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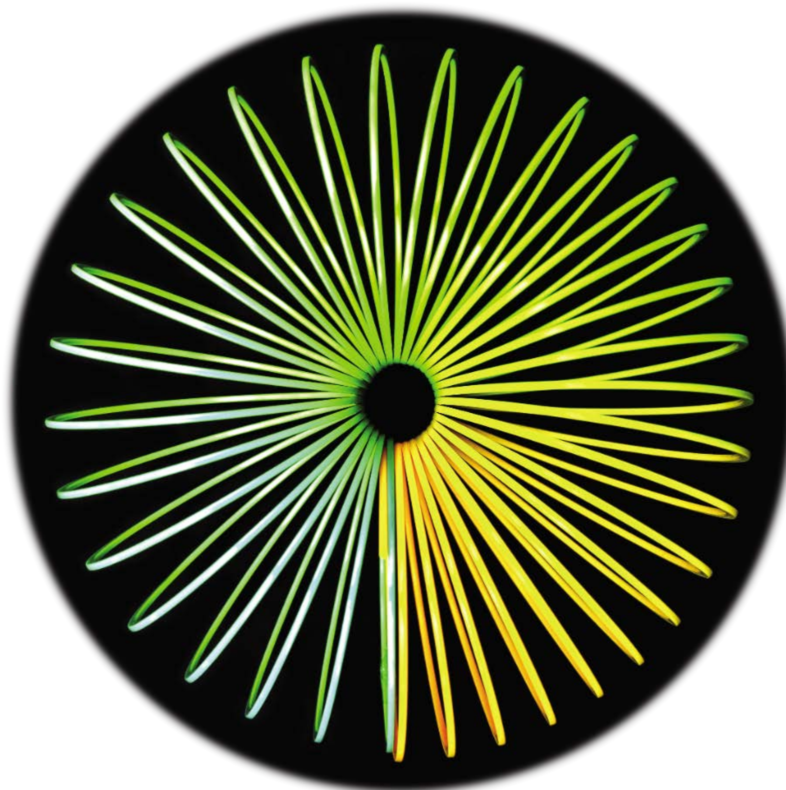

Canadian indirect tax news

Draft GST/HST legislative proposals for drop-shipment rules, RESPs, public sector changes and pensions

October 10, 2017

On September 8, 2017, the Department of Finance (Finance) released draft goods and services tax/harmonized sales tax (GST/HST) legislative proposals and explanatory notes, including proposals previously announced on July 22, 2016. In a series of two newsletters, we highlight the most significant changes. This newsletter covers the drop-shipment rules, registered education savings plans (RESPs), public sector changes and pensions. A second newsletter covers investment limited partnerships.

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Modernization of the drop-shipment rules

As we indicated in our September 6, 2016 edition of Canadian indirect tax news, the legislative and regulatory proposals released on July 22, 2016 aimed at modernizing the drop-shipment rules in section 179 of the Excise Tax Act (ETA). The proposals included the following:

- the modernization, rewriting and renumbering of section 179, with the aim of addressing certain legislative drafting inaccuracies that had been identified over time;
- the introduction of new certificate of registered owner. This new certificate allows non-resident companies party to complex chains of transactions involving goods located in Canada to benefit from GST/HST relief in cases that were not covered by the existing rules; and
- the addition of new provisions to include several leasing scenarios within the drop-shipment mechanism.

When these proposed changes were first published on July 22, 2016, they were proposed to be applicable either as of the date of the publication, with limited retroactivity for certain transactions, or as of the date of Royal Assent (mostly for the rules regarding the leasing scenarios).

The September 8, 2017 proposals do not fundamentally differ from those released in July 2016. However, they provide for retroactive application of the new certificate of registered owner in the case of supplies made before July 23, 2016 in respect of which no GST/HST was charged, collected or remitted. This is a welcome amendment that is meant to cure an unintended problem with respect to the use of the drop-shipment provisions in complex supply chain scenarios - one that has existed since the inception of the GST/HST. A literal interpretation of the drop-shipment rules could require the Canadian supplier to charge a tax to its non-resident customer, creating an unrecoverable tax cost for the non-resident. Not allowing for some retroactivity on this amendment would have left the taxpayers defenseless against potential assessment that would have been contrary to Finance's policy intention.

RESPs – adjustments to July 22, 2016 announcements

Effective July 22, 2016, group RESP trusts are included in the definition of investment plans. This requires them to follow the compliance requirements applicable to selected listed financial institutions (SLFIs), under which the net GST/HST rate is governed by the subscriber distribution, based on their province of residence and a proportional GST/HST rate calculation. RESP trusts could apply for this status on a retroactive basis under certain circumstances (back to July 1, 2010, when the SLFI rules were significantly amended). However, the previous announcement only permitted a retroactive correction for RESP trusts that had registered and reported as if they were SLFIs, despite the original 2010 legislative exclusion for RESPs. If the RESP manager had historically reported tax accordingly, but the RESP trust had not done so, there was no ability for the RESP to avail itself of this retroactive correction to their compliance. The September 8, 2017 proposals now permit RESP trusts to register and file retroactively (effective as early as July 1, 2010, if applicable). The trusts will have until six months after Royal Assent of the amending

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legislation to file a retroactive registration application and prior period returns. Consequentially, the Canada Revenue Agency (CRA) audit period has been extended past the normal four year statute of limitations after such historical returns are submitted.

Public sector changes - New transit rules

Prior to July 22, 2016, the exemption for municipal transit services was very narrow:

> A supply made to a member of the public of a municipal transit service or of a public passenger transportation service designated by the Minister to be a municipal transit service [is exempt].

Consequently, any municipal transit services supplied to anyone who was not a "member of the public" was taxable. A member of the public was not defined, with the result that the ordinary, everyday use of this phrase was used to interpret its meaning as an individual. As such, only supplies to individuals were exempt under this provision. In addition, as the exemption specifically referred to a municipal transit service, any intangible rights associated with the supply of transit (such as the sale of passes that are not prepaid) were also excluded from the exemption and were taxable.

The main impact of the narrow scope of the exemption was to effectively exclude transit services provided to non-individuals, such as subway tokens sold in bulk to corporations, UPasses sold to colleges and universities, and rights given by one transit authority to allow another's residents to use the system. With no other applicable exemptions available, GST/HST should have been collected on consideration for these supplies. However, most transit authorities operated as if the exemption did cover supplies to non-individuals and supplies of intangible property. Notwithstanding, little or no enforcement action appears to have been taken by the CRA. Amendments introduced on July 22, 2016 and subsequently rereleased on September 8, 2017, for supplies made after July 22, 2016, seek to "clarify" the imposition of tax on transit services.

As a result of these clarifications, the limitations concerning supplies to members of the public and for intangible rights have been removed and the exemption broadened considerably. The intention would appear to be to exempt all supplies of transit services by a transit authority, including rights to use a transit system.

Even under the new rules, not all transit services are exempt, and the following supplies remain taxable:

- Charters;
- Sightseeing and similar tours;
- VIA Rail and other similar private passenger rail services;
- Coach services such as Greyhound buses and other similar private coach services;
- Air travel; and
- Supplies of services, staff and equipment by for-profit subcontractors.

The new rules apply to such supplies made after July 22, 2016 and for supplies made before that date unless the transit authority had charged, collected and remitted amounts on account of this tax. In other words, if transit authorities treated supplies that were excluded from the original scope of the exemption as taxable and accounted for tax on these supplies, there would be no change required to their historic treatment.

Public service body rebates

Section 259 of the ETA provides public service body (PSB) rebates to charities, substantially government funded non-profit organizations and other public service bodies (e.g., universities, public colleges, school authorities, hospital authorities and municipalities). The PSB rebates are calculated and claimed on a claim period basis. The CRA's administrative policy outlined in Excise and GST/HST News 89 (Summer 2013) stated that GST/HST payable in one period generally cannot be included in the non-creditable tax charged for a subsequent claim period. Therefore, if a PSB has not claimed a PSB rebate for several claim periods, it must file a separate rebate application form for each claim period. A new provision allows for a rebate to be claimed in a future period providing certain conditions are met. Most notably, the proposed change includes a time-base restriction which effectively states that the application for a subsequent claim period must be filed within two years after the day on or before the return is due. For claims made after two years, the prior application must be amended.

Pension entities

The complex rules applicable to pension entities of registered pension plans and their related employers with master pension entity (MPE) structures since 2009 resulted in unrecoverable tax in excess of that borne by plans which held investments directly in a pension entity. In order to address the resulting double taxation, Finance released legislative and regulatory proposals on July 22, 2016.

A brief overview of the proposed amendments relating to MPEs is provided:

- A participating employer of a pension plan and a MPE of the pension plan may jointly elect to treat actual taxable supplies made by the employer to the MPE as being made for no consideration provided interest held in the MPE by all of the pension entities in respect of a pension plan is greater or equal to 90%;
- Where this election has not been made and there are actual and deemed supplies from the employer with respect to the MPE activity, a tax adjustment note (TAN) may be available to mitigate double taxation; and
- A specified/designated pension entity in respect of a MPE should now be eligible to claim the 33% pension rebate in respect of the tax actually or deemed to be paid by the MPE and/or the pension entities in respect of the MPE.

These rules are discussed in greater detail in our September 6, 2016 edition of Canadian indirect tax news.

The September 8, 2017 proposals clarify certain elements of the above-mentioned proposed legislative amendments related to MPEs, and modify the existing pension rules to reduce the compliance burden for certain pension entities, as follows:

1) The definition of pension entity is amended to remove the reference to a person that is deemed a trust for income tax purposes.
2) The definition of MPE is amended to include a trust which may qualify for an election for income tax purposes to be a master trust. Further, the new election between a participating employer of a pension plan and MPE is not applicable to property or services acquired, or employer resources consumed prior to July 21, 2016.
3) Changes have been proposed with respect to the obligation of a pension entity to repay a portion of the rebate in respect of deemed tax, following the receipt of a TAN from a participating employer, where the repayment is only required if the pension entity has included the amount of deemed tax in its pension rebate. Furthermore, the deadline for the pension entity to make the payment required to the Receiver General is now the later of (a) the day on which the rebate claim is filed and (b) the last day of the claim period of the pension entity that immediately follows its claim period that includes the day on which the TAN is issued. The obligation for a participating employer to pay back any deduction that it claimed following an election to transfer the 33% rebate from the pension entity to the participating employer have been amended in the same way. These proposed amendments are generally applicable retroactively to any claim period of a pension entity that begins after September 22, 2009. Therefore, where a pension entity or a participating employer has been assessed on this issue, a submission can be made for a reassessment during the one-year period following royal assent of the legislation.

Employers and pension entities should carefully review the new rules, including the proposed amendments of September 8, 2017, in order to determine how the changes may apply to certain supplies made to MPEs and/or pension entities, including potential Quebec Sales Tax implications.

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