



How not

to get sued over the GST

by David M. Sherman

Are you at risk of being sued over a GST mistake?

If you practise real estate law, commercial litigation or corporate/commercial law, the answer is "yes." As counsel who's frequently called on by LAWPRO, I've seen numerous GST-related negligence claims, many made against lawyers by clients who have received an unexpected GST assessment from the Canada Revenue Agency (CRA). The examples below are fictitious scenarios based on that experience and illustrate some common areas where a lawyer can unexpectedly get into GST trouble.

The GST legislation is found in the Excise Tax Act (ETA).

Real estate law

The GST rules for real property are extraordinarily complex. Although the general rules are often simple to understand, there are myriad exceptions and special cases in the legislation. You should assume that you need to check the GST rules carefully on all but the simplest of transactions.

1. NOT UNDERSTANDING HOW THE GST APPLIES ON A COMMERCIAL SALE

Everyone who practises real estate law knows that you don't collect GST on a sale of commercial property to a GST-registered purchaser. But does that mean the sale is not taxable?

George is a real estate lawyer. His client, Tony, comes to him with an offer to review. Tony wants to sell a commercial property for \$1 million. The purchaser's offer is for \$1 million, on an OREA standard Agreement of Purchase and Sale form. The agreement states: "If GST applies, it is included in the price above." Should George let Tony accept the offer?

NO. This is not an offer for \$1 million. It is really an offer for \$943,396 plus GST. Because GST is stated to be included if it applies, GST of 6/106ths, or \$56,604, is included in the \$1 million.

If Tony signs this offer, he will have a nasty surprise on closing. Instead of \$1,000,000, he will get less than \$944,000.

Some lawyers think that the price is still \$1 million because they believe GST does not apply on a sale to a GST-registered purchaser. This is incorrect. GST *does* apply. The sale is taxable. However, under ETA subsection 221(2), the vendor does not collect the tax. Under subsection 228(4), the purchaser must "self-assess" and pay the tax directly to the CRA.

"But" – some lawyers say – "the purchaser doesn't really pay the GST, because he has an offsetting input tax credit!" Yes, the purchaser has an ITC, and that may net his payment obligation down to zero. But the sale is still taxable.

For a case confirming this interpretation, see *Bumac Properties Inc. v. 1221 Limeridge Inc.*, [2001] GSTC 4 (Ont. SCJ, Fedak J., Dec. 4, 2000).

2. NOT MAKING SURE THE PURCHASER IS GST-REGISTERED

George, the real estate lawyer, has another client, Laura, who is selling a commercial property for \$1 million. The purchaser is "12345678 Ontario Ltd." The purchaser's lawyer has faxed George a 2005 letter from the CRA confirming that the company is registered for GST.

George knows that, on closing, his client doesn't need to collect GST because the purchaser is GST-registered. Is George right?

NO. The registration could have been cancelled, or the letter could be a forgery. In either case, if the purchaser is not currently GST-registered, Laura will be assessed for \$70,000 in unremitted GST, plus interest, once this transaction comes to the CRA's attention. There is no "due diligence" defence to such an assessment. (If Laura is not filing GST returns, there is no time limit on such assessment – it could show up 15 years from now!)

George should check the CRA's GST/HST Web registry, www.cra.gc.ca/gsthstregistry, to ensure that the purchaser really is registered.

George should also determine, if possible, that the purchaser is not acting as a bare trustee for another party that is not GST-registered. If it is, the law is unclear as to whether Laura must collect GST.

3. HOUSE HOPPERS

Poor George has another client, Jimmy, who works in the construction industry. In 2005, Jimmy built a new home for his family, and they moved in. They decided they didn't like the home, so they built another home and moved there a year later, in 2006. Happily, Jimmy sold the first home for a nice gain.

Now they've decided to move again, and Jimmy has built a third home where the family will move. He has an offer on the second home, and wants George to handle the sale. Does George have to worry about the GST?

YES — but not in the way you may be thinking. There is no GST to collect on the sale of the second home. Because it's been lived in, it will be GST-exempt. (ETA Schedule V, Part I, section 4.)

However, George should be warning Jimmy about a very serious problem Jimmy is facing. If the CRA considers that he's a "builder" (ETA subsection 123(1)), who built the homes with the intention of selling them, he will be assessed for GST on the value of the home *upon moving into each home*. This is the so-called "self-supply" rule. Jimmy may be facing a very substantial GST assessment, plus interest and penalty, on all three homes. The onus will be on Jimmy to prove that his family really intended to live in each home for a long time, and only sold because of unexpected circumstances.

To make matters worse, the CRA will also assess Jimmy for income tax on the profits from each home. The "principal residence" income tax exemption applies only to capital gains,

and Jimmy's gains will be considered business profits, not capital gains.

4. IS THE SALE OF VACANT LAND TAXABLE?

It's George again. His client, Millie, is selling a piece of vacant land. She comes to George to handle the sale. George tells Millie that since the land is vacant, she doesn't have to collect or remit GST. Is he setting himself up for a call to LAWPRO?

MAYBE. A sale of vacant land may be exempt, but George needs to check a number of facts first. He should review ETA Schedule V, Part I, section 9, which provides the exemption.

Examples of facts which *may* cause the sale to be taxable:

- Millie has been using the land for profit.
- Millie subdivided the property many years ago.
- The property is actually owned by Millie's corporation.
- Millie holds title to the property, but as a bare trustee for a corporation.

If tax applies and George doesn't advise Millie to collect and remit GST, the CRA may catch up with Millie years down the road, and assess her for the GST plus substantial interest. Guess where she'll look for recourse?

Commercial litigation

Sally is a litigation lawyer. Her client, MCo, had an agreement to provide services to JCo. JCo has terminated the deal. MCo was entitled to \$10,000 monthly, or \$50,000 if JCo terminated early. Sally files a claim against JCo for \$50,000. JCo quickly comes up with a cheque for \$50,000 to stop the litigation, and seeks a release and withdrawal of the claim. What's wrong?

Sally has forgotten the GST. If she accepts \$50,000 for MCo, MCo will only get \$47,170. ETA section 182 deems a settlement (or Court award) received by a supplier to be a "GST-included"

amount, and MCo will have to remit 6/106ths of the settlement as GST it is deemed to have collected.

Sally must make sure to claim \$50,000 plus \$3,000 for the GST, and to accept a settlement of \$53,000 if her client is to be made whole.

So what does the poor sole practitioner do?

Unfortunately for the non-specialist, you're stuck with the GST – and if you don't advise your clients about it in cases where it's relevant, you may find yourself making a call to LAWPRO.

Although you don't need to have all the answers on GST, you have to know what the issues are, and when to call a GST specialist, or to tell your client to consult their accountant.

At a minimum, you should have the GST legislation and CRA's GST publications. If you know what section or document you're looking for, use www.canlii.org for the legislation and www.cra.gc.ca for the publications (both free). However, these sites are not indexed or annotated, so you may find yourself lost at times.

For fully annotated and indexed legislation, see *The Practitioner's Goods and Services Tax Annotated*, and for annotated and indexed CRA publications, see *GST Memoranda, Bulletins and Policies*. Both are written by me and published by Carswell.

Another resource you may find useful is my book *Basic Tax and GST Guide for Lawyers*, published annually by Carswell. It's full of answers to the questions that come up in each area of practice.

For detailed analysis of every provision of the legislation, see the 14-volume *Canada GST Service* (online at www.taxnetpro.com). And don't make any assumptions about how the GST will apply before you check the legislation!

David M. Sherman (www.davidsherman.ca) is a leading expert on the GST and income tax law, and the author of numerous Carswell publications including The Practitioner's Income Tax Act, Canada GST Cases, GST Times, and the books mentioned above.