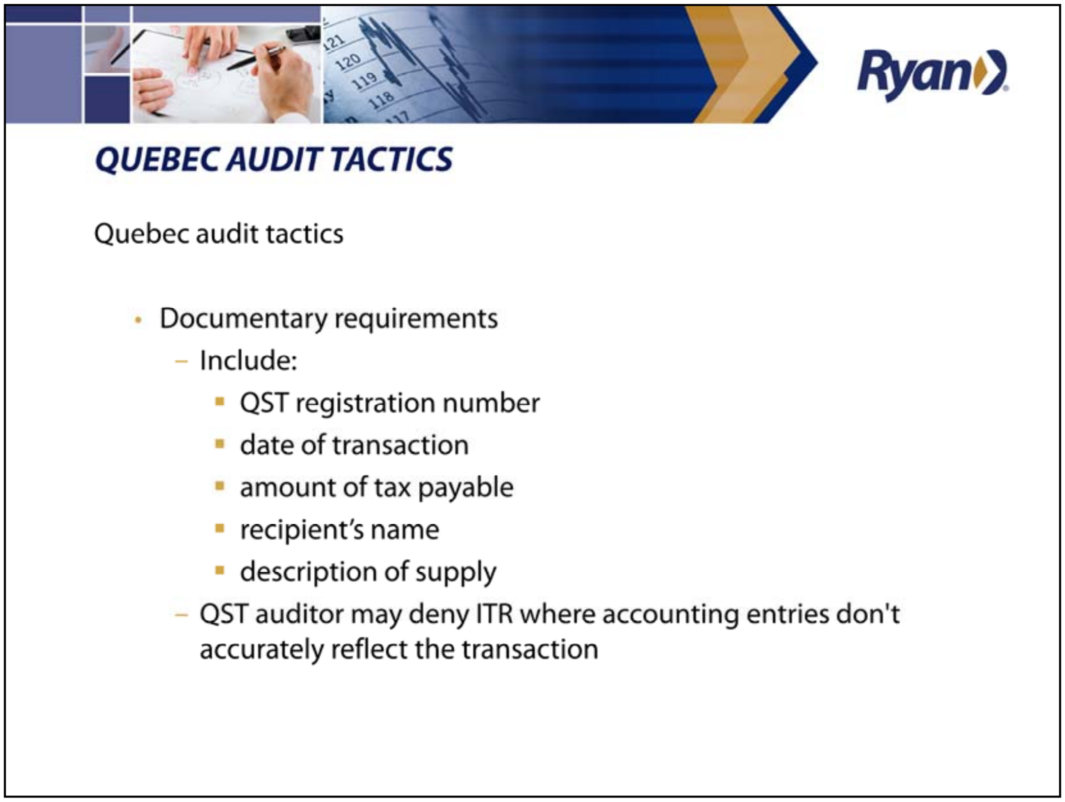
- Organizations who want to recover tax paid must be able to show that tax was paid to a registrant. A person is, therefore, required to obtain certain supporting documentation from the supplier to support their right to claim an input tax refund (“ITR”) or a rebate.

- The fact that tax is collected and remitted on sales does not automatically provide a person with the right to claim ITRs for tax paid. Before filing a claim, organizations must address a number of issues prior to recovering the tax to avoid the possibility of the recovery being denied during the course of an audit.

- Firstly, only the recipient of a supply is permitted to recover the tax. The recipient of a supply is generally the person who has the legal obligation to pay for the goods or services (usually indicated as the “bill to” on an invoice). The legislation allows that the name on the invoice may be either the recipients legal name or its trade name.

- Let’s consider the following situation where the legal name of the business is Able Manufacturing Canada Limited. As we know, invoices for purchases by this business may state the name in the “bill to” section of the invoice as follows:
    - Able
    - Able Manufacturing
    - Able Manufacturing Canada
    - Able Manufacturing Canada Inc.

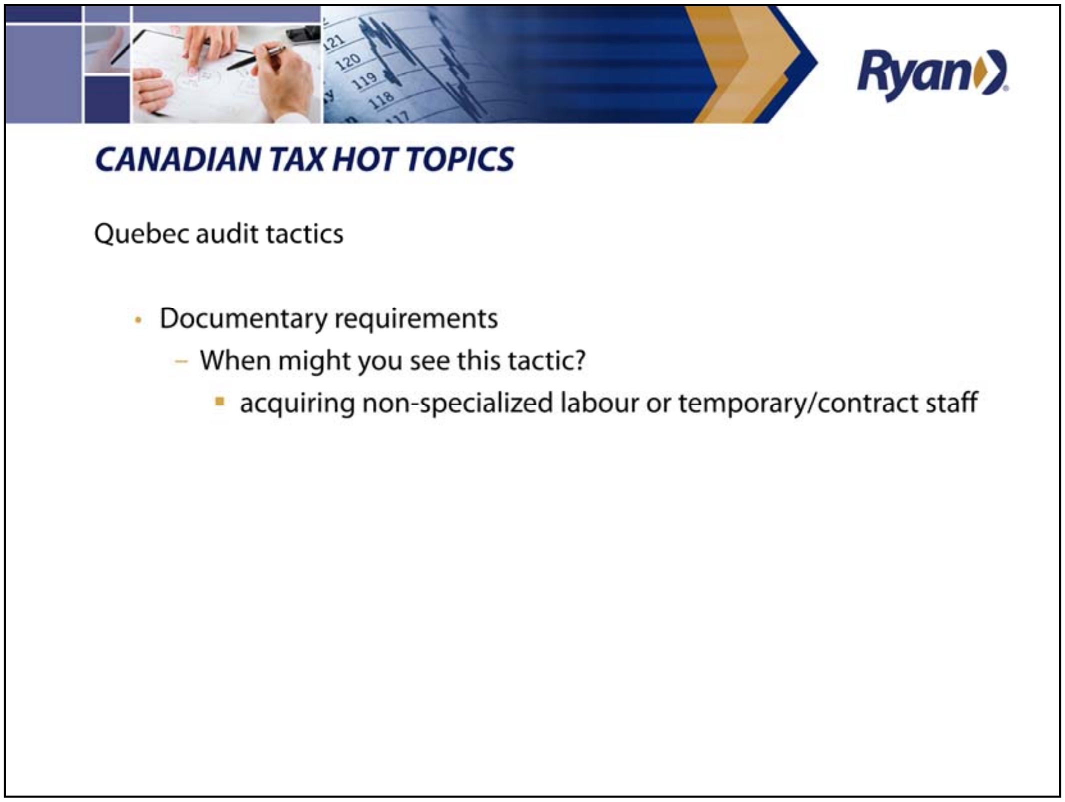
- The QST auditor may now only allow ITRs on invoices in name of Able Manufacturing Canada Limited, which is the name that the business is registered under with the Inspecteur General des Institutions Financieres. ITRs are denied under other names as the auditor claims that the corporation name is not registered or that they are in fact doing business under another name.



- Organizations who want to recover tax paid must be able to show that tax was paid to a registrant. A person is, therefore, required to obtain certain supporting documentation from the supplier to support their right to claim an ITR or a rebate.

- For purchases over $30, registrants are generally required to obtain, among other things, the QST registration number of the supplier and the amount of tax paid on the invoice, or an indicator that the price is "QST-included" at a rate of 9.975%. In addition, the name of the supplier is required for purposes of verifying that QST is being charged by a registrant and an invoice date is used to determine the time period within which an ITR may be claimed to recover the tax paid. Finally, a description of the property or service being supplied is also required to ensure that ITRs are claimed on eligible expenses only (excludes club memberships, items for the exclusive personal use of an employee, and ITR restricted items) and also for determining whether tax was properly charged on the supply.

- It is now not unusual for a QST auditor to take a very strict approach to ensure that the taxpayer has all the prescribed information on hand prior to claiming an ITR. In addition, they may also review the accounting entries to ensure that they properly reflect the transaction. Where the auditor asserts that the accounting entries do not reflect the nature of the transaction, they will deny the ITR. This tactic is questionable given that the legislation does not contemplate that a recipient has to meet this additional burden in order to claim an ITR.



- When might you see this assertion by a QST auditor that the accounting entries do not reflect the nature of the transaction and, therefore, they will deny the ITR claim on the underlying invoices?

- It is possible to see this where a business, typically a manufacturer or distributor, requires some non-specialized or temporary labour on short notice. This labour will often be sourced from a temporary agency that is registered for QST purposes. The agency bills the manufacturer or distributor for the time worked by the temporary staff, typically at rates that are close to the minimum wage.

- The QST auditor may deny the ITR claims on the agency's invoices to the recipient for the following reasons:
  - actual supplier (the temporary worker) has no office, no facilities;
  - poor information on the invoice and no description of service provided – only name of worker, hours worked and wage rate appear on the invoice;
  - hourly rate paid for worker suspiciously low; and
  - employees of supplier do not look legitimate.

- Generally, in situations similar to that noted above, the QST auditor will simply state the ITR is being denied on the basis that the documentation does not represent the true legal transaction. They may even assert that the supplier did not actually provide a service to the recipient.

- Word has it that this is a tactic that front-line auditors have been directed to use. If the auditor insists on assessing your organization on such transactions, you may wish to speak to their superior, as the auditor's hands could be tied, but discretion may be available at a higher level.

- The QST rate increased three times from January 1, 2011 to January 1, 2013. Quebec auditors will likely review transactions near the rate change dates to detect any under remittance of tax on sales or over-recovery of tax on purchases. Some potential sales tax exposure areas resulting from the QST rate change may include:

  - failure to charge the new rate where the supply is made in a period with at a lower rate, but the supply is not invoiced until the rate increased and the customer did not make a prepayment on the purchase in the first period;
  - employee expense reports (when Large Business Simplified Factor is in use):
    - large businesses can claim ITRs using a Large Business Simplified factor, however, this factor has changed twice during this time period and over-recovery exposures can be created where a new factor was applied to an expense incurred in an earlier period.

  - on full or partial refunds or price adjustments that occur after the QST rate increased on purchases made prior to the change, where QST is included in the refund, the refunded tax must be calculated using the QST rate originally charged, despite any taxpayer POS system limitation that may exist; and

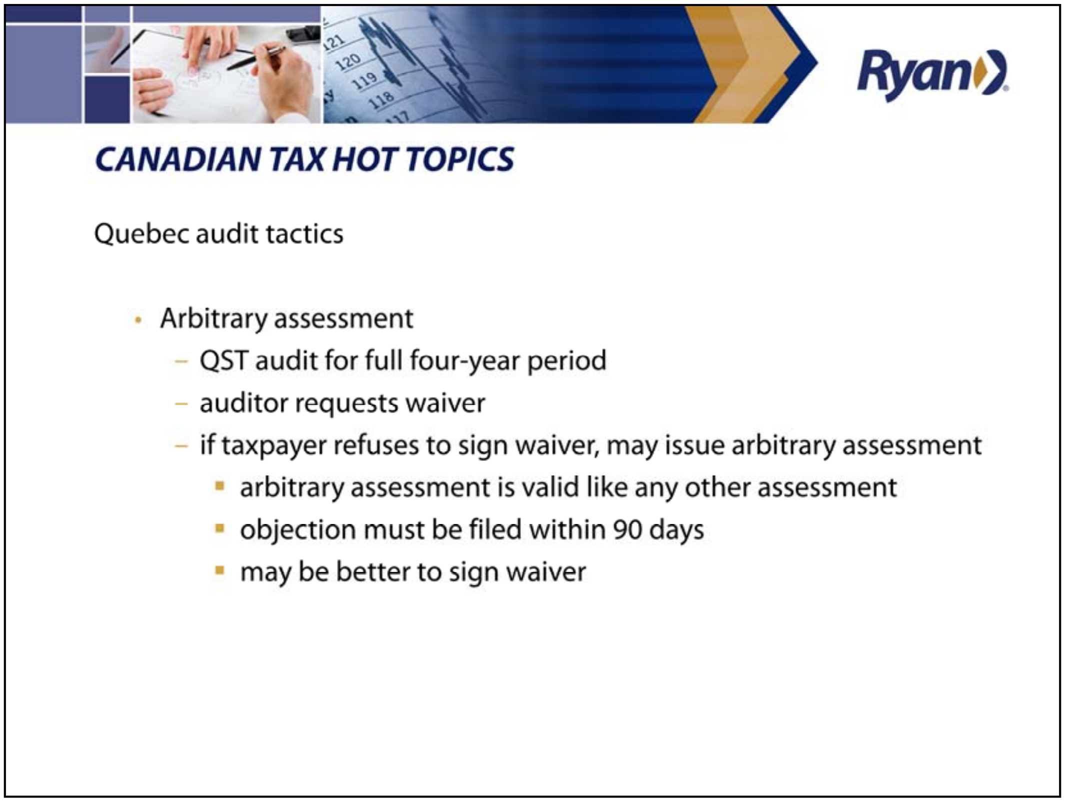
  - QST auditors will be searching for ITRs claimed at a higher (i.e., wrong) QST rate where the supplier only collected QST at the previous lower rate.

- Where agency exists in a transaction, it is the principal who is required to collect and remit tax on the supply and is eligible to claim ITRs for QST paid on expenses incurred in relation to the supply to the extent they are incurred in the course of commercial activities. The agent is simply an extension of the principal.

- A distinction must be made between expenses incurred by the agent in the performance of its duties as an agent and expenses incurred by the agent on behalf of the principal. As a general rule, the QST auditor will deny ITRs to the agent.

- In addition, on expenses where the agent incurs and pays for expenses on behalf of the principal, the auditor may deny the principal ITRs. The reason for this ITR denial is that there may not be an agency agreement in place between the agent and principal. However, it is important to note that the legislation does not require that an agency agreement be in place in order for the agency relationship to be established. It truly is a question of fact in determining whether or not agency exists. It is simply not good enough to deny an ITR to the principal simply because an agency agreement has not been entered into between the agent and principal.

- This issue is being raised often by QST auditors on transactions between related parties where the transactions are often handled by journal entries and where there is often no formal agreement in place between the related parties.



- In situations where the QST auditor is about to commence an audit with a taxpayer that is for the full four-year audit period, the auditor may request that the taxpayer provide them with a waiver to protect items at the end of the audit period from becoming statute-barred. If the taxpayer refuses to sign a waiver, the QST auditor may then threaten the taxpayer with an arbitrary assessment. This arbitrary assessment will be based on the auditor's judgment for what they believe to be an estimate of the tax related to transactions that will become statute-barred during the audit.

- When the arbitrary assessment is issued to the taxpayer, the QST auditor will often indicate that it will be taken into account when the final assessment is issued at the completion of the audit.

- It is important to note that any assessment, even an arbitrary assessment, is a valid assessment, and if it is to be contested by the taxpayer, it must be done within the required time limits. Currently, if one is to object to an assessment for QST purposes, it must be done within 90 days of the date of the assessment. This does not leave much time to object to an arbitrary assessment and it is unlikely that the audit will be completed within the 90-day time period. This situation is dangerous and potentially costly for a taxpayer where the arbitrary assessment is not taken into account when the final assessment is raised on an audit taking longer than 90 days to complete. Since the audit took longer than 90 days to complete, the time limits in place for objecting to the arbitrary assessment will have expired, leaving no opportunity for the taxpayer to reverse the arbitrary assessment. The taxpayer may then be on the hook for both the final assessment and the arbitrary assessment.

- Under these circumstances, it may be in the taxpayer's best interests to sign a waiver rather than taking the risk that the arbitrary assessment is not taken into consideration when the final assessment is raised by the auditor.

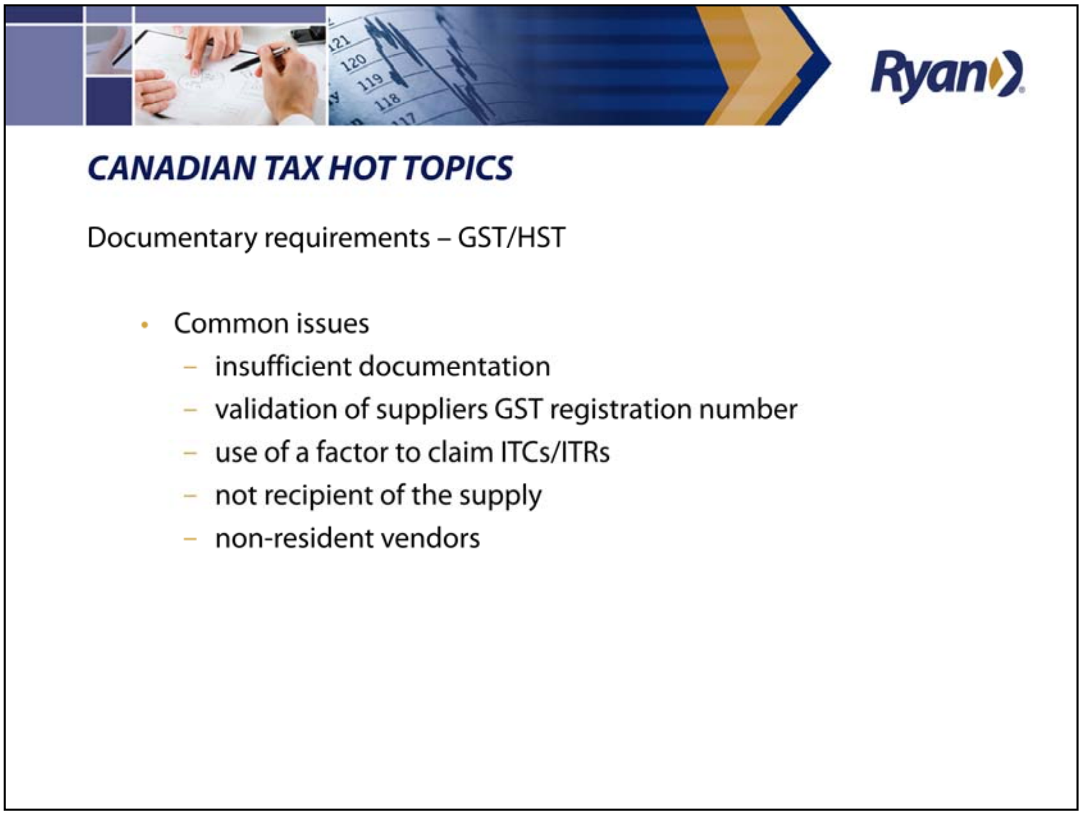
- In order that tax not be incorporated into the cost of goods or services under a value-added tax system, registrants involved in commercial activities are generally permitted to recover tax paid by way of an ITC in respect of expenses relating to their commercial activities, subject to certain conditions.

- The fact that tax is collected and remitted on sales does not automatically provide a person with the right to claim ITCs for tax paid. Before filing a claim, organizations must address a number of issues prior to recovering the tax to avoid the possibility of the recovery being denied during the course of an audit.

- Firstly, only the recipient of a supply is permitted to recover the tax. The recipient of a supply is generally the person who has the legal obligation to pay for the goods or services (usually indicated as the "bill to" on an invoice). In addition, the goods or services supplied to the recipient must have been acquired for consumption, use or supply in a commercial activity carried on by the recipient.

- Organizations who want to recover tax paid must be able to show that tax was paid to a registrant. A person is therefore required to obtain certain supporting documentation from the supplier to support their right to claim an ITC.

- Where all of the required information is not obtained prior to claiming an ITC, an organization's claim could be denied and they could be subject to interest during the course of an audit.



- Some of the most significant audit assessments relate specifically to a person's failure to obtain sufficient documentation prior to claiming an ITC on taxable purchases used to provide taxable goods and services. This may be as simple as not having the supplier's GST registration number on hand prior to claiming the credit, or can involve issues relating to who is the true recipient of the supply.

- Under the CRA's current policies, it is the purchaser's responsibility to validate the registration number of a supplier for purposes of establishing an entitlement to an ITC. GST/HST registration numbers may be confirmed on the GST/HST Registry web page located on the CRA's web site.

- Unless tax is charged by a registrant, and the appropriate documentation is obtained, ITCs cannot be claimed. An organization should never assume an invoice includes tax and calculate an ITC at 5/105 (or 13/113, 14/114, or 15/115 for HST) unless the appropriate documentation is available. If tax is not paid to a registrant, an organization is not generally eligible to recover the tax.

- ITCs are often claimed by the wrong entity within a closely-related group of registered taxpayers (e.g., where the supplier has invoiced the wrong party). Note that assessments may be limited to the wash transaction interest rate of 4% if each of the parties involved is entitled to a full ITC in any case.

- Exposures occur where taxes are claimed on invoices from non-registrants, as well as from registrants whose transactions are poorly documented. Non-resident vendors, in particular, are not always familiar with Canadian rules and regulations. Even if they are registered, they may not provide sufficient documentation to support a recipient's claim for ITCs .


Ryan
Innovative Solutions to Taxing Problems.
Canadian Tax Hot Topics
Payroll Tax
Kerry Thomas, CGA
Director, Payroll Tax Services
www.ryanco.ca

CANADIAN TAX HOT TOPICS

Payroll taxes

- Federal
  - Canada Pension Plan (“CPP”) contributions
  - Employment Insurance (“EI”) premiums
  - Income Tax on employment earnings
- Provincial
  - Workers’ compensation premiums (WSIB/WCB/CSST)
  - Health taxes
  - Employer contributions to work-related funds (Quebec)

- Federal payroll taxes are administered by the Canada Revenue Agency (“CRA”).

- Provincial payroll taxes are administered by provincial taxing authorities, e.g. Revenu Quebec for the province of Quebec.

Ryan

CANADIAN TAX HOT TOPICS

Payroll tax obligations

- Registration
  - "employer" (statutory definition)
- Reporting
  - annual statements of employment earnings
- Remitting (withholdings and self-assessments)
  - penalties

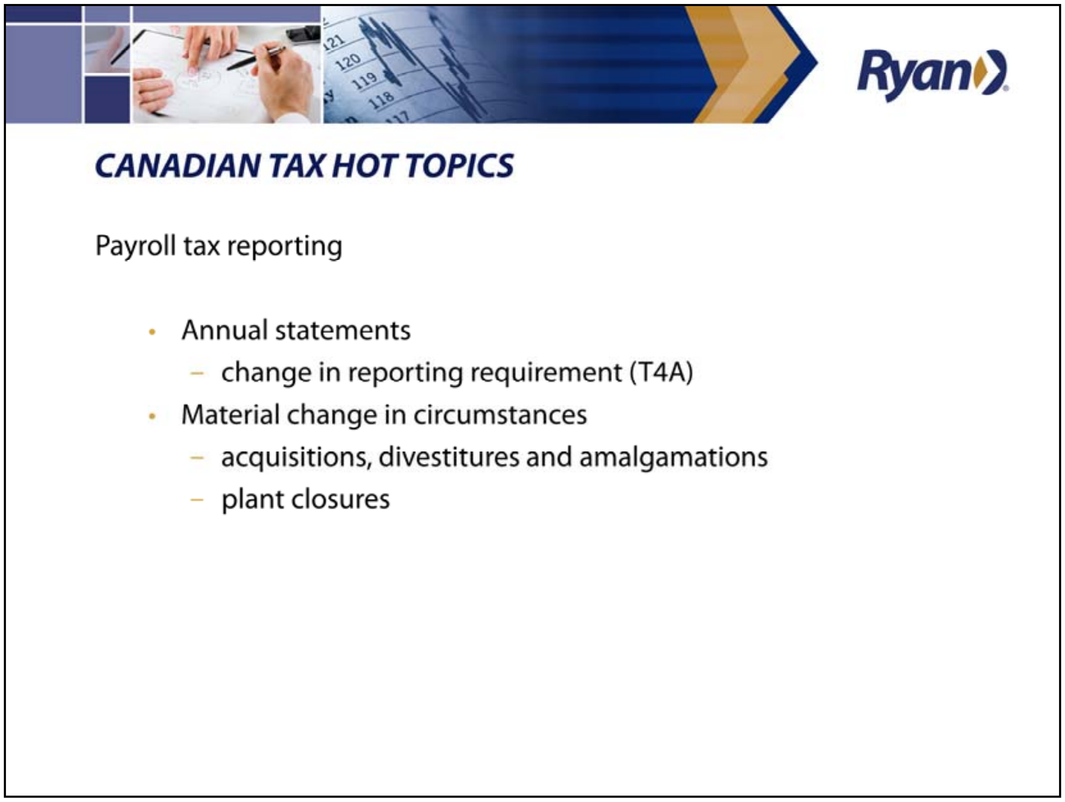
- "Employer" status is generally determined by the existence of a contract of service. However, a statute may provide for an extended meaning, e.g. a payer of remuneration.

- Registration for WSIB/WCB/CCST purposes may not be compulsory.

- Annual return for Federal payroll taxes is the T4 Summary and for Quebec payroll taxes the RL-1 Summary. The RL-1 Summary must be signed and submitted by the employer in paper form.

- The absence of a "permanent establishment" in Canada is not a sufficient condition for exemption from Canadian payroll taxes

- The location of an employee's regular place of employment, i.e., workplace, determines which province provides workers' compensation coverage.



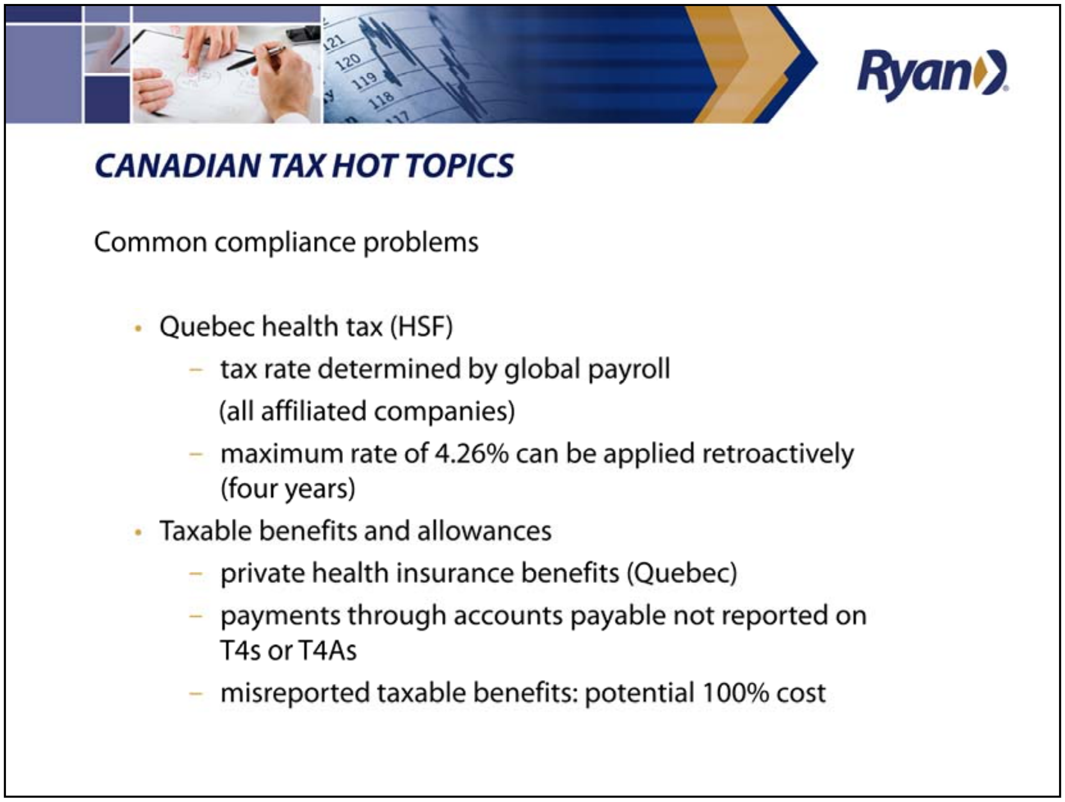
- CRA changed the prescribed form T4A to require reporting of payments of fees for services, starting in 2011. This means that payments of fees to service contractors must now be reported through the payer's CRA Payroll Account.

- Material changes in circumstances are significant events which may affect an employer's payroll tax obligations, e.g., the closure of a manufacturing plant may affect an employer's workers' compensation premiums/assessments and its provincial health taxes (if the plant is its only permanent establishment in a province).

- CRA imposes a penalty of 10% (or 20%) on amounts not withheld and/or not remitted. Revenu Quebec imposes a penalty of 15%.

- Payer is liable to pay as tax the amount that should have been withheld on payments with respect to employment services provided in Canada by a non-resident employee.

- A non-resident corporation may be the employer or co-employer (i.e. joint employer) of an individual who is on the payroll of a resident corporation, i.e., the resident corporation may be merely the employer of record (payment agent).



- CRA performs Employer Compliance Audits, with a focus on the reporting of taxable employee benefits and payments to service contractors.

- The cost to an employer of correcting a misreported taxable benefit, i.e. ,an unreported or under-valued benefit, can be as much as 100% of the value of that benefit: if an employer applies a ”make whole” approach , paying the affected employees’ income tax re-assessments (a taxable benefit in itself), plus related income tax on the corrective payments (grossed-up amounts) , it would be required to pay related provincial payroll taxes, resulting in a total cost of correction which could equal the taxable value of the benefit.

- Reference – CRA publication T4130, *Employer’s Guide – Taxable Benefits and Allowances.*

Canadian Tax Hot Topics

Property Tax
John Havrilchak, J.D. LL.M.
Manager, Property Tax

www.ryanco.ca

AGENDA – PROPERTY TAX

Contents

- Property Taxation in Canada
- Filing Property Appeals & Municipal Tax Rebates
- Current Issues Affecting Assessments & Taxation

CANADIAN TAX HOT TOPICS

Property taxation in Canada

- All properties in Canada are assessed using either one, or a combination of the three approaches to arrive at market value:
  - income approach
  - cost approach
  - sales approach
- Principals of property assessment
  - assessments should be what the property will command in terms of money in the open market.
  - taxpayer should not be taxed on the non-productive features of a building.
  - assessment should be the lesser of its actual value or its fair and equitable value.
  - market value requires that there must be more than one potential purchaser in the market.

CANADIAN TAX HOT TOPICS

Filing property appeals & municipal tax rebates

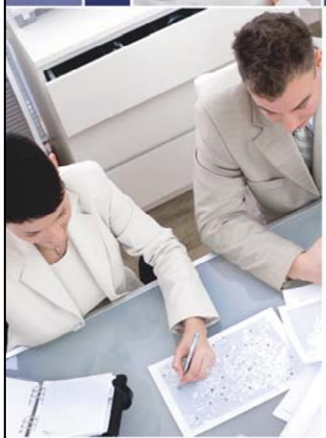
- Property Assessment Appeals
  - every province in Canada has their own legislation and regulations, which includes appeal deadlines and policies
  - your property should be assessed at either the correct market value or at the same value as similar properties in the vicinity, whichever is the lower of the two amounts.
  - if the value is not fair and equitable you have the right to file an Appeal/Request for Reconsideration.
- Municipal Tax Rebates
  - available in Ontario, properties that are vacant, or undergo renovations or demolition, for 90 consecutive days or more, are eligible for a 35% rebate of taxes.

CANADIAN TAX HOT TOPICS

Current issues affecting assessments & taxation

- Preparing the Ontario MPAC Income and Expense Request Form
  - is it mandatory?
- Penalties for failing to answer pursuant to the *Ontario Assessment Act,* s.40(18)
  - *can I still pursue a tax appeal?*


WHAT IS IT?
AN ASSESSMENT. APPARENTLY WE'RE NOW WATERFRONT PROPERTY...
THIS END UP
FRAGILE
CANADA POST



QUESTIONS AND ANSWERS