SIGNIFICANT CHANGES FOR BUSINESSES MAKING TAXABLE SUPPLIES INTO QUÉBEC

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Government of Québec Proposes and Enacts Requirement for Non-Resident Businesses to Register for the Québec Sales Tax (the "QST")

A proposal to amend and modernize An Act respecting the Québec Sales Tax (the "**QST Act**"), announced by the Minister of Finance of Québec ("**Finance**") in the 2018 Québec budget (the "**Budget**"), will impose QST registration and collection agent compliance obligations on out-of-province businesses where such businesses make taxable supplies to "specified Québec consumers" (who, for these purposes, are persons not registered for the QST and whose usual place of residence is located in Québec), but where such businesses do not have a physical or otherwise significant presence in the province and are, therefore, not currently required to register for the QST under the existing rules (the "**Out of Province Suppliers**"). This proposal became law last month on June 12 when Bill 150 was adopted by the National Assembly of Québec.

Specifically, these Out of Province Suppliers will soon be required to register with Revenu Québec for QST purposes, and to charge, collect, report and remit QST on certain taxable supplies made to specified Québec consumers. These changes are expected to come into effect as of the following:

- **January 1, 2019**, in respect of Out of Province Suppliers who are located outside of Canada (the **"Non-Canadian Out of Province Suppliers"**), and
- **September 1, 2019**, in respect of Out of Province Suppliers located in the rest of Canada (the **"Canadian Out of Province Suppliers"**).

Why these New QST Compliance Requirements

The first point to keep in mind is that these rules do not legally introduce a new tax under the QST Act, despite being commonly referred to as the "Netflix tax", which implies that these new rules have the effect of extending the application of the QST on e-commerce and digital transactions. This is not the case, as such transactions have always been subject to the application of the QST. What these rules will do is plug or repair a massive hole in the tax net to prevent further significant tax leakage and revenue loss to the Québec Government. While no new tax is imposed under the law, the new rules establish a viable collection mechanism for the existing tax. The practical effect is that Québec consumers will now prospectively pay QST on transactions that previously escaped the application of the QST, despite such transactions being taxable.

Unlike when tangible goods enter Canada for shipment to Québec consumers, there is no QST collection mechanism at the Canadian border for imported services or intangible personal property (the "**IPP**") acquired by Québec consumers from Non-Canadian Out of Province Suppliers. The provision of such services and IPP is often facilitated through e-commerce digital platforms, by which various content, such as television shows, movies, music and magazines, may be accessed or downloaded online/electronically (referred to as the "**Digital Supplies**" herein).

When taxable goods are imported into Canada for shipment to Québec consumers, under an agreement between the Federal Government and the Québec Government, the Canada Border Services Agency (or another designated border collection agent, such as Canada Post) can collect the GST and QST on behalf of the Federal and Québec Governments. In the case of taxable supplies of services or IPP, including Digital Supplies, made by Non-Canadian Out of Province Suppliers to Québec consumers, the onus is on the Québec consumers to self-assess, report and pay the QST (as well as the GST) directly to Revenu Québec. The reality is that they almost never do.

In the case of the Canadian Out of Province Suppliers, there is an additional problem. There is no border authority to collect QST on taxable goods shipped into Québec from another province or a Canadian territory. Once again, the onus is on the Québec consumers to self-assess, report and pay the QST directly to Revenu Québec. In reality, consumers rarely, if ever, comply with these QST self-assessment, reporting and payment obligations.

Enforcement by Revenu Québec directly against consumers is impractical. The collection costs for enforcement against many consumers, each owing a relatively small amount of tax per transaction, would outweigh the benefits of collecting such unpaid QST. Furthermore, from a political perspective, it is probably a non-starter to seek to collect any such unpaid QST directly from the numerous Québec consumers (and voters).

The other problem with the existing system is that QST-registered Québec suppliers, who are required to charge and collect QST to and from Québec consumers, are put at a competitive disadvantage vis-à-vis Out of Province Suppliers, who are not required to do so. In effect, the taxable Digital Supplies (and certain other taxable supplies) made by Out of Province Suppliers can effectively be made free of any QST (as the consumers would not generally voluntarily self-assess and pay the applicable QST). As far as these consumers are concerned, they have saved the 9.975% QST cost, putting unfair downward pricing pressure on Québec suppliers. No jurisdiction wants to treat its own domestic businesses worse than foreign businesses and put them at an unfair competitive disadvantage. This consideration alone warranted remedial action.

The Solution Proposed and Passed into Law by the Québec Government – Simplified QST Registration and Compliance

Finance introduced, and the Québec Government enacted, a new, streamlined QST registration regime (the "**Simplified Registration**") for Out of Province Suppliers. This Simplified Registration will be available to require QST collection, reporting and remittance (i) by Out of Province Suppliers making taxable supplies of services or IPP (known in Québec as incorporeal moveable property), including taxable Digital Supplies, to specified Québec consumers, and (ii) by Canadian Out of Province Suppliers in the case of taxable supplies of goods to specified Québec consumers. Like with the existing, general QST registration regime (the "**General Registration**"), there will be a "small supplier" exception from the Simplified Registration requirement for businesses with annual taxable supplies not exceeding $30,000.

The requirement to register under the Simplified Registration will also apply to digital property and services distribution platforms playing a key intermediary role in making taxable supplies of IPP and services from these platforms to specified Québec consumers on behalf of Out of Province Suppliers. The requirement to register will apply to a business operating such a digital platform or providing such a distribution service in circumstances where the business controls the key elements of the transaction (such as billing, transaction terms and conditions, and delivery terms). However, businesses providing only a transfer service (such as ISPs for example), access to a payment system or advertising services that inform and link customers to suppliers' websites will generally not be considered to control the key elements of transactions, and therefore will not be subject to the new registration requirements.

Under the Simplified Registration, the registration will be processed online, quarterly QST returns will be filed electronically, and QST remittances may be made electronically. The QST returns and remittances will be due one month after each quarter. Changes will be made to the QST system to allow the Out of Province Suppliers to remit the QST collected in currencies other than Canadian dollars (which would be convenient for those Non-Canadian Out of Province Suppliers who would not normally retain Canadian dollars in a bank account).

It will be further simplified and streamlined because QST collected under the Simplified Registration will be reported and remitted without any netting of input tax refunds ("**ITRs**"). Out of Province Suppliers will have no access to ITR claims to recover QST paid on business inputs. For Out of Province Suppliers, the inability to claim ITRs may not be a significant concern because they may pay little, if any, QST on business inputs. If, for some reason, it is a significant concern, then the Out of Province Suppliers could voluntarily choose to register for the QST under the General Registration, provided that such Out of Province Suppliers furnish and maintain security that is satisfactory to Revenu Québec.

The QST payable by "specified Québec consumers" under the Simplified Registration system would not give rise to ITR claims. Out of Province Suppliers will, therefore, be relieved from providing prescribed ITR documentary information to specified Québec consumers. In this regard, even if the QST had been payable to a supplier under the General Registration system, no ITRs would have been available to a specified Québec consumer. As a non-registrant, a specified Québec consumer would generally not be entitled to ITRs. Moreover, imported services or IPP acquired for personal use or enjoyment should not be recoverable through ITR claims in any event, as such acquisitions would not relate to a "commercial activity".

There will be a one-year period following the date of application of the Simplified Registration to allow Out of Province Suppliers to adopt suitable compliance measures by adjusting their own internal processes. Where they have taken reasonable measures to comply with the Simplified Registration requirements, but are still unable to meet these obligations, Revenu Québec would offer assistance and impose no penalty. After the one-year grace period, penalties would be imposed for non-compliance.

In order to meet these new requirements, Out of Province Suppliers will need to ascertain whether the recipients of their taxable supplies are "specified Québec consumers," and the law will require such suppliers to verify their recipients' usual place of residence by obtaining two non-contradictory pieces of information (i.e., a billing address, personal residential address, etc). The law also imposes a significant penalty (equal to the greater of $100 and 50% of the QST payable in respect of each transaction), on any specified Québec consumer that provides false residence information to avoid the imposition of QST.

Modifications to the Place of Supply Rules

Generally, under the QST system, where a non-resident of Québec is unregistered under the General Registration system and does not carry on business in Québec for QST purposes, then any taxable supplies of goods, IPP or services would be considered to be supplied outside of the province of Québec, thereby relieving the supplier from any obligation to charge and collect QST. In order to require Out of Province Suppliers to charge and collect QST on taxable supplies made in Québec, this place of supply presumption would be reversed in the following circumstances:

- taxable supplies of services and IPP made to specified Québec consumers by Out of Province Suppliers registered under the Simplified Registration,
- taxable supplies of services and IPP made to specified Québec consumers by Out of Province Suppliers through a digital platform registered under the Simplified Registration or Normal Registration, and
- taxable supplies of goods made to specified Québec consumers by Canadian Out of Province Suppliers.

What these modified rules mean is that an Out of Province Supplier registered under the Simplified

Registration would generally not be required to charge and collect QST to and from Québec businesses, and any other persons registered for the QST, who are not specified Québec consumers. An Out of Province Supplier's taxable supplies to such persons under the Simplified Registration would generally continue to be deemed to be supplied outside of the province of Québec, and thereby relieve the Out of Province Supplier from charging and collecting QST.

A Sensible, Modern and Fair Approach, but could it be Challenged?

In addressing inbound cross-border e-commerce transactions (so-called taxable Digital Supplies), the approach adopted by Québec Government is reasonable, modern and fair. It is adapted to how commerce is transacted in the 21st century. In fact, Finance has explicitly applied principles established recently by the Organisation for Economic Co-operation and Development (the "OECD") to impose value-added taxes ("**VAT**") on inbound international trade transactions based on the jurisdiction of consumption or use in accordance with the destination principle.[1]

To encourage the Simplified Registration by Out of Province Suppliers, the Québec Government has reduced the administrative burden of QST compliance relative to the requirements under the General Registration, and has foregone any requirement for Out of Province Suppliers to post security. Finance will not only plug a huge gap in its ability to collect taxes, it will remove the unfair competitive advantage enjoyed by Out of Province Suppliers over Québec suppliers. There is no valid reason for two otherwise identical transactions to be taxed differently, based solely on whether a transaction is entered into with an Out of Province Supplier or a Québec supplier.

One concern with the approach taken by the Québec Government, however, is whether the enacted tax collection mechanism can ultimately be enforced against Out of Province Suppliers, particularly Non-Canadian Out of Province Suppliers. What are the jurisdictional limits on Revenu Québec's ability to enforce these new rules against an Out of Province Supplier, with limited or no nexus with Québec, and require an Out of Province Supplier to be a QST collection agent under Québec tax laws? Stay tuned.

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[1] OECD (2017), *International VAT/GST Guidelines,* OECD Publishing, Paris, pp. 15-17, as discussed at pages A-9 to A-10 of Finance's Additional Information on the Fiscal Measures in Budget 2018-2019.[ps2id id='1' target=''/]

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.