CANADIAN TAX Highlights

Apples, Oranges, and Natural Gas

A major headache for Canadian natural gas exporters and importers is making its way through the CBSA, the CRA, and the courts. A physical export and import of Canadian natural gas occurs as it moves from western to eastern Canada if it is transported via pipeline connections that pass through the United States.

Specific rules in both the Customs Act (CA) and the Excise Tax Act (ETA) appear to deem no import or export to occur (sections 23 and 144.01, respectively). CA section 23 deals with "transportation over territory outside Canada": goods transported from one place to another within Canada, but over territory or waters outside Canada, are deemed--for duty purposes only--to be transported entirely within Canada. ETA section 144.01, which was enacted to deal with "continuous transmission commodities" (CTCs) such as oil, gas, and electricity, effectively arrives at the same result for GST purposes, deeming the commodity not to be exported or imported. Thus, there seems to be no obligation on the owner to pay division III GST when "importing" the gas as it flows back into Canada in the east. (The provisions overlap somewhat, because "duties" in the CA include GST.)

Despite clear legislative wording and intent, the CBSA says either that these provisions do not apply or that it has no jurisdiction to apply them. The CBSA may be of the view that CA section 23 does not apply to CTCs because the actual good leaving Canada is not the same one entering Canada: the good has been "mixed" along the way with other like goods. ETA section 144.01 appears to deal with the fungibility issue, but the CBSA seems reticent to apply it, either on the basis that section 23 takes precedence or because section 144.01 does not relieve the GST applicable. The bottom line? The CBSA is currently assessing GST on such importations.

To make matters worse, although the GST assessed is generally soon recovered as an input tax credit, the assessment throws up unrecoverable interest on the GST owing, payable back to the original importation date. This interest penalty can be significant, and on large-volume transactions extends into millions of dollars for companies that move their natural gas in

this fashion. Those affected perceive an injustice in the lack of resolution for what appears to be an easily resolved issue and in the imposition of ludicrously high and inequitable interest penalties.

What makes the situation even more egregious is the fact that the ETA seems to block an appeal of the GST-interest portion of a CBSA assessment under either the CA or the ETA. The ETA establishes the right to appeal CBSA assessments of GST and defines available appeals narrowly as involving the "determination of the tax status," such as whether goods are "included in Schedule VII," and thus may be imported on a non-taxable basis. No appeal is afforded regarding the application of ETA section 144.01, which deems no importation to occur in the first place; there is thus no effective appeal from a CBSA assessment that declines to apply the rule.

Current applications before the Federal Court on the jurisdictional issue should soon clarify matters, but in the meantime, affected natural gas producers, marketers, and traders face the prospect of substantial and continuous interest assessments. The only present realistic option is to apply for judicial review.

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