ISSUE 2014-01
WWW.BDO.CA

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THE TAX FACTOR

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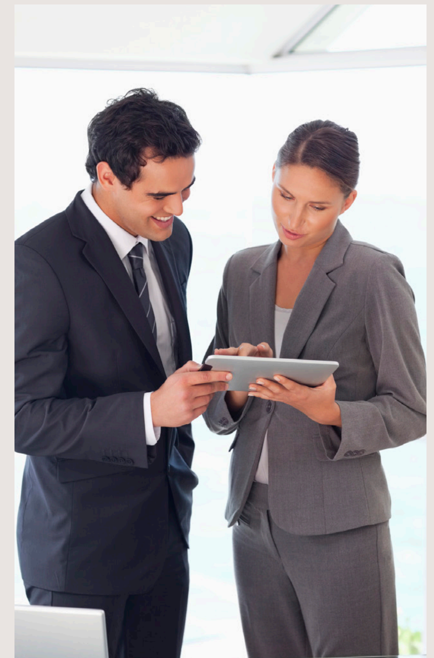

TAX TREATMENT OF WEBSITE DEVELOPMENT COSTS

In today's "wired" world, it is now generally expected that businesses have a website. Whether your business is selling goods online or whether the website is strictly a resource for information about your product or service, ensuring that you have an online presence for customers to either make purchases or browse and learn more about your business is an essential requirement in an increasingly competitive marketplace.

Interestingly, despite the widespread acceptance of websites as a crucial business tool, there are no specific tax rules that govern the deductibility of website development costs. In absence of any special rules, the general tax principles established by accepted jurisprudence act as guidelines to distinguish between those expenses that are currently deductible and those that may have to be capitalized and written off under Canada's tax depreciation rules, known as capital cost allowance (CCA). Since these principles have to be applied to the relevant facts in each particular situation, there may be some uncertainty surrounding how the specific costs of building a website should to be treated for tax purposes.

Over the last decade or so, the Canada Revenue Agency (CRA) has been asked several times to comment on whether the expenses incurred to develop a website are capital or current in nature. In their responses, the CRA has consistently noted that a website is comprised of several different components, and that the underlying nature of each of these components must be analyzed separately to determine their appropriate tax treatment. In this article, we will identify several of the most common categories of costs incurred in creating a website, and how each of these types of costs should generally be treated for tax purposes.

A website is an "electronic creation"

The CRA has characterized a website as an electronic creation that enables a taxpayer to sell products or services, advertise its business and/or provide information to the public over the internet. Since a website is not a permanent asset — it can be modified, taken down or rebuilt — the predominant costs incurred to develop a website would generally include those related to purchasing the required hardware and software, as well as the labour or costs associated with designing and building the site's functionality and populating its content.

Current vs. capital expenditures

In addressing the variety of costs incurred to develop a website, the CRA is of the opinion that the component costs of building the site should be classified individually as either on account of income (i.e. currently deductible) or capital. In order to provide additional clarification, the CRA has stated that the determination of whether a particular expenditure is on account of income or capital would rely predominantly on whether the expense was incurred to purchase or create an asset that would have "enduring benefit". In assessing whether an asset has enduring benefit, the CRA indicated that one of the factors to be considered would include the expected useful life of the website.

Since there are several categories of costs that together make up a website, it would follow that some of these component costs (such as those attributable to the purchase of hardware and/or software) would have a longer useful life than others (such as the fees incurred to update the site's content) and as such would be considered on account of capital rather than currently deductible. For further clarification on how website development costs should be treated, let's take a quick look at each of the common components individually:

Hardware

Some businesses may decide to purchase the computer equipment required to host their own website. For example, the acquisition of data network infrastructure equipment would be a capital expenditure and generally can be depreciated for Canadian tax purposes under the CCA rules at 30% per year on a declining balance basis (with the deduction in the year of acquisition being limited to 15%). There are specific rules applicable to when an asset would qualify for CCA treatment. Your BDO advisor can provide more details about the rules governing how assets are to be written off for tax purposes.

Software

Any costs incurred in respect of the application software used to develop or carry out the website functions would likely be considered capital in nature. The CRA has stated that it is their opinion that the cost of application software would include both the amount paid to purchase packaged software from third parties, as well as any labour or consulting costs incurred to acquire, design or develop customized software. Application software generally can be written off under the CCA rules over two years, at 50% per year. You should note that application software is separately defined from system software, with costs to acquire system software generally being written off on the same basis as the related computer hardware. For additional guidance on what would differentiate system from application software, contact your BDO advisor.

Labour and consulting fees

As described above, labour or consulting fees relating to the acquisition or development of software to build the website functions would generally be considered capital in nature. However, if the costs incurred do not relate to the purchase or development of application or system software, or were not incurred for the purpose of altering the structure of the website, then these costs would likely be fully deductible for tax purposes in the year incurred. An example of such expenses would include fees paid to consultants or website developers to update existing web content. In addition to consulting fees, periodic fees paid to web-hosting companies for hosting a website are generally deductible in the year paid. Your BDO advisor can provide more information on which website-related costs would likely be currently deductible.

Tax treatment will depend on the underlying costs

While there are no special tax rules with respect to website development costs, the CRA has issued some administrative guidance to assist taxpayers in determining the tax treatment of the costs incurred to build a website. Analyzing the nature of the underlying costs that make up the total amount spent on your website will assist in determining how each of these amounts should be treated for tax purposes.

Whether you are setting up a new website or making improvements to your existing site, your BDO advisor can assist in providing clarification on the tax treatment of website development costs.

CANADIAN SALES TAX IMPLICATIONS OF SELLING GOODS OVER THE INTERNET

Over the past several years, the sale of goods over the internet has become something that both vendors and consumers have grown accustomed to. This is largely because many businesses operate on-line stores and have the capability of delivering goods right to the door of their customers. While some retailers offer goods for sale over the internet in addition to maintaining physical stores, others simply operate solely on-line. No matter what type of retailer you may be, you will likely agree that it is necessary to understand the Canadian sales tax implications of transacting on-line with customers in Canada.

This article highlights some of the sales tax considerations that you, as a business owner, need to be aware of. For purposes of this article, we will limit our discussion to sales made by Canadian on-line retailers in Canada. Note that Canadian on-line retailers selling into the United States (US) should seek advice on sales tax issues to ensure their tax collection and remittance policies are compliant with the relevant US rules.

The basics of GST/HST and interprovincial on-line sales

As you know, the Goods and Services Tax (GST) is a federal tax that is applied on most goods and services supplied across Canada. The current GST rate is 5%. Certain provinces, which are often called participating provinces, have harmonized their provincial sales tax systems with the GST. The tax that is imposed by participating provinces is referred to as the Harmonized Sales Tax (HST) and is effectively the GST at a rate of 5% plus a provincial component which can range from 8% to 10%. Once a business is registered for GST, it is automatically registered for HST as there is effectively one tax system administered by the federal government. The current participating provinces and their respective HST rates for 2014 are:

- Ontario — 13%;
- Nova Scotia — 15% (rate reduction to 14% in 2014 is not likely);
- Newfoundland — 13%;
- New Brunswick — 13%; and
- Prince Edward Island — 14%.

There are rules which provide that all Canadian retailers making sales in Canada, either through a physical location or over the internet, are required to be registered for GST/HST unless they are considered a small supplier (which is an entity with sales on an associated basis of less than $30,000 annually).

Further to this, a retailer (that is not a small supplier) with only one physical location in Canada that makes sales across Canada through their on-line store would be required to charge and collect GST/HST at the rate that applies to the province in which the taxable goods are delivered to. For example, a retailer with a store in Alberta that sells and delivers a computer to an Ontario consumer would be required to charge and collect GST/HST at the Ontario rate of 13%.

In addition, a Canadian resident on-line retailer with no physical stores would also be required to charge GST/HST at the rate that applies to the province in which the taxable goods are delivered to. For example, let's say a company incorporated in British Columbia (BC) that does not have any physical stores, sells taxable sporting goods over the internet. If the company arranges for the delivery of its product to a consumer in New Brunswick, it is required to charge and collect GST/HST at a rate of 13% from the consumer in New Brunswick, even though the company was established in BC.

Québec Sales Tax

The Québec Sales Tax (QST) system is very similar to the GST/HST. Although the rules are generally harmonized with the GST/HST, you should note that it is a separate and distinct system governed by separate legislation and it is administered by Revenu Québec. As such, unlike the rules that apply to the participating provinces, if your business is registered for GST/HST, it is not automatically registered for QST.

It is worth pointing out that under the QST legislation, every person (defined for sales tax purposes to include a corporation, individual, partnership or trust) that makes a taxable supply (sale) in Québec in the course of a commercial activity carried on in Québec is required to be registered for QST, except where:

1. The person is a small supplier;
2. The only activity is making sales of real property otherwise than in the course of a business; or
3. The person is not a resident of Québec and does not carry on business in Québec.

Note that with respect to point 3 above, the concept of "carrying on business in Québec" is not defined in the legislation. Therefore, one must look at certain administrative guidelines to help make the determination. Keep in mind that each situation must be determined on a case-by-case basis to take into account the specific facts of the situation. For example, let's say there is an on-line retailer incorporated in Ontario with no place of business, no employees or agents, no bank accounts and no inventory in Québec. In this example, the retailer makes sales of taxable raw materials that are only sold to other businesses and not to individual consumers located in Québec. As a non-resident of Québec who is not carrying on business pursuant to administrative guidelines, the on-line retailer would not be required to register for QST. This means that only GST at a rate of 5% would apply.

Please note, however, that there are special registration rules for residents of Canada (outside Québec) who solicit orders in Québec for the sale of taxable goods to individual consumers that are to be delivered within Québec. In this case, the on-line retailer would be required to register for QST. For example, consider a business incorporated in Manitoba that is an on-line retailer that solicits orders for the sale of hair products to individual consumers in Québec. The products are delivered to customers in Québec. In this example, the Manitoba retailer would be required to register for QST and the goods would be subject to GST at a rate of 5% and QST at a rate of 9.975%.

British Columbia PST

As you are well aware, BC recently re-introduced a Provincial Sales Tax (PST) at a rate of 7% that is based on the consumption of goods in the province. It is worth noting that the PST in BC is not a value added tax and is imposed on the end user. As well, there are many exemptions under the PST legislation. For example, goods acquired for purposes of resale are not subject to PST.

Bear in mind that generally an on-line retailer is required to register to collect PST if they carry on business through an establishment in BC. In addition, a business located in Canada, but outside of BC, is also required to be registered for PST if that business:

1. Solicits orders for sale to purchasers in BC by advertising or other means;
2. Accepts purchase orders that originate from locations in BC;
3. Sells goods to persons in BC for use or consumption (not for resale); and
4. Delivers the goods into BC.

Quite clearly, a Canadian on-line retailer who delivers taxable goods to customers in BC will have to review these requirements to determine if they must register to collect PST.

Manitoba PST

The province of Manitoba has a PST system similar to that of BC, but the tax is imposed at a rate of 8%. Where an on-line retailer has a fixed place of business (i.e. a head office) in Manitoba, it is required to register to collect PST on the sale of taxable goods. A business outside of Manitoba may also be required to register for PST if it has on-line sales of taxable goods where all of the following criteria are met:

1. The goods are acquired to be used in Manitoba (and not for resale);
2. The vendor delivers the goods into Manitoba;
3. The vendor, directly or through an agent, solicits orders for the sale of goods in Manitoba by advertising or by any other means. This would include solicitation by email targeted towards Manitoba customers; and
4. The vendor accepts purchase orders that originate in Manitoba.

Keep in mind that the rules are quite similar to the rules that apply in BC. For instance, an on-line retailer who does not have a physical place of business in Manitoba may be required to register to collect PST where all of the above criteria are

met. Therefore, it is advisable for on-line retailers outside of Manitoba with sales to customers in Manitoba to carefully review these rules to determine if they are required to register for this tax.

Saskatchewan PST

The province of Saskatchewan also imposes PST, but at a rate of 5%. However, unlike Manitoba and BC, the Saskatchewan PST legislation does not have specific rules governing the registration requirements for non-residents of the province. However, the province has posted a "Q & A" on their website which states that it is recommended that a non-resident of Saskatchewan who is making a retail sale of taxable goods which are delivered to a location in Saskatchewan, register for PST "as a convenience" to their customer who would otherwise have to self-assess the tax. This is quite different from BC and Manitoba where there are specific provisions in their respective legislation dealing with non-residents of those provinces. It is advisable for on-line retailers outside of Saskatchewan that have sales in Saskatchewan to carefully consider the legislative requirements to determine if they need to register for PST in the province.

Summary

As you will likely agree, all on-line retailers selling taxable goods across Canada need to be aware of the various types of sales tax that apply within our country. Although the GST was intended to be a national sales tax system with uniform application, you can see that this is clearly not the case today. The Canadian sales tax landscape is still divided between the provinces as there are different rates charged in the HST provinces and separate rules governing the sales tax systems in Québec, BC, Manitoba and Saskatchewan.

For more information about the sales tax implications of on-line sales, please contact your BDO advisor.

GOOD NEWS FOR PARTNERSHIP REPORTING

Partnership Information Return filing requirements changed effective January 1, 2011, and in early 2012 the Canada Revenue Agency (CRA) released a revised T5013 Partnership Information Return (including related forms). These changes caused concerns due to added compliance requirements in general, and for family farm partnerships in particular. The concerns were discussed in detail in the article titled "Changes in partnership reporting" in the 2012-04 issue of the *Tax Factor*. Since the changes were announced, the CRA has engaged in discussions with tax advisors and stakeholders on the issues. As a result, some of the concerns raised were addressed with further revisions to the T5013 reporting package last fall and with an exemption for certain family farm partnerships. The T5013 revisions together with some new changes, as well as details of the exemption, are outlined below.

T5013 revisions and electronic filing

The following is a summary of the more significant changes that have been introduced for 2013 partnership reporting:

- Schedule 50, *Partner's Ownership and Account Activity*, has been revised in response to concerns of having to report on the actual adjusted cost base (ACB) and at-risk amount (ARA) of each partner's interest in the partnership (note that the ARA is applicable for limited partners). Requirements to provide this information would have placed a significant compliance burden on certain partnerships, and may have been impossible for large commercial partnerships. The recently revised Schedule 50 no longer requires the calculation and reporting of a partner's ACB and ARA. Instead, it will be necessary to report certain components of these amounts. In particular, the revised form includes a requirement to report cost base, which is generally the acquisition cost of the partnership interest, along with certain other amounts that should be known to the partnership. If the cost base is not known, an amount of "zero" can be reported. The form also requires the reporting

of a partner's disposition of an interest in the partnership during the fiscal period.

- Schedule 9, *Affiliated Corporations, Partners, Partnerships or Trusts*, reporting has been simplified and will alleviate uncertainty that had arisen from earlier form changes where some partners are members of multiple partnerships.
- Schedule 2, *Charitable Donations, Gifts, and Political Contributions*, has been updated to provide for the reporting of any gifts of medicine and municipal political contributions made in the fiscal period.
- For fiscal periods ending in 2013 and later years, nominees or agents will only have to complete a T5013 slip and Summary for each partnership in which they held an interest. They will no longer be required to file the T5013 FIN, *Partnership Financial Return*, or the T5013 Schedule 50.
- Another beneficial change implemented by the CRA for partnership reporting is that beginning in January 2014, the T5013 Partnership Information Return can be filed electronically.

For more details on the changes to the T5013 Partnership Information Return, refer to the What's New section of the CRA's guide for this return.

Family farm partnership exemption

Due to the additional compliance burden on family farm partnerships resulting from the reporting changes implemented by the CRA in 2011, a reporting exemption has been provided. More specifically, family farm partnerships composed of only individual partners will be exempt from filing the T5013 Partnership Information Return for the 2013 and 2014 fiscal periods. This change is beneficial as there is already an established reporting system in place for these partners through their personal tax returns and depending on the circumstances, by using forms for specific farm program purposes. The exemption will remove the additional compliance burden of filing a T5013 Partnership Information Return.

The CRA will study the issue further and consult with stakeholders in order to make a decision on reporting requirements for family farm partnerships for 2015 and later fiscal periods. It is hoped that the exemption will be made permanent.

It is important to note that a farm partnership that includes a trust, corporation or another partnership as a partner is currently still required to file a T5013 Partnership Information Return.

If you have any questions regarding partnership reporting requirements, contact your BDO advisor.

The information in this publication is current as of January 1, 2014.

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact BDO Canada LLP to discuss these matters in the context of your particular circumstances. BDO Canada LLP, its partners, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

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