Noteworthy 2020 GST/HST developments for corporate commercial operators

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Two important Goods and Services Tax/Harmonized Sales Tax (GST/HST) case law trends continued in 2020: the Tax Court of Canada (the TCC) confirmed the broad interpretation of "consideration" for GST/HST purposes, and the importance of substance over form when characterizing a legal relationship for GST/HST purposes.

"Consideration " for GST/HST purposes includes amounts payable by operation of law, and is interpreted broadly by the courts: *CanLII and Casolino* .

CanLII

GST/HST liability is calculated based on the value of consideration given for a supply. Two TCC decisions this year highlight the broad definition of "consideration" for GST/HST purposes. The broad definition of "consideration" can lead to unanticipated and unrecoverable GST/HST costs for businesses involved in exempt activities but may also lead to GST/HST planning opportunities in other circumstances.

In *Canadian Legal Information Institute v. The Queen* (*CanLII*) the appellant had claimed ITCs on the GST/HST incurred in the course of operating a virtual law library. The CRA denied CanLII's ITC claims on the basis that its law library was provided free of charge to users and was an exempt supply, which precluded CanLII's claim to recover GST/HST incurred on their expenses. This is because providing "free" services engages s. 10 of Part VI of Schedule V of the ETA, which provides that a non-profit organization such as the appellant makes an exempt supply if "all or substantially all" of the supplies are for no consideration (subject to some limited exemptions).

The TCC allowed the appeal concluding that the funding the appellant received from the Canadian Federation of Law Societies (the Federation) was consideration for providing the virtual law library even though the service itself was free to the public. The TCC noted that "consideration" for GST/HST purposes is a defined term in the ETA and includes amounts payable "by operation of law." When the Federation determined each year the annual funding it would provide to the appellant each year, the Federation's

constating documents required the Federation to pay this funding; it was not discretionary. The mandatory nature of the funding meant it was payable by operation of law.

For more details and commentary on CanLII, see BLG's previous *CanLII* commentary.

Casolino

Casolino v. The Queen (*Casolino*) is another decision interpreting the meaning of "consideration" for GST/HST purposes. In *Casolino*, the appellant's spouse operated a business that could not service its debt obligations under a line of credit secured against the appellant and spouse's jointly held family home. They refinanced their home in order to satisfy the debt obligation. As part of this transaction, appellant's husband transferred his interest in the family home to the appellant, and the appellant assumed the debt vis-à-vis the business line of credit.

At the time the family home transferred, the appellant's spouse owed a debt to the CRA. The CRA tried to recover this tax debt from the appellant pursuant to s. 325 of the *Excise Tax Act*, which in part allows the CRA to assess the spouse of a tax debtor where the spouse pays consideration exceeding fair market value for property transferred from the tax debtor. The appellant appealed the CRA's methodology for calculating the consideration paid by the appellant for the family home.

In allowing the appellant's appeal in part, the TCC confirmed the appellant's assumption of her spouse's business's debt was consideration for a supply. Notably, the appellant did not directly assume this debt – she obtained a mortgage in her own name, and used part of the mortgage funds to pay off her spouse's business debt. *Casolino* is a good reminder that the assumption of debt is "consideration" for GST/HST purposes.

Takeaway

The *Casolino* and *CanLII* decisions are stark reminders that "consideration" is not necessarily restricted to the purchase price for a supply; consideration can be found lurking in ancillary arrangements to a transaction (such as in assuming the business debt of a spouse in *Casolino*), or even a third party's documents (such as the Federation's constating documents and agreements with law societies in *CanLII*). Accurately identifying the consideration for a supply becomes an integral exercise for any business or individual who cannot fully recover the GST/HST incurred on purchases.

Substance over form: *Zomaron* and *Montecristo*. Courts rely on substance over form when characterizing a transaction for GST/HST purposes.

In *Zomaron Inc. v. The Queen* (*Zomaron*) and *Montecristo Jewellers Inc. v. the Queen* (*Montecristo*), the TCC stressed the importance of considering the factual substance of parties' activities when determining the GST/HST implications of a transaction.

Zomaron

In *Zomaron,* the CRA assessed the appellant for uncollected GST/HST on the basis the appellant, a "merchant services provider", was providing a taxable supply of promotional, marketing and administrative services. The appellant had operated as if it were providing a GST/HST-exempt service of "arranging for" financial services by connecting prospective clients to credit card processing companies. The appellant appealed the CRA's assessment to the TCC.

The TCC allowed the appeal, finding that the "vital" and "predominant" elements of the appellant's activities amounted to "arranging for" financial services. Notably, the TCC made its findings based largely on witness testimony of actual industry practices and the practices of the appellant. This was despite explicit contract language suggesting the appellant was providing marketing, promotional and advertising activities.

For more details and commentary on Zomaron, see BLG's previous *Zomaron* commentary.

Montecristo

Similarly, in *Montecristo*, the Federal Court of Appeal confirmed that terms of a contract (in this case, implied terms of an unwritten contract) must reflect the actual transaction that occurred. In Montecristo, the appellant was a jeweller who sold jewellery and watches it claimed was either (a) delivered or made available outside of Canada (goods delivered outside of Canada are not subject to GST/HST) or (b) shipped to a destination outside of Canada (such goods are "zero-rated", meaning technically taxable but at a rate of 0 per cent).

The issue with the appellant's position was that the appellant transferred possession of the goods to its customer after they cleared customs within an airport in Canada, but that the customer would transport the goods to themselves at a destination outside of Canada. The Federal Court of Appeal affirmed the TCC's findings that the facts scenario did not reflect the appellant's alleged implied terms. The appellant simply provided the jewelry or watches to its customers in Canada, and customers obtained full use and possession of the goods and assumed all risk associated with the jewelry at that time. For more details and commentary on *Montecristo*, see BLG's previous *Montecristo* commentary here.

Takeaway

When read together, *Zomaron* and *Montecristo* confirm the importance of a business ensuring it understands how GST/HST applies to its business, ensuring its business operations are legally documented to reflect the desired business arrangement (and the GST/HST implications of arrangement), and ensuring this intended relationship is being followed in practice. In other words, "substance" is key, both in practice and in documenting that practice.

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