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TAX LETTER

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HST QUIZ — IS YOUR BUSINESS CHARGING IT PROPERLY?

Whether or not you're in a Harmonized Sales Tax province, if you carry on business you need to know the rules for when to charge HST. You might be surprised!

The GST/HST rates are:

- 13% HST for a supply "made in" Ontario (generally customers located in Ontario)
- 15% HST for a supply "made in" New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland & Labrador (generally customers located in the Atlantic provinces)
- 5% GST for a supply "made in" in any other province or the territories. (Quebec has a GST-like Quebec Sales Tax, which is not part of the HST, and is discussed in the next article. Alberta and the territories have only the 5% GST. Each of B.C., Saskatchewan and Manitoba has a provincial retail sales tax that does not apply to vendors outside the province.)

Try this quiz and see how you do. Answers are on page 6.

1. You're in Calgary and you sell widgets. A customer in Halifax orders a widget and you ship it to her in Halifax. What rate of tax do you charge?
2. You're in Calgary and you sell widgets. A customer in Halifax orders a widget and you "deliver" it at your warehouse in Calgary. In order to get the widget to her, you also arrange (as your customer's agent) for a courier company to deliver the widget to her. What rate of tax do you charge?
3. You're in Calgary and you sell widgets. A customer in Halifax orders a widget

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and you deliver it at your warehouse in Calgary. In order to get the widget, your customer calls a courier company to have the widget picked up at your warehouse. What rate of tax do you charge?

4. You're an engineer based in Charlottetown. A client in Winnipeg thinks he's invented a new device, and wants you to review his design plans to tell him if they will work. You stay at your office in Charlottetown, review the plans, write a report and bill the client. What rate of tax do you charge?
5. You're an engineer based in Charlottetown. A client in Winnipeg thinks he's invented a new device, and wants you to review his design plans to tell him if they will work. You travel to Winnipeg, review the plans, write a report and bill the client. What rate of tax do you charge?
6. You're an engineer based in Charlottetown. A client in Winnipeg thinks he's invented a new device, but is being sued by a competitor in Ontario who says your client stole the plans. They're in litigation in the Ontario courts. You stay at your office in Charlottetown, review the plans, write an expert report for your client to use in the litigation and bill the client. What rate of tax do you charge?
7. Following #6, you travel to Toronto to testify as an expert witness in the trial, on behalf of your Winnipeg client. What rate of tax do you charge?
8. You're a hair stylist in Edmonton. You style the hair of a client from New Brunswick who is visiting Edmonton. What rate of tax do you charge?
9. You're a plastic surgeon in Edmonton doing facelifts (which are taxable when done solely for cosmetic reasons). You do a facelift for a patient from New Brunswick who is visiting Edmonton. What rate of tax do you charge?
10. You're a computer expert based in New Brunswick. A business customer from a nearby town in Quebec sends you a computer to repair. You repair it and return it. What rate of tax do you charge?

(See page 6 for the answers.)

NON-QUEBEC BUSINESSES SELLING TO CONSUMERS IN QUEBEC

Quebec is not part of the Harmonized Sales Tax (HST) system discussed in the quiz above. Federally, only the 5% GST applies for sales to customers in Quebec, and the HST does not apply.

However, Quebec has the 9.975% **Quebec Sales Tax (QST)**, which uses the same rules as the GST for businesses in Quebec. In fact, Revenu Québec administers the GST and the QST together in Quebec, so that businesses have to deal with only one tax administration for both taxes.

Until now, the QST has not been an issue for businesses that do not have offices or locations in Quebec. A business in, say, Ontario that sells goods or provides services to a Quebec customer would charge the 5% GST and nothing more.

However, as of September 2019, Quebec has introduced a requirement on **Canadian businesses** outside Quebec to register and collect QST on **sales to consumers in Quebec**. (Similar rules have applied since January 2019 on non-resident businesses.)

These new QST rules are known as the **"Netflix tax"**, because they were introduced

in part to catch businesses like Netflix that provide digital services from outside Canada. However, for Canadian businesses they apply to goods as well as services and intangibles. (Goods from outside Canada are taxed by Canada Customs when they cross the border; digital services and intangibles, like downloaded movies and software, cannot be caught at the border.)

If your business is outside Quebec but sells **over $30,000 per year to Quebec consumers**, then Revenu Québec will tell you that you need to register under its "simplified" registration system, and that you need to collect QST on your sales to Quebec consumers and remit that QST to Revenu Québec. Businesses using this registration system are not able to claim input tax refunds, the QST equivalent to input tax credits, so any QST they pay cannot be recovered (but for the most part, a business outside Quebec does not pay QST). For details, see the Revenu Québec website.

These rules do not apply to business-to-business sales.

It is not yet clear whether what Quebec is doing is actually *legal*. Quebec might not legally have jurisdiction to impose tax-collection obligations on businesses outside the province. This will have to be determined by the Courts, and will likely be resolved by the Supreme Court of Canada some years from now. In the meantime, Revenu Québec has said that it is engaged in a "collaborative" effort with non-Quebec businesses to have the QST collected. (Netflix and some other large non-resident businesses have already begun to comply and are collecting the QST.)

It is also uncertain whether Revenu Québec will have any practical way to enforce these new rules on businesses outside Quebec. If you ignore Revenu Québec's directives, does the province have any remedy? Revenu Québec has stated publicly that it could assess a non-Quebec business, and then collect from that business by garnishing VISA and other credit-card payments being paid by banks in Quebec to merchants outside Quebec — so if this tax is legal, it might have teeth.

WHEN CAN THE CRA NO LONGER REASSESS YOU?

If you have invested in a tax shelter, or claimed some deduction or credit that you think the CRA might disallow, when can you stop worrying?

The normal rule is that the Canada Revenue Agency (CRA) can reassess you up to **three years from your original assessment**. The three-year clock starts running from the date shown on the Notice of Assessment that you receive shortly after filing your return. In most cases, if you haven't been reassessed by the time the clock runs out, you are safe for that year. But not always!

Note, first of all, that the clock is not "restarted" by a reassessment. If the CRA reassesses you at some point during the three-year period, the time limit for any further reassessment is still three years from the *original* assessment date.

There are some exceptions to the three-year rule. The following are the most notable:

- *Fraud.* If you have committed any fraud in filing your return or in supplying any information under the *Income Tax Act*, you can be reassessed **at any time**. The clock never runs out. If you go to court, the CRA must prove that you committed fraud.

- *Neglect, carelessness or willful default.* If you have made a misrepresentation that is attributable to "neglect, carelessness or willful default", you can be reassessed **at any time**. Again, the clock never stops running. If you go to court, the onus is on the CRA to prove that there has been neglect, carelessness or willful default on your part. Note, however, that the term "carelessness" is quite broad. There is extensive case law interpreting the meaning of these words.
- *Tax shelters.* If you're involved in a tax shelter where you're required to file a tax shelter information form with the CRA, and you don't, then you can be reassessed **at any time**. (The deadline is three years after you file the form, so if you never do, the clock never starts running.)
- *Failing to file an accurate T1135.* If you own foreign property with total cost over $100,000, and you don't properly report *all* of it on Form T1135 with the level of detail the form requires, and you have *any* foreign income that you haven't reported, then you can be reassessed up to **six years** from the original assessment date.
- *Dealings with related non-residents.* If the reassessment relates to a transaction between you and a non-resident with whom you "did not deal at arm's length" (typically a family member, or a corporation or trust controlled by you or a family member), then the reassessment can be issued up to **six years** from the original assessment date.
- *Loss carrybacks.* If you are carrying back a loss, which generally can be done to any of the three years preceding the loss, then your return will have to be reassessed to allow this. A reassessment resulting from any one of a large number of such carryback provisions can be done up to **six years** from the original assessment date. (Normally it's to your benefit to have such a reassessment.)
- *Foreign tax credits.* If your tax payable to another country changes (e.g., due to a reassessment by that country), your foreign tax credits may change. The CRA can reassess you to reflect these changes (which could be good or bad for you) up to **six years** from the original assessment.
- *Consequential assessments.* If a reassessment is made to a return that is still open for reassessment, and as a result a "balance" changes which is carried over (forward or back) to another year, then that other year can be reassessed even if it would otherwise be past the deadline.
- *Waiver.* If before the deadline expires you sign a waiver with respect to any taxation year, that year will remain "open" forever for the CRA to reassess, unless you revoke the waiver (which requires six months' notice). Usually you should only sign a waiver with respect to a particular, identified issue, rather than giving the CRA blanket power to reassess a given year. Also, remember that you are under no obligation to sign a waiver. If the deadline is approaching and you think it will expire before the CRA can get an assessment issued, you might choose not to sign a waiver.
- *Time spent contesting a demand for information.* If the CRA makes a formal demand for information from you (via a Requirement for Information, or seeking a Compliance Order from the Federal Court), and you bring a Court application to try to have the CRA's demand struck down, any time spent in that legal process stops the clock from running, so the deadline is extended.
- *Corporations that are not CCPCs.* For a Canadian-controlled private corporation (CCPC), the limit is three years, as it is

for individuals and most trusts. For any other corporation (or a mutual fund trust), the limit is **four years**. This would apply, for example, to a corporation controlled by a non-resident or by a public corporation. For such corporations, the limit is one year more than for individuals; thus, in the examples above where individuals have six years, it is seven years.

There are numerous other exceptions as well, many of them buried in transitional rules of application that amend the *Income Tax Act*. All of which goes to show that you must be careful on your return, and don't rely too heavily on the three-year assessment period expiring!

TAX-FREE SAVINGS ACCOUNTS

Every taxpayer can contribute, cumulatively, up to $5,000 to a **Tax-Free Savings Account (TFSA)** for each year 2009-2012, $5,500 per year for 2013-2014 and 2016-2018, $10,000 for 2015 and $6,000 for 2019. Income earned on the funds in a TFSA is tax-free.

If you were at least 18 by 2009 when the TFSA began (i.e., you were born in 1991 or earlier), and you have been resident in Canada since 2009, then you now have a total of **$63,500** in contribution room. It's well worth it to have that money earning income in a TFSA where it is completely tax-free, even if you take the income out and spend it.
Each taxpayer has the same limit, so you and your spouse can each contribute the maximum.

TFSA contributions are not deductible for tax purposes, but income earned in the TFSA is tax-free and you can withdraw the funds at any time (subject to any restrictions on your investments — for example, if you have bought a two-year GIC, you might have to wait out the two years before you can access the funds, or pay a penalty to the bank for early withdrawal).

If you have investments that are earning interest or dividends that are subject to tax, make sure to max out your Tax-Free Savings Account.

A few TFSA tips and traps to be aware of:

- You can withdraw funds from your TFSA at any time, but you must **wait until the next year to replace those funds**, once you have hit the contribution limit. Otherwise the funds you replace will be subject to a 1% penalty tax *per month*.

  Example: suppose you have already contributed the maximum amount by February 2019. In March 2019 you need some cash and withdraw $3,000. If you replace any of that $3,000 by recontributing to the TFSA later in 2019, you will be subject to the penalty tax. You have to wait until January 2020 to replace the $3,000. (Once January 2020 comes, you will also have additional contribution room of at least $6,000 for 2020.)

- The Income Tax Act provides "attribution rules" to prevent income splitting that can reduce tax. For example, if you give or lend money or property to your spouse, income earned from that money or property is generally "attributed" back to you and taxed in your hands rather than in your spouse's hands. However, **income earned in a TFSA is not subject to the attribution rules**.

  Example: you earn $150,000 per year, and your spouse has no income and no

TFSA. If you give your spouse $10,000 and your spouse invests the funds in stocks that pay a 4% dividend, the resulting $400 of income will be taxed in your hands at your high marginal rate. But if you put $10,000 into your spouse's TFSA and the TFSA buys the stocks, the $400 of income is tax-free. (Note however that the attribution rules will start to apply if your spouse takes the funds or stocks out of the TFSA and they continue to generate income.)

- If you are thinking of playing any games with your TFSA to generate inappropriate tax savings, think again. The TFSA rules are designed to catch such game-playing, and have been severely tightened in recent years. **Swaps between TFSA and other accounts, deliberate overcontributions, investments in non-qualified investments** (such as one's own business) intended to generate huge tax-free dividends ... these and other "planning" schemes are caught and in most cases subject to a 100% tax, so that they will backfire. Don't believe anyone who proposes to "help" you use your TFSA (or RRSP for that matter) to access tax-free funds, unless you have the scheme reviewed and approved by an expert tax lawyer or chartered accountant.

HST QUIZ — THE ANSWERS

Here are the answers to the quiz on page 1.

1. You charge 15%, the rate for Nova Scotia. Goods sold and shipped anywhere in Canada bear GST or HST based on the rate of tax in the destination province.
2. You still charge 15%, the rate for Nova Scotia. As long as you're arranging the shipping, even as the customer's agent, the same rule applies as in #1: the GST or HST applies at the rate in the destination province to which you've shipped the goods.
3. You charge only 5% GST, the rate for Alberta. You've completed delivery at your Calgary warehouse, and the customer has made her own arrangements to pick up the goods.
4. You charge only 5% GST. Services are normally taxed based on the customer's address (subject to some exceptions), and there's no HST in Manitoba.
5. Again you charge only 5% GST. It doesn't matter where you perform the work. Services are normally taxed based on the customer's address (subject to some exceptions).
6. You charge 13% HST, the rate for Ontario. A service "rendered in connection with litigation" in a province's courts is taxed at the rate for that province. The litigation is in an Ontario court. This rule is often thought to apply only to lawyers' services, but is actually much broader!
7. Again you charge 13% HST, the rate for Ontario, because this is a service in connection with litigation in an Ontario court. It doesn't matter where you perform the service.
8. You charge only 5% GST, the rate for Alberta. Even though services are normally taxed based on the customer's address, there is an exception for "personal services" performed in the presence of the individual to whom the services are rendered. Such services are taxed based on where they are performed. Since you

perform the service in Alberta, the Alberta rate applies.

9. You charge 15% HST, the rate for New Brunswick. The exception for "personal services" in #8 above doesn't apply to an "advisory, professional or consulting service". Instead, such a service is subject to the normal rule for services, based on the customer's address. (A physician's service is a "professional" service.)
10. You charge only 5% GST, the rate for Quebec. There is a special rule for goods that are sent for repair, alteration, cleaning or a similar physical service. The tax applies based on the address to which the goods are returned after being repaired, altered, cleaned, etc. (If you had an office in Quebec, you would have to charge Quebec Sales Tax as well.)

If you didn't score too well on the quiz, don't be surprised. The rules are complex and confusing. What's important is that you ensure that your business applies the rules correctly. Otherwise you could be in for a very costly assessment when a CRA auditor shows up to audit your business for the last several years of GST and HST.

AROUND THE COURTS

Penalty for not providing T5018 slips to subcontractors

The Contract Payment Reporting System targets the underground economy by requiring construction contractors (anyone who derives their income primarily from "construction activities") to report to the CRA all payments to subcontractors (of at least $500 services per year per subcontractor), along with the subcontractor's Business Number or Social Insurance Number. This is done either on Form T5018 slips (given to each subcontractor), or line-by-line on a T5018 summary. These rules are found in section 238 of the Income Tax Regulations

In *Apex City Homes Limited Partnership v. The Queen*, 2018 TCC 247, Apex was a partnership, in the business of developing and selling residential condominiums in Calgary. Apex hired a general contractor to handle all the construction. The general contractor hired all the subcontractors.

The CRA assessed Apex for not filing a T5018 reporting its payments to the general contractor. Apex appealed to the Tax Court of Canada.

The Court ruled that Apex derived its income from "construction activities" and was required to file the T5018. It was thus subject to a $2,500 penalty for not filing the form, for each of the three years for which it was assessed.

Businesses engaged in construction, even those that leave all the actual construction work to a contractor, need to be aware of this obligation!

* * *

This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with an expert before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.