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## GET THE CREDIT YOU DESERVE: DOCUMENT YOUR CREDIT AND DEBIT NOTES

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In light of the many recent changes and proposed changes to provincial and federal sales taxes, it is worth reviewing how your credit and debit note processes function. At Collins Barrow, we have encountered two situations that demonstrate how “incorrectly” processed credit notes can have a substantial effect on your bottom line.

On December 31, 2010, one of our clients issued some significant invoices to several of its Quebec customers for taxable goods and services. Our client charged, reported, and remitted the appropriate amounts of GST and QST on its December 2010 returns. On receipt of the invoices, the Quebec customers contacted our client to dispute the charges. After much discussion, our client agreed to reverse the invoices. It made the appropriate adjustments in its accounting system and sent credit notes to the Quebec customers detailing the reversal of the appropriate GST and QST in March 2011.

In November 2012, Revenu Quebec (RQ) audited the March 2011 return. At that time, we were engaged specifically to assist our client in liaising with RQ. During the audit, the RQ auditor reviewed the above-referenced credit notes and contacted the Quebec customers to “validate” the notes. Many of the Quebec customers could not produce copies of the credit notes as they had not claimed input tax credits (ITCs) and input tax refunds (ITRs) in respect of these invoices because they believed the charges were invalid and would never be paid. In the Quebec customers’ opinion, since ITCs and ITRs were never claimed in respect of these charges, no adjustment was needed. Therefore, they did not document receipt of the credit notes and did not keep copies. As a result of this response, the auditor then denied our client’s ITC and ITR claims.

While this interpretation may appear inequitable, it appears to be supported by current legislation. Subsection 232(3) of the *Excise Tax Act* and section 449 of the *Quebec Sales Tax Act* provide that, where

a credit or debit note is issued, the person issuing the note shall make an adjustment to net tax in the reporting period in which the note is issued. It stands to reason that, in order to support that a credit or debit note has been issued to a person, the issuer must be able to confirm that it was sent, either by tracking the method used to send the note or by confirming that the person has received the note. Where this confirmation is not available, the credit or debit note is considered not to have been issued. Accordingly, the issuer cannot make any adjustment to its net tax payable in the period when the credit or debit note was originally sent.

Notwithstanding the above, our client did not lose these ITCs and ITRs. As less than four years had passed since the initial credit notes were issued, our client was able to re-issue the credit notes to the Quebec customers (and receive confirmation from them that the credit notes were received). Our client then claimed these ITCs and ITRs on its next periodic return.

Even though our client ultimately recovered the ITCs and ITRs, it paid a substantial cost for this issue. RQ re-assessed the March 2011 return and applied full penalties and interest for over-claiming QST and GST, since the “wash” penalty and interest was unavailable to our client as the criteria for that relief were not met.

To avoid this result, taxpayers should be proactive when issuing credit and debit notes. Where notes are issued electronically, adding an automatic ‘read receipt’ or ‘received receipt’ to that correspondence would serve as satisfactory evidence of receipt to government auditors. For paper notes, sending them by courier (with the requirement that the recipient sign for them) would also provide this support. Alternatively, documenting conversations with the client (in particular, receiving a voice-mail or e-mail confirmation) would suffice to document that the credit note was received.

Properly documenting credit notes is also important where there are changes to sales tax legislation or when the sales tax application is improperly addressed. While requirements of the various provincial retail sales tax (PST) legislations (excluding Quebec) in respect of credit and debit notes are not as stringent as those for GST/HST and QST, documentation must be maintained in order to support the tax adjustments made.

In particular, paragraphs 88(1)(k) through 88(1)(n) of the British Columbia *Provincial Sales Tax Regulations*, section 55 of the Saskatchewan *Revenue and Financial Services Act* (RFSA), section 11 of Regulation 2 (*Revenue Collection Administration Regulations*) of the Saskatchewan *RSFA Regulations*, and paragraph 3(i) of the Manitoba *Tax Administration and Miscellaneous Taxes Act Regulations* provide that records supporting the relevant tax calculations must be kept. Presumably, the documentation requirements for the B.C., Manitoba and Saskatchewan PST are less onerous due to the fact that the respective taxation authorities are not at risk for issuing tax refunds without collecting the tax beforehand. However, there are cases in which this documentation will be necessary to rectify PST issues.

A hypothetical client experience illustrates this situation. On March 31, 2013, a B.C. client is issued an invoice with 12% HST applied. The very next day, the client calls to request a price adjustment. A price reduction is agreed upon, and a credit note is issued to the client showing that 5% GST and 7% B.C. PST is applied to the reduction. Accordingly, the net B.C. PST to be remitted includes an adjustment in respect of the credit note.

Should the B.C. PST return for April 2013 be audited, the 7% PST will likely be reassessed, in addition to the penalties and interest applicable for not remitting enough B.C. PST. Even though the credit note can be appropriately re-issued to recover a net amount equal to the 7% PST as an ITC, the penalties and interest applied by the B.C. tax authorities are not recoverable.

Similarly, the Manitoba Retail Sales Tax (RST) rate change from 7% to 8% effective on July 1, 2013, may also cause issues with automated debit and credit notes. If an invoice is issued prior to July 1, 2013, the invoice will have 7% RST. However, if the amount payable is decreased after June 30, 2013, care must be taken not to provide a client with a credit note with 8% RST. This will also create a discrepancy that may cause the application of unnecessary penalties and interest on audit.

In light of these changes, your credit and debit note procedures should be reviewed to ensure that you receive all of the credits for which you are eligible. The relevant taxation authority will give you credit when your credit (and debits) are in order. Contact your Collins Barrow advisor for guidance through this complicated procedure.

## BEST PRACTICES: INDIRECT SALES TAX OVERPAYMENT AND EXPOSURE ANALYSIS

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At Collins Barrow, we strive to bring extra value to our clients. To that end, we can provide an indirect sales tax overpayment and exposure analysis. This is a specialty tax service above and beyond the thorough general audit process typically provided.

Our Indirect sales tax practice has extensive experience with GST/HST and provincial sales taxes at the recovery and advisory level. We practice exclusively in identifying potential refunds and exposures for a number of market segments that process Canadian sales taxes, including public service bodies. Conducting this sales tax analysis provides the ability to dig well beyond the normal audit process and ensures our clients realize all refund opportunities and address any potential exposures.

Typically, federal and provincial sales taxes are often overlooked in the face of competing priorities and perceived simplicity in processing. The recent significant multijurisdictional changes to these taxes in Quebec, British Columbia, Prince Edward Island and Nova Scotia (to name a few) can escalate an initial small exposure or refund into a substantial dollar amount. The potential problems can include miscalculated systemic adjustments, erroneous vendor invoices, misinterpretation of legislation, and missed ITCs or RITCs.

Now is an opportune time to consider this analysis, in light of the recent increased audit activity in all sectors by the Canada Revenue Agency and PST authorities. As calendar/quarterly reporting and audits are quite often completed in early summer, July through September is an ideal time to consider this specialty service and implement an additional process of checks and balances.

A typical engagement outline would include these factors:

- Minimal time required by the finance staff during the engagement. Prior to arrival on site, we extract the raw data from your accounting ERP accounts payable system, enabling us to begin our in-depth electronic analysis off site, reducing the on-site time by 60%.

- Our Senior IT Manager assists in the extraction and has extensive experience in dealing with organizations ranging from multi-billion dollar public and private companies to mid-market clients to public sector bodies. We deal with systems ranging from SAP to QuickBooks to sector-specific systems.
- Once on site, we will need about an hour of the client's time to discuss our preliminary findings and the location of the hardcopy accounts payable files. After that point, we work independently, interacting at structured intervals or at the end of each day. We pull and validate all files on our own.
- Within two weeks of completion of the engagement, we provide a complete Overpayment Report and separate Management Exposure Report outlining our findings.
- Post-engagement, we provide an *ad hoc*, no-fee indirect sales tax hotline for questions regarding GST/HST throughout the year.

Finally, we have implemented the contingency fee model to adapt to the market for this type of service, providing a win-win scenario to our clients; if no refunds are identified, there are no charges.

Contact your Collins Barrow advisor to discuss our indirect sales tax overpayment and exposure analysis services further.

Collins Barrow periodically publishes a *Indirect Tax Alert* for its clients and associates. It is designed to highlight and summarize the continually changing tax and business scene across Canada. While *Indirect Tax Alert* suggests general planning ideas, we recommend professional advice always be sought before taking specific planning steps.

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