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# Explanatory Notes Relating to the Excise Tax Act

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## **Preface**

These explanatory notes describe proposed amendments to the *Excise Tax Act*. These explanatory notes describe these proposed amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

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These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

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## Excise Tax Act

### Clause 1

#### Definitions

ETA  
123(1)

Subsection 123(1) of the *Excise Tax Act* (the Act) defines terms used in Part IX of the Act and in the Schedules to the Act relating to the goods and services tax/harmonized sales tax (GST/HST).

#### Subclause 1(1)

##### Definition “financial instrument”

ETA  
123(1)

The definition “financial instrument” is primarily relevant to the definition “financial service” in subsection 123(1). A financial instrument is anything that is described in any of paragraphs (a) to (i) of the definition “financial instrument”.

The definition “financial instrument” is amended to add new paragraph (f.1), with the result that a “virtual payment instrument” (as newly defined in this subsection) will now be a financial instrument.

This amendment is deemed to have come into force on the day after Announcement Date.

#### Subclause 1(2)

##### Definition “virtual payment instrument”

ETA  
123(1)

Subsection 123(1) is amended to add the new definition “virtual payment instrument”, which is used in the definition “financial instrument” in this subsection.

A virtual payment instrument is property (as defined in this subsection and, as a result, does not include money) that

- is a digital representation of value that functions as a medium of exchange (i.e., like money, it is an instrument that is accepted as payment in transactions for property and services and is recognized as a measure of value); and
- exists only at a digital address of a publicly distributed ledger (e.g., blockchain).

Paragraphs (a) to (c) of the definition “virtual payment instrument” set out property that is excluded from that definition. Paragraph (a) describes property that confers a right of any kind to be exchanged or redeemed for money or specific property or services or to be converted into money or specific property or services. For example, a security token that confers the future contingent right to be exchanged for a common share of a corporation would be excluded from the definition “virtual payment instrument” by paragraph (a). Paragraph (b) describes property that is primarily for use within, or as part of, a gaming platform, an affinity or rewards program or a similar platform or program. Paragraph (c) describes property that is prescribed property. (Currently, no property is proposed to be prescribed.)

The new definition “virtual payment instrument” is deemed to have come into force on the day after Announcement Date.

## **Clause 2**

### **Drop shipments**

ETA

179

Section 179 of the Act generally allows a person that is a non-resident and not registered for purposes of the GST/HST to acquire in Canada goods, or commercial services in respect of goods, on a tax-free basis, provided the goods are ultimately exported, or are retained in Canada by a registrant that agrees to accept a potential liability for tax in respect of a subsequent transfer or non-commercial use of the goods. In addition, this provision generally ensures that GST/HST applies to goods located in Canada that are supplied by an unregistered non-resident person for final consumption in Canada in the same way as that tax would apply to the goods if they were acquired from an unregistered non-resident person outside of Canada and imported for final consumption in Canada.

Section 179 is amended to add new subsection 179(7.1), which provides an interpretative rule that generally ensures that the drop-shipment rules found section 179 apply to commercial services that involve fungible goods. The new interpretative rule does not, however, apply to commercial services that involve fungible goods that are continuous transmission commodities transferred to a consignee by means of a wire, pipeline or other conduit.

New subsection (7.1) applies in respect of any supply of a service made after Announcement Date and in respect of any supply of a service made on or before that day if the supplier did not, on or before that day, charge, collect or remit any amount as or on account of tax under Part IX of the Act in respect of the supply.

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## **Clause 3**

### **Holding corporations and takeovers**

ETA

186

Section 186 of the Act sets out rules designed to enable registrants investing in related corporations that are engaged in commercial activities to claim input tax credits in respect of the shares or indebtedness of those corporations or related holding corporations.

Section 186 is amended to add new subsections 186(0.1) and (0.2) and to amend subsections 186(1), (2) and (3).

#### **Definition “unit”**

ETA

186(0.1)

New subsection 186(0.1) creates a definition of “unit” for the purposes of section 186. A definition of unit is introduced in respect of corporations and this definition is subsequently amended in respect of partnerships and trusts.

First, subsection (0.1) provides that unit means, in respect of a corporation, a share of the capital stock of the corporation.

New subsection (0.1) applies in respect of any property or service acquired, imported or brought into a participating province after July 27, 2018.

Second, subsection (0.1) is amended to provide that unit also means, in respect of a partnership, an interest of a person in the partnership, and, in respect of a trust, a unit of the trust.

Amended subsection (0.1) is deemed to have come into force on the day after Announcement Date.

#### **Operating corporation**

ETA

186(0.2)

New subsection 186(0.2) provides, for the purposes of amended section 186, an interpretation rule that sets out the test for determining if a particular corporation is an “operating corporation of another corporation”. This interpretation rule is used in determining if the other corporation is entitled to benefit from the deeming rules in amended subsections 186(1) and (2) (see commentary below on those subsections), provided that the other conditions of those subsections are met.

First, new subsection (0.2) provides that a particular corporation is, at a particular time, an operating corporation of another corporation if two conditions are met at the particular time. The first condition is satisfied if all or substantially all of the property of the particular corporation is property that was last manufactured, produced, acquired or imported by the particular corporation for consumption, use or supply by the particular corporation exclusively in the course of its commercial activities (within the meaning of subsection 123(1) of the Act). The second condition is satisfied if the particular corporation is related (within the meaning of subsection 126(2) of the Act) to the other corporation.

New subsection (0.2) applies in respect of any property or service acquired, imported or brought into a participating province after July 27, 2018.

Second, subsection (0.2) is amended to provide that a particular corporation may also be, at a particular time, an operating corporation of another person that is a partnership or a trust if two conditions are met at the particular time. The first condition is the same condition in respect of the property of the particular corporation that applies in cases where the other person is a corporation. The second condition is satisfied if at the particular time

- where the other person is a trust, the particular corporation is related (within the meaning of subsection 126(2)) to the trust; and
- where the other person is a partnership, the particular corporation is controlled by a person described in any of subparagraphs 186(0.2)(b)(i), (ii) or (iii) or a combination of such persons. Subparagraph (i) describes the other person (i.e., the partnership) itself. Subparagraph (ii) describes a corporation controlled by the other person (i.e., the partnership). Subparagraph (iii) describes a corporation related (within the meaning of subsection 126(2)) to a corporation controlled by the other person (i.e., the partnership).

Amended subsection (0.2) applies in respect of any property or service acquired, imported or brought into a participating province after Announcement Date.

### **Input tax credit**

ETA  
186(1)

Existing subsection 186(1) applies when a corporation (referred to in this subsection as “the parent”) acquires, imports or brings into a participating province property or a service for consumption or use in relation to the shares or indebtedness of another corporation that meets certain conditions. If the conditions of subsection (1) are met, the parent is deemed to have acquired or imported that property or service, or to have brought it into the participating province, in the course of a commercial activity of the parent. This enables the parent to claim input tax credits in respect of that property or service.

Three amendments are made to subsection 186(1).

The first amendment to subsection 186(1) is made to paragraph 186(1)(b), which contains a “commercial operating corporation property test” that the other corporation must meet in order for the parent to benefit from the rule in subsection (1). Under existing subsection (1), this test must be applied at the time that tax in respect of the acquisition, importation or bringing in becomes payable, or is paid without having become payable, by the parent. This test requires that, at that time, all or substantially all of the property of the other corporation is property that was last acquired or imported by the other corporation for consumption, use or supply by the other corporation exclusively in the course of its commercial activities.

Paragraph 186(1)(b) is amended to provide that the other corporation can meet the “commercial operating corporation property test” at that time if all or substantially all of its property is property that was last manufactured, produced, acquired or imported by it for consumption, use or supply by the other corporation exclusively in the course of its commercial activities.

This first amendment to subsection 186(1) applies in respect of any property or service acquired, imported or brought into a participating province before July 28, 2018 if tax became payable or was paid without having become payable in respect of the acquisition, importation or bringing into the participating province. In respect of any property or service acquired, imported or brought into a participating province after July 27, 2018, this amendment to the “commercial operating corporation property test” is instead incorporated into the term “operating corporation” that is defined in new subsection 186(0.2) (see commentary for that subsection) and through that term incorporated into subsection (1) as amended by the second amendment, which is described below.

The second amendment to subsection 186(1) provides greater precision as to the application of the deeming rule contained in the subsection.

In particular, subsection 186(1), as amended by the second amendment, applies to the acquisition, importation or bringing into a participating province of a particular property or service by a parent at a particular time if all of the following conditions are met at the particular time:

- the parent is a registrant (as defined in subsection 123(1)) and is a corporation resident in Canada;
- a particular corporation is an operating corporation of the parent (within the meaning of subsection 186(0.2)); and
- subsection 186(2) does not apply to the acquisition, importation or bringing in of the particular property or service.

If these conditions are met, amended subsection 186(1) provides that the parent is deemed, for the purpose of determining an input tax credit of the parent, to have acquired or imported the particular property or service or brought it into the participating province, as the case may be, for

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use in the course of commercial activities of the parent, but only to the extent that paragraph 186(1)(a), (b) or (c) describes the acquisition, importation or bringing in.

Paragraph 186(1)(a) describes cases where the parent acquired or imported the particular property or service, or brought it into the participating province, as the case may be, for any of the following purposes:

- the parent selling or otherwise disposing of units (as newly defined in subsection 186(0.1)) or indebtedness of the particular corporation;
- the parent purchasing or otherwise obtaining units or indebtedness of the particular corporation;
- the parent holding units or indebtedness of the particular corporation (e.g., custodial costs); or
- the particular corporation redeeming, issuing or converting or otherwise modifying units or indebtedness of itself.

This applies, for example, if a parent acquires property in part for the purpose of purchasing units of a particular corporation that is an operating corporation of the parent. In that example, the parent would, for the purposes of claiming an input tax credit, be deemed to have acquired the property in commercial activities of the parent to the extent that the property was acquired for that purpose, provided that all the conditions of subsection 186(1) are met.

Paragraph 186(1)(b) describes cases where the parent acquired or imported the particular property or service, or brought it into the participating province and

- the acquisition, importation or bringing into the participating province, as the case may be, by the parent is for the purpose of issuing or selling units or indebtedness of the parent;
- the parent transfers to the particular corporation (i.e., an operating corporation of the parent corporation) proceeds from the issuance or sale. This transfer is made either by lending money to the particular corporation or by purchasing or otherwise obtaining from the particular corporation units or indebtedness of the particular corporation; and
- the proceeds transferred to the particular corporation are for use by it in the course of its commercial activities.

Where paragraph 186(1)(b) applies, it deems the parent to have acquired the particular property or service or brought it into the participating province, as the case may be, for use in the course of commercial activities of the parent to an extent that is the product determined by multiplying the following three extents:

- the extent to which the acquisition, importation or bringing into the participating province by the parent is for the purpose of issuing or selling units or indebtedness of the parent;

- the extent to which the proceeds from the issuance or sale (meaning the net proceeds determined after deducting the cost of the issuance or sale from its gross proceeds) are transferred to the particular corporation; and
- the extent to which the proceeds that are transferred to the particular corporation are for use by the particular corporation in the course of its commercial activities.

For example, consider a case where a parent acquires legal services, 85 per cent of which are acquired for the purpose of issuing bonds, which in turn generate \$1,000,000 in net proceeds for the parent. The parent then transfers \$800,000 of those proceeds (i.e., 80 per cent) to an operating corporation of the parent through the purchase of common shares of the operating corporation. From that transfer, \$600,000 of the \$800,000 (i.e., 75 per cent) are for use by the operating corporation to purchase equipment used exclusively in the course of its commercial activities and the remaining \$200,000 invested in shares of unrelated corporations.

In that case, for the purposes of the parent claiming an input tax credit in respect of the legal services, paragraph 186(1)(b) would apply to deem the extent of the use of the legal services in commercial activities of the parent to be 51 per cent (85 per cent multiplied by 80 per cent multiplied by 75 per cent). This would be dependent on all the conditions of subsection 186(1) being met.

Paragraph 186(1)(c) only applies if, at the particular time the parent acquired, imported or brought into the participating province the particular property or service in question, the parent satisfies a property test. This property test is met if all or substantially all (i.e., 90 per cent or more) of the property of the parent is

- property that was last manufactured, produced, acquired or imported by the parent for consumption, use or supply exclusively in the course of its commercial activities;
- units of operating corporations of the parent;
- indebtedness of operating corporations of the parent; or
- a combination of such property, units or indebtedness.

If the property test is satisfied, paragraph 186(1)(c) describes cases where the parent acquired or imported the particular property or service, or brought it into the participating province, as the case may be, for the purpose of carrying on, engaging in or conducting an activity of the parent, other than an activity described in subparagraphs 186(1)(c)(i) or (ii).

Subparagraph 186(1)(c)(i) describes an activity that is primarily in respect of units or indebtedness of a person that is neither the parent nor an operating corporation of the parent. For example, consider a case where a parent that satisfies the property test acquires investment management services for the purpose of investing in shares generally (i.e., not limited to shares of the parent or of operating corporations of the parent). In that case, because the investment management services were acquired for the purpose of carrying on an activity described in

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subparagraph 186(1)(c)(i), the services would not be deemed to have been acquired for use in the course of commercial activities of the parent.

Subparagraph 186(1)(c)(ii) describes an activity that is carried on, engaged in or conducted in the course of making an exempt supply by the parent. However, excluded from subparagraph (c)(ii) is an activity that is a financial service (as defined in subsection 123(1), meaning that the activity must be described in any of paragraphs (a) to (m) of the definition and not be excluded by any of paragraphs (n) to (t) of the definition) and that is any of the following activities:

- the lending or borrowing of units or indebtedness of an operating corporation of the parent;
- the issue, granting, allotment, acceptance, endorsement, renewal, processing, variation, transfer of ownership or repayment of units or indebtedness of the parent or an operating corporation of the parent;
- the provision, variation, release or receipt of a guarantee, acceptance or indemnity in respect of units or indebtedness of the parent or an operating corporation of the parent;
- the payment or receipt of money as dividends (other than patronage dividends), interest, principal, benefits, or similar receipt or payment of money in respect of units or indebtedness of the parent or an operating corporation of the parent; or
- the underwriting of units or indebtedness of an operating corporation of the parent.

For example, consider a parent that satisfies the property test and acquires a computer to be used 80 per cent to make exempt supplies of residential units and 20 per cent to pay dividends to its shareholders. In that case, paragraph 186(1)(c) would deem the computer to be acquired 20 per cent for use in the course of commercial activities of the parent. This is because 20 per cent is the extent to which it is acquired for use in paying dividends and neither of the exclusions described in subparagraphs (c)(i) and (ii) would apply to that use. However, paragraph (c) would not deem the computer to be acquired for use in the course of commercial activities of the parent to the remaining 80 per cent extent that it is acquired for use in making exempt supplies of residential units, as this use is excluded by subparagraph (c)(ii).

The second amendment to subsection 186(1) applies to any acquisition, importation or bringing into a participating province of property or a service after July 27, 2018.

The third amendment to subsection 186(1) expands the scope of the subsection by replacing the requirement that the parent must be a corporation by a requirement that the parent must be a corporation, partnership or trust. All the other conditions of subsection (1) continue to apply.

The third amendment to subsection 186(1) applies in respect of any property or service acquired, imported or brought into a participating province after Announcement Date.

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**Takeover fees**

ETA

186(2)

Existing subsection 186(2) applies in situations where a corporation (referred to in this subsection as the “purchaser”) acquires or proposes to acquire all or substantially all of the voting shares of the capital stock of another corporation that is engaged exclusively in commercial activities (the “target corporation”). This enables the purchaser to claim input tax credits for property or services that it acquires in relation to the take-over or proposed take-over.

Existing paragraph (2)(b) contains a “commercial operating corporation property test” that requires that all or substantially all of the property of the target corporation to be property that was acquired or imported by the target corporation for consumption, use or supply by it exclusively in the course of its commercial activities.

Paragraph (2)(b) is amended to provide that the target corporation can meet this “commercial operating corporation property test” if all or substantially all of its property is property that was last manufactured, produced, acquired or imported by it for consumption, use or supply by it exclusively in the course of its commercial activities.

This amendment applies to any acquisition, importation or bringing into a participating province of property or a service in respect of which tax is payable or is paid without having become payable.

**Shares, etc., held by corporation**

ETA

186(3)

Existing subsection 186(3) applies in cases where a parent corporation holds shares or indebtedness of a particular corporation that is related to the parent. Existing subsection (3) provides that if, at a particular time, the particular corporation meets a “commercial operating corporation property test”, its shares and indebtedness held by the parent are treated as property acquired for use exclusively by the parent in commercial activities. The existing “commercial operating corporation property test” requires that, at the particular time, all or substantially all of the property of the particular corporation is property that was acquired or imported by the particular corporation for consumption, use or supply by it exclusively in the course of its commercial activities.

Two amendments are made to subsection 186(3).

The first amendment to subsection 186(3) provides that the particular corporation can meet the “commercial operating corporation property test” at the particular time if all or substantially all of its property is property that was last manufactured, produced, acquired or imported by it for

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consumption, use or supply by the particular corporation exclusively in the course of its commercial activities.

The first amendment to subsection 186(3) applies in respect of any property or service acquired, imported or brought into a participating province before July 28, 2018 if tax became payable or was paid without having become payable in respect of the acquisition, importation or bringing into the participating province.

The second amendment to subsection 186(3) is consequential to the enactment of new subsections 186(0.1) and (0.2). Subsection (3) is amended to remove the “commercial operating corporation property test” and the requirement that the particular corporation be related to the parent corporation. Instead, those two requirements are incorporated into subsection (3) by reference to the term “operating corporation” that is described by new subsection (0.2). As well, a consequential amendment is made to replace the term “shares of common stock” with “units”, which is defined in new subsection (0.1) as being, in respect of a corporation, shares of the capital stock of the corporation.

The second amendment to subsection 186(3) applies in respect of any property or service acquired, imported or brought into a participating province after July 27, 2018.

#### **Clause 4**

##### **Registration permitted**

ETA

240(3)(d)

Subsection 240(3) of the Act permits persons engaged in a commercial activity (as defined in subsection 123(1) of the Act) in Canada and certain other specified persons to apply to become registered for purposes of the GST/HST. Existing paragraph 240(3)(d) generally allows a particular corporation resident in Canada to register where it is deemed by subsection 186(1) or (2) of the Act to have acquired, imported or brought into a participating province property or a service in the course of its commercial activities. To qualify to register under paragraph (d), the particular corporation must either (1) own shares of the capital stock or hold indebtedness of another corporation that is related to the particular corporation and that meets a “commercial operating corporation property test”; or (2) be acquiring or proposing to acquire all or substantially all of the voting shares of another corporation that meets this commercial operating corporation property test. This commercial operating corporation test in existing paragraph 240(3)(d) requires that all or substantially all of the property of the other corporation is property that was acquired or imported by the other corporation for consumption, use or supply by the other corporation exclusively in the course of its commercial activities.

Two amendments are made to paragraph 240(3)(d).

The first amendment to paragraph 240(3)(d) provides that the other corporation can meet the “commercial operating corporation property test” if all or substantially all of its property is property that was last manufactured, produced, acquired or imported by it for consumption, use or supply by the other corporation exclusively in the course of its commercial activities.

The first amendment to paragraph 240(3)(d) applies in respect of any application for registration for the purposes of Part IX of the Act made on or before Announcement Date.

In respect of applications made after Announcement Date, the first amendment is instead incorporated into the term “operating corporation” that is defined in new subsection 186(0.2) (see commentary for that subsection) and through that term incorporated into paragraph 240(3)(d), as amended by the second amendment, which is described below.

The second amendment is consequential to amendments to subsection 186(1) that generally allow a partnership or trust to benefit from the rule in that subsection if it meets the requirements of that subsection. To qualify to register under amended paragraph 240(3)(b), the partnership or trust must be resident in Canada and must own units (as defined in new subsection 186(0.1)) or hold indebtedness of an operating corporation of the partnership or trust (within the meaning of new subsection 186(0.2)).

The second amendment is deemed to have come into force on the day after Announcement Date.

## **Clause 5**

### **Definitions**

ETA

Sch. VI, Pt. VII, s. 1(1)

Subsection 1(1) of Part VII of Schedule VI to the Act defines terms used in that Part. Under Part VII of Schedule VI, certain supplies of freight transportation services are zero-rated.

The definition “freight transportation service” in subsection 1(1) is amended to include a service of driving an automotive vehicle that is designed or adapted to be used on highways and streets for the purpose of delivering the vehicle to a destination. As a result of this amendment, these driving services will be subject to the zero-rating and other GST/HST rules that apply to freight transportation services.

This amendment is deemed to have come into force on the day after Announcement Date but also applies in respect of any supply made on or before that day if the supplier did not, on or before that day, charge, collect or remit any amount as or on account of tax under Part IX of the Act in respect of the supply.