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CANADIAN COMMODITY TAXATION OF HIGH TECHNOLOGY PRODUCTS

Deborah E. Nesbitt*

I. INTRODUCTION

Although there are at least six pieces of legislation which govern the operation of Canadian Commodity Tax Law on a federal level, the most relevant to the foreign exporter of high technology products to Canada are the Customs Act¹ which imposes duties on certain goods imported into Canada; the Customs Tariff² which sets forth the rates of duty applicable to those goods; and the Excise Tax Act,³ which levies a sales or excise tax on the duty paid value of those goods.

This article will review the new Customs Act, which received Royal Assent and was proclaimed in force on November 10, 1986. It will discuss the treatment of high technology products under the recently introduced valuation system for the calculation of duty paid value. It will also consider the tariff classification of computer hardware and corresponding duty rates, as well as the federal sales tax and the possibility of its replacement by a business transfer tax. Finally, this article will conclude with an analysis of the provincial retail sales taxes.

II. NEW CUSTOMS ACT

In April of 1978, a new Customs Act was introduced in the House of Commons in recognition of, inter alia, the antiquated approach of the then current statute, most of which predated Canada's confederation in 1867. Several governments and substantial revisions later, Bill C-59 "An Act Respecting Customs" (The Customs Act)⁴ was introduced in June of 1985 and received second
The Customs Act imposes no tax in and of itself. Rather, it controls the movement of goods into and out of Canada and provides the basic framework for the administration and enforcement of all laws relating to customs and excise taxes.

While almost universally welcomed as long overdue, some commentators believe the legislation is flawed in several respects. Following are some of the concerns regarding the Customs Act:

1. The Customs Act has expanded the definition of "duties" to include taxes, federal sales tax and anti-dumping duties. Accordingly, the duty paid value, upon which federal sales tax is calculated, is inflated.

2. The Customs Act allows the Deputy Minister two years to reappraise entries, but limits the importer's right to appeal an appraisal to ninety days from the date of entry (although the Minister may extend the period). The importer thereby loses his right to appeal while the minister can still reappraise.

3. The Deputy Minister may reappraise or redetermine at any time in order to give effect to a Tariff Board or judicial decision. This deprives an importer of all certainty with respect to liability for past entries.

4. To seize goods the Minister must furnish reasons for seizure but he need not furnish reasons for his ultimate decision regarding the disposition of the goods.

The following are some of the positive changes in the legislation:

1. The government is liable for interest on monies paid that are later determined to be refundable.

2. When there is a dispute over excess duties and the matter is taken to the Tariff Board or Federal Court, the importer may post security in lieu of cash.

3. The issuance and execution of search warrants will be governed by provisions similar to those found in the Criminal Code.

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5. See, e.g., the submission of the The Canadian Importers Association to the House of Commons Committee on Bill C-59, An Act Respecting Customs.


It remains to be seen how effective the legislation will be. There is little doubt, however, that the new Customs Act is an improvement on the prior law.

III. Valuation

The vast majority of large, high performance mainframe computers and disc storage products bought in Canada are imported from the United States, Ireland or Japan through wholly-owned Canadian subsidiaries. In fact, imports of high technology products have been one of the main sources of the Canadian trade deficit. Accordingly, an understanding of Canadian customs duties and valuation methods for high technology products is essential to any high technology company that intends to trade in Canada.

The new Customs Act makes no change in the method of valuation for duty on imported goods because the previous Act had been recently amended to adopt a new valuation system for assessing duties. This new system replaced the fair market value system of valuation which had been used in Canada for over one hundred years. Under the fair market value system, value for duty was the higher of the invoice price to a Canadian purchaser or the value of similar goods sold under similar circumstances by the exporter in the country of export. This system often led to onerous duty charges because sale prices in home markets often exceeded actual selling prices to the Canadian importer.

Under the new system, and in keeping with Article VII of the General Agreement on Tariffs and Trade (GATT), the value of imported goods is based on the actual value of the imported goods or of like merchandise and is not to be based on values in the country of export or on fictitious values. The new valuation system was continued in the new Act.

Although the new valuation system provides for six methods of valuation, the most frequently employed is that known as the "transaction value" which is "the price actually paid or payable for goods, as adjusted, when sold for export to Canada." Ignoring adjustments to the price, the transaction value in a

19. Adjustments to price include: adding certain commissions and brokerage fees, packaging costs, royalty and license fees and transportation costs prior to entry; and deducting
Section 48(1)(d) of the Act restricts the use of the transaction value method, obviously to eliminate the possibility of fictitiously low transfer prices in parent-subsidiary transactions. Essentially, this method cannot be used unless the importer can, if required by Revenue Canada (the federal taxation ministry), establish that at the time of export, the relationship between the parent and the subsidiary did not influence the price or that the transaction value has met certain test values set out in the Act.  

To date, no judicial standard has been set on how related companies may demonstrate that their relationship did not influence the price. However, Revenue Canada, in the early days of the system’s introduction, published Memorandum D13-4-5, which expressly acknowledged the lack of guidance in the old Customs Act and by inference acknowledged a lack of guidance in the new one.

The Memorandum indicated that Customs officials would be looking for objective evidence that the price paid or payable would not have differed significantly had the two companies not been related. There are three indicia that the transfer price was not affected by the parent-subsidiary relationship: first, information on normal pricing practices in the industry; second, sales by the vendor to other unrelated Canadian purchasers; and third, evidence that the price paid reflects the recovery of costs and a standard profit margin.

Companies who export goods to their Canadian subsidiaries have three primary concerns regarding these evidentiary requirements. First, it is difficult to obtain pricing information from one’s competitors, although Revenue Canada has access to such information through entry documentation furnished by those competitors with their own importations. However, due to the confidential nature of this information, the discretion to interpret it remains solely with Revenue Canada, making rebuttal of the interpretation difficult. Second, few parent companies sell other than to their own subsidiaries within Canada.

Due to the unavailability of the first two types of evidence, evidence that the price reflects the recovery of costs and profit will probably be the most commonly used. It is significant that Revenue


Canada will look for a profit margin that is "representative of the firm's overall profit realized over a representative period of time."\textsuperscript{22} Clearly, profit margins vary greatly from product to product although they are of the same class or kind. Profit margins can also increase dramatically over the life of the product as the research and development costs are written off and inefficiencies in the manufacturing process are eliminated.

The new provisions for valuation provide five additional valuation methods. These methods, which closely resemble those of the other GATT signatories, are beyond the scope of this paper. It is strongly suggested that before entering the Canadian marketplace, an exporter should consult with Canadian counsel to ensure the application of the appropriate valuation method.

IV. THE CUSTOMS TARIFF

The rates of customs duties for particular goods are contained in the Customs Tariff.\textsuperscript{23} The Customs Tariff is not a single document but is a rather lengthy compendium. It consists of four main divisions, the last three of which list rates of duty applicable to all imports. The first division lists the countries of the world and the tariff treatment applicable to each.\textsuperscript{24}

There is also a list of about two thousand descriptive classifications of tariff items and the duty rate for each is contained in Schedule "A". The duty rate depends on the particular goods and the country of origin or export of goods. In the case of computer hardware imported under Tariff Item 41417-1, rates vary from free, for goods coming from "British Preferential" countries, to 35%, for computer parts entering under 41417-2 from "General" countries. These duties are considered ad valorem, that is, not specific, in that they are applied to the dutiable value, rather than as an amount per unit of measure. The rate may be applied to the transaction value or the price paid to the parent by the Canadian subsidiary.

The Customs Tariff classifies the countries of the world into five tariff treatments: General Preferential, British Preferential, United Kingdom and Ireland, Most Favored Nations (MFN) and General.

An example will help to clarify the operation of the system. A personal computer entering Canada from Libya would have a duty rate of 25% while its parts would enter at 35% (General class).

\textsuperscript{22} Id., at § 3(c).
\textsuperscript{23} R.S.C. ch. 41 (1970), as amended.
\textsuperscript{24} R.S.C. ch. 41, Schedule A (1970), as amended.
The same machine coming from Ireland would enter at 3.9% and parts would enter at the same rate (U.K. and Ireland class). If it came from the U.S.A., it would enter at 3.9%; its parts would enter free (MFN class). From Zimbabwe, it would enter free, as would its parts (British Preferential class). If it entered from any third world country, both the personal computer and its parts would enter duty free (General Preferential class). Most of the computer hardware entering Canada today comes from the U.S., Japan and Ireland and is subject to a duty rate of 3.9% of the dutiable value.

Computer hardware is covered by Tariff Items 41417-1 and -2 which replaced nineteen different items under which hardware importations previously could be classified. Although the new tariff items differ significantly from those recommended by the Tariff Board the process of classification is more straightforward than that which existed prior to 1980.

Richard Dearden, in his review of Tariff Item 41417, summarized the principles enunciated by the Tariff Board in three cases involving 41417-1:

1. 41417-1 is a generic Tariff Item; it is all-embracing and to use the analogy of another commentator, it is the "trump" card which takes precedence over all other Tariff Items;
2. All computers are electronic data processing apparatuses but the reverse is not necessarily true; and
3. A machine need not be a computer to come under 41417-1, e.g., modems.

On November 22, 1985, Canada announced its intention to join with the U.S. and Japan in eliminating tariffs on computer parts and semiconductors. Accordingly, computer parts which had been imported into Canada from the U.S. or Japan at a duty rate of 3.9% were to be duty free effective February 27, 1985, under a new Tariff Item (41417-3). The life span of this commendable intention was relatively short. On June 2, 1986, the Minister of Finance announced a number of tariff measures in response to the decision of the U.S. Government to impose a 35% duty on imports of red cedar shakes and shingles from Canada. Accordingly, computer parts were again subject to a duty rate of 3.9% following a seven-month duty-free status. Subsequently, though, the budget of February 18, 1987 once more eliminated duty on such parts.

However, Tariff Items 41417-1 and -2 and the entire Customs Tariff may soon be preempted. In June of 1983, the Customs Co-

operation Council in Brussels approved the Harmonized Commodity Description and Coding System (the Harmonized System) which will, when fully implemented by the majority of the 122 signatories to GATT, bring all major trading nations (including Communist countries) into a uniform system of tariff classification. Canada had previously indicated an implementation date of January 1, 1987. It is now generally accepted that January 1, 1988 is a more realistic target.

The Harmonized System is based upon a presumption that commodities should be described in terms of their principal characteristics. It is implemented by a six to eight digit nomenclature which progresses from the basic raw material, from which the good is made, to the finished product.

The Tariff Board is conducting an ongoing study of the Harmonized System and convened most recently on July 30, 1986, in Ottawa. At that time, submissions were made on behalf of the Canadian data processing industry. Many hours have been spent analyzing the new classifications and associated rates for their impact on selling prices since one basic presumption of the Harmonized System is that duties will not be increased.

Tariff Item 41417 for electronic data processing machines was created several years ago to gather under one item everything related to that technology and, as a result, has simplified the classification process. The new Harmonized System, however, excludes certain machines from the new Tariff Item 84.71 for automatic data processing machines. Additionally, many more accessories, attachments and parts are specifically named in new tariff items. As might be expected, higher rates of duty are being applied to these goods. Accordingly, of particular concern to the electronic data processing industry is that the new Tariff Item ostensibly eliminates duty-free status for all electronic data processing equipment while the Annex to the Harmonized System preserves 41417-1 and -2 which hold that some electronic data processing equipment will remain duty free. The critical and unresolved issue is which of the two systems of classification will take precedence over the other.

It is expected that the clarity of the Harmonized System will reduce the volume of appeals to the Tariff Board on classification issues. On the other hand, the greater clarity will probably cause some degree of displeasure among importers who have been relying

27. Tariff Board Reference No. 163.
on the vagueness of the present tariff in order to obtain a favorable result.

The Tariff Board is expected to issue its recommendations on the Harmonized System in the near future and, as mentioned previously, implementation is not expected before 1988.

V. FEDERAL SALES TAX

The Excise Tax Act\(^\text{28}\) imposes sales and excise taxes in Canada. These taxes are imposed in a concentrated fashion on a few commodities at the import or manufacturing level. Presently, sales tax on most of these commodities, including high technology products, is 12\%.\(^\text{29}\) The sales tax is a tax of single incidence and in the case of imported goods is applied to the duty-paid value of the imported goods.\(^\text{30}\) Where the goods are produced in Canada, the tax is levied on the manufacturer or producer based on the sale price at the time of sale.

Canada is virtually the last country in the industrialized world to use a manufacturer's sales tax. Although introduction of the present system sixty-three years ago caused a considerable stir, public cognizance of its existence has faded with the man on the street being largely unaware of its impact on his daily purchases.

An extensive review of the system was undertaken in the early 1980s resulting in a report of the Federal Sales Tax Review Committee chaired by Dr. Wolfe Goodman (the Goodman Report). Although the Goodman Report recommended a value-added tax, thus following the example of many European countries, the present government has announced its intention to pursue the somewhat similar route of a business transfer tax.\(^\text{31}\) The value-added tax or the business transfer tax would broaden the present tax base rather than simply increase the nominal rates on the present, narrow commodity base.

The manufacturer's sales tax (a major source of funds in the federal tax system) has traditionally favored imported goods since they are taxed on the duty-paid value which usually does not include costs for promotion, product warranty and after-sales service that are frequently contained in the domestic manufacturer's sale price. The business transfer tax, which is a variation on the usual

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value-added tax, will eliminate this favoritism provided it is structured to impose tax throughout the production and distribution process up to the point of final sale.

Under the business transfer tax, tax is collected on the value added at each level. This "subtraction type" value-added tax, where the value added at each level is defined as the output at that level minus the taxable inputs, allows the tax imposed on goods and services to be hidden in the retail price of the good. It is unlike the typical value-added tax which simply imposes tax on the value added at each level. It may be this characteristic that accounts for the popularity of the business transfer tax with the present Canadian Finance Ministry since, in this regard, the tax is not unlike the present federal sales tax. While the adoption of the business transfer tax may go a long way towards eliminating the favored position long held by imported goods, the benefit may be illusory since the quantity of Canadian production of such goods is relatively low, as evidenced by the Canadian trade deficit in this area.32

Proponents of a business transfer tax argue that the present federal sales tax arrangement is unfair in that it treats some industries with great indulgence while imposing substantial tax burdens on others. However, the greatest concern regarding the adoption of a value-added tax or business transfer tax in the eyes of the government has to do with its ability to raise very large amounts of revenue. It is generally believed that the same amount of revenue would be generated as under the present federal sales tax system.

Additionally, because the business transfer tax would apply to a greater range of goods and services, it could be set at a lower rate: however, the likelihood that such a rate would ever be adopted and maintained is not great. While the government may feel it politically favorable to introduce the tax at a low rate, there is clearly nothing to prevent them from increasing the rate as they deem it necessary. It is worth noting that for each percentage point increase, Ottawa would be able to collect approximately an additional 2.6 billion dollars. That in itself seems a very great incentive for future increases.

VI. CUSTOMS DUTIES AND FEDERAL SALES TAX FOR SOFTWARE

Prior to January, 1985, and the introduction of the new valuation system, the valuation of software was determined by reference

to Memo D 13-11-2.\textsuperscript{33} That document rather arbitrarily distinguished between application software, which enables a computer to perform specific tasks, and systems software, which is essential for the operation of the computer. It was thought that system software was generally sold with the computer by the manufacturer and its value for duty was therefore implicit in the value for duty of the computer. Application software, presumably because of its characterization as specific-task oriented, was seen as a true intangible and, therefore, not subject to tax. The value for duty of application software was determined to be the fair market value of the physical medium on which it was recorded.

It was not immediately apparent that the new valuations methodology discussed above applied to software. It has now been determined that the new valuation system is appropriate.\textsuperscript{34} Although the final result is that only the carrier medium is subject to duty and federal sales tax, it is worth noting that this is the end result, achieved through a tortious route. The procedure for valuation is as follows.\textsuperscript{35}

1. The tariff classification of the software is determined by the tariff item which best describes it. Where, for example, the software is contained on a magnetic tape, the software should be classified under the general 41417-1 item, since there is no more specific provision in the Tariff.
2. The value for duty should include the value of the medium, the value of the instructions or data contained on the medium and the value of reproducing the instructions on the medium.
3. The value of the medium will be the price paid for it by the exporter in an arms-length situation.
4. The value of the reproduction service is determined in a similar fashion.
5. The value of the data or instructions must be indicated separately from the value of the medium and the reproduction service.
6. The importer pays duty and federal sales tax on an aggregate of all three amounts, then obtains a remission of duties and taxes paid on that value which relates solely to the value of the data or instructions. It should be noted, however, that if the importer claims remission at the time of importation, the importer may obtain immediate remission and pay duty and federal sales tax on the value of the medium only.

\textsuperscript{35} D Memorandum D-8-3-15, April, 1985, at Guidelines and General Information.
A number of difficulties are immediately apparent in the foregoing system. First, in those circumstances in which an operating system is imported with the hardware and has a single value associated with the transaction, it is incumbent on the importer to allocate the price paid to the elements mentioned above. The task is impossible for most importers.

Second, commonly in a parent-subsidiary transaction, no transfer price exists for software products. In situations in which there is no transfer price, Revenue Canada has recommended that the importer rely on one of the other five valuation techniques for establishing the value for duty. While the alternate methodologies have not been reviewed in this article, none of them adapts well to software industry practices.

Third, information on the media and reproduction costs, not to mention the value of the information itself, is not only difficult to obtain but, in the case of the information value, is clearly associated with the life of the software product. If one were to allocate the research and development costs associated with a new operating system in its early years over the few copies of the product, the value attributable to the information would be extremely high. Although taxes paid on this are ultimately remitted, this requirement puts a great burden of tracking and adjusting on the importer.

It is generally recognized that this remission practice differs from the practice of Canada's major trading partners who simply value the carrier media and exclude the value of the information. The practice of first collecting and then remitting also creates additional bureaucracy for remissions not offset by interest revenues and it imposes a burden on importers greatly disproportionate to any benefit received. Nonetheless, Revenue Canada has not been amenable to changing its practices to recognize business realities and to conform to the practices of other GATT signatories.

VII. PROVINCIAL RETAIL SALES TAXATION

All Canadian provinces except Alberta have retail sales tax statutes which impose a tax on the purchase of tangible personal property. The rates range from 5% in Saskatchewan to 12% in Newfoundland. This tax is relevant to the U.S. exporter who may be obliged to apply for registration as a vendor in that province and who may, even if exempt from registration requirements, be liable for collection of sales tax as an agent for the provincial treasury. The nonresident vendor may choose to disregard the obligation to collect and remit by virtue of its nonresident status, but such a cava-
lier attitude should be carefully considered in light of the possible consequences for Canadian customers of nonresident vendors. Since the customer is the one liable for the tax, there remains on the purchaser an obligation to pay the appropriate tax and failure to pay results in penalties. Clearly, however, where a nonresident is carrying on business from a fixed base of operations within a province, all the usual provisions of the retail sales tax legislation apply. Accordingly, the sale or lease of computer hardware is generally subject to sales tax in varying amounts, depending upon the situs of the contract.

The situation with respect to software is less clear. Some provinces distinguish between application and operating software in levying the tax. Others, like Manitoba, tax all software unless customized. A further complication may arise out of the manner in which the software is provided to the customer. If licensed rather than leased, the transaction may be exempt. Due to the variety of tax treatment for retail sales, the vendor should seek advice regarding the tax statute in the particular province.

1. British Columbia

The starting point of any discussion of provincial commodity tax treatment of software in Canada must be the well-known decision of the British Columbia Court of Appeal in Continental Commercial Systems Corporation c/o Telecheque v. The Queen in Right of British Columbia. In Chequecheck (as it is known), the plaintiff had agreed to purchase those assets of another company which related to a cheque verification operation run by them. In addition to the sale of the hardware used by the vendor to run the business, the vendor agreed to assign to the plaintiff, by way of a sub-assignment, its rights as a licensee to "all of the vendor's right, title and interest in and to: all computer software ... including negative data...."

A purchase price of $327,991.00 was allocated to the software, and tax was levied pursuant to the British Columbia Social Services Tax Act in the amount of $13,119. The plaintiff appealed from a decision of the Minister of Finance affirming its liability. At trial, the Court reviewed the nature of the software in question and grouped it into categories of operating software, applications

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37. 18 B.C.L.R. 52 (1982).
38. 18 B.C.L.R. 56 (1982).
software and the data bank of "negative information." After noting various authorities the Court distinguished them on grounds that in those cases, the taxpayer had purchased a service in the form of preparation of programs by the vendor for use in the taxpayer's computer system. Here, the taxpayer was acquiring not an intangible, but a business, including its equipment. The court noted that, "the equipment included a computer into which had been introduced the software." Therefore, the court ruled, the taxable value of the transaction included the software.

The Court of Appeal disagreed. It noted that another part of the purchase agreement allocated a separate price, which was not taxed, to the sale of the vendor's franchise rights. The Court interpreted the failure to tax the franchise rights as an affirmation by the Minister that allocation of price between tangible and intangible personal property was valid. The relationship between the vendor and the licensor of the software was also reviewed and described as a personal, nontransferable, nonexclusive license to use (at least with respect to the operating and application software). The "negative information" was of the vendor's own authorship and was a very valuable part of the software.

The Court of Appeal was concerned with whether it was artificial reasoning to allocate price when software is linked so closely with hardware and resides on disks. The Court concluded that it is the knowledge that is the essence of the transaction; the disks are merely a means for moving it. The operating and applications software were of no use outside the computer. 41

Although the Canadian data processing industry welcomed the decision, it was then taken aback by the interpretation placed on it by the Minister of Finance for British Columbia. Bulletin 40-83 42 states that prepackaged application software is tangible personal property and that operating software is part of the hardware and is taxable accordingly. Presumably, due to uncertainty about this interpretation, British Columbia subsequently amended the Social Services Tax Act to include software as tangible personal property and to define software as "packaged or pre-written computer software programs ... or the right to use those programs ...." 43

Although the amendment was treated as a "clarification" by
the Ministry, it has created problems for the industry. The “clarification” has, for example, done away with the option of transferring software onto customer-owned media, thereby providing a nontaxable service. Only those programs which are designed and developed solely to meet a specific lessee’s needs are considered a nontaxable service.

2. Alberta

Alberta is the only Canadian province which presently does not have a retail sales tax. Although it was the first province to institute such a tax in 1936, it was short-lived, having been eliminated one year later. Occasionally, speculation surfaces that Alberta is on the verge of announcing or implementing a retail sales tax.

3. Saskatchewan

Saskatchewan was one of the first Canadian provinces to take the initiative in the area of software taxation. On June 1, 1984, the Provincial Legislature passed a bill which defined computer services to mean “[p]ackaged or prewritten computer software programs that are designed for general application or the right to use those programs and excludes modifications to these programs but does not include a computer software program that is designed and developed to meet the specific requirements of the consumer or user,”44 and included such services in the definition of “taxable services.”45

Accordingly, in Saskatchewan, packaged and prewritten computer software are subject to tax at time of purchase, lease or license. It is worth noting that the bill went through first, second and third readings in the Legislature in a three day time span and, due to this expedited process, no opportunity was afforded the Canadian data processing industry to respond to its provisions. Although the industry’s concerns have been raised with the Premier of the province, the position of the government is that software license fees have always been taxable and that the amendment to the Legislation was for clarification purposes only.

44. Education and Health Tax Act, Sask. Stat. ch. 38 § 3(a.1).
4. Manitoba

The Manitoba Retail Sales Tax Act\textsuperscript{46} makes no specific provision for the taxation of computer software. In practice, the province differentiates between operating and application software for tax purposes. The position is similar to that of the federal government prior to the implementation of the new valuation provisions, in that Manitoba deems operational software to be subject to tax insofar as it constitutes part of the hardware being purchased. Although application software is considered to be tangible personal property by that government, it is generally being treated as an exempt item. Tax liability for the procedure of duplicating software onto customer-owned media is presently under review, although the Director of the Retail Sales Tax Branch of the province has informally indicated to this author that whether the transfer will be taxed depends on whether the underlying software is taxable.

5. Ontario

In February, 1985, Ontario issued an Information Bulletin which purported to explain the Ministry's policy on the taxation of software.\textsuperscript{47} At the heart of the policy was the statement that license fees for prepackaged software were taxable, whereas the sale of custom software is a nontaxable service.

Previously, Ontario exempted license transactions from tax on the basis that a license was not a sale. The bulletin indicated a change of direction, however, in that it stated that software was to be considered tangible personal property and thus taxable to the consumer, regardless of how transferred. Taxable software was defined as:

Software programs interchangeably known in the trade as “off-the-shelf,” “pre-written” programs supplied in executable code only and not intended to be modified or changed by or on behalf of the purchaser. These programs are normally mass-produced and supplied with instructions and on disks, tapes or other media supplied by the vendor together with the license arrangement commonly referred to as an assumed or adhesion or shrink-wrapped license.\textsuperscript{48}

Furthermore, system software was to be taxable regardless of

\textsuperscript{46}. \textit{MAN. REV. STAT.} ch. R150 (1970), as amended.
\textsuperscript{48}. \textit{Id.}
how it was conveyed because it forms an integral part of the computer.

This approach has recently undergone another revision, ostensibly in response to and in concurrence with the finding of the British Columbia Court of Appeal in the Chequecheck case.49 The Branch now distinguishes between system (operating) software, "other software-prepackaged" (application) and "other software-customized" (application). System software is taxable only if bundled with the hardware both contractually and physically. "Other software" is taxable only if: (1) it is "off-the-shelf" and in executable code; (2) it is provided on vendor-supplied media; and (3) it is provided pursuant to a license agreement either shrinkwrapped or bilateral.

The province has specifically indicated that the practice of transferring software to media supplied by the purchaser is not taxable as the practice is considered a nontaxable service.

This recently announced variation represents a clearer position on the part of the Branch.

6. Quebec

Section 17(Ah) of the Retail Sales Tax Act was enacted in 1980 to provide that:

Sales of software intended for other than personal or domestic purposes, sales of reports, whatever the support, produced by a peripheral device connected to a computer and on which are recorded the results of the processing, by that computer, of the data furnished by the purchaser of these reports [are exempt from tax].50

In that single step, Quebec excluded from tax business software of all types, whether the transaction was a sale, lease or license.

7. New Brunswick

New Brunswick's Social Service and Education Tax Act51 does not include any specific provisions relating to the taxation of computer software. Like several other provinces, however, administrative practices have resulted in the classification of software as tangible personal property and therefore subject to tax if it is: 1) prepackaged computer software; 2) slightly modified prepackaged

49. 18 B.C.L.R. 52 (1982).
computer software; or 3) software licensing arrangements in which the software is as described in 1 and 2 above.

New Brunswick follows the same practice as Manitoba in determining whether the practice of transferring software onto customer-owned media is taxable. The nature of the software being transferred is determinative. If the software is ordinarily subject to tax, then the practice of transferring it is also subject to tax.

8. Nova Scotia

The Nova Scotia Health Services Tax Act\textsuperscript{52} also omits any specific reference to the taxation of software. Through administrative practice, some types of software, such as canned, prepackaged software, are considered tangible personal property and therefore subject to tax. License fees are also subject to tax if the software under license is canned and prepackaged. Unlike several other provinces, however, the practice of transferring software onto customer-owned media does not constitute the provision of a taxable service.

9. Prince Edward Island

Prince Edward Island has followed the lead of several other provinces in that no specific provision is made in their Revenue Tax Act\textsuperscript{53} for the taxation of software. A distinction is made with respect to prepackaged software, and custom software. Unlike the latter, the purchase or lease of prepackaged software is taxable. The tax status of license fees for the use of such software is presently under review. The duplication of software onto customer-owned media is not a taxable service.

10. Newfoundland

In the Newfoundland Retail Sales Tax Act,\textsuperscript{54} there is no specific provision for taxing software, although in practice software is considered tangible personal property if it is canned and prepackaged or if it is sold to a third party after being designed for someone else. License fees are not taxable regardless of the nature of the software. The practice of transferring software onto customer-owned media is also exempt from tax.

\textsuperscript{52} N.S. \textsc{Rev. Stat.} ch. 126 (1967), as amended.
\textsuperscript{54} Nfld. Stat. ch. 36 (1978), as amended.
VIII. Conclusion

The commodity tax laws of Canada are many and complex. The federal laws have been amended recently and may soon be changed again. The provincial retail sales taxes are as diverse as the provinces themselves. A prudent exporter of high technology goods to Canada, whether of hardware or software, will consult with Canadian counsel prior to entering the Canadian market in order to comply with Canada’s myriad commodity tax laws and to minimize their impact. While the recent changes in the valuation system and the introduction of the Harmonized System, business transfer tax and the new Customs Act reflect an attitude that Canada is open for trade, these very changes may prove to be a pitfall for the unwary importer.