March 7, 2002

Ed Gauthier
Deputy Assistant Commissioner
Canada Customs and Revenue Agency
Excise and GST/HST Rulings
15th Floor, Tower A, Place de Ville
320 Queen Street
Ottawa, ON K1A 0L5

Dear Mr. Gauthier:

Re: GST/HST and Electronic Commerce Discussion Paper

I write on behalf of the Sales and Commodity Tax Section of the Canadian Bar Association (the Section) to provide you with comments concerning the Electronic Commerce Discussion Paper. The Section appreciates the opportunity to provide its input.

The new e-commerce environment presents new challenges from a commodity tax perspective. We commend the Canada Customs and Revenue Agency (CCRA) for issuing a discussion paper that is thoroughly researched, contains many practical and concrete examples and discusses the merits of several options to address the various issues. It is evident from the overall quality of the Discussion Paper that the CCRA expended significant effort in producing it.

We do, however, have some concerns with respect to specific aspects of the Discussion Paper. In particular, it proposes a new "place of operations" test for determining whether a non-resident person is carrying on business in Canada. This new approach would not give predominance to any single factor and is therefore more flexible than the current test. However, flexibility has its downside. The new test would be much more subjective, leading to greater uncertainty in its application. This uncertainty would be increased because the new test is contrary to established jurisprudence on the meaning of "carrying on business". It is recommended that this matter be discussed with the Department of Finance for purposes of enacting an amendment to the Excise Tax Act.

On page 16 of the Discussion Paper, the CCRA proposes that, "[t]he weight to be ascribed to any particular factor depends on the nature of the business under review and the particular facts and circumstances of each case." In our view, this proposed test is too open-ended and would make it quite difficult to advise some clients whether they are carrying on business in Canada.

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We suggest that the CCRA review the list of 12 factors set out in the place of operations approach and establish three or four key factors for e-commerce purposes. The remaining factors could be considered in appropriate circumstances if it is still not clear from applying the key factors whether a person is carrying on business in Canada. Our proposed approach strikes a better balance between certainty and flexibility.

We agree that the place of contract should not be a predominant factor in considering whether a non-resident is carrying on business in Canada. Indeed, we question whether the place of contract should even be a key factor for e-commerce purposes. The place of contract is difficult to analyze and is less important in the instantaneous electronic communication of offer and acceptance. For example, if a customer places an order on a vendor web site, this would likely constitute an "offer", which would be "accepted" by the vendor when the customer's credit card information is processed in Canada and the customer receives electronic notification that the order has been accepted. In the majority of cases the place of contract will likely be in Canada.

There is extensive income tax jurisprudence on the issue of carrying on business in Canada. This jurisprudence will continue to be relevant, notwithstanding these proposed changes in administrative policy. As noted above, amendments to the Excise Tax Act will be required if the intent is to replace the current common law tests for carrying on business.

In addressing the place of supply for services, the Discussion Paper recommends that a service should be considered as being performed at least in part in Canada if "the supply involves doing something to or with the recipient's computers by accessing them from a remote location and the recipient's computers are in Canada" (pp. 60-61). This recommendation should not be adopted, as it is overly broad and wrong in law. In the above situation, no services are being provided in Canada. Most registrants would presume that their remote access services are performed wholly outside of Canada, and may therefore be at risk for failing to collect GST for such services.

We also have comments on specific examples set out in the Discussion Paper. Example 5 (p. 38) sets out that software supplied electronically (whether or not under limited-period use) should be characterized as a supply of intangible personal property, whereas off-the-shelf (shrink wrapped) software delivered on a tangible medium should be characterized as tangible personal property. We agree. However, this still leaves a great deal of uncertainty for supplies of software that do not fall within these two categories. For example, would custom software that is licensed and delivered on a tangible medium be characterized as intangible or tangible personal property?

As evident in examples 21 and 22 (pp. 43-44), it continues to be difficult to characterize a supply made by electronic means (in this case data retrieval) as intangible personal property or a service. We are of the view that the data retrieval supplies in these examples should be characterized as a service, rather than as intangible personal property. We understand the business community holds the same view.

In distinguishing between a service and a supply of intangible personal property, the CCRA's recommended “factor approach” (pp. 32-34) adheres too rigidly to the factor of human involvement in making the supply. The CCRA seems to narrowly interpret this factor as active human involvement. Active human involvement is not necessarily required for all services, as many services involve embedded labour. In the case of data retrieval, labour is embedded in the service (for example, setting up and maintaining the database and creating the necessary software to allow for fully automated, self-serve searching and retrieval of information). We suggest that the factor of human involvement be more broadly defined to include both active and embedded labour.

Given that intangible personal property is often taxed when supplied to non-residents (for example, assignment of world-wide distribution rights to a non-resident), while services generally are not, the CCRA should request that the Department of Finance broaden Schedule VI, Part V, section 10. Characterizing a supply as a service or as intangible personal property should not result in such a discrepancy. In June 2001, John Bain of the Department of Finance advised us that the Department may consider broadening section 10. In our view, this would make the often arbitrary distinction between intangible personal property and services less important.

The foregoing are our preliminary comments. We expect new issues will arise on the specific topics addressed in the Discussion Paper as we gain experience with real-life examples. We will continue to monitor the progress of the Discussion Paper and welcome further opportunities to assist the CCRA in any further refinements.

Yours truly,

Allan J. Gelkopf
Chair, Sales Tax Committee
Sales and Commodity Tax Section