THE CANADIAN BAR ASSOCIATION

Club Intrawest: Is it a supply? If so, what is the supply and where is it made?

November 14, 2016 | Jamie M. Wilks

Save

OVERVIEW

In *Club Intrawest v The Queen,* [1] the Tax Court of Canada considered certain intricate and novel issues. The court grappled with whether Club Intrawest made supplies, the nature of Club Intrawest's supplies, the place of these supplies, and whether a single supply could have a dual tax status. The appellant, Club Intrawest, administered a plan that allowed members to use condominium units in various vacation resorts in Canada and in the United States and Mexico.

A. FACTS

In 1993, Intrawest Resort Ownership Corporation, which we'll call the Canadian developer, incorporated Club Intrawest as a non-profit, non-stock corporation and established the Intrawest Program. It built or purchased certain Canadian vacation homes, which it sold to Club Intrawest. Similarly, Intrawest Resort Ownership U.S. (United States) Corporation and Resort Ventures L.P., which we'll call the U.S. (United States) developer, purchased or built the U.S. (United States)/Mexican vacation homes and sold them to Club Intrawest.

When the Canadian developer sold a Canadian vacation home to Club Intrawest, title to the home was transferred to a Canadian corporation to hold the property as a bare trustee (with no discretionary authority) on behalf of the beneficial owner, Club Intrawest. When the U.S. (United States) developer transferred a U.S. (United States)/Mexican vacation home to Club Intrawest, the home was transferred to a U.S. (United States) corporation to hold the property as a bare trustee on behalf of the beneficial owner, Club Intrawest. To pay for the purchase of the vacation homes from the Canadian and U.S. (United States) developers, Club Intrawest transferred rights to occupy the vacation homes in perpetuity (i.e., beneficial ownership interests in the vacation homes). In addition, Club Intrawest retained the Canadian developer to manage and operate the vacation homes.

The Canadian developer marketed and sold the Intrawest Program to the Canadian resort point purchasers in Canada. The U.S. (United States) developer marketed and sold the Intrawest Program to the American resort point purchasers in the U.S. (United States) The occupancy rights were

determined by reference to a point system, under which:

> The Canadian developer assigns "a point value" (resort points) to the right to occupy one day in each [vacation home], with possible variations in assigned point value for the particular [vacation home], depending on which of five Intrawest program seasons … the particular day falls within.

The Intrawest Program members are the Canadian resort point purchasers, the American resort point purchasers, the Canadian developer and the U.S. (United States) developer. The members paid an annual fee to Club Intrawest to meet membership costs. Club Intrawest billed the annual resort fee to the Canadian and American resort point purchasers in October of each year. The Canadian and U.S. (United States) developers were billed the annual resort fee in equal monthly *pro rata* proportions.

B. CENTRAL ISSUE

The central issue in the case was the tax status of the annual resort fees. Club Intrawest maintained the annual resort fee was not subject to GST/HST (Harmonized Sales Tax) because it was a reimbursement of expenses incurred by Club Intrawest as agent on behalf of the members. The Canada Revenue Agency contended that the annual resort fee is part of the consideration for the membership in the Intrawest Program. As such, the annual resort fee was payable as consideration for a taxable supply of intangible personal property (i.e., membership rights).

C. DID CLUB INTRAWEST INCUR EXPENSES AS AGENT?

Since neither party brought expert witnesses to explain the operation of foreign agency law in the U.S. (United States) and Mexico, Mr. Justice D'Arcy assumed that the foreign agency law in Mexico and the U.S. (United States) is the same as in Canada under the legal concept of *lex fori*. He then outlined the following three generally accepted components of agency law:

1. The consent of both the principal and agent for the latter to act as agent on behalf of the former
2. Authority given to the agent by the principal to affect the principal's legal position
3. The principal's control of the agent's actions

Regarding the second criterion above, Mr. Justice D'Arcy found that the members had no obligation to maintain, repair, improve and operate the vacation homes or to incur expenses with regard to the vacation homes. As such, Club Intrawest could not affect the members' legal position by incurring expenses on their behalf because Club Intrawest had the obligation to pay such expenses (not the members). A critical factor in reaching this conclusion was that Club Intrawest assumed the risk of damage to the vacation homes through its beneficial ownership of the vacation homes. [2]

The court could not find an express written agency agreement between Club Intrawest and its members indicating their consent to an agency relationship; nor did the conduct of the parties, as revealed by the evidence, indicate such consent. As such, the first criterion of agency above was not satisfied.

The master declaration, entered into between Club Intrawest and the Canadian developer, [3] contained agency language, added at the direction of an accountant three years after the master declaration was first executed. Due to inconsistencies in the relevant article of the master declaration concerning whether the agency relationship existed, the Tax Court was not persuaded that an agency relationship was thereby established. Moreover, even if an agency relationship was thereby established, members that were not parties to the master declaration (i.e., the Canadian resort point purchasers, the American resort point purchasers and U.S. (United States) developer) would not be bound by the agency agreement.

Club Intrawest also argued that the Canadian purchase and membership agreement, entered into between a Canadian resort point purchaser and the Canadian developer, established an agency relationship. Mr. Justice D'Arcy rejected this argument for the following reasons.

Certain language in one section of this agreement refers to Club Intrawest acting as agent on behalf of the Canadian resort purchaser, but as with the agency language added to the master declaration, this language was added three years after the creation of the Intrawest Program on the advice of an accountant. That meant with respect to the Canadian resort point purchasers entering into their membership agreements in the first three years of the Intrawest Program, there was no reference to any agency arrangement. In any event, the membership agreement could not establish an agency relationship with Club Intrawest as the agent because Club Intrawest was not a party to, or bound by, this membership agreement. While certain of the membership agreements did indicate that Club Intrawest would be appointed to act as the agent of the Canadian resort point purchasers (i.e., those membership agreements entered into more than three years after the Intrawest Program was created), no such agency agreement to give effect to this intention was presented to the court.

CRA (Canada Revenue Agency) called as a witness a Canadian resort point purchaser who testified that Club Intrawest was not holding itself out as agent, as far as he was aware. As this testimony was the only direct evidence concerning whether the parties (members and Club Intrawest) consented to an agency relationship by way of their conduct, the court had no choice but to find a lack of consent. Further, the members did not control Club Intrawest in a way that would suggest an agency relationship, so the third criterion of agency above was not satisfied.

Other evidence suggested that no agency relationship existed. Not all portions of the annual resort fee related directly to costs incurred to operate the vacation homes. Club Intrawest calculated the annual resort fee in part in reference to internal costs, "such as the cost of its annual general meeting, the cost of its auditor, income tax and legal costs." [4] Clearly, these costs were not incurred by Club Intrawest as agent on behalf of its members, but were required for Club Intrawest to operate its business as a separate corporate entity.

Another portion of the annual resort fee related to a reserve fund maintained by Club Intrawest. This portion was not a reimbursement of an actual expense, but "represents a contingency fee for future unexpected costs." [5] As it was not an expense payable to a supplier, it could not be incurred as agent.

Finally, the third party expenses did not appear to be the members' direct liabilities. While the amount of the annual resort fee was based on estimated costs, the actual amount of the fee was at the sole discretion of Club Intrawest's board of directors. In fact, the Canadian developer had the option of not paying the annual resort fee if it elected to subsidize Club Intrawest's financial operations.

D. NATURE OF THE SUPPLIES – IPP (INTANGIBLE PERSONAL PROPERTY) OR SERVICES?

Once the Tax Court decided that no agency relationship existed and Club Intrawest made taxable supplies to the members, for which Club Intrawest received the annual resort fees as partial or the entire consideration for the supplies, the next issue to consider was the nature of these supplies, which would determine which place-of-supply rule would apply. Specifically, CRA (Canada Revenue Agency) argued that the members paid the annual resort fees as partial consideration for taxable supplies of intangible personal property (i.e., rights). Club Intrawest countered that the annual resort fees were payable by the members for services.

In the first instance, Club Intrawest argued that its services were supplied in relation to both Canadian and foreign real property. If correct, then Club Intrawest would be considered to make a single supply of bundled services to each member, and two conflicting place-of-supply rules would potentially apply to this single supply. First, paragraph 142(1)(d) of the ETA (Excise Tax Act) would deem a supply "of a service in relation to real property … situated in Canada" to be made in Canada. Conversely, paragraph 142(2)(d) of the ETA (Excise Tax Act) would deem a supply "of a service in relation to real property … situated outside Canada" to be made outside Canada.

In resolving whether Club Intrawest made supplies of IPP (Intangible Personal Property) or services, the Tax Court considered the definition of "property" and "service" in subsection 123(1) of the ETA (Excise Tax Act). The question was whether the members received any rights for the payment of the annual resort fees. The Tax Court could find none.

The annual resort fee was not paid as part of the consideration for the supplies of the memberships in the Intrawest Program. Of significance to the court, a different person than Club Intrawest supplied the memberships. The Canadian developer supplied the memberships to the Canadian resort point purchasers. The U.S. (United States) developer supplied the memberships to the American resort point purchasers.

Subsection 123(1) residually defines "service" as "*anything* other than property, money and certain services supplied to an employer by an employee, an officer and certain other persons." [6] The court found that Club Intrawest supplied something other than property, money and these excluded services. Hence, Club Intrawest supplied services within the meaning of subsection 123(1).

E. SINGLE SUPPLY OR MULTIPLE SUPPLIES OF SERVICES?

The court examined whether Club Intrawest made single supplies or multiple supplies of services to each member. The services comprised four separate groups of activities by Club Intrawest:

1. The maintenance, operation and improvement of each vacation home
2. The operation of the Intrawest Program

3. The internal operation of Club Intrawest
4. The maintenance of the reserve fund

As Club Intrawest could only continue to operate the Intrawest Program by conducting and paying for all these activities, the Tax Court concluded that Club Intrawest supplied a single supply of services to each member. What each member purchased was the entire package of activities necessary to operate Club Intrawest. Without any one of these components, the Intrawest Program could not continue to operate. All of the components were so inextricably intertwined in the commercial objective of the transaction that each component was integral in making the overall supply. [7]

F. WERE THE SERVICES SUPPLIED 'IN RELATION TO REAL PROPERTY'?

Although agreeing with Club Intrawest's counsel "that, in light of the Supreme Court of Canada's decision in *Nowegijick v. The Queen,* [8] the phrase 'in relation to' as used in paragraphs 142(1)(d) and 142(2)(d) should be given wide scope," Mr. Justice D'Arcy went on to limit the scope of this phrase. He found that, "within the context of section 142, the words require a direct relationship between the service and the real property." He amplifies what is meant by such a "direct relationship:" [9]

> The service must be performed directly on the real property or relate directly to the real property. This would include services such as repairs to the real property, maintenance of the real property, architectural services relating to a specific building or legal services performed in respect of the sale or rental of the real property.

Although he found that certain of the services, "such as the front desk and concierge services, and the housekeeping, maintenance, and cleaning and security services, clearly relate directly to the vacation homes," he found others "do not relate directly to the vacation homes." He pointed to the general and administrative services as examples of services that do not relate directly to the real property because they "are in relation to the operation of the appellant as a corporation." In particular, the administration of the Club Intrawest membership program did not relate directly to the vacation homes. As a consequence, he concluded that the services related (1) partly to real property in Canada (i.e., the Canadian vacation homes), (2) partly to real property outside Canada (i.e., the U.S. (United States)/Mexican vacation homes), and (3) partly to services unrelated to any real property.

G. WERE THE SERVICES SUPPLIED IN CANADA?

To give effect to paragraph 142(2)(d) of the ETA (Excise Tax Act), legal counsel for Club Intrawest argued that tax should be relieved on the proportion of the fees for services relating to real property situated outside Canada. Moreover, this position was consistent with the CRA (Canada Revenue Agency)'s administrative policy.

The Tax Court could find no legal basis, however, for a single taxable supply to be made both inside and outside Canada and attract a dual tax status. To resolve the inconsistency between paragraphs 142(1)(d) and 142(2)(d), the court interpreted these paragraphs to "only apply if the single supply of a service relates solely to real property." In the case here where only part of the services relate to real

property, then either paragraph 142(1)(g) or 142 (2)(g) should apply. Since Club Intrawest performed the services partially in Canada, the services were supplied (entirely) in Canada pursuant to paragraph 142(1)(g). Interestingly, despite this finding, Mr. Justice D'Arcy concluded that since the CRA (Canada Revenue Agency) "cannot appeal its own decision, my judgment cannot increase the tax assessed by the Minister." [10]

On the Tax Court's point about a single supply only attracting one tax status, the Tax Court in an earlier case seemed to reach a different conclusion. In *Robin Aerospace Products Ltd. v. R.,* [11] the Tax Court allowed one-third of the GST (Goods and Services Tax) on billings to be relieved. While two-thirds of the services supplied to a non-resident related to services performed in Canada in respect of tangible personal property and could, therefore, not be zero-rated exported supplies under section 7, Part V of Schedule VI to the ETA (Excise Tax Act), the other third of the services were performed outside Canada. The Tax Court found that these services were supplied outside Canada pursuant to paragraph 142(2)(g) of the ETA (Excise Tax Act).

Arguably, however, the services performed inside and outside Canada were a single, bundled supply. In such case, a single supply of services performed partly in Canada would be deemed to be supplied in Canada pursuant to paragraph 142(1)(g) of the ETA (Excise Tax Act) and the entire bill would attract GST (Goods and Services Tax). Paragraph 142(2)(g) of the ETA (Excise Tax Act) is consistent with paragraph 142(1)(g). Where the services are performed entirely outside Canada, the supply of the services is deemed to be made outside Canada. While the Tax Court's relief of one-third of the GST (Goods and Services Tax) assessed against the supplier in *Robin Aerospace* appears reasonable, the technical basis for this relief, as a single supply, is dubious.

H. DID CRA (Canada Revenue Agency) ASSESS NET TAX CORRECTLY?

As Club Intrawest appealed only the net tax for each of the October monthly reporting periods in the years 2002 to 2007, the Tax Court could only consider whether the net tax assessments within those monthly reporting periods were correct. Under subsection 225(1) of the ETA (Excise Tax Act), GST (Goods and Services Tax)/HST (Harmonized Sales Tax) collectible within a reporting period is added to net tax. While the Tax Court could find no specific provision to identify when GST (Goods and Services Tax)/HST (Harmonized Sales Tax) became collectible, "it would appear that GST (Goods and Services Tax) becomes collectable by a registrant at the time it becomes payable by the recipient of the supply." [12]

Pursuant to subsections 168(1) and (2) of the ETA (Excise Tax Act), GST (Goods and Services Tax)/HST (Harmonized Sales Tax) becomes payable on the earlier of (a) the day the consideration for the supply is paid, and (2) the day it becomes due. When consideration becomes due is determined in reference to the rules in section 152 of the ETA (Excise Tax Act). As Club Intrawest billed the Canadian and American resort point purchasers in October of each year, "under section 152, the full consideration (the annual resort fee) for the supply of these services became due in October of each year. Therefore, under subsection 168(1), all of the GST (Goods and Services Tax)/HST (Harmonized Sales Tax) on the annual resort fee invoice to Canadian resort point purchasers and American resort point purchasers who held resort points on September 30 of each year became payable and collectable in October of each year." [13]

Club Intrawest billed the Canadian and U.S. (United States) developers monthly for one-twelfth of the annual resort fee. Therefore, CRA (Canada Revenue Agency) should not have assessed GST (Goods and Services Tax)/HST (Harmonized Sales Tax) on the full amount of the annual resort fee, but rather on one-twelfth of the annual resort fee, for the October reporting periods. The Tax Court found other technical errors arising from CRA (Canada Revenue Agency) assessing net tax following its own administrative methodologies. The Tax Court said that CRA (Canada Revenue Agency) "cannot rely on the consent of the taxpayer as a reason to ignore the provisions of the *GST (Goods and Services Tax) Act*." [14]

Still, as discussed above, CRA (Canada Revenue Agency) assessed less tax than should have been assessed had CRA (Canada Revenue Agency) correctly imposed tax on the annual fees on the basis that they related to single supplies of services made in Canada. For that reason, the assessments were unchanged, despite CRA (Canada Revenue Agency) having assessed insufficient net tax under Part IX of the ETA (Excise Tax Act), and Club Intrawest's appeal was, therefore dismissed.

I. SIGNIFICANCE OF THE DECISION

This decision provides meaningful guidance on certain fundamental concepts in the GST (Goods and Services Tax)/HST (Harmonized Sales Tax) legislation. Where a registrant makes a bundled, single supply of different services and certain of the services relate to real property, while others do not, the determination of whether the supply is made in Canada or outside Canada depends on the application of the general place of supply rules for services under either paragraph 142(1)(g) or 142 (2)(g) of the ETA (Excise Tax Act).

Although the CRA (Canada Revenue Agency)'s administrative policy seeks to provide GST (Goods and Services Tax)/HST (Harmonized Sales Tax) relief to the extent that a single supply of services relates to real property situated outside Canada (purportedly pursuant to paragraph 142(2)(g) of the ETA (Excise Tax Act)), there is no legal authority for doing so. A single supply of services can only have one tax status. This issue was arguably resolved differently in the earlier Tax Court decision in *Robin Aerospace*. [15]

If Club Intrawest's single supply of services had related solely to real property situated in Canada and outside Canada, it would have been interesting to see how the Tax Court would have resolved this issue. The two rules in paragraph 142(1)(d) and 142 (2)(d) of the ETA (Excise Tax Act) potentially conflict. To resolve this conflict, Mr. Justice D'Arcy would not have artificially split a single supply of services into two separate supplies (one relating to the real property situated inside Canada and the other relating to the real property situated outside Canada).

It should be borne in mind that this case considered transactions that arose before the significant changes to the place-of-supply rules for determining in which province (a GST (Goods and Services Tax) or HST (Harmonized Sales Tax) province) a service is supplied, which took effect on July 1, 2010. With these changes, and more provinces joining the HST (Harmonized Sales Tax) regime, these place-of-supply rules [16] have become more significant. In particular, careful consideration may need to be given to whether to apply the general place-of-supply rule for services [17] or the specific place of supply rule for a service "in relation to real property." [18]

Another important guiding principle derived from this case is that CRA (Canada Revenue Agency) has to assess net tax pursuant to the legal requirements in Part IX of the ETA (Excise Tax Act). CRA (Canada Revenue Agency) has no legal authority to depart from those requirements, even with the taxpayer's consent. The CRA (Canada Revenue Agency)'s errors resulted in a lower assessment of net tax than would have arisen had CRA (Canada Revenue Agency) complied with the terms of the ETA (Excise Tax Act) in assessing net tax. The taxpayer benefitted from this error because CRA (Canada Revenue Agency) did not, and could not, appeal its own assessment.

This case also serves as a useful reminder about the three essential elements of an agency relationship. To establish an agency relationship, all three elements must exist. At an accountant's suggestion, changes made to add agency language to a legal document, the master declaration, three years after the declaration came into force, and to incorporate agency language into the prospective membership agreements starting three years after the Intrawest Program was established, were not enough to demonstrate an agency relationship existed in this case. To establish an agency relationship to minimize taxes, careful planning and implementation, with the assistance of legal counsel, should be undertaken.

It is unclear whether the services supplied to non-resident members (e.g., the American Point Purchasers and U.S. (United States) developer) could have been zero-rated (tax-free) exported supplies of services pursuant to section 7, Part V of Schedule VI to the ETA (Excise Tax Act). At paragraphs 295 to 299 of his decision, Mr. Justice D'Arcy discusses generally zero-rating export provisions available to relieve from taxation supplies of services or intangible personal property made in Canada to non-residents. However, the issue does not seem to have been addressed directly in the decision.

There is an exclusion from zero-rating export treatment in paragraph (d) of section 7, Part V of Schedule VI to the ETA (Excise Tax Act) for "a service in respect of real property situated in Canada." Would Club Intrawest's supplies of services to non-residents be thereby excluded from zero-rating because they relate, in part, to real property situated in Canada? This interpretation is plausible. Unlike with the place of supply rules, which potentially directly conflict in the case of a supply of services relating to both real property situated inside and outside Canada, no such conflict arises in considering the application of this exclusion.

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FOOTNOTES

1 *Club Intrawest v The Queen*, 2016 TCC 149.

2 The Tax Court examined the four elements of beneficial ownership: (1) possession, (2) use, (3) risk and (4) control. The Tax Court found that the Canadian Developer held the right to occupy or use the Canadian Vacation Homes. The Canadian Developer also held the possession rights, subject to any residual interest that Club Intrawest may have had in the homes. Critically, the risk of loss for the Canadian Vacation Homes belonged exclusively to Club Intrawest. Finally, the Canadian Developer and Club Intrawest shared control of the Canadian Vacation Homes. As a result, Club Intrawest and the Canadian Developer shared beneficial ownership of the Canadian Vacation Homes. "More importantly for the purposes

of this appeal, the risk of damage to the property through fire, misconduct of the users or normal wear and tear rested with" Club Intrawest. This risk "included the liability to repair and maintain the Canadian Vacation Homes in order to ensure that they were suitable for occupancy under the Intrawest Program." The foregoing quoted portion is at paragraph [108] of the decision. For the same reasons, the Tax Court found that the U.S. (United States) Developer and Club Intrawest jointly owned beneficial interests in the U.S. (United States)/Mexican Vacation Homes, with Club Intrawest solely responsible for the risk of loss to the homes.

3 Under the Master Declaration, Club Intrawest and the Canadian Developer agree (1) to establish the Intrawest Program, and (2) on how to operate the program.

4 *Supra*, footnote 1, paragraph [174].

5 *Supra*, footnote 1, paragraph [175].

6 *Supra*, footnote 1, paragraph [235].

7 In reaching this decision, the Tax Court relied on the principles set out in *O.A. Brown Ltd. v. Canada,* [1995] G.S.T.C. 40, *Jema International Travel Clinic Inc. v. The Queen,* 2011 TCC 462, and *Gin Max Enterprises Inc. v. The Queen,* 2007 TCC 223.

8 *Nowegijick v. The Queen,* [1983] 1 S.C.R. 29.

9 This interpretation is consistent with the CRA (Canada Revenue Agency)'s administrative policy in GST (Goods and Services Tax)/HST (Harmonized Sales Tax) Policy Statement P-169R, Meaning of "in Respect of Real Property Situated in Canada" and "in Respect of Tangible Personal Property that is Situated in Canada at Time the Service is Performed", for Purposes of Schedule VI, Part V, Sections 7 and 23 to the *Excise Tax Act.*

10 *Supra*, footnote 1, paragraph [321].

11 *Robin Aerospace Products Ltd. v. R.,* 2005 TCC 128.

12 *Supra*, footnote 1, paragraph [327].

13 *Supra*, footnote 1, paragraph [330].

14 *Supra*, footnote 1, paragraph [345].

15 *Supra*, footnote 11.

16 Incorporated into the New Harmonized Value-added Tax System Regulations (the "HST (Harmonized Sales Tax) Regulations") pursuant to section 144.1 of the ETA (Excise Tax Act) and section 3, Part IX, Schedule IX to the ETA (Excise Tax Act).

17 HST (Harmonized Sales Tax) Regulations, section 13.

18 HST (Harmonized Sales Tax) Regulations, section 14.