

4th Annual Tax Efficient Finance Structures: Harmonized Sales Tax & Goods and Services Tax

Lang Michener LLP
Lawyers – Patent & Trade Mark Agents

A Few Tools for the
Structured Financier's Toolkit

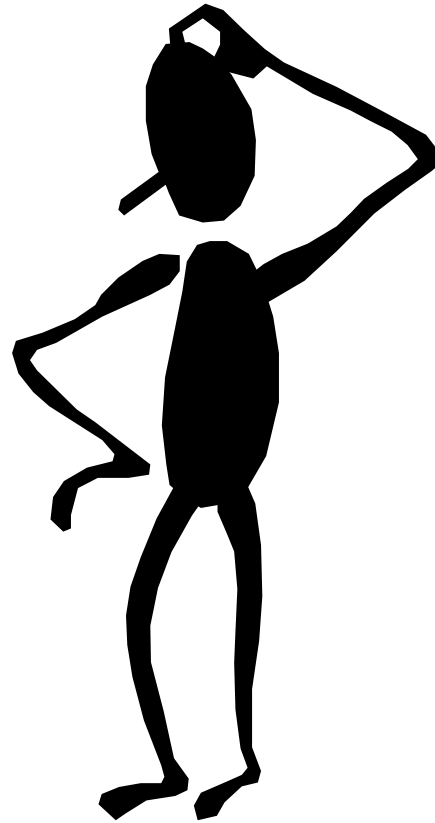
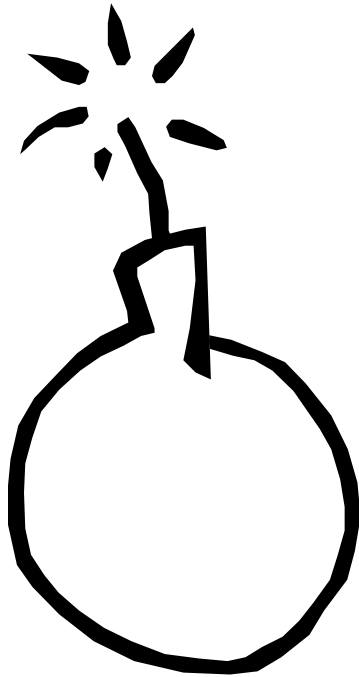
LEGAL TAX SERVICES



Speaker:
Cyndee Todgham Cherniak, LL.B., J.D., LL.M.
Federated Press, Toronto – November 2, 2009



I Am Not Going to Tell You Structured Finance Transactions Are Easy



Slide 2



Reality Check

- Commodity & Sales Taxes Can Be A Non-Recoverable Cost Of A Financing Transaction
- Mistakes Can Be Costly
- Governments Need Revenues
- Auditors Have Difficulty Understanding Complicated Transactions

Slide 3



Top 10 Commodity Tax Questions for Structured Finance Transactions

- 1. Where is the transaction occurring?**
- 2. When is the transaction occurring?**
- 3. When will consideration be paid?**
- 4. What are the deliverables?**
- 5. What is the commodity tax status of the deliverables?**

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Top 10 Commodity Tax Questions for Structured Finance Transactions (Cont.)

- 6. How is the transaction to be structured (using corporations, partnerships, trusts, etc.)?**
- 7. Are there ongoing management and administrative fees paid in connection with the transaction?**
- 8. Are any elections available?**
- 9. Are other relief provisions available?**
- 10. Are there pre-closing or post-closing reporting/compliance requirements?**

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Commodity Taxes to be Discussed

- **Harmonized Sales Tax (Ontario)
 (“OHST”)**
- **Goods and Services Tax (“GST”)**

Slide 6



March 26, 2009
Ontario Budget Announcement

“Ontario is proposing a comprehensive tax reform package that includes moving to a single value-added sales tax on July 1, 2010 and providing tax relief for people and business”

**Dwight Duncan,
Minister of Finance
March 26, 2009**

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March 26, 2009

Ontario Budget Announcement (Cont.)

- **Announcement**

- **Starts July 1, 2010**
- **ORST will be converted into a value-added tax structure and combined with the Federal GST**
- **To be administered by Canada Revenue Agency**
- **File single HST return**
- **Combined rate of 13% (provincial portion = 8%)**
- **Continues Land Transfer Tax, Employer Health Tax, Fuel Tax, Gasoline Tax, etc.**
- **Continues ORST on insurance (8%) and used vehicles**
- **Eliminates vendor compensation (after March 31, 2010)**

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March 26, 2009

Ontario Budget Announcement (Cont.)

“Additional information on technical design issues and transitional issues will be released in the coming months to help tax payers and businesses prepare for the proposed changes. The Government will also establish an implementation panel to assist with the transition to a single sales tax”

- **Expected to be substantially similar to HST in NS, NB, Nfld/Lab**
- **However, not the same as QST**
- **BC announced on July 23, 2009 that they will also harmonize @ 12%**

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HST Will Not Result in a Single National Sales Tax



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Legislative Process

- **Federal**

- **Changes to *Excise Tax Act* to be tabled in HoC**
 - **Minority Govt needs support for passage**
 - **First & Second Reading**
 - **Committee**
 - **Third Reading**
- **Senate**
 - **Readings**
 - **Committee**
- **Back to HoC to receive Royal Assent**

- **Provincial**

- **Changes to the *Retail Sales Tax Act* tabled in Legislature**
 - **Majority McGuinty Govt will pass if MPPs must vote with Party**
 - **First & Second Reading**
 - **Committee**
 - **Third Reading/Royal Assent**

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The HST Good News



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The HST Good News (Cont.)

- **Full input tax credits if business is engaged in commercial activities and sales less than \$10 Million**
- **“Small suppliers” do not need to register (taxable sales less than 30,000/year or \$50,000 (Public Service Body))**
- **File only one sales tax return if sales only in Ontario**
- **ORST Vendors stop filing ORST returns in July 2010 unless sell taxable insurance**

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The HST Bad News – Ontario's HST Plans

THE HST PLAN IS FLAWED!



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Bad News For Businesses – HST Will Be Imposed On:

- **Almost Everything You Buy For Your Business**
 - **Equipment, computers, printers, parts**
 - **Printer cartridges**
 - **Anything purchased to be resold or incorporated into goods to be resold (e.g., printing)**
 - **Inventories**
 - **Commercial Rent/Fixtures/Repairs to real property**
 - **Signs**
 - **Electricity**
 - **Services (legal, book-keeping, accounting, janitorial, photographers etc.)**
 - **Services of temporary placement workers**
 - **Licenses to use (e.g., transparencies, trademarks, copyrights)**
 - **All computer programs**
 - **Freight transportation services**
 - **Internet access**
 - **Stationary**

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The HST Bad News – HST Cash Flow Costs

- **No longer can provide purchase exemption certificates – must pay the HST to supplier and claim ITCs on next HST return**
- **Imbedded HST in equipment and inventory remains**
- **If issue invoice or rules require remittance of HST, must remit HST regardless of whether collect from client/customer**
- **With new 13% HST obligations, may need to find new financing**
- **May have difficulties obtaining additional financing in this economy**

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The HST Bad News – Clients/Customers May Be Affected – Some Cannot Claim ITCs

- **Financial Services**
 - Banks
 - Credit unions
 - Insurance companies
 - Insurance agents/brokers
 - Other financial service providers
- **Health Care**
 - Hospitals
 - Nursing homes, Retirement homes
 - Doctors, Dentists, Optometrists, Chiropractors, Physiotherapists
- **Universities**
- **Colleges**
- **Schools / Private Schools**
- **Child Day Care**
- **Charities**
- **Not-for-profit**
- **Municipalities (e.g. City of Toronto)**
- **Certain religious/ educational camps**

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The HST Bad News – HST Rebates For Public Service Bodies - Not Enough Relief

<u>MUSH Sectors</u>	<u>Sector Rebate</u>
Municipalities	78% (GST 100%)
Universities and Colleges	78% (GST 67%)
School Boards	93% (GST 68%)
Hospitals	87% (GST 83%)
Charities and Qualifying Non-Profit Organizations	82% (GST 50%)

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Temporary Restrictions in Claiming ITCs for Large Businesses Problematic

- **ITC Restrictions for 8% provincial component of HST**
- **Reason: Province needs the money**
- **Applies to Large business = annual taxable sales in excess of \$10 Million (If your sales are under \$10 million, doesn't affect you, but may be audited to ensure sales are below threshold)**
- **Businesses near \$10Million threshold may find themselves over at end of annual reporting period and have bid ITC recapture cost**

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Temporary Restrictions in Claiming ITCs for Large Businesses Problematic (Cont.)

- **Businesses with sales above \$10 M & financial institutions are NOT ALLOWED to claim ITCs July 1, 2010 – June 30, 2012 on purchases of:**
 - **Energy (except where purchased by farms or used to produce goods for sale)**
 - **Telecommunications services (other than internet access fees or charges for toll-free numbers)**
 - **Automobiles and certain other road vehicles and fuel to power**
 - **Food, beverages and entertainment expenses**

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Temporary Restrictions in Claiming ITCs for Large Businesses Problematic (Cont.)

- **Restriction on ITCs may continue beyond stated period**
- **Restricted ITCs are phased out between June 30, 2012 and June 30, 2015 (not allowed full ITCs until after June 30, 2015)**
- **Will need to track Fed. and Prov. components separately**
- **Will need to set up additional ledger accounts to translate ITC restrictions into income tax accounting**

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Temporary Restrictions in Claiming ITCs for Large Businesses Problematic (Cont.)

- **Serious issues for companies operating across Canada**
- **Serious issue for companies that trade in energy products (e.g., gas, home heating fuel, natural gas, electricity, etc)**
 - **Unclear whether ITCs restricted at each stage of the supply chain**
 - **Extractor ► Refiner ► Trader ► Retailer ► Consumer**
 - **Could exponentially inflate prices for consumers if HST cost is not removed on prior transactions**

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Temporary Restrictions in Claiming ITCs for Large Businesses Problematic (Cont.)

- **Serious issue for trucking companies & companies who require individuals to travel as part of their job**
 - **ITCs restricted on automobiles and certain other road vehicles and fuel to power**
 - **Restricted ITCs will increase costs of goods in cities and towns away from major centers (creating North/South, Big/Small, Urban/Rural divisions)**
 - **Will require separate recordkeeping for businesses to ensure not claiming ITCs = audit risk (also may affect depreciation and CCA calculations)**

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The HST Transition Rules

- **June 18, 2009: Ontario Ministry of Revenue issued rules for construction industry**
- **October 14, 2009: Ontario Ministry of Revenue and CRA issued general transition rules**
- **3 dates to MEMORIZE:**
 - **Implementation Date: July 1, 2010**
 - **Pre-Implementation Date: May 1, 2010**
 - **Release Date: October 14, 2009**

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The HST Transition Rules (Cont.)

- **May 1, 2010: Is the date on or after which HST will be payable on consideration that (1) becomes due or (2) is paid without becoming due WHERE PROPERTY OR SERVICES ARE DELIVERED AFTER July 1, 2010**
- **E.g., If agreement of purchase and sale is signed on May 3, 2010 AND money paid in escrow AND closing occurs after July 1, 2010**
 - **▶ HST WILL APPLY TO MAY 3, 2010 ESCROW PAYMENT**

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The HST Transition Rules (Cont.)

- **October 14, 2009: Certain businesses and Public Service Bodies MUST GO BACK IN TIME AND SELF-ASSESS PROVINCIAL COMPONENT / HST after this date for property and services delivered after July 1, 2010**
 1. **Selected listed financial institution, which use special attribution method in determining net tax**
 2. **If acquire property or services for consumption, use or supply otherwise than exclusively in the course of their commercial activities (e.g., financial institution acquires property/services to make exempt supplies)**

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The HST Transition Rules (Cont.)

- 3. If acquire property or services for consumption, use or supply otherwise than exclusively in the course of their commercial activities in circumstances where are not entitled to full input tax credits (e.g., where restricted ITC rules apply (i.e., Businesses with taxable sales over \$10M) or MUSH rebates (e.g., hospitals, universities, schools, municipalities, not for profit, charities)**
- 4. Where business uses simplified procedures for accounting for net tax (e.g., charities, public service bodies, small businesses)**

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The HST Transition Rules (Cont.)

Type of Supply	Consideration Due or paid after July 1, 2010	Consideration Due or paid between May 1, 2010 and July 1, 2010	Consideration Due or paid between October 14, 2009 and July 1, 2010	Consideration Due or Paid Before October 14, 2009
Sales TPP	HST applies	HST applies – registered vendors should begin collecting	HST applies re certain businesses required to self assess	NO HST ☺
Leases and Licenses TPP	HST Applies	HST applies – registered vendors should begin collecting	HST applies re certain businesses required to self assess	NO HST ☺
Services	HST Applies	HST applies – registered vendors should begin collecting	HST applies re certain businesses required to self assess	NO HST ☺
Sales IPP	HST Applies	NO HST ☺	NO HST ☺	NO HST ☺
Sales of RP (not residential)	HST Applies	NO HST ☺	NO HST ☺	NO HST ☺

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The HST Transition Rules (Cont.)

Type of Imported Supply	Consideration Due or paid after July 1, 2010	Consideration Due or paid between May 1, 2010 and July 1, 2010	Consideration Due or paid between October 14, 2009 and July 1, 2010	Consideration Due or Paid Before October 14, 2009
Imported TPP (crosses border into Ontario/BC after July 1, 2010)	HST applies	HST applies	HST applies re certain businesses required to self assess	NO HST ☺
Imported Services for consumption, use or supply in ON or BC to extent service performed a/f July 1, 2010	HST Applies	HST applies	HST applies re certain businesses required to self assess	NO HST ☺
Imported IPP for consumption, use or supply in ON or BC to extent IPP leased, licenses a/f July 1, 2010	HST Applies	HST applies	HST applies re certain businesses required to self assess	NO HST ☺

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The HST Transition Rules (Cont.)

- **Specific HST Rules**
 - **Residential real estates**
 - **Subscriptions to newspapers and magazines**
 - **Pre-paid Funeral and cemetery services**
 - **Passenger Transportation services**
 - **Freight Transportation services**
 - **Commercial Parking**
 - **Memberships**
 - **Admissions**

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The HST Transition Rules (Cont.)

- **Specific HST Rules**
 - **Progress payment and Hold-backs**
 - **Certain real property contracts (greater than 3 months)**
 - **Direct Sellers**
 - **Continuous supply transmissions/budget payment arrangements**
 - **Combined supplies**

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The HST Place of Supply Rules

- **NOT YET ISSUED – BUT WILL ADD LAYER OF COMPLICATION FOR SERVICE PROVIDERS**
- **Issue for service providers/IP providers who operate in more than one province or inside/outside Canada**
- **What is the nature of the supply (goods, services, transportation, telecommunications, etc.)?**
- **Where were the services performed?**
- **Where was the contract negotiated?**

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The HST Place of Supply Rules (Cont.)

- **Service providers will have to keep detailed records:**
 - **Dockets of time spent on projects?**
 - **What was completed for clients?**
 - **Where they were at the time services provided?**
 - **where there clients are located?**
 - **If client has a number of locations, the number of users in each location (for IP)**
 - **Issues when act as temporary employee of a client and documenting relationship**

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Goods and Services Tax (GST)

- **Three types of transactions:**
 - **Taxable Supplies**
 - **Zero-Rated Supplies**
 - **Exempt Supplies**

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Goods and Services Tax (GST)

- **Many supplies purchased by persons engaged in financial transactions are subject to GST**
- **Many supplies made by persons engaged in financial transactions are exempt**
- **Some supplies to non-residents of a financial nature are zero-rated**
- **Recent HST announcements will turn 5% GST issues into 13% GST/HST issues**

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GST Rules Relating to Financial Transactions Are Important For:

- **Banks, trust companies, credit unions**
- **Investment advisors, brokers, traders**
- **Certain trustees**
- **Lenders**
- **Insurance companies**
- **Investment plans**
- **Holding companies**
- **Partnerships**
- **Trusts (Including REITS and income trusts)**

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7 Issues to be Discussed

- 1. Section 167 Elections**
- 2. Section 156 Elections**
- 3. Holding Companies**
- 4. Single vs multiples supplies**
- 5. Conversion of Activities**
- 6. “Arranging for” a “financial service”**
- 7. Management Contracts**

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Section 167 Elections

- **Section 167 eligibility**
- **Common issues**
 - **Multiple suppliers**
 - **Multiple recipients**
 - **Registration status of recipients**
 - **Business or part of a business**
 - **Business was established or carried on by the supplier or was established or carried on by another person and acquired by supplier**
 - **“All or substantially all”**
 - **Completing the proper forms and filing on time**

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Section 167 Elections

- **Less Common issues**
 - **Wind-up of a Partnership**
 - **Amalgamations**

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Section 167 Misunderstood

- **Section 167 is an election to not charge, collect and remit GST in certain circumstances**
- **Conditions may not exist if the vendor does not sell the real property**
- **Numerous CRA statements on when Section 167 is not available**

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Section 156 Election

- **Section 156 eligibility**
- **Common issues**
 - **Newly incorporated companies**
 - **Limited definition of “Canadian partnership”**
 - **Indirect ownership**
 - **Multiple owners**


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Holding Companies

- **Common Issues**
 - **Restricted to corporations**
 - **Registration**
 - Resident corporations
 - Non-resident corporations
 - **Requirements under Section 186 of the ETA**
 - **Exported intangible property may not be zero-rated**

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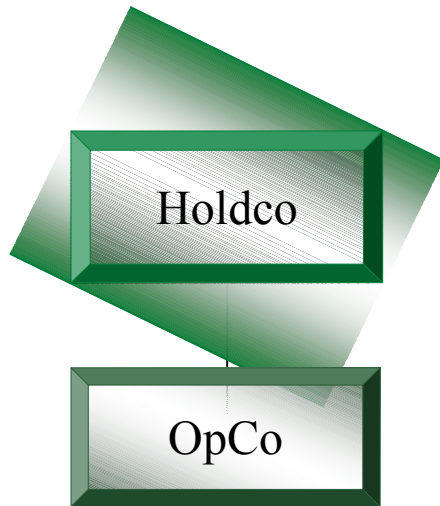


Registration of Holding Companies (Section 240(3)(d))

- **An application to the Minister MAY be made by a corporation resident in Canada that:**
 - **owns shares of the capital stock of, or holds indebtedness of another corporation; or**
 - **is acquiring or proposes to acquire all or substantially all of the issued and outstanding shares of a target corporation, having full voting rights in all circumstances**

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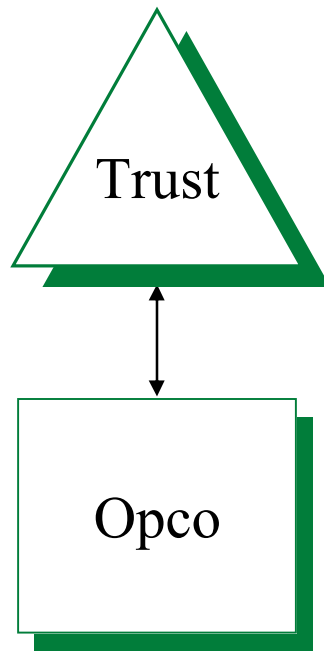
Section 186(1) – Related Corporation Fees



- **HoldCo is a corporation resident in Canada**
- **HoldCo is a registrant**
- **OpCo is engaged in commercial activities**
- **HoldCo acquires or imports property or a service for consumption or use in relation to the shares or the capital stock or indebtedness of OpCo**
- **HoldCo pays GST**
- **HoldCo may be entitled to claim ITCs**

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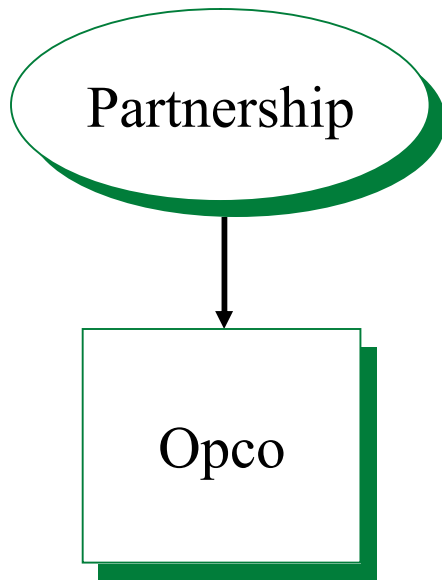
Section 186(1) – Does not apply



- **Since Trust is not a corporation, section 186(1) does not apply**
- **Trust cannot claim ITCs in respect of goods and services purchased for consumption or use in relation to units of OpCo or indebtedness of OpCo**

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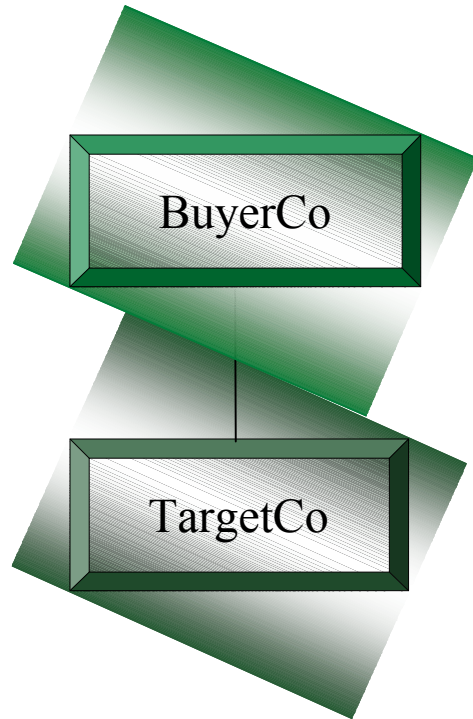
Section 186(1) – Does not apply



- **Since Partnership is not a corporation, section 186(1) does not apply**
- **Partnership cannot claim ITCs in respect of goods and services purchased for consumption or use in relation to units of OpCo or indebtedness of OpCo**

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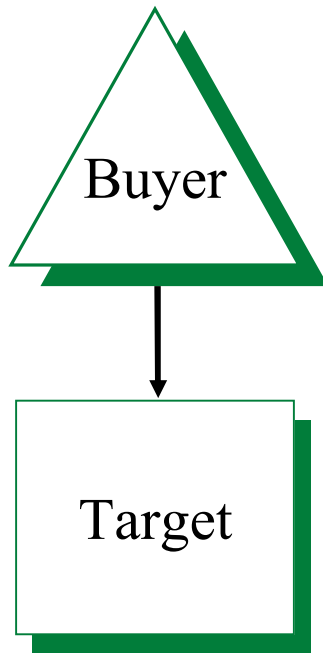
Section 186(2) – Takeover Fees



- **BuyerCo is a corporation resident in Canada**
- **BuyerCo is a registrant**
- **TargetCo is engaged in commercial activities**
- **BuyerCo acquires or imports property or a service relating to the acquisition or proposed acquisition of TargetCo**
- **BuyerCo to buy all or substantially all of the issued and outstanding shares, having full voting rights under all circumstances**
- **BuyerCo pays GST**
- **BuyerCo may be entitled to claim ITCs**

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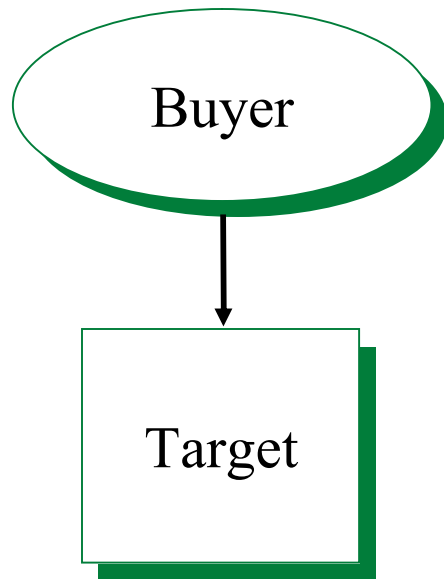
Section 186(2) – Takeover Fees



- **Since Buyer is not a corporation, section 186(2) does not apply**
- **Buyer cannot claim ITCs in respect of takeover fees relating to Target**

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Section 186(2) – Takeover Fees

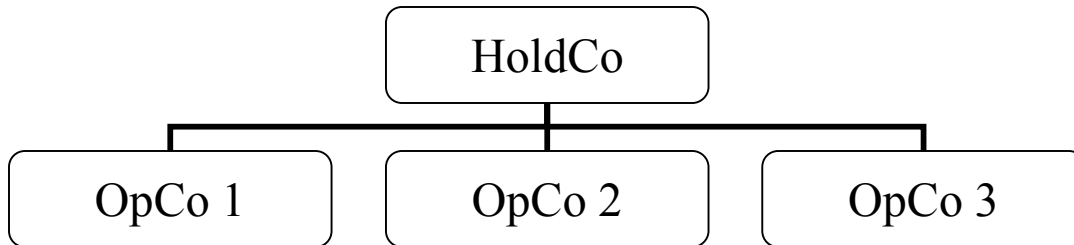


- **Since Buyer is not a corporation, section 186(2) does not apply**
- **Buyer cannot claim ITCs in respect of takeover fees relating to Target**

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Holding Companies – Special Situations



- **HoldCo is a portfolio or investment vehicle**
- **HoldCo holds and invests**
- **HoldCo may be considered to be a *de minimis* financial institution**
- **New ITC allocation requirements**
- **New annual information returns**

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De Minimis Financial Institution Test (section 149(1))

- **Financial revenues greater than \$10M and 10% of total revenue; or**
- **More than \$1M in interest or fee revenue from lending activities**
- **Exclusion from calculation (149(4)) - interest and dividends from corporations related to the person**

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Single vs Multiple Supply Issues

- **There are many single vs multiple supply issues relating to financial transactions**
- **Reason: Desire for the transaction to be exempt or taxable, depending on particular circumstances**

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Single vs Multiple Supply Issues

- **Section 138 – Incidental supplies**
- **Test:**
 1. **More than two properties and/or services are provided together**
 2. **Single consideration**
 3. **Some of the properties and/or services are incidental to the provision of particular property or service**

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Single vs Multiple Supply Issues

- **Section 139 – Deemed Exempt Financial Services**
- **Test:**
 1. **One or more financial services are supplied together with one or more services that are not financial services or with non-capital property**
 2. **Single consideration**
 3. **The financial services are related to other services or property**
 4. **The usual practice of the supplier is to supply these services and/or property together in the ordinary course of business**
 5. **Total amounts for the financial services is greater than 50% of the total for all services and property**

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Conversion of Activities Depending on the Identity of the Supplier

- **Definition of “financial service” needs careful consideration**
- **Certain “financial services”- like transactions become taxable depending on who provides the service**
- **Example – lock box services**

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“Arranging For” a Financial Service

- **Section 123(1) “financial service” (j) - defines “financial service” to include the agreeing to provide, or the arranging for, a service referred to in any of paragraphs (a) – (i) (typical financial service items)**
- **Policy Statement P-239 “Meaning of the term ‘arranging for’ as provided in the definition of “financial service”**

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Management Companies

- **Common issues**
 - **Registration**
 - **Charging, collecting and remitting GST**
 - **Imported taxable services**

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Management Contracts

- **Services provided under management contracts are subject to GST**
- **Turns non-GST-taxable labour into taxable employment services**
- **Potential to restructure activities as agency**
- **CBSA recently issued “Subsequent Proceeds” admin statement for post-entry adjustments on imported goods requires compliance reporting**

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Partnerships

- **Partnerships are persons for GST purposes**
- **Issues for general partners**
- **Registration**
- **Charging GST to the partnership**
- **Issues relating to interpretation of the phrase “anything done by a person as a member of a partnership”**

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