THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

GST and HST on E-commerce Supplies

CANADIAN BAR ASSOCIATION
COMMODITY TAX, CUSTOMS AND TRADE SECTION

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PREFACE

The Canadian Bar Association is a national association representing 36,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the Canadian Bar Association Commodity Tax, Customs and Trade Section, with assistance from the Advocacy Department at the CBA office. The submission has been reviewed by the Law Reform Subcommittee and approved as a public statement of the CBA Section.

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I. INTRODUCTION

The Canadian Bar Association Commodity Tax, Customs and Trade Section (CBA Section) is pleased to comment on proposed changes to the application of the GST/HST on e-commerce supplies outlined in the November 30, 2020 Fall Economic Statement.[1]

The CBA is a national association of 36,000 members, including lawyers, notaries, academics and students across Canada, with a mandate to seek improvements in the law and the administration of justice. The CBA Section addresses issues related to the law and practice in commodity tax, customs and trade remedy matters, GST/HST, transfer pricing, valuation and more.

II. SPECIFIED SUPPLIES MADE THROUGH A SPECIFIED DISTRIBUTION PLATFORM

In practice, where a distribution platform operator (DPO) becomes responsible to collect GST/HST on behalf of unregistered suppliers, the registered suppliers that remain required to collect GST/HST could be held liable in circumstances beyond their control.

Under proposed subsection 211.13(1) of the *Excise Tax Act* (ETA), if a specified supply is made through a specified distribution platform by a specified non-resident supplier to a specified Canadian recipient and the DPO is registered for GST/HST under subdivision E of Division V of Part IX of the ETA, the supply is deemed to be made by the DPO, not the specified non-resident supplier. The deemed supply by the DPO to the specified Canadian recipient is deemed to be made in Canada for GST/HST purposes under proposed subsection 211.14(1).

However, GST/HST registered suppliers of intangible personal property and services (Canadian Supplier) may seek to make supplies through non-resident DPOs that are registered under the simplified GST/HST regime. In this case, the supplies by the Canadian Supplier would not be deemed to be made by the DPO. As a result, the Canadian Supplier

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1 *Supporting Canadians and Fighting COVID-19: Fall Economic Statement 2020*.

remains liable to collect GST/HST on the supplies made in Canada, irrespective of whether the recipient is a specified Canadian recipient.

In practice, the DPO, which controls or sets the essential elements of the transaction and receives the consideration payable for the supply, would be the main interface with the Canadian Supplier's customer for the transaction. In these cases, the DPO would likely collect and report GST/HST on the same basis that it collects and reports tax for specified non-resident suppliers.

Accordingly, although tax would be collected and remitted on certain supplies by the Canadian Supplier, it is likely that the tax would be reported and remitted by the DPO on its returns. Currently, the ETA does not permit a DPO registered under the simplified regime to make an election with a Canadian supplier under section 177 to have the DPO collect and report tax on behalf of the Canadian Supplier. In addition, the DPO would only collect tax on supplies to persons that do not given satisfactory evidence that they are registered for GST/HST under Subdivision IV of Division V of Part IX of the ETA. As a result, the Canadian Supplier may not be able to collect GST/HST on supplies to businesses.

For example, where a large non-resident DPO is registered under the simplified rules, it is required to collect GST/HST on behalf of the non-registered vendors that sell on its platform. But some vendors may already be registered and required to collect tax on their own account. Software and informational limitations of the DPO may prevent GST/HST-registered vendors from opting out of the DPO's remittance program once it is implemented. The GST/HST-registered vendors will be unable to remit their required taxes.

The proposed legislation should address situations where a DPO facilitates supplies by Canadian Suppliers to ensure tax is properly collected and that the Canadian Supplier does not incur liability if it seeks to make supplies through a non-resident distribution platform registered under the simplified regime. Finance Canada should also consider a default rule where the DPO will be solely responsible for collecting and remitting GST/HST in these circumstances, subject to the parties electing out of the rule (in which case the registered Supplier would be liable to collect and remit).

We recognize that it may be preferable for the government to collect GST/HST from a vendor that is registered under the normal GST/HST regime than from a DPO that is registered under the simplified regime (due to concerns with enforcement of the simplified regime).

III. INEQUITY FAVOURING SUPPLIERS OF SHORT-TERM ACCOMMODATIONS

Under paragraphs 211.13(3)(b) and (4)(b), the supplier of short-term accommodation is deemed not to receive a supply from the accommodation platform operator. This relieves GST/HST on the platform fees charged by a registered accommodation platform operator to the supplier, whether the supplier is registered or not. We support this tax relief measure.

However, this measure favours the short-term accommodation industry over other participants in the "sharing" or "gig" economy where individuals are charged taxable platform fees by the DPO. For example, platforms that facilitate supplies of other services, such as grocery delivery, ridesharing and home repairs, may charge GST/HST to suppliers on their platforms who do not benefit from similar relief. A specific benefit for the short-term accommodation sector is unfair. We recommend that any services offered to a supplier that makes a supply facilitated through a DPO should be similarly relieved from GST/HST.

IV. QUALIFYING SUPPLIES MADE THROUGH SPECIFIED DISTRIBUTION PLATFORMS: FULFILLMENT WAREHOUSE RULES

The proposed "fulfillment warehouse" rules are troubling because they impose obligations on the DPOs that sell tangible personal property in Canada that may not be practical.

Proposed section 211.22 deems a DPO to be the supplier of a "qualifying tangible personal property supply" made through a "specified distribution platform" if the supplier is not registered for GST/HST purposes. The rules deem the supplies not to have been made by the actual supplier. If the DPO is registered for GST/HST purposes and (a) the supplier paid Division III tax on importation, (b) if section 180 of the ETA does not apply, and (c) the supplier gives evidence to the DPO that is satisfactory to the Minister that the tax was paid, then the DPO is deemed to have paid the tax and is eligible for input tax credits.

Under the CRA's current administrative interpretation, a supplier who makes a qualifying tangible personal property supply from an inventory in Canada will, in many cases, be "carrying on business in Canada" (see GST/HST Policy Statement P-051R2, Example 9). The proposed rule in section 211.22 would also capture sales made by small suppliers in and outside Canada. To the extent that the supplier is not a small supplier, they are already required to register, under the CRA's published administrative position, on the basis that they are making taxable supplies in Canada, in the course of a business carried on in Canada

(see subsections 240(1) and 143(1) of the ETA). We assume that Finance Canada is not focused on taxing the supplies made by small suppliers.

The proposed rules appear to alleviate the obligation of such non-resident suppliers who would otherwise be carrying on business in Canada from registering for GST/HST purposes, because the supplies will be deemed to be made by the DPO, not the supplier. It is unclear whether the non-resident suppliers would be permitted to register under the voluntary registration rules in subsection 240(3) of the ETA, in view of the rule that deems them not to be making any supplies that are made through the distribution platform. If Finance Canada's intention is for non-resident suppliers who sell through DPOs not to be eligible to register for GST/HST purposes, this should be clarified. However, as discussed below, such a policy is not without challenges.

The proposed rules shift an unfair degree of liability to DPOs for transactions for which they do not have sufficient control or information.

- DPOs, by definition, do not always control or set the essential elements of a transaction (i.e., price, delivery terms). Paragraph (b) of the definition of DPO includes entities that are only involved with payments (as long as they are not "solely" payment processors).
- DPOs often do not have information about the products themselves and in many cases will not be able to determine firsthand whether they are taxable at normal rates, zero-rated or exempt. [Note: This is not only the case for DPOs facilitating the sales of goods. DPOs facilitating the sales of intangible personal property and services will face the same issues. For example, a DPO that facilitates supplies of tutoring or telemedicine services may not have any insight into whether the underlying services provided by suppliers on the platform are taxable or exempt. A DPO registered under Subdivision D of Division V may also not have knowledge on whether a service supplied by a specified non-resident supplier is wholly performed outside of Canada for purposes of determining whether the supply is deemed to be made by the DPO under subsection 211.13(2) or is made by the non-resident specified supplier., which has implications for both parties.]
- In many cases, the supplier and recipient will make shipping arrangements between themselves and the DPO is not necessarily informed. Even if the DPO obtained this information as part of the original transaction, the supplier and recipient may change their arrangements without informing the DPO.
- DPOs generally do not currently have a workable process for validating whether a supplier who sells products on the distribution platform are validly registered for GST/HST because the process has not previously been required. The CRA website is cumbersome for such purposes. In particular, the website requires that a person manually input a registrant's BN and legal or trade name exactly as the CRA has entered it in its system (which may or may not be accurately given to the DPO), one at a time, and the results may only be checked for one specific date at a time.

- DPOs do not receive the benefit of sales of the goods on the platforms for which they will be responsible to collect GST/HST (they receive only service fees and soft benefits like customer loyalty) and should not be liable for collecting GST/HST as agent for the Crown in the same way as a supplier, who benefits directly from the sale.

Therefore, we believe that responsibility for collecting and remitting should not shift from the supplier to the DPO.

The rules could possibly lead to double tax where goods are imported. For Division III tax, the proposed rule requires the supplier to give the DPO evidence satisfactory to the Minister that the tax was paid (often assumed to be the Customs entry form i.e., Form B3), but the input tax credit is claimed by the DPO. This mismatch in information will often not work well in practice.

In our experience, suppliers resist sharing their Form B3s to third parties, including a DPO, because the forms include commercially sensitive information such as the supplier's cost of those products. The form also often includes lines of importations unrelated to the DPO.

If this is implemented, the legislation should say that proof of payment of GST on import is all that is needed (e.g., the Customs Brokers Invoice). Based on these concerns, in practice, where the goods are imported, the Division III tax may not be recovered in the manner contemplated by proposed paragraph 211.22(c) without clear changes, resulting in double tax (i.e., GST payable on importation and GST/HST collected on the sale of the goods), and increased costs to consumers. There may also be commercial competition issues to consider. For example, if the DPO sells its own products that compete with the supplier's, knowing the supplier's costs would be helpful to set their own price. Conversely, as this could potentially breach competition laws, the DPO may incur additional costs to ensure the information given by suppliers is not used by its pricing groups. Even then, just having the information will leave the DPO open to accusations that it used the information inappropriately.

It does not seem fair to put suppliers in the position of either telling the DPO their own mark-up (which the DPO could potentially use) or bearing the cost of GST/HST on importation or putting the DPOs in a situation where they must incur even more costs to ensure the confidential information they receive is not used inappropriately. Also, as a practical matter, parties will have to renegotiate their contracts to implement this rule and ensure the DPO gives an amount equal to the input tax credits it claimed based on information given by the supplier to the DPO. This is not always feasible and could be costly to both parties.

To address these concerns, an alternative is to apply and enforce the existing drop shipment rules, with necessary modifications, to address the issues raised in the Fall Economic Statement on goods sold through fulfillment warehouses. We suggest that the information return for warehouses in proposed section 211.23 should assist the CRA with its enforcement of these rules. Another policy alternative is that the mandatory registration under subsection 240(1) be enacted for these non-resident vendors using Canadian fulfillment warehouses and then enforced for non-resident suppliers that maintain an inventory of goods in Canada.

V. DEFINITION OF DISTRIBUTION PLATFORM OPERATOR IS TOO BROAD

Proposed subsection 211.1(1) would define a DPO as:

> **distribution platform operator,** in respect of a supply of property or a service made through a specified distribution platform, means a person (other than the supplier or an excluded operator in respect of the supply) that;
>
> (a) controls or sets the essential elements of the transaction between the supplier and the recipient;
>
> (b) if paragraph (a) does not apply to any person, is involved, directly or through arrangements with third parties, in collecting, receiving or charging the consideration for the supply and transmitting all or part of the consideration to the supplier; or
>
> (c) is a prescribed person.

It is not clear why paragraph (b) is needed to cause a person to be included in this definition, as paragraph (b) will only apply where the distribution platform does not control the essential elements of the transaction between the supplier and the recipient.

The essential elements of the transaction could include several factors, including providing listing services for the sale of goods, setting payment terms and delivery conditions (as in Annex 4 of the Fall Economic Statement) and billing (as included with some of the other conditions in the definition of "specified digital platform" in section 477.2 of the Quebec legislation). Entities that fall under paragraph (b) of the definition of "distribution platform operator" will, by definition, not control at least some of the payment terms, delivery conditions, billing or not provide listing services.

An entity that falls within paragraph (b) may have no knowledge of the delivery conditions, payment terms, or even exactly what goods or services are sold. It is not clear how that entity is expected to be able to determine whether a particular supply is taxable and what rates to charge on it. This is especially true where the vendor controls all the essential elements of the supply.

More specifically, as DPO is defined, an entity that does not control the essential elements of the supply would be captured by paragraph (b) merely by being "involved, directly or through arrangements with third parties, in collecting, receiving or charging the consideration for the supply and transmitting all or part of the consideration to the supplier." This is extremely broad and would include a third party who merely collected amounts from purchasers and transmitted these amounts to the supplier. The wording would even encompass someone who hired a third party to perform this service.

The types of services that fall within proposed paragraph (b) appear to include many, if not all, services typically offered by a payment processor. This result seems to be at odds with the intention of paragraph (c) of the proposed definition of "excluded operator" which includes a person who is "solely a payment processor". That is, most payment processors appear to fall within the definition of paragraph (b) of distribution platform operator unless they are "solely" a payment processor.

However, since most payment processors perform at least some activities in addition to pure payment processing, as drafted, paragraph (b) would likely cause many payment processors to become distribution platform operators. For example, if a company hired a payment processor to process transactions, the latter entity is less likely to be engaged "solely" as a payment processor even where it does not control any essential elements of the supply.

It is not clear that the definition of DPO was intended to be this broad, particularly in light of the limiting language in the definitions of "excluded operator" and "digital platform". An unforeseen consequence of this treatment is that companies that are primarily payment processors deemed to be distribution platform operators under paragraph (b), will presumably be entitled to a higher level of input tax credits as many of the supplies they make will now be deemed to be taxable supplies.

In contrast, section 477.2 of the Quebec legislation defines “specified digital platform” to mean:

> a digital platform for the distribution of property or services through which a particular person enables another person who is a specified supplier to make a taxable supply in Québec of incorporeal movable property or a service to a recipient, provided the particular person controls the essential elements of the transaction between the specified supplier and the recipient such as billing, the terms and conditions of the transaction and the terms of delivery.

Further, section 477.6 of the Quebec legislation requires a person to collect the tax payable by specified Quebec consumers if they are registered for QST and “operate a specified digital platform and receives an amount for the taxable supply of incorporeal movable property or a service made in Québec by a specified supplier to a specified Québec consumer”.

The Quebec legislation appears to effectively apply only where the platform controls the essential elements of the transaction (which includes billing and terms of delivery) and receives an amount for the supply. We believe this approach works well because it will only require platforms actively involved in the transactions to register in situations where they should have the information needed to determine the correct amount of tax to apply but will not require persons to register where they do not control or know the essential elements of the supply.

We propose that language like the Quebec rules be used for determining whether a company is a DPO and whether the DPO must charge and collect tax.

If Finance Canada prefers to work with the proposed rules, we suggest that a distribution platform operator should be required to meet the conditions of paragraph (a) *and* paragraph (b) – rather than paragraph (a) *or* (b) – or, if Finance Canada wants broader rules than Quebec’s, that paragraph (b) be deleted.

We believe this is required as only platforms that control the essential elements of the supply will have the necessary knowledge to determine the applicable taxes on supplies made through the platform. From a policy perspective, if Finance Canada wants persons who do not control and possibly have no knowledge of the essential elements of the supply to be the party responsible for charging tax on the supplies, we believe paragraph (b) should be changed from “collecting, receiving *or* charging the consideration" to “collecting, receiving *and* charging the consideration".

While this change will still present challenges where the party that must collect the tax may not have much knowledge of the important elements of the supply, it should at least prevent companies primarily engaged in only collecting and receiving funds from falling under the regime.

VI. BURDENSOME ONUS FOR DETERMINING "SPECIFIED CANADIAN RECIPIENT"

The "threshold" for determining if a non-resident must register under the new rules is based on sales to a "specified Canadian recipient", which applies a reverse onus test: every person whose usual place of residence is in Canada is a "specified Canadian recipient" unless the supplier obtains "evidence satisfactory to the Minister" that the recipient is registered.

Even if the non-resident supplier only makes "business to business" sales, if it has no evidence "satisfactory to Minister" that its customers are registered, then technically the supplier has made supplies to specified Canadian recipients and must be registered. This is overly broad and will capture too many non-resident suppliers who do not obtain evidence of their customers' registration, notwithstanding that these customers are in fact registered.

The Quebec experience is instructive. Obtaining QST registration numbers from businesses has been a challenge for sellers (i.e., to validate that the person is not a consumer). This is not the norm for indirect tax systems when making sales (i.e., it is different than VAT in the EU). Given that QST registration numbers were a challenge to collect from purchasers, this issue will be further magnified since GST/HST impacts all sellers' customers in Canada, particularly if GST/HST registered customers seek a refund from the sellers in the future.

A *reasonableness* test, where a person is considered a specified Canadian recipient where it is reasonable to assume that person is not registered, would be more appropriate for this purpose. Furthermore, because corporations are generally registered for GST/HST, we recommend that the rule apply only to sales to consumers (i.e., individuals).

VII. OTHER ISSUES

Given Quebec's experience implementing a similar simplified registration regime, the following issues should be addressed:

Registration with a different format: The proposed legislation does not state specifically that the CRA will provide a different format for the registration under subsection 211.14(4) for the simplified regime. Quebec has done so. This is critical because businesses cannot claim input tax credits based on a registration number issued under subsection 211.14(4). We recommend that the requirement for a different format be imposed directly in the legislation or conveyed directly to the CRA in published explanatory notes.

Credits to Customers: Sellers are experiencing issues with the simplified QST regime as the seller is the sole administrator of the refund claim for Revenue Quebec. Customers may only recover the tax paid from the seller. Given the administrative issues and costs incurred by sellers issuing refunds, customers should have the ability to claim GST/HST refunds directly from the CRA. The CRA can verify that the seller is registered and has been reporting tax collected before issuing the refund claim.

VIII. TIMING FOR IMPLEMENTATION

In our view, the GST/HST proposals on e-commerce supplies will impact the largest number of taxpayers and is the most significant change to the GST/HST regime since harmonization of GST/HST in Ontario and British Columbia in 2010. This change potentially affects an enormous segment of the business community in Canada and internationally.

As such, the timeframe for companies to implement the new rules is not long enough. Given that the measures were announced just before the holidays (and during a pandemic), it will be difficult for many companies to update accounting and billing systems to comply with their new obligations. The uncertainty on platform transactions and the allocation of responsibility for the collection and remittance of taxes between parties exacerbate the problem.

Changing enterprise resource planning systems entails significant costs and requires sufficient lead time. This is especially true for the proposed rules, where platforms will need to create different rules for collection of tax (depending on whether a purchaser is a registrant or not), determine whether products that they know nothing about are taxable or exempt, and potentially create different rules on whether they must report and remit tax

(depending on whether suppliers are registered or not and under what regime). Many suppliers do not have systems or software to deal with these intricacies. The July 1, 2021 effective date may not give companies sufficient time to comply.

IX. CONCLUSION

Thank you again for the opportunity to comment on the proposed changes. We would be pleased to arrange a meeting to further discuss our comments and any other issues that may have arisen from the consultations.