



GST/HST Memoranda Series

3.3.1 Drop-Shipments

February 2001

Overview	This memorandum explains the term “drop-shipment” and the rules governing transactions involving the transfer of tangible personal property by a registrant in Canada to another person in Canada on behalf of unregistered non-residents for purposes of the Goods and Services Tax (GST)/Harmonized Sales Tax (HST), as required under the <i>Excise Tax Act</i> (the Act). It also explains the mechanism of the flow-through of input tax credits and/or rebates of the tax paid by the non-resident on the importation of goods by the unregistered non-resident, and the non-resident rebate for installation services supplied in Canada to a non-resident.
Disclaimer	<p>The information in this memorandum does not replace the law found in the <i>Excise Tax Act</i> 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 GST/HST Memorandum 1.2, <i>Canada Revenue Agency GST/HST Rulings Centres</i>. If you wish to make a technical enquiry on the GST/HST by telephone, please call the toll-free number 1-800-959-8287.</p> <p>If you are located in the Province of Quebec, please contact Revenu Québec by calling the toll-free number 1-800-567-4692 for additional information.</p>
Note - HST	Reference in this publication is made to supplies taxable at 7% or 15% (the rate of the HST). The 15% HST applies to taxable supplies (other than zero-rated) made in Nova Scotia, New Brunswick and Newfoundland (the "participating provinces"). If a person is uncertain as to whether the supply is made in a participating province, the person may refer to Technical Information Bulletin B-078, <i>Place of Supply Rules under the HST</i> , available from any Canada Customs and Revenue Agency (CCRA) tax services office.
[Proposed amendments]	[Where information reflects proposed amendments, the information is enclosed in square brackets.] In this publication, the proposed amendments that are indicated through the use of square brackets arise from Bill C-13, which received first reading on February 23, 2001. At the time of publication, Parliament has not enacted these proposed amendments. Any commentary should not be taken as a statement by the CCRA that such amendments will in fact be enacted into law in their current form.

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Drop-shipments

General
s 179

1. The rules governing transactions (referred to as drop-shipments) involving the transfer of tangible personal property by a registrant in Canada to another person in Canada on behalf of a non-resident person who is not registered for purposes of the GST/HST are outlined in paragraphs 15 to 26.

2. A drop-shipment generally occurs where an unregistered non-resident acquires tangible personal property from a registrant in Canada and instructs the registrant to deliver the property to another person in Canada.

Commercial service

3. A drop-shipment also occurs when an unregistered non-resident contracts with a registrant in Canada to have certain commercial services performed on tangible personal property, and the registrant causes the property to be delivered to another person in Canada or to a non-resident person for export.

Definition of commercial
service
ss 123(1)

4. The definition of “commercial service” states that a commercial service in respect of tangible personal property means any service in respect of the property other than shipping services supplied by a carrier and financial services.

5. A drop-shipment also occurs when a registrant supplies a service in Canada of manufacturing or producing tangible personal property to an unregistered non-resident.

Exclusions
para 179(1)(d)

6. Shipping and storage services supplied in Canada are generally excluded from the drop-shipment rules in that such services remain taxable at the full rate of tax unless they are zero-rated. [A supply of a service of storing tangible personal property will be included among those services that can be provided tax-free under the drop-shipment rules. This amendment applies to supplies of storage services for which all of the consideration became due or was paid without becoming due after February 28, 2000.]

3.3.1 Drop Shipments (continued)

[Railway rolling stock] 7. Under the current GST/HST rules, a sale of railway rolling stock to an unregistered non-resident is tax-free only if it is not used in Canada after delivery and prior to export. [An amendment to the Act proposes to amend the drop-shipment rules so that the use of railway rolling stock in the course of its exportation will not disqualify it from tax-free treatment, provided that the rolling stock is exported within 60 days after delivery to the exporter. This amendment applies to railway rolling stock the physical possession of which is transferred by a registrant pursuant to a supply by way of sale by the registrant for which all of the consideration became due or was paid without becoming due after February 28, 2000.]

General rules for taxable supplies made in Canada

Imposition of GST/HST ss 165(1) and (2) 8. Generally, every recipient of a taxable supply (other than a zero-rated supply) made in Canada is required to pay tax in respect of the supply calculated at the GST rate of 7% or the HST rate of 15% (for those supplies made in participating provinces) on the value of the consideration for the supply.

Place of supply s 142 9. Section 142 sets out the general rules for determining whether a supply is deemed to be made in or outside Canada. Generally, the GST/HST applies only to a supply made or deemed to be made in Canada. However, section 142 is subject to the drop-shipment rules set out in section 179. The place of supply rules under section 142 are discussed in GST/HST Memorandum 3.3, *Place of Supply*.

Non-resident registration and residence status

Registration required ss 240(1) 10. Every non-resident person who makes taxable supplies in Canada in the course of carrying on business in Canada, other than a small supplier, must register for purposes of the GST/HST. To determine if a non-resident person is carrying on business in Canada, refer to GST/HST Memorandum 2.5, *Non-Resident Registration*, of Chapter 2, *Registration*.

Suppliers' responsibility 11. Suppliers involved in drop-shipment transactions who are registrants are responsible for determining the residence and registration status of their customers. For this purpose, satisfactory evidence should be retained by suppliers, indicating that their customers are non-residents and, where applicable, not registered for GST/HST purposes.

Documentation 12. The CCRA will accept written certification as evidence that the customer is both a non-resident and is not registered. This documentation should be dated and signed by the non-resident and be effective on the date the supply is made. The CCRA will consider other forms of documentation as proof of non-residence and the non-registered status of the customer.

Non-resident requirement 13. To determine if a supply is made to a non-resident person, the CCRA will look at the facts of the particular situation. This will generally involve determining the contracting parties to a supply. In other words, assuming a typical arm's-length situation, the CCRA will consider that a supply has been made to a non-resident person if the supplier has contracted for the supply with the non-resident person.

3.3.1 Drop Shipments (continued)

Additional information 14. For guidance in determining the residence of a person and for examples of satisfactory evidence of residence status for GST/HST purposes, refer to GST/HST Memorandum 3.4, *Residence*. Information on the determination of residence status relating to zero-rated supplies is available in GST/HST Memorandum 4.5.1, *Exports-Determining Residence Status*, of Chapter 4, *Zero-Rated Supplies*.

General rule for drop-shipments

General 15. The general rule is that, where a registrant transfers physical possession of tangible personal property to another person in Canada on behalf of an unregistered non-resident person, the registrant is liable for tax, generally calculated on the fair market value of the property at that time. However, tax relief is made available through a system of drop-shipment certificates where registrants are not required to account for tax in respect of the property as long as they have transferred it to registered persons in Canada on behalf of the non-resident. This is explained in paragraphs 20 to 29.

Delivery to consignee ss 179(1) 16. The general rule for drop-shipments applies where a registrant, under an agreement with an unregistered non-resident person, makes a taxable supply in Canada of tangible personal property by way of sale, or a taxable supply in Canada of a service of manufacturing or producing tangible personal property to the non-resident person, and the registrant causes physical possession of the property to be transferred, at a place in Canada, to a third person (referred to as the “consignee”) or to the non-resident person.

Supply of a commercial service ss 179(1) 17. The provision also applies where a registrant, under an agreement with an unregistered non-resident person, acquires physical possession of tangible personal property (other than property of a person who is resident in Canada or is registered for GST/HST purposes) of the non-resident for purposes of making a supply of a commercial service in respect of the tangible personal property to the non-resident, and at any time transfers physical possession of the property in Canada to a consignee or to the non-resident.

18. Where the requirements described above are met and, provided the non-resident person is not a consumer of the property or service supplied by the registrant under the agreement, the following rules apply:

Deemed supply para 179(1)(c) (a) the registrant is deemed to have made to the non-resident person, and the non-resident person is deemed to have received from the registrant, a taxable supply of the property;

Participating province para 179(1)(c.1) (b) where physical possession of the property is transferred at a place in a participating province, the supply is deemed to be made in the participating province;

Value of consideration para 179(1)(c.2) (c) that supply is deemed to have been made for consideration, that becomes due and is paid at the time of transfer, equal to:

(i) where the registrant has caused physical possession of the property to be transferred to a consignee to whom the non-resident person has supplied the property for no consideration, nil, and

(ii) in any other case, the fair market value of the property at that time; and

3.3.1 Drop Shipments (continued)

Service deemed not to be a supply para 179(1)(d)	(d) where the registrant made a supply of a commercial service in respect of the property to the non-resident person (except in the case of a supply of a service of storing or shipping the property) the registrant is deemed not to have made that supply of the service.
[Storage services ss 179(2) and (3)]	19. [A supply of a service of storing tangible personal property will be included among those services that can be provided tax-free under the drop-shipment rules. This amendment applies to supplies of storage services for which all of the consideration became due or was paid without having become due after February 28, 2000.]
Example - ss 179(1) applies	An unregistered non-resident purchases computers from a registered supplier in Canada. The unregistered non-resident sells the computers to a Canadian consumer. The unregistered non-resident enters into an agreement with the registered supplier for the delivery of the computers to the consumer in Canada on behalf of the non-resident. In this example, the registered supplier of computers is deemed to have made the supply for consideration equal to the fair market value of the computers. The registered supplier is then required to account for tax in respect of the supply made to the non-resident person on the fair market value of the computers. The registered supplier delivers the computers to the consumer but does not charge the consumer the GST/HST because the registered resident did not make a taxable supply to the consumer. The unregistered non-resident invoices the consumer for the computers, but does not charge the GST/HST because the non-resident is not a registrant.
Example - ss 179(1) does not apply	A registered non-resident publisher contracts with an unregistered non-resident mailing house to provide mailing house services (e.g., packaging, labelling and mailing) for magazines to be shipped to the publisher's customers. The non-resident mailing house subcontracts the Canadian portion of the contract to a registered Canadian mailing house that then ships the magazines to the publisher's customers in Canada. In this example, the non-resident mailing house charges the non-resident publisher for its service, but does not collect the GST/HST as the supply is deemed to be made outside Canada. The registered Canadian mailing house has a contract with the unregistered non-resident mailing house and not the registered publisher. Therefore, because the Canadian mailing house is acquiring physical possession of magazines that are the property of the registered non-resident publisher, subsection 179(1) does not apply. The Canadian mailing house charges the GST/HST on the supply of the service provided to the unregistered mailing house. The registered publisher invoices the Canadian consumer for the magazines and is required to collect and remit the GST/HST.

Drop-shipments to registered persons

Exception where delivery to registered consignee ss 179(2)	20. Subsection 179(2) outlines the GST/HST treatment of transactions involving property drop-shipped by a registrant to a registered consignee on behalf of an unregistered non-resident. In these cases, the supply made by a registrant to an unregistered non-resident is deemed to be made outside Canada where the registered consignee provides the registrant with a drop-shipment certificate.
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3.3.1 Drop Shipments (continued)

Eligible supplies
para 179(2)(a)

21. Specifically, subsection 179(2) applies where a registrant supplier under an agreement with an unregistered non-resident person:

- makes a taxable supply in Canada of tangible personal property by way of sale to the non-resident person, or
- makes a taxable supply in Canada of a service of manufacturing or producing tangible personal property to the non-resident person, or
- acquires physical possession of tangible personal property (other than property of a person who is resident in Canada) for the purpose of making a taxable supply of a commercial service in respect of the property to the non-resident person, and
- causes physical possession of the property to be transferred, at a place in Canada, to a registered consignee of the non-resident.

Supply deemed to be
made outside Canada
paras 179(2)(b) and (c)

22. Where the unregistered non-resident person is not a consumer of the property or service supplied by the registrant and the registered consignee furnishes the registrant supplier with a drop-shipment certificate (refer to paragraphs 27 to 29 for details), subsection 179(1) will not apply and the supply will be deemed to be made outside Canada, provided it is not a supply of a service of storing (see amendment in paragraph 23) or shipping the property. Consequently, the registrant supplier is not required to charge, collect or account for the 7% or 15% tax on the supply.

[Storage services
ss 179(2)]

23. [A supply of a service of storing tangible personal property will be included among those services that can be provided tax-free under the drop-shipment rules. This amendment applies to supplies of storage services for which all of the consideration became due or was paid without having become due after February 28, 2000.]

Example
ss 179(2)

An unregistered non-resident purchases computers from a registered computer manufacturer in Canada. The non-resident instructs the registrant to deliver the computers to a registered retailer. The registered retailer provides the registrant with a drop-shipment certificate. In this example, the registrant supplier of computers invoices the unregistered non-resident for the computers, but does not charge the GST/HST because the registered retailer provided the registered manufacturer with a drop-shipment certificate. The non-resident invoices the registered retailer, but does not charge the GST/HST because the non-resident is not a registrant.

Self-assessing the tax
s 217

24. Where an unregistered non-resident purchases tangible personal property from a registrant for supply to a registered consignee who is acquiring the property for use otherwise than exclusively in commercial activities and the consignee gives a drop-shipment certificate to the registrant, the consignee's purchase is treated as an imported taxable supply. As a result, the consignee must self-assess tax on the price for which the tangible personal property was purchased from the non-resident. Refer to paragraphs 30 to 40 for information on self-assessing tax by a recipient of drop-shipped property.

3.3.1 Drop Shipments (continued)

ss 179(2) 25. Tangible personal property of an unregistered non-resident may be processed in Canada by one or more registrants without tax being applied, provided the property is eventually exported or continues to be in the possession of a registered person who has assumed liability for tax in respect of the property under the drop-shipment rules. These rules do not apply to the supply of a service of storing (see amendment in paragraph 26) or shipping goods, which is generally taxable at 7% or 15% when supplied in Canada. Subsection 179(2) also provides non-residents with an alternative to the input tax credit (ITC) flow-through mechanism for drop-shipments. Refer to paragraphs 68 to 72 for more information on the ITC/rebate flow-through mechanism.

[Storage services
ss 179(2)] 26. [A supply of a service of storing tangible personal property will be included among those services that can be provided tax-free under the drop-shipment rules. This amendment applies to supplies of storage services for which all of the consideration became due or was paid without having become due after February 28, 2000.]

Drop-shipment certificates

para 179(2)(c) 27. A supply of tangible personal property made to an unregistered non-resident may be deemed to be made outside Canada under certain conditions. One of the conditions is that the consignee gives to the registrant, and the registrant retains, a certificate that:

- states the consignee's name and Business Number, and
- acknowledges that the consignee, on taking physical possession of the property, is assuming liability to pay or remit any amount that is or may become payable or remittable by the registrant under subsection 179(1) or Division IV (tax on imported taxable supplies) in respect of the property.

A sample of a drop-shipment certificate acceptable to the CCRA is provided in Appendix A.

28. Drop-shipment certificates ensure that consignees upon acquiring physical possession of the property of an unregistered non-resident person acknowledge their liability to account for tax on the fair market value of the property in the event they subsequently transfer physical possession of the property to an unregistered person (otherwise than for export) or to another registered person who does not issue a drop-shipment certificate and who is not exporting the property. Drop-shipment certificates ensure that the consignees understand that they are required to self-assess the tax under Division IV if they are not acquiring the property for consumption, use or supply exclusively in their commercial activities.

Blanket certificate 29. The drop-shipment certificate may be restricted to a single transaction of a shipment of tangible personal property or it may be a blanket certificate covering several contracts, transactions, or shipments. The certificate should identify the shipments, transactions, or contracts to which it relates.

Self-assessment by a recipient of drop-shipped tangible personal property

Tax on imported taxable supplies
s 217

30. Division IV imposes the GST/HST on certain supplies of services and intangible personal property that are imported without tax being applied at the time of importation, and certain supplies of tangible personal property supplied in Canada. Generally, Division IV requires persons to self-assess and remit the tax on these supplies where they are acquired for consumption, use or supply in Canada otherwise than exclusively in the course of a commercial activity of the recipient. These supplies are referred to as “imported taxable supplies” and are defined in section 217.

Additional information

31. Detailed information on imported taxable supplies will be available in GST/HST Memorandum 6.2, *Imported Services and Intangible Property*, of Chapter 6, *Imports*. In this publication, only the self-assessment rules of Division IV pertaining to the drop-shipment of tangible personal property are examined.

32. Generally, the imported taxable supply rules do not apply to tangible personal property because this type of property would usually attract tax when acquired in Canada or imported into Canada. However, under the drop-shipment rules, a supply of tangible personal property or a service made by a registrant to an unregistered non-resident in respect of property drop-shipped by the registrant to a registered person who issues a drop-shipment certificate is deemed to be a supply made outside Canada, and therefore is not taxable at 7% or 15% under Division II.

Self-assessing the tax on imported taxable supplies
para 217(b)

33. Paragraph (b) of the definition of imported taxable supply in section 217 ensures that a registered person to whom such property is transferred in Canada and who issues a drop-shipment certificate referred to in paragraph 179(2)(c) upon taking possession of the property in Canada is required to self-assess tax under Division IV if the property is not acquired for consumption, use or supply exclusively in the course of the registrant’s commercial activities. The drop-shipment certificate constitutes an acknowledgement by the issuer that it may be required to self-assess tax under Division IV.

Self-assessing the tax on passenger vehicles

34. Self-assessment of the tax is also required if the property is a passenger vehicle that is acquired for use in Canada as capital property in commercial activities, where the cost of the vehicle exceeds the vehicle’s capital cost threshold for income tax purposes.

ITCs
ss 169(1)

35. When an imported taxable supply is for use partly, but not exclusively, in commercial activities, a registrant must self-assess the tax payable on the entire value of the consideration for the supply. Such a registrant may be entitled to claim an ITC for the tax paid or payable to the extent that the supply is for use in a commercial activity. Further information on ITCs will be available in Chapter 8, *Input Tax Credits: Eligible ITCs*.

3.3.1 Drop Shipments (continued)

Example An unregistered non-resident purchases telephone equipment from a Canadian manufacturer who is a registrant and resells it to a registered resident. The Canadian manufacturer delivers the equipment directly to the registered resident. If the registered resident gives a drop-shipment certificate to the manufacturer, the manufacturer is not required to account for tax on the sale to the non-resident. If the registered resident is acquiring the equipment to be used 25% in non-commercial activities, the registered resident must self-assess tax on the full value of the consideration under the imported taxable supply rules in Division IV. The registered resident may then be entitled to claim an ITC to the extent it is acquiring the equipment for use in its commercial activities.

Imposition of tax on imported taxable supply

Imposition of the GST s 218 36. Every recipient of an imported taxable supply is required to pay a tax equal to 7% of the value of the consideration for the supply.

Tax in participating provinces para 218.1(1)(b) 37. In addition, every registrant who is the recipient of an imported taxable supply included in paragraph (b) of the definition in section 217, must self-assess the 8% provincial component of the HST where physical possession of the property is transferred to the registrant in a participating province. The tax is to be assessed based on the full value of the consideration that is paid or becomes due at that time.

Selected listed financial institutions ss 218.1(2) 38. Selected listed financial institutions are not required to self-assess the provincial component of the HST under this provision as this is done through their net tax calculation, subject to certain exceptions.

Time of payment/filing for tax on imported taxable supplies s 219 39. Registrants who are required to self-assess tax on imported taxable supplies will report that amount on their regular return and pay the tax payable on or before the due date for that return.

When tax payable s 218.2 40. The tax imposed on an imported taxable supply is payable on any amount of consideration for the supply at the time it is paid or becomes due, whichever is earlier.

Drop-shipped property subsequently exported

Exception when exports ss 179(3) 41. The rules for drop-shipments apply in situations where drop-shipped property of an unregistered non-resident is exported. The rules also apply to transactions involving drop-shipments of property where delivery is made to a person, other than the non-resident owner, for export. Where all the conditions of subsection 179(3) are met, the supply made to an unregistered non-resident is deemed to be made outside Canada, and therefore is not subject to the GST/HST.

Eligible supplies para 179(3)(a) 42. Specifically, subsection 179(3) applies where a registrant, under an agreement with an unregistered non-resident person,

- makes a taxable supply in Canada of tangible personal property by way of sale to the non-resident person, or
- makes a taxable supply in Canada of a service of manufacturing or producing tangible personal property, to the non-resident person, or

3.3.1 Drop Shipments (continued)

- acquires physical possession of the property (other than property of a person who is resident in Canada) for the purpose of making a taxable supply of a commercial service in respect of the property to the non-resident person.
- Supply deemed to be made outside Canada para 179(3)(b) and (c)
43. The supply of the property, the service of manufacturing property or a commercial service to the non-resident is deemed to be made outside Canada, provided the non-resident person is not a consumer of the property or service supplied by the registrant and the registrant, as the case may be:
- transfers physical possession of the property to a person at a place outside Canada or to a carrier; or
 - mails the property for export and delivery to a person at a place outside Canada; or
 - transfers physical possession of the property at a place in Canada to the non-resident person or any other person who will export the property.
- Conditions to be met para 179(3)(c)
44. Where the registrant transfers physical possession of the property at a place in Canada to a person for export, tax relief can be obtained only if all the following conditions are met:
- the property must be exported by the person who took physical possession of it;
 - the property must be exported as soon as can reasonably be expected and, if applicable, in accordance with the normal business practices of the exporter and the owner of the property;
 - the property has not been acquired by the non-resident person or any owner for consumption, use or supply in Canada at any time after physical possession of the property is transferred to the exporter and before it is exported;
 - the property is not further processed, transformed or altered in Canada before being exported, except to the extent reasonably necessary or incidental to its transportation; and
 - the registrant supplier has satisfactory evidence that the property has been exported, or will be exported.
- Evidence of exportation
45. Evidence of exportation must enable the entire shipment of property to be traced from its origin in Canada to its destination outside Canada. Detailed information on what constitutes satisfactory evidence of exportation is available in GST/HST Memorandum 4.5.2, *Exports - Tangible Personal Property*, of Chapter 4, *Zero-Rated Supplies*.

3.3.1 Drop Shipments (continued)

[Storage services
ss 179(3)]

46. The provisions of subsection 179(3) do not apply to services of storing or shipping tangible personal property. [However, pursuant to a proposed amendment, a supply of a service of storing tangible personal property will be included among those services that are deemed to be supplied outside Canada under the provisions of subsection 179(3). This amendment applies to supplies of storage services for which all of the consideration became due or was paid without having become due after February 28, 2000.]

Property retained by registered suppliers

Retention of possession
ss 179(4)

47. The rules for drop-shipments also apply in situations where tangible personal property is sold by a registrant to an unregistered non-resident, but physical possession of the property is retained by that registrant or another registrant (e.g., a registrant who previously sold the property or performed a commercial service in respect of it).

Conditions to be met
para 179(4)(b)

48. Specifically, subsection 179(4) provides that the sale of tangible personal property to an unregistered non-resident in these circumstances is deemed under subsection 179(2) to be made outside Canada. Accordingly, the sale is relieved of tax. To qualify for this treatment, paragraph 179(4)(b) specifies that the registrant retaining physical possession of the property must be doing so for the purpose of:

- transferring physical possession of the property to the non-resident person, a subsequent purchaser or another person designated by the non-resident purchaser or subsequent purchaser;
- supplying a commercial service in respect of the property to the non-resident person or a subsequent purchaser; or
- consumption, use or supply by that registrant, pursuant to an agreement for a supply of the property made by way of sale or lease to that registrant by the non-resident person, by a subsequent purchaser or by a lessee or sub-lessee of the non-resident person or of the subsequent purchaser. Leaseback transactions are explained in paragraph 57.

para 179(4)(c)

49. Where the above conditions are met and the registrant retaining physical possession of the property is the same registrant who supplies the property to the non-resident, the registrant is deemed to have transferred physical possession of the property to another registrant and to have obtained a drop-shipment certificate.

Supply deemed to be
made outside Canada

50. Subsection 179(2), together with paragraph 179(4)(c), deems the supply of the property by the registrant to the non-resident in these circumstances to be a supply made outside Canada, and therefore not subject to tax. In addition, as a result of this deeming provision, there is no requirement for the registrant to obtain a drop-shipment certificate in these circumstances.

Where another
registrant retains
physical possession of
the property
para 179(4)(d)

51. Where a registrant, other than the registrant who supplies the property to the non-resident, retains physical possession of the property at the time ownership is transferred to the non-resident, the registrant selling the property to the non-resident is deemed to have transferred physical possession of the property to another registrant at that time.

3.3.1 Drop Shipments (continued)

Liability on registrant selling the property	52. Consequently, subsection 179(1), together with paragraph 179(4)(d), places a potential liability on the registrant selling the property to the non-resident unless that registrant obtains a drop-shipment certificate from the registrant who retains physical possession of the property.
Registrant obtains a drop-shipment certificate	53. If a drop-shipment certificate is obtained by the registrant selling the property to the non-resident, pursuant to subsection 179(2), the sale of the property is deemed to be a supply made outside Canada, and therefore relieved of tax.
Deemed to have acquired property for purpose of 179(4)(b)	54. The registrant who retains physical possession of the property at the time ownership is transferred to the non-resident is deemed to have acquired physical possession of the property for the purpose referred to in paragraph 179(4)(b). Refer to paragraph 48 for details.
Potential liability on registrant retaining possession of the property	55. Paragraph 179(4)(d), together with Division IV (tax on imported taxable supplies) and subsection 179(1), places a potential liability on the registrant retaining possession of the property if the property is acquired by the registrant otherwise than for consumption, use or supply exclusively in commercial activities, or if the registrant transfers physical possession of the property of the non-resident to another person without obtaining a drop-shipment certificate. 56. The rule set out in subsection 179(4) defers the time at which tax must be accounted for by the registrant. Instead of accounting for tax on the initial sale at the time of payment or delivery, the registrant becomes potentially liable to account for tax under the drop-shipment rules when physical possession of the goods is transferred to another person.
Example	A registered lumberyard sold logs to another registered supplier and retained possession in the expectation that it would eventually mill the logs for the other registered supplier or a subsequent purchaser. If the registered supplier then sells the logs to an unregistered non-resident for delivery at the lumberyard, the registered supplier would usually charge tax to the non-resident at the time of sale under the general rules of the Act. However, if the lumberyard issues a drop-shipment certificate to the registered supplier, the registered supplier need not collect the tax from the non-resident. The logs may be milled by the lumberyard and exported, for instance, to the non-resident without any tax being applied.

Property sold to non-resident and leased back in Canada

57. The drop-shipment rules in subsection 179(4) may also be used in situations where a registrant sells property to an unregistered non-resident and then the same registrant leases the property back for use in commercial activities. Under the general rules of the Act, if the property remains in Canada, the registrant would usually be required to charge tax to the non-resident on the sale and the non-resident would not be able to recover the tax. However, the drop-shipment rules deem the registrant to have transferred and reacquired physical possession of the property when ownership is transferred to the non-resident. Therefore, the registrant has no further liability in respect of the sale to the non-resident, but may potentially be liable to pay tax under Division IV if the property is not being leased for consumption, use or supply exclusively in the course of the registrant's commercial activities.

Transfer of property to a carrier or warehouse

Bailees deemed not to have acquired possession of the property

58. Subsection 179(5) deems bailees (e.g., warehouse operators and carriers), to whom tangible personal property of an unregistered non-resident person is transferred by a registrant, not to have acquired physical possession of the property for purposes of the drop-shipment rules. Possession by a bailee is usually regarded as possession either by the person who transferred physical possession to the bailee or by the person to whom the bailee is required to transfer physical possession. As a result, a registrant transferring physical possession of the tangible personal property of an unregistered non-resident to a bailee is not required to account for tax on the property by virtue of that transfer.

Example

A registrant transfers physical possession of tangible personal property to a bailee for the purpose of storing or shipping the property. The bailee subsequently transfers physical possession back to the registrant. In this example, the registrant is treated as having retained physical possession throughout the period during which the property remains in the bailee's possession. For example, this rule allows a registrant who is processing the property for a non-resident to use a common carrier for shipping the property between the registrant's own plants, or to store the property on behalf of the non-resident owner pending further instructions without tax consequence under the drop-shipment rules.

Transfer to an identified consignee para 179(5)(c)

59. Where the registrant transfers physical possession of the tangible personal property to a bailee for the purpose of storing or shipping the property and, at the same time, instructs the bailee to transfer physical possession of the property to an identified third person (consignee), the registrant is treated as having transferred physical possession of the property to the consignee.

60. If a registrant sells property to a non-resident and agrees to deliver it to a consignee in Canada, the consignee is deemed to have taken physical possession as soon as physical possession is transferred to a common carrier with instructions that it be delivered to the consignee. If the registrant fails to obtain a drop-shipment certificate from the consignee, the registrant is liable to account for tax on the fair market value of the property.

Consignee is not identified para 179(5)(d)

61. However, where the consignee is not identified, the registrant arranging for the transfer is deemed to retain physical possession of the property throughout the period beginning at that time and ending at the earliest of:

- (a) the time the consignee becomes identified;
- (b) the time the bailee transfers physical possession of the property to the registrant; and
- (c) where the bailee is not a carrier to whom physical possession of the property has been transferred for the sole purpose of shipping the property, the time the bailee gives the registrant a drop-shipment certificate.

3.3.1 Drop Shipments (continued)

Time when consignee becomes identified subpara 179(5)(d)(iv) to (vi)

62. The consignee becomes identified at the earliest of the following:

- (a) the time the registrant gives the consignee sufficient documents (i.e., a warehouse receipt) to require the bailee to transfer physical possession to the consignee;
- (b) the time when the registrant directs the bailee in writing to transfer physical possession to the consignee; and
- (c) the time the bailee transfers physical possession of the property to the consignee.

Warehouse receipt

63. Generally, where property is stored at an independent warehouse, the warehouse operator will issue a warehouse receipt to the person who placed the property in storage. Anyone may obtain release of the property by presenting the warehouse receipt.

Example

If a registrant who sells tangible personal property to an unregistered non-resident agrees to store it until the non-resident can find a purchaser, and the registrant stores the property at a warehouse without providing the warehouse operator with specific instructions to release the property to the non-resident or to a consignee, the registrant will be treated as having retained physical possession of the property. However, if the non-resident subsequently directs the registrant to deliver the property to an identified consignee, and the registrant complies by delivering the warehouse receipt to the consignee, the registrant is deemed to have transferred physical possession of the property to the consignee when the warehouse receipt is delivered.

Bailee issues a drop-shipment certificate to a consignee

64. A bailee who takes physical possession of tangible personal property of an unregistered non-resident for the purpose of storing the property or storing and shipping the property may use the drop-shipment rules by issuing a drop-shipment certificate to a registrant supplier in respect of the property. If the bailee issues a certificate to such a registrant supplier, the bailee is treated as having taken physical possession of the property.

Liability transferred to the bailee

65. Furthermore, by issuing a drop-shipment certificate to the registrant, the potential liability to account for tax on the property would then be transferred to the bailee. The bailee has to account for tax on the fair market value of the property if physical possession of the property is transferred in Canada to an unregistered person (otherwise than for export) or to a registered person who does not issue a drop-shipment certificate and who is not exporting the property.

Transfer of property to bailee by a non-resident

ss 179(6)

66. Where an unregistered non-resident transfers physical possession of tangible personal property to a bailee who is a registrant for the sole purpose of storing or shipping the property, the bailee is deemed not to have taken physical possession of the property for purposes of the drop-shipment rules, provided the bailee is a carrier who is acquiring physical possession of the property for the sole purpose of shipping the property, or does not claim an ITC in respect of the property.

3.3.1 Drop Shipments (continued)

ITCs 67. Where a bailee claims an ITC in respect of the property, under subsection 169(2) or section 180 (discussed in the following paragraphs), the bailee is considered to have taken physical possession of the property for the purposes of the drop-shipment rules. Where an ITC is claimed by the bailee, a potential liability applies when the bailee subsequently transfers physical possession of the property to another person on behalf of the non-resident.

Flow-through mechanism of ITCs or rebates

General s 180 68. Section 180 deals with situations where tax is imposed on the importation or delivery in Canada (e.g., Division III tax or tax under subsection 179(1)) of tangible personal property acquired by a registrant, but the tax is paid by an unregistered non-resident person who cannot claim an ITC or rebate in respect of the tax. Section 180 provides for a flow-through of the ITC and/or rebate from the unregistered non-resident to the registrant. The registrant must be acquiring the property for consumption, use or supply in the course of its commercial activities, or for the purpose of supplying a commercial service in respect of the property. In addition, where the non-resident is supplying the property to the registrant, the property must be delivered or made available in Canada to the registrant before it is used in Canada by or on behalf of the non-resident.

69. Similarly, where the person acquiring the property is entitled to claim a rebate under section 259 or 260, that person may claim a rebate in respect of the tax paid by the non-resident under subsection 179(1) or Division III. For example, an unregistered non-resident who has paid tax in respect of tangible personal property under subsection 179(1) or Division III (tax on importation of goods) may pass on the ability to claim an ITC or rebate in respect of the property to a registrant.

Flow-through ITC or rebate for purpose of supplying a service 70. An unregistered non-resident may also pass on the ability to claim an ITC or rebate to a registrant who is taking physical possession of the property for the purpose of supplying a commercial service (other than shipping) to the non-resident in respect of the property.

Providing evidence 71. To pass on the credit to the registrant, the non-resident must provide the registrant with satisfactory evidence that the tax was paid in respect of the property. Satisfactory evidence includes Form B3, *Canada Customs Coding Form*, showing that the GST was paid upon importation, or the sales invoice from the supplier to the non-resident showing the GST/HST paid or payable. To claim an ITC, the registrant will be required to maintain this evidence that tax was paid by the non-resident as well as other relevant documents such as a contract for the provision of processing services to the non-resident, clearly establishing the relationship between the two parties and the property involved.

ITC flow-through not available 72. An ITC or rebate may not be passed on where the non-resident purchased tangible personal property in Canada and took physical possession of the property from the supplier. To pass on the ITC, the property must be delivered directly from the supplier to the purchaser or to the registrant who is providing the services to the non-resident.

3.3.1 Drop Shipments (continued)

Example An unregistered non-resident purchases goods in Canada from a registrant and pays tax on the fair market value of the goods pursuant to subsection 179(1). The non-resident then sells these goods to another registrant and instructs the first registrant to ship the goods directly to the other registrant who purchased the goods from the non-resident. In this case, the registrant who purchases the goods from the non-resident may claim an ITC for the tax paid on the goods by the non-resident if the non-resident provides the registrant with satisfactory evidence that the tax was paid.

Non-resident rebate respecting installation services

Rebate
s 252.41

73. In some instances, the drop-shipment rules do not apply. Such a situation occurs when an unregistered non-resident has paid tax on the service of installing tangible personal property in real property situated in Canada. In this situation, the unregistered non-resident may apply for a rebate in respect of the tax paid on the service of installing the tangible personal property.

74. To qualify for the rebate, the tangible personal property must be supplied on an installed basis by an unregistered non-resident to a registered person. In addition, the unregistered non-resident who supplies the property or another unregistered non-resident must be the recipient of a taxable supply in Canada of installing the tangible personal property in real property located in Canada for the use of the registered recipient. The application for the rebate by the unregistered non-resident recipient of the installation service must be filed within one year after the installation service is completed using form GST189, *General Application for Rebate of Goods and Services Tax (GST)/Harmonized Sales Tax (HST)*. Detailed information on the rebate is available from any CCRA tax services office. A sample of the form is provided in Appendix B.

Example

If a registered person purchases a generator from an unregistered non-resident supplier who is responsible for the installation of the generator in real property located in Manitoba, but who entered into an agreement with another registered person to perform the installation, the unregistered non-resident supplier will be eligible for a rebate of the 7% GST paid on the installation service. The rebate is also available where the unregistered non-resident supplier of the tangible personal property acquires the installation service from an unregistered non-resident who in turn hires a registered installer to perform the installation service. In these examples, the non-resident recipient of the taxable supply of the installation service is eligible for the rebate provided the other requirements outlined above are met.

Enquiries

If you wish to make a **technical enquiry** on the GST/HST by telephone, please call one of the following toll-free numbers:

1-800-959-8287 (English service)

1-800-959-8296 (French service)

General enquiries about the GST/HST should be directed to Business Enquiries at one of the following toll-free numbers:

1-800-959-5525 (English service)

1-800-959-7775 (French service)

If you are in the Province of Québec please call the following toll-free number:

1-800-567-4692 (Ministère du Revenu du Québec)

All GST/HST memoranda and other Canada Customs and Revenue Agency publications are available on Internet at the CCRA site <http://www.ccra-adrc.gc.ca/> under the heading "Technical Information" in "Tax".

DROP-SHIPMENT CERTIFICATE
(under subsection 179(2) of the *Excise Tax Act*)

To: _____
(Name of Supplier)

Name of Consignee: _____
(the "Consignee")

I, the [authorized officer/agent of the Consignee]/[the Consignee (if an individual)], hereby certify and acknowledge [on behalf of the Consignee (if agent or officer of a corporation)] as follows:

1. (a) The Consignee has or will receive physical possession of [describe tangible personal property in sufficient detail to identify specific shipment of tangible personal property] (the "Property") ordered from you by [name of unregistered non-resident]; OR
(b) During the period from _____ to _____ the Consignee has or will receive physical possession of [describe tangible personal property in sufficient detail to identify specific shipment of tangible personal property] (the "Property") ordered from you by unregistered non-residents.
2. The Consignee is acquiring possession of the Property for the purpose of supplying a commercial service(s) (as defined in the *Excise Tax Act*) in respect of the Property, or for consumption, use or supply in the course of its commercial activities.
3. If the Consignee subsequently transfers physical possession of the Property to a person who is not registered for the purposes of the GST/HST, otherwise than for export, or to another person who is registered for purposes of the GST/HST who does not provide to the Consignee a drop-shipment certificate under subsection 179(2) of the *Excise Tax Act*, the Consignee will be required to account for the GST/HST on the fair market value of the Property at that time.
4. If the Consignee is not acquiring the Property for consumption, use or supply exclusively in the course of its commercial activities, or if the Property is a passenger vehicle that is acquired for use as capital property, where the cost of the vehicle exceeds the vehicle's capital cost for income tax purposes, the Consignee is required to self-assess the GST/HST under Division IV of the *Excise Tax Act*.

DATE: _____

(Signature of individual who is Consignee or officer of Consignee)

GST/HST Business. No _____

NOTE: Part 1(a) is for use in the case of one or more deliveries relating to orders by the same unregistered non-resident.

Part 1(b) is for more general use in the case of shipments, over a specified period time, of tangible personal property of a particular description or class - not necessarily restricted to orders placed by the same unregistered non-resident.

Form GST189, *General Application for Rebate of Goods and Services Tax (GST)/Harmonized Sales Tax (HST)*

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