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September 30, 2016

Via email: fin.gsthst2016-tpstvh2016.fin@canada.ca

Sean Keenan
Director, Sales Tax Division
Tax Policy Branch
Department of Finance
90 Elgin Street
Ottawa, ON K1A 0G5

Dear Mr. Keenan:

Re: July 22, 2016 Legislative and Regulatory Proposals on GST/HST – Proposed Drop Shipment Rules

I write on behalf of the Commodity Tax, Customs and Trade Section of the Canadian Bar Association (the CBA Section), in response to the draft legislative and regulatory amendments for the Goods and Services Tax and Harmonized Sales Tax (GST/HST) released for consultation by Finance Canada on July 22, 2016.

The Canadian Bar Association is a national association representing over 36,000 jurists, including lawyers, notaries, law teachers and students across Canada. Our primary objectives include improvements to the law and the administration of justice. The CBA Section comprises CBA members from across Canada who routinely deal with and advise on transaction tax matters, including GST/HST, sales tax and excise duties.

First and foremost, we wish to thank the Department for its efforts to modernize and clarify the GST/HST provision of the *Excise Tax Act*, and to amend the legislation to more closely reflect the intended underlying tax policy. Our members have had an opportunity to consider the proposed amendments – particularly those on the GST/HST drop shipment rules – and offer for your consideration our observations and concerns.

Proposed Amendments to the Drop Shipment Rules

We welcome the proposed revisions to the drop-shipment rules, and in particular their application to services supplied to a non-resident, and the introduction of specific rules for leasing transactions.

We have however, identified three principal concerns.

1. Retroactive Application of Subsection 179(2.1)

Finance Canada has proposed new subsection 179(2.1) to address the “registered last supplier problem”, which is illustrated in example #11 in GST Memorandum 3.3.1. The new subsection will only apply to supplies made after the Announcement Date. This provides no relief for any taxpayer that has been assessed GST/HST for supplies made prior to the Announcement Date arising from this legislative inadequacy.

New subsection 179(2.1) should retroactively apply to supplies made on or before the Announcement Date to persons who acted as if the subsection was in effect, prior to any assessment or other enforcement action of the Minister.

The drop shipment rules were intended to be remedial, and were brought in to facilitate cross-border drop shipment arrangements involving non-resident persons as intermediaries between Canadian suppliers and Canadian consignees. They were meant to relieve GST/HST on the sale from the Canadian supplier to the non-resident person, thereby relieving the non-resident person from having to be registered for GST/HST purposes (which would be a disincentive for non-resident persons to participate in these arrangements).

2. Ownership of Property At Time of Commercial Service

Under the existing rules, where a person acquires physical possession of tangible personal property for the purpose of making a taxable supply of a commercial service in respect of the property to a non-resident person, the property in question must not be property of a person who is resident in Canada or is registered for GST purposes. Under the proposed amendments, the restriction that the property must not be property of a person who is registered for GST purposes has been removed.

However, proposed subsection 179(1)(a)(iii) still reads that, “For the purposes of this Part, if a registrant acquires physical possession of particular tangible personal property (other than property of a person that is resident in Canada) for the purpose of making a taxable supply in Canada of a commercial service...”

The concern arises that the property must not be property of a person resident in Canada at the time the registrant acquires physical possession of the particular tangible personal property, rather than at the time the commercial service is performed with respect to the property. If the property in question is being sold to the non-resident by a registrant (“Canadian Vendor”) who will transfer physical possession of the property to another registrant (“Canadian Service Provider”) who will perform a commercial service on the property for the non-resident, the concern arises that the drop shipment rules may not apply if transfer of title from the first registrant to the non-resident occurs after physical possession of the property has been transferred to the second registrant.

For example, if a Canadian registrant is selling a continuous transmission commodity (CTC) (i.e. water) to a non-resident who intends to have a second Canadian registrant freeze the water into blocks of ice, physical possession of the water may pass from the water vendor to the ice-maker at the time the water leaves the pipeline and enters the intake pipe to the ice-maker’s plant. The title to the water however, will not pass from the water supplier to the non-resident until immediately after the water passes through the first volumetric meter at the ice-maker’s plant – which may be some distance from the start of the intake pipe.

Similarly, a Canadian registrant may supply property to a non-resident of Canada, but transfer physical possession of that property to a second Canadian registrant who will perform a commercial service on that property. It will remain owned by the first Canadian registrant, but held in the first inventory storage point of the second Canadian's facility, and title to the property will not transfer to the non-resident from the first Canadian until the second Canadian registrant removes the property from the first inventory storage.

This issue could be solved if the phrase about ownership of the property, as set out above, were moved: "For the purposes of this Part, if a registrant acquires physical possession of particular tangible personal property for the purpose of making a taxable supply in Canada of a commercial service in respect of the particular property (other than property of a person that is resident in Canada) to a non-resident person that is not registered under Subdivision D of Division V...".

3. Blanket Drop Shipment Certificates

The new drop shipment rules now refer to the "particular tangible personal property" and, in the case of leases, to the "particular taxable supply of tangible personal property".

This gives rise to the concern that the CRA will now require a separate drop shipment certificate for (a) every relevant agreement for the supply of tangible personal property, manufacturing service, or commercial service, (b) every purchase order issued under the relevant agreement, or, in the worst case scenario, (c) every shipment or transfer of physical possession of the relevant tangible personal property. We have seen the CRA take this position in the past with exports of CTCs where the purchase certified under section 15.2 of Part V of Schedule VI. Specifically, the CRA has refused to accept blanket statutory declarations under section 15.2 that are applicable to all purchases by a particular recipient to the supplier on the basis that section 15.2 refers to "a *particular* supply". The CRA has focused on the word "particular" to imply that a separate statutory declaration is required under section 15.2 of Part V of Schedule VI for each contract or purchase order placed by the recipient with the supplier.

Our concern is that given the use of the words "particular tangible personal property" and "particular taxable supply of tangible personal property" in new section 179, the CRA will begin to refuse to accept blanket drop shipment certificates and require separate certificates for each transaction or shipment of particular property in question.

This concern could possibly be addressed by adding a subsection to 179 to clarify that a single certificate given by a particular consignee to a particular registrant may be for one or more acquisitions of physical possession of particular property or more simply, specifies that a blanket certificate covering acquisitions of physical possession of particular property during either a specific period of time or on an ongoing basis are acceptable.

Similarly, the proposed drop shipment rules now refer to and apply to "*particular* tangible personal property" (and in the case of the new leasing provisions, to a "particular taxable supply in Canada of tangible personal property"). This very specific language eliminates the application of the drop shipment rules when dealing with fungible goods (such as natural gas). For example, if a non-resident purchases a quantity of natural gas from a Canadian registrant and requests that it be drop-shipped to a second Canadian registrant for further processing, they will be subject to the same, "it's not the same molecule" arguments that have been made with section 144.01.

For example, new subsection 179(1)(a)(i) in combination with subsection 179(1)(b) reads, “For the purpose of this Part, if a registrant makes a taxable supply in Canada of particular tangible personal property by way of sale to a non-resident person that is not registered under Subdivision D of Division V, ... (b) the registrant, at a particular time, causes physical possession of the particular property to be transferred, at a place in Canada, to a third person (in this subsection referred to as the consignee)...” In the case of natural gas, the Canadian registrant/producer would deliver a quantity of gas to a pipeline for transmission by pipeline to a processor who may be under contract with the non-resident purchaser, but the gas delivered to the pipeline would not be the same gas that would have been received by the processor – just the same quantity.

This concern could be resolved if paragraph 179(1)(b) (and similar sections throughout) were revised to read, “the registrant, at a particular time, causes physical possession of the particular property (or where the particular property is a continuous transmission commodity or other fungible good, such property may include an identical quantity of the particular property) to be transferred at a place in Canada, to a third person (in this subsection referred to as the consignee)...”

We also have one typographic comment – there is a comma missing between “consumption” and “use” in proposed subsection 179(4)(b)(ii)(C).

Again, we thank you for this opportunity to participate in the legislative process and for your consideration of our concerns. Should you have any questions or wish to meet with representatives to discuss our comments, please contact Kate Terroux at 613-237-2925 x.173 or katet@cba.org.

Yours truly,

(original letter signed by Kate Terroux for Maurice Arsenault)

Maurice Arsenault
Chair, Sales Tax Committee
CBA Commodity Tax, Customs and Trade Section

cc: Annie Donolo – Press Secretary, Minister of Finance
Via email: Annie.Donolo@canada.ca