MARCH 2, 2021

Villa Ste-Rose: FCA Confirms Interest and Penalties Apply After GST Rebates Are Deducted

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In *Canada v Villa Ste-Rose Inc.* (2021 FCA 35), the Federal Court of Appeal (FCA) confirmed the decision of the Tax Court of Canada (TCC) that interest and penalties on the late filing and remittance of goods and services tax (GST) must take into account offsetting rebates to which the taxpayer was entitled. This decision runs contrary to the tax authorities' policy that interest and penalties apply to the late-filed and paid GST amount, without any deduction of the rebates receivable by the taxpayer for the same period.

Background

Villa Ste-Rose Inc. (Villa Ste-Rose) operates an assisted-living facility in Québec. Since all the supplies it makes are exempt under the *Excise Tax Act* (ETA), it is not registered for GST purposes.

On February 1, 2013, a fire destroyed the building operated by Villa Ste-Rose, so it had a new facility built by a contractor. When the construction ended and the first tenant moved in, Villa Ste-Rose was deemed to have self-supplied a rental property – a taxable supply – which had two consequences under the ETA:

- Subsection 191(3) ETA obliged Villa Ste-Rose to remit an amount of $736,864.18, corresponding to the GST calculated on the fair market value of the newly built facility.
- Under subsections 256.2(3) and 257(1) ETA, Villa Ste-Rose was entitled to two rebates, totalling $860,665.48, corresponding to GST paid in connection with the construction of the facility.

Since the return reporting the GST owed on the supply of the facility was filed after the expiry of the time limit under the ETA, the tax authorities charged interest and a late-filing penalty in accordance with sections 280 and 280.1 ETA. The interest and penalty were calculated on the amount of GST payable ($736,863.18) despite the fact that, after netting its rebates against the gross GST payable, Villa Ste-Rose was in a refund position.

The Issue

The appeal raised the issue of whether late-filed and remitted GST should be reduced by a rebate owed for the same period for the purposes of computing interest and penalties.

This issue arises in the specific context of a self-supply made by a non-registrant. It was not contested that a registrant would have benefited from the computation of the *net tax* – that is, that the GST owed by the registrant would have automatically been reduced by the input tax credits (ITCs) allowed in respect of the GST paid during the same period.[1]

The FCA's Decision

Sections 280 and 280.1 ETA provide that the interest and penalty are computed on the "amount" to be remitted or paid. The FCA interpreted the term "amount" using the modern method of statutory interpretation. Particular emphasis was given to the purpose and context of these provisions, and of the ETA more generally:

- The ETA seeks to put non-registrants on an equal footing with registrants by giving them a rebate on the GST paid in respect of the construction of a building. Otherwise, non registrants would find themselves in the unwanted situation of double taxation.
- When, as in this case, the conditions established by the ETA are met, a rebate of the GST paid must be allowed. The tax authorities have no discretion regarding an application for a rebate.
- When the tax authorities note that a person was entitled to a rebate but did not apply for it, they must issue the rebate even if the period for claiming it has expired.[2] Therefore, if Villa Ste-Rose had failed to file its GST return altogether, the tax authorities would have been obliged to apply a rebate against the difference between the GST and the rebate owed without penalty or interest. Thus, the FCA refused to endorse an interpretation of the ETA by which a person who has failed to file a mandatory return altogether would receive better treatment than a person who has simply filed the return late.
- In enacting sections 280 and 280.1 ETA, Parliament could not have intended to impose interest and a penalty on a taxpayer in Villa Ste-Rose's position, since the rebate applied for is inextricably linked with the taxable supply that was made and relates to the same period.

In light of the above, the FCA held that the term "amount" on which interest and the penalty are computed represents the tax as reduced by the taxpayer's rebate entitlements, even though the ETA uses the phrase "net tax" for that concept elsewhere. Since the net amount must be considered, Villa Ste-Rose should not have been assessed interest and a penalty.

Impact of the Decision

This decision sends a clear message that in indirect tax matters, courts will not hesitate to reject a literal interpretation of the law when it leads to an incongruous result.

Notwithstanding the TCC's decision rendered in March 2019, the tax authorities had maintained their policy and continued to compute interest and penalties on the amount of late-filed and remitted GST, regardless of the person's rebate entitlements.[3] Unless the tax authorities are given leave to appeal to the Supreme Court, they will have to change their policy in accordance with the jurisprudence.

In addition to a self-supply made by a non-registrant, as in this case, a similar situation occurs when a person, whether a registrant or not, is both the debtor and the creditor for the same period as a result of filing two separate returns. This will happen, for instance, where a non-profit organization collects GST on its taxable supplies and claims a rebate in respect of its exempt supplies. For a financial institution, this will occur notably when GST is payable in respect of imported taxable supplies (such as management services) while the institution is entitled to a net tax refund pursuant to its regular GST/HST return for the same period.

Taxpayers that have been assessed interest and penalties on an amount of GST/HST (and/or QST) without the rebates owed for the same period being taken into account should consult a professional to determine whether any recourse is available to them.

[1] However, a registrant is in the same position as a non-registrant with respect to new residential rental housing rebate (subsection 256.2(3) ETA), to which both are entitled. This rebate is not taken into account in computing the net tax and must be claimed in a separate return.

[2] Subsection 296(2.1) ETA and *United Parcel Service Canada Ltd. v Canada*, 2009 SCC 20, para 30.

[3] Canada Revenue Agency, Policy Statement P-194R2 (August 27, 2007); Revenu Québec, Questions techniques de l'heure – Direction générale de la législation, 26e Symposium sur les taxes à la consommation de l'Association de planification fiscale et financière (May 28, 2019).

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