



Reduction of Penalty and Interest in Wash Transaction Situations

Note: This memorandum supersedes GST/HST Memorandum 16.3.1, *Reduction of Penalty and Interest in Wash Transaction Situations*, dated September 2000.

In this memorandum, Part I sets out the guidelines for the reduction of penalty and interest in wash transaction situations where the amount of penalty and interest has been assessed under section 280 of the *Excise Tax Act* (the Act) for transactions for which net tax was remittable or an amount was payable to the Receiver General before April 1, 2007. Part II sets out the guidelines for the reduction of interest assessed under section 280 of the Act in wash transaction situations where the net tax was remittable or an amount was payable to the Receiver General after March 31, 2007. The information in this memorandum applies only to amounts assessed under section 280 of the Act. It does not apply to the tax on the importation of goods, which is paid and collected under the *Customs Act*.

Disclaimer

The information in this memorandum does not replace the law found in the *Excise Tax Act* and its regulations. It is provided for your reference. As it may not completely address your particular operation, you may wish to refer to the Act or appropriate regulation, or contact a Canada Revenue Agency (CRA) GST/HST Rulings Centre for more information. These centres are listed in pamphlet RC4405, *GST/HST Rulings – Experts in GST/HST Legislation*. If you wish to make a technical enquiry on the GST/HST by telephone, please call 1-800-959-8287.

If you are located in Quebec, please contact Revenu Québec by calling 1-800-567-4692 or visit their Web site at www.revenu.gouv.qc.ca.

Wash transactions

Meaning of wash transaction

1. A wash transaction occurs when a taxable supply (other than a supply taxable at 0%) is made and the supplier has not remitted an amount of net tax by virtue of not having correctly charged and collected the tax from the recipient who is a registrant who would have been entitled to claim a full input tax credit (ITC) if the tax had been applied correctly.

Closely related group or associated persons ss 128(1) and s 127

2. A wash transaction may also occur where tax is collected and reported (or ITCs are claimed) by the wrong entity within a closely related group or between associated persons, all the members or persons of which are engaged exclusively in commercial activities.

Quick Method of accounting

3. A wash transaction may involve a supply made to a recipient that has elected to use the Quick Method of accounting. In this situation, the Quick Method percentage rate used by the recipient takes into account the full ITC. However, a wash transaction does not include a supply made to a recipient that would have been entitled to claim a rebate, as opposed to a full ITC, if the tax had been charged correctly.

4. Where a full ITC is not available to the recipient, the transaction will not be considered a wash transaction. Examples of recipients that may not be entitled to full ITCs include persons such as listed financial institutions, charities, non-profit organizations, and municipalities. The only exception to this is where a registrant fails to charge tax on a taxable supply to a department of the Government of Canada, or to a participating provincial government entity that pays the HST. When a registrant fails to

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charge tax on a taxable supply to a department of the Government of Canada or to a participating provincial government entity, a wash transaction may occur.

Ministerial authority
s 281.1

5. The Minister has the authority to waive or cancel penalty and/or interest payable by a person under section 280. This memorandum provides guidelines on:

- how this authority is exercised where penalty and interest are assessed on net tax remittable or amounts payable to the Receiver General before April 1, 2007, in wash transactions; and
- how this authority is exercised on interest assessed under section 280 on net tax remittable or amounts payable to the Receiver General after March 31, 2007, in wash transactions.

Effective April 1, 2007, section 281.1 was amended so that the CRA may, on or before the day that is 10 calendar years after the end of a reporting period of a person, or on application by the person on or before that day, waive or cancel all or any portion of the interest or penalty payable under section 280 in respect of the reporting period.

6. This authority to waive or cancel penalty and/or interest is also exercised in extraordinary circumstances beyond a person's control. Detailed information on the guidelines for waiving or cancelling penalty and/or interest in these circumstances is available in GST/HST Memorandum 16.3, *Cancellation or Waiver of Penalty and/or Interest*.

Cancelling or waiving
penalty and interest
s 281.1

7. The cancellation or waiver of penalty and/or interest is an exceptional matter; however, it is recognized that, on occasion, an error in applying the tax does not result in any net revenue loss to the government. In such situations, the CRA will assess the registrant's net tax to account for the tax collectible or the ITCs claimed by the wrong entity, and if the circumstances warrant, may consider waiving or cancelling a portion of the penalty and/or interest payable by the registrant.

Part I – Administrative guidelines in wash transactions where penalty and interest are assessed on net tax remittable or amounts payable before April 1, 2007

Waiving or cancelling
penalty and interest

8. Where there is a wash transaction, the CRA will consider waiving or cancelling the portion of the penalty and interest payable at the time of assessment that is in excess of 4% of the tax not properly collected or the ITCs not properly accounted for by the supplier where the conditions identified in paragraph 12 are satisfied. Any amount of the assessment, including the wash penalty, that is unpaid on the date of assessment will be subject to normal penalty and interest under section 280 from the date of assessment until the earlier of the date the outstanding amount is paid, or March 31, 2007. Any amount outstanding on April 1, 2007, is subject to interest at the new prescribed rate until paid. See paragraph 18 for more information on the new interest rate.

9. Where it is determined that the penalty and interest will be reduced to 4% of the tax not properly collected, or the ITCs not properly accounted for, the CRA will first waive or cancel all or a portion of the interest. In most cases, the remaining 4% will be penalty that is payable, in addition to the amount assessed, to account for the GST/HST not properly collected or the ITCs not properly accounted for.

Due diligence

10. In the case of a wash transaction where the penalty and interest are reduced to a penalty of 4% of the tax not properly collected or the ITCs not properly accounted for, and the CRA has determined that the person has exercised due diligence, the remaining

penalty will be cancelled. For more information on due diligence, see Policy Statement P-237, *The Acceptance of a Due Diligence Defence for a Penalty Imposed Under Subsection 280(1) of the Excise Tax Act for Failure to Remit or Pay an Amount When Required, and for a Penalty Imposed Under Section 280.1 for Failure to File a Return When Required*.

Voluntary disclosure

11. Where a disclosure involving a wash transaction has been made and is accepted by the CRA as a valid disclosure in accordance with IC00-1R2, *Voluntary Disclosures Program*, the interest and penalty will first be reduced to a penalty of 4% of the transaction amount at the time of assessment. This 4% penalty will not be applied to the transaction identified as a wash transaction and reported in the course of a disclosure pursuant to the Voluntary Disclosures Program. In such circumstances, up to the date of assessment, only the taxes that should have been collected originally by the supplier, or the ITCs not accounted for properly for that transaction, will be sought by the CRA. Any amount of the assessment that is unpaid on the date of assessment will then be subject to normal interest under section 280 from the date of assessment until the date the outstanding amount is paid.

Conditions to be met

12. The CRA will consider waiving or cancelling the portion of the penalty and interest that is in excess of 4% of the tax not properly collected, or the ITCs not properly accounted for in a wash transaction where the following conditions are satisfied:

- it must be demonstrated that the taxable supply in question was made to a registrant who would have been entitled to a full ITC if the tax had been properly applied, or to a federal department, or to a participating provincial government entity; or where an ITC is claimed by the wrong member of closely related group, or an associated person, it must be demonstrated that the person properly entitled to claim the ITC is a registrant that would have been entitled to a full ITC;
- the person being assessed must not have been previously assessed for the same mistake and must have a satisfactory history of voluntary compliance;
- the person being assessed must have remedied the situation to ensure that tax is collected and ITCs properly claimed on future supplies of a similar nature; and
- the person being assessed must not have been negligent or careless in the conduct of its affairs to ensure that tax is properly collected and remitted on its taxable supplies and that the person claims ITCs only where properly entitled to do so.

13. These conditions will be applied to any audit period under review by the CRA, and may be adjusted in the future if the CRA considers it necessary.

14. In all circumstances where the CRA is considering whether to waive or cancel penalty and interest, the CRA retains the right to either waive or cancel only a portion of the penalty and interest, or only one of the components (i.e. penalty or interest) in whole or in part.

15. The waiver of penalty and interest in excess of 4% of the tax not properly charged or the ITCs not properly accounted for in a wash transaction will normally be considered automatically by the CRA during the audit process. The CRA may also consider requests that are made after a notice of assessment has been issued.

Deductibility of penalty	16. Where the policy respecting wash transactions has been applied during the course of an audit, and the penalty and interest is reduced to a penalty of 4% of the amount of the tax not properly charged, this penalty is deductible under the <i>Income Tax Act</i> .
Assessment periods 298	17. Generally, reassessments must occur within a four-year limitation period.
Examples	Note: The net tax in each of the following examples is remittable before April 1, 2007.
No. 1	<p>In March 2005, a registered wholesaler sold goods to a registered convenience store operator in Nova Scotia and did not charge the 15% HST because the wholesaler assumed that the goods were zero-rated basic groceries. An audit determined that the goods were taxable at 15%. In this case, the convenience store operator would have been entitled to claim full ITCs if the HST had been properly charged by the registered wholesaler.</p> <p>The CRA will assess the registered wholesaler for the HST collectible that it did not take into account in its net tax calculation for the reporting period. Subject to the conditions listed in paragraph 12, the CRA will consider waiving the penalty and interest that is in excess of 4% of the HST not properly charged.</p>
No. 2	<p>In February 2006, Corporation X, the parent of Corporation Y, claimed ITCs to which it was not entitled. Its subsidiary, Corporation Y was entitled to claim these ITCs, but did not do so. An audit of Corporation X disallows the ITCs. This results in an assessment of \$19,249 in net tax, \$1,847 in penalty and \$2,458 in interest. Corporation Y has since claimed the ITCs that were disallowed to Corporation X. Corporation X has a satisfactory history of voluntary compliance, has not been previously assessed for the same mistake and has taken steps to ensure that, in the future, it does not claim ITCs to which it is not entitled.</p> <p>Although the CRA will assess Corporation X's net tax for the ITCs that it claimed in error in its net tax calculation for the reporting period, subject to the conditions listed in paragraph 12, the CRA will consider waiving the penalty and interest that is in excess of 4% of the ITCs that were claimed in error.</p>
No. 3	<p>In September 2006, a registered dairy farmer in New Brunswick believed that he had received a grant from the federal government with respect to certain aspects of his farm activities. An audit determined that the amount of money that the dairy farmer received from the federal government was not a grant (i.e., there was a direct link established between the funds received and the activities), but was consideration for a taxable supply. In this case, the registered farmer was assessed the HST collectible.</p> <p>Although the federal government is not eligible to claim ITCs for tax paid, there is an offset of the tax mechanism available to it pursuant to the <i>GST Federal Government Departments Remission Order</i> (P. C. 1990-2854). Subject to the conditions listed in paragraph 12, the CRA will consider waiving the penalty and interest that is in excess of the 4% of the HST not properly charged.</p>
No. 4	<p>In November 2006, a registered retailer in Ontario sold goods to consumers and did not collect the GST based on the fact that it had not been charged the GST when it acquired the goods. An audit determined that the goods were taxable at 6%, and that the retailer was required to charge and collect the GST. The supplies between the retailer and the consumers are not wash transactions because the consumers would not have been entitled to claim ITCs for the tax payable on their purchases if the retailer had properly charged the GST.</p> <p>The CRA will assess the retailer's net tax for the 6% GST collectible that was not taken into account in its net tax calculation for the reporting period. Furthermore, the retailer will be assessed penalty and interest.</p>
No. 5	<p>In March 2006, a registered automotive parts dealer sold repair parts for public transit buses to a municipality in Alberta. It did not charge the GST on the repair parts because it assumed that the municipality was exempt from paying the GST. In February 2007, an audit determined that the supplies were taxable at 7%. In this case, the municipality would have been entitled to a rebate of 100% of the GST if the automotive parts dealer had properly charged the GST on the repair parts.</p> <p>The CRA will assess the supplier's net tax for the GST collectible that was not taken into account in its net tax calculation for its reporting period. Furthermore, the supplier will be assessed penalty and interest as a full ITC is not available to the municipality.</p>
No. 6	In August 2006, a registered wholesaler sold goods to a registered retailer in Ontario and did not charge the GST

because the wholesaler assumed the goods were zero-rated. In January 2007, an audit determined that the goods were taxable at 6%. In this case, the retailer would have been entitled to claim full ITCs if the GST had been properly charged by the wholesaler.

In January 2007, the CRA assessed the wholesaler's net tax for the GST collectible that was not taken into account in its net tax calculation for the reporting period. As the conditions listed in paragraph 12 were met, the CRA waived the penalty and interest that is in excess of 4% of the GST not properly charged.

In March 2007, the amount of the assessment had not been paid. The wholesaler requested that a portion of the interest and penalties accruing since January 2007 be cancelled pursuant to the wash transaction provisions. Although the wash transaction provisions were used to waive a portion of the interest and penalties at the time the assessment was made, the interest and penalties that have accrued since the assessment continue to apply at the full rate.

Part II – Administrative guidelines in wash transactions where interest is assessed on net tax remittable or amounts payable after March 31, 2007

- New interest rate
18. Effective April 1, 2007, the 6% penalty does not apply to amounts owing after March 31, 2007. Instead, a new interest rate applies to amounts owing as of April 1, 2007. The interest rate charged on overdue amounts under subsection 280(1) is the basic rate, plus 4%. The term “basic rate” is defined in the *Interest Rate (Excise Tax Act) Regulations* and is based on the rate charged on 90-day Treasury Bills adjusted quarterly, and rounded up to the nearest whole percentage (expressed as a per cent per year).
- Waiving or cancelling interest
19. Where there is a wash transaction, the CRA will consider waiving or cancelling the portion of the interest payable at the time of assessment that is in excess of 4% of the tax not properly collected or the ITCs not properly accounted for by the supplier where the conditions listed in paragraph 22 are satisfied. Any amount of the assessment (including the interest not waived or cancelled) that is unpaid on the date of assessment will then be subject to normal interest under section 280 from the date of assessment until the date the outstanding amount is paid.
20. Where it is determined that the interest will be reduced to 4% of the tax not properly collected or the ITCs not properly accounted for, the CRA will waive or cancel a portion of the interest. The remaining 4% will be payable, in addition to the amount assessed, to account for the GST not accounted for properly.
- Voluntary disclosure
21. Where a disclosure involving a wash transaction has been made, even though there may be no penalty applicable, if it otherwise would be accepted by the CRA as a valid disclosure in accordance with IC00-1R2, *Voluntary Disclosures Program*, the interest will be reduced to 0% of the amount of the transaction identified as a wash transaction when it is reported through the Voluntary Disclosures Program. In such circumstances, up to the date of the assessment, only the taxes that should have been collected originally by the supplier, or the ITCs not accounted for properly, for that transaction will be sought by the CRA. Any amount of the assessment that is unpaid on the date of assessment will then be subject to normal interest under section 280 from the date of assessment until the date the outstanding amount is paid.

Conditions to be met

22. The CRA will consider waiving or cancelling the portion of the interest that is in excess of 4% of the tax not properly collected in a wash transaction where the following conditions are satisfied:

- it must be demonstrated that the taxable supply in question was made to a registrant who would have been entitled to a full ITC if the tax had been properly applied, or to a federal department, or to a participating provincial government entity; or where an ITC is claimed by the wrong member of closely related group, or an associated person, it must be demonstrated that the person properly entitled to claim the ITC is a registrant that would have been entitled to a full;
- the person being assessed must not have been previously assessed for the same mistake and must have a satisfactory history of voluntary compliance;
- the person being assessed must have remedied the situation to ensure that tax is collected and ITCs properly claimed on future supplies of a similar nature; and
- the person being assessed must not have been negligent or careless in the conduct of its affairs in ensuring that tax is properly collected and remitted on its taxable supplies and that it claimed ITCs only where properly entitled to do so.

23. These conditions will be applied to any audit period under review by the CRA, and may be adjusted in the future if the CRA considers it necessary.

24. In all circumstances where the CRA is considering whether to waive or cancel interest, the CRA retains the right to either waive or cancel only a portion of the interest.

25. The waiver of interest in excess of 4% of the tax not properly charged in a wash transaction will normally be considered automatically by the CRA during the audit process. The CRA may also consider requests that are made after a notice of assessment has been issued.

Deductibility of interest

26. Interest that accrues in a taxation year that commences on or after April 1, 2007, is **not** deductible under the *Income Tax Act*.

Assessment periods
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27. Generally, reassessments must occur within a four-year limitation period.

Examples

Note: The net tax in each of the following examples is remittable after March 31, 2007.

No. 1

In January 2008, a registered agricultural wholesaler sold goods to a registered operator of a livestock farm in Ontario and did not charge the GST because the agricultural wholesaler assumed that the goods were zero-rated agricultural goods. An audit determined that the goods were taxable at 5%. In this case, the farm operator would have been entitled to claim full ITCs if the GST had been properly charged by the agricultural wholesaler.

The CRA will assess the agricultural wholesaler for the GST collectible that it did not take into account in its net tax calculation for the reporting period. Subject to the conditions listed in paragraph 22, the CRA will consider waiving the interest that is in excess of 4% of the GST not properly charged.

No. 2

In November 2007, Corporation A, the parent of Corporation B, claimed ITCs to which it was not entitled. Its subsidiary, Corporation B was entitled to claim these ITCs but did not do so. An audit of Corporation A disallows the ITCs. This results in an assessment of \$12,949 in net tax and \$1,956 in interest. Corporation B has since claimed the ITCs that were disallowed to Corporation A. Corporation A has a satisfactory history of voluntary compliance, has not been previously assessed for the same mistake and has taken steps to ensure that, in the

future, it does not claim ITCs to which it is not entitled.

Although the CRA will assess Corporation A's net tax for the ITCs that it claimed in error in its net tax calculation for the reporting period, subject to the conditions listed in paragraph 22, the CRA will consider waiving the interest that is in excess of 4% of the ITCs that were claimed in error.

No. 3 In February 2008, a registered pulp and paper mill operator in Quebec believed that he had received a grant from the federal government with respect to certain aspects of the mill's conservation activities. An audit determined that the amount of money that the pulp and paper mill operator received from the federal government was not a grant (i.e., there was a direct link established between the funds received and the activities), but was consideration for a taxable supply. In this case, the registered pulp and paper mill operator was assessed the GST collectible.

Although the federal government is not eligible to claim ITCs for tax paid, there is an offset of the tax mechanism available to it pursuant to the *GST Federal Government Departments Remission Order* (P. C. 1990-2854). Therefore, subject to the conditions listed in paragraph 22, the CRA will consider waiving the interest that is in excess of the 4% of the GST not properly charged.

No. 4 In August 2007, a registered operator of a hardware store sold 5kg bags of fertilizer to consumers in Nova Scotia and did not collect the HST based on the fact that the operator had not been charged HST when he made his bulk purchases of fertilizer. An audit determined that the supplies were taxable at 14%. In this case, the operator was required to charge and collect the HST. The supplies between the operator and the consumers are not wash transactions because the consumers would not have been entitled to claim ITCs for the 14% HST payable on their purchases if the operator had properly charged the HST.

The CRA will assess the operator's net tax for the 14% HST collectible that was not taken into account in its net tax calculation for the reporting period. Furthermore, the operator will be assessed interest.

No. 5 In July 2007, a registered software consultant in Ontario supplied consultancy services to a municipality in Ontario, but did not charge the GST because the software consultant assumed that the municipality was exempt from paying the GST. In February 2008, an audit determined that the supplies were taxable at 6%. In this case, the municipality would have been entitled claim a rebate of 100% of the GST if the software consultant had properly charged the GST.

The CRA will assess the software consultant's net tax for the GST collectible that was not taken into account in its net tax calculation for its reporting period. Furthermore, the software consultant will be assessed interest as a full ITC is not available to the municipality.

No. 6 In September 2007, a registered wholesaler of bottled beverages supplied a registered retailer in Alberta with carbonated mineral water and did not charge the GST because the wholesaler assumed that the beverages were zero-rated basic groceries. In March 2008, an audit determined that the supplies were taxable at 6%. In this case, the retailer would have been entitled to claim full ITCs if the wholesaler had properly charged the GST.

In January 2008, the CRA assessed the wholesaler's net tax for the GST collectible that was not taken into account in its net tax calculation for the reporting period. As the conditions listed in paragraph 22 were met, the CRA waived the interest that is in excess of 4% of the GST not properly charged.

In March 2008, the amount of the assessment had not been paid. The wholesaler requested that a portion of the interest accruing since January 2008 be cancelled pursuant to the wash transaction provisions. Although the wash transaction provisions were used to waive a portion of the interest at the time the assessment was made, the interest that has accrued since the assessment continues to apply at the full rate.

Enquiries by telephone

Technical enquiries on the GST/HST: 1-800-959-8287

General enquiries on the GST/HST: 1-800-959-5525 (Business Enquiries)

If you are located in Quebec: 1-800-567-4692 (Revenu Québec)

All technical publications related to GST/HST are available on the CRA Web site at www.cra.gc.ca/gsthsttech.