



**TeleStrategies 2016:  
Managing Canadian Tax  
Risks for US  
Communications Providers**

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## Agenda

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- GST/HST overview
- New OECD International VAT guidelines
- Non-resident registration requirements
- Place of supply for:
  - Cloud (IPP v. services)
  - Telecommunications services
- Non-resident override (carrying on business, nexus standards)
- What's coming? (changes in laws/enforcement)

*Note: Reference materials, important links and known tax rate changes at end of presentation*



## Overview of GST/HST system

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- **GST:** 5% federal VAT tax administered by *Canada Revenue Agency* (CRA)
- **HST:** the provincial VAT tax (levied at rate selected by each province) administered by CRA for the province
- **Unique Fed/Prov arrangement:** each participating province agreed to let the Feds take over indirect tax responsibility
- **Key Features of GST/HST:**
  - One national registration system & one set of rules (jurisprudence, rulings, etc)
  - one audit body
  - one return (which doesn't even break out the HST amounts)
- **System has, for 25 years, been very good at:**
  - one single sales tax authority for business to work with
  - picking up GST on imports and stripping out GST on exports
- But new technologies are testing its limits...(see OECD Guidelines)



## OECD *International VAT/GST Guidelines*: November 2015

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- Existing VAT regimes have not kept pace with technological advances, and international tax framework is disjointed resulting in non-taxation (leakage) and trade distortion (often preferable to buy technology offshore)
- **B2C is leading concern:** non-residents selling remotely into domestic economies with minimal/no physical presence and thus not triggering local VAT registration requirements
  - reverse charge mechanism ineffective for B2C
- Affirmation: **destination sourcing** and **country of consumption maintains the right to tax** (origin/performance sourcing no longer viable in technology driven world)
- **OECD Recommendations:**
  - **New (lower) thresholds to compel non-residents to become registered** if selling remotely into domestic market
  - Standardized “**proxy**” approaches re: **destination sourcing**
  - Simplify **reporting/filing requirements** for non-residents
- OECD recommendations are not binding on member countries (but VAT tax leakage concerns growing for all OECD member states – Tokyo 2014)
- OECD has also made important comments about info sharing, enforcement



## Registration requirements: “Supply in Canada” concept

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- **GST registration required** if non-resident vendor makes a supply in Canada:

Except if: small supplier (small supplier is rarely available - \$30K worldwide revenue)

Or if: fall within the Non-Resident Override (NRO)

- Option to **voluntarily register**
  - Allows for access to flow through ITCs (input tax credits)
  - GST registration doesn't impact income tax status
  - Practical issue: are your Canadian operations contained in a single entity?
- But, are you truly a non-resident? GST extends the residency concept (picks up many technology providers with PE concept)



## Deemed Resident due to PE in Canada

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- **Deemed resident in Canada if (ss. 132(1))**
  - Corporation → incorporated or continued in Canada
  - Partnership → management and control in Canada (majority rule)
  - Individual → if deemed resident under *Income Tax Act*
  - All of above are in addition to common law residency tests
  
- **Extended PE rule:** A non-res who has a PE in Canada is deemed to be Cdn resident in respect of activities carried on through that PE (ss. 132(2))
  
- **What's a PE?**
  - A fixed place of business of the NR through which the NR makes supplies; or
  - fixed place of business of some other person (but not a broker or independent agent), who is acting in Canada on behalf of the NR, and through whom the NR makes supplies in ordinary course of business
  
- **CRA technology guidance:**
  - Supply through **website** in Canada → **NOT a PE** - website is not tangible and thus not a place of business
  - Supply through **server** in Canada → **YES PE** if the server is “at disposal of the NR” and if activities conducted through server are “significant and essential” to NR’s business as a whole.
  - “at disposal of NR” typically means owned or leased by NR. Server from ISP is not at disposal of NR.



## Deemed supply in Canada: IPP & Services

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- Codified “place of supply” rules are very broad
- Deemed Cdn Supply if sale of:
  - **intangible property** → property may be used even partially in Canada
  - **services** → service performed even partially in Canada
    - “performed” is not defined in Act
    - **Traditional view:** where are humans located who do the work
    - **Extended technology view:** “do something to or with” rule is becoming more relevant (note: OECD comments re: destination sourcing)

- **Whats “intangible property”? What’s a “service”?**

*“property”* means any property, whether real or personal, movable or immovable, tangible or intangible, corporeal or incorporeal, and includes a right or interest of any kind, a share and a chose in action, but does not include money

*“intangible property”* not defined – but *“personal property”* is all property other than real property

*“service”* means anything other than

(a) property, or

(b) money...

- Can it be argued that a deliverable is outside scope of Cdn taxation because it is neither property or a service?







## Distinguishing IPP v. services: CRA guidance

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### ■ Factors to suggest supply is IPP

- Provision of **right in a product** or **right to use product** (permanent or temporary rights)
- Product is already in existence
- Can even be product which is created for specific customer but ownership must be retained by vendor
- Right to make a copy of digitized product

### ■ Factors to suggest supply is service:

- **No provision of rights** or if provision of rights they are merely incidental to the leading supply
- Specific work done for a specific customer
- **Human involvement** in making the supply (but see OECD)



## Cloud computing: is it IPP or service?

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- What is cloud computing? An on demand service model for IT provision, typically based on virtualization and distributed computing technologies
- Key characteristics of cloud:
  - On demand self service/pay as you go re: software, infrastructure/computing resources, platform
  - no perpetual license (SAAS)
  - Rapid expansion capability (IAAS/SAAS/PAAS)
  - Rights to use and to access (but lite bundle of rights)
  - Broad network access to service but installed on vendor's hardware
  - Customer does not purchase maintenance (falls on vendor)
- Cloud as deployment spectrum: i.e., SAAS as software rights on subscription basis v. IAAS as access to computing resources (processing, storage, networks)



## Cloud: Review against CRA guidelines for IPP v. services

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### Cloud: factors that suggest IPP

- Provision of right in a product or right to use product (including temporary rights) ✓ (but 'right to use' (interact with) v. 'something provided')
- Product is already in existence ✓
- Can even be product which is created for specific customer but ownership must be retained by vendor N/A
- Right to make a copy of digitized product N/A

### Cloud: factors that suggest service

- No provision of rights or if provision of rights they are merely incidental to the leading supply × (care on this one)
- Specific work done for a specific customer ×
- Human involvement in making the supply × (minimal)
- If IPP, then supply in Canada if cloud deliverables may be used even partially in Canada
- BUT, look at terms of agreement, invoicing, POs (e.g., specific work done for the customer, or if no/few rights accrue to customer – will quickly shift to being services)
- **Strategic Consideration:** adopt a defensive/fall back GST strategy? (i.e., services or IPP)



## CRA guidance on IPP v. services re: cloud and related

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- Right to download and use a digital product → **IPP**
- Access website that allows downloads → **IPP**
- Software maintenance (BUT where main value is software updates, not tech support) → **IPP**
- Customer tech support but by means of existing materials (email support only as last resort) → **IPP**
- Application hosting:
  - & vendor is not providing any software rights → **service** [even though no human involvement]
  - & vendor is providing software license & tech support → **IPP** [but CRA assumption that principal object of K is the license]
- Access to existing data (e.g., industry data) for fee → **IPP** (key: data not customized for customer)
- Right to access a website and interact with existing content while online → **IPP**
- Provision of limited duration software by way of license → **IPP**
- *Supplier is licensee of specialized software, offers pay processing service (using the software). Customer gets to access the software → **service** (key: customer doesn't get control of or rights in software)*





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## Deemed supply in Canada rules for telecom

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- Telecom services don't follow ordinary "services" place of supply rules
- "telecommunication service" is either of:

(a) the service of emitting, transmitting or receiving signs, signals, writing, images or sounds or intelligence of any nature by wire, cable, radio, optical or other electromagnetic system, or by any similar technical system



Deemed Canadian Supply based on **2 out of 3 rule**  
(emit & receive or "billing location" in Canada + either emit or receive)

(b) making available for such emission, transmission or reception telecommunications facilities of a person who carries on the business of supplying services referred to above



Deemed Canadian Supply if **any of those facilities** are in Canada

**"telecommunications facility"** means any facility, apparatus or other thing (including any wire, cable, radio, optical or other electromagnetic system, or any similar technical system, or any part thereof) that is used or is capable of being used for telecommunications



## CRA guidance on telecom service v. ordinary service

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- **Challenge:** identify whether supply is **telecom** or is it **ordinary service** (but with telecom as delivery mechanism) because different place of supply rules
- CRA uses “**predominant purpose of supply**” test
  
- Supply is “**telecom service**” where:
  - Provide for emission, reception of signals
  
  - Make available telecom facility
  
  - Provide a **means** through which other services or IPP can be delivered (vendor may or may not be supplying the “other” piece)
  
- Supply is an “**ordinary service**” where:
  - Telecom service is **used or consumed** by supplier in making the supply (contract and billing is key)
  
  - Supply includes providing telecom but only as means of delivering another service or property (fine line)
  
  - Telecom is **incidental** to some other property or service deliverable



## CRA examples: Telecom v. ordinary services

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- **Internet access service** → **telecom** (predominant purpose of service is to provide the connection)
- **Email** → **telecom** (PP is to allow customer to send and receive email)
- **Website hosting** → **ord service** (PP is storage and hosting of website on server which has access to Internet. ISP consumes and uses telecom in making the supply)
- **VOIP** → **telecom** (PP is transmission of voice)
- **EDI transmission** of income tax returns → **telecom** (PP is transmission of data)
  - But prepare income tax returns and then transmit → **ord service** (PP is return prep, telecom is incidental)
- **Digitized product** can be downloaded by customer → **IPP**





## The non-resident override (nexus test for non-residents)

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- What is the NRO? Cdn GST version of Quill Corp. v. North Dakota (codified)
- **NRO Rule:** even if supply made in Canada (IPP, services, telecom services or any combination) then **not required to become GST registered** unless
  - supply is made in the **course of a business carried on in Canada**
- If already GST registered, then NRO is not available
- NRO is often used as a “fall back” position for US telecom/technology suppliers (i.e., place of supply as first line of defence and then NRO)



## When is a person carrying on business in Canada?

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- Question of fact whether COB in Canada
- CRA focuses on:
  - place of agents/employees
  - place of delivery
  - place of payment
  - place where purchases made
  - place where business is solicited
  - place of inventory or other assets
  - place where contracts concluded
  - where is bank acct
  - place where listed in directories
  - location of branch/office
  - service performance
  - place of mfg/production
- But, many of the **factors don't fit with technology/cloud** (or even traditional service model). CRA agrees – and so additional guidance:
  - Not a mechanical test (not a mathematical accounting)
  - Weighting and interpretation of **factors should be flexible to take into account nature of business** (especially for technology businesses) – for example “place of payment” can be highly flexible concept (place of approval for electronic payment v. place of receipt of money)
- Consider OECD Int'l VAT Guidelines
- With technological advances (in delivery mechanisms, market penetration without traditional “boots on Ground” that **maybe the standard will soften?**



## CRA cloud/remote examples re: COB in Canada

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- **Music:** Rights to download and use music in Canada from website hosted on servers outside Canada, ads aimed directly at Cdns, K concluded in Can

→ **Not COB in Can**

- **Software billed by the hour:** Software supplier solicits orders from Cdns (Cdn newspaper ads), software delivered from third party ISP server in Canada not owned by supplier, after sales tech support by independent contractors in Can, payments processed in Canada by third party service provider, K concluded in Can

→ **COB in Can (Cdn marketing, Cdn third party support, K concluded in Can).** Note that server in Canada is red herring – not at disposal of supplier.

- **Software right to use:** application provider with apps hosted on server outside Canada, solicits sales in Canada (via ads on website), K concluded in Can, customer can remotely access and use software for inventory control

→ **Not COB in Can**



## What's next?

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- Moving pieces:
  - New Cdn federal government: in office for only 6 months
  - OECD Int'l VAT Guidelines: released in Nov 2015
- May see lower registration standard for non-res vendors and possibly bifurcated registration standard (i.e., B2C v. B2B)
- May see changes in services sourcing (i.e., is place of performance test still relevant?)
  - What if: services sourcing moved closer to intangibles sourcing?
- Possible pressure points to deal with B2C gaps:
  - Enhanced obligation on payment processors who enable these activities? (but Bitcoin?)
  - Enlisting of other intermediaries? Telecom?





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## GST/HST and PST rates (as of May 5, 2016)

Province	GST	HST	PST	Combined rate - existing	New rate	Notes
<b>British Columbia</b>	5%	No	7%	12%	12%	BC had HST for 3 years but scrapped it in 2013 to revert back to traditional PST model
<b>Alberta</b>	5%	No	No	5%	5%	Alberta has never had a provincial sales tax but now on the table as possibility
<b>Saskatchewan</b>	5%	No	5%	10%	10%	Now that BC has rejected would it consider?
<b>Manitoba</b>	5%	No	8%	13%	13%	Now that BC has rejected would it consider?
<b>Ontario</b>	5%	8%	No	13%	13%	Adopted HST in 2013
<b>Quebec</b>	5%	No	9.975% QST	14.975%	14.975%	QST is a multi-stage tax modeled after the GST but with separate registration and administration apart from the GST.
<b>New Brunswick</b>	5%	8% *	No	13%	15%	HST rate will increase on July 1, 2016 to 10%
<b>Nova Scotia</b>	5%	10%	No	15%	15%	
<b>Prince Edward Island</b>	5%	9%*	No	14%	15%	HST rate will increase on Oct 1, 2016 to 10%
<b>Newfoundland</b>	5%	8% *	No	13%	15%	HST rate was to increase by 2% on January 1, 2016 but ultimately rejected. Then on April 14, 2016 reversed again – goes to 10% on July 1, 2016
<b>Nunavut/NWT/Yukon</b>	5%	No	No	5%	5%	



## Reference Materials

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### ■ OECD Vat Guidelines

- <http://www.oecd.org/ctp/consumption/international-vat-gst-guidelines.htm>

### ■ CRA Policy statements and Tech Interpretation Bulletins

- [http://www.cra-arc.gc.ca/menu/GTPP\\_200-e.html](http://www.cra-arc.gc.ca/menu/GTPP_200-e.html)
  - P-051R2 COB in Canada
  - P208R Meaning of PE
  - P-150 Imported Software
  - TIB 90 E-Commerce

### ■ *Excise Tax Act:*

- <http://laws-lois.justice.gc.ca/eng/acts/E-15/>

### Key sections of ETA:

- 123 definitions
- 142 place of supply services, goods and IPP
- 142.1 place of supply telecom
- 143 NRO
- 148 small supplier
- 152 consideration
- 165 imposition of tax
- 168 timing of tax payable
- 169 input tax credits
- 177 agency rules
- 212 Div III tax (goods only)
- 217/218 Div IV tax (reverse charge)
- 221 require to collect tax
- 225 net tax calculation
- 240 registration (required and permitted)



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