Docket: 2019-4341(GST)I

BETWEEN:

1410109 ONTARIO LTD.,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeal heard on September 1, 2022, at Hamilton, Ontario

Before: The Honourable Mr. Justice Randall S. Bocock

Appearances:

Counsel for the Appellant:	James Rhodes
Counsel for the Respondent:	Caitlin Ward

JUDGMENT

WHEREAS the Court has published its reasons for judgment in this appeal on this date;

NOW THEREFORE THIS COURT ORDERS THAT:

1. The appeal concerning the Reporting Period(s) April 1, 2014 to December 31, 2015 is dismissed; and,

2. There shall be no costs pursuant to section 18.3001 of the *Tax Court of Canada Act* governing the amount of tax in dispute in this appeal and the issue of costs.

Signed at Ottawa, Canada, this 9th day of November, 2022.

"R.S. Bocock"

Bocock J.

Citation: 2022TCC141
Date: 20221109
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1410109 ONTARIO LTD.,

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Respondent.

REASONS FOR JUDGMENT

Bocock J.

[1] The Minister assessed the Appellant for certain reporting periods for uncollected Harmonized Sales Tax ("HST"). The Appellant did not collect HST on a 15% gratuity itemized and paid by patrons of the Three Bridges Banquet Hall ("Banquet Hall") in St. Jacobs, Ontario.

[2] The facts in the appeal are straightforward and not in dispute. The principal of the Appellant, Mr. Frengos, described the business of the Banquet Hall and the process for booking and staging its hosted events.

[3] The Banquet Hall hosts primarily weddings, and also Christmas and other seasonal and life celebrations. To book and hold an event at the Banquet Hall, a patron, invariably a single purchaser, met with the manager and signed a deposit and function contract (the "Contract"). The Contract specified the food, beverage and event packages to be purchased for a specific date. Sometimes either a host bar or cash bar was purchased. The type of meal service was also described: country style, buffet or plate service. The total cost was identified and the parties signed the Contract.

[4] Specifically, regarding taxes and gratuities the Contract stated:

All Pricing is Subject to 13% HST and 15% Gratuities

[5] At the end of the event on the date held, an itemized invoice ("Invoice") was completed. The Invoice itemized the charges for the ceremony, reception, hall fee, late night buffet (if any) and the bar charges. All of these line items specified the quantity multiplied by the price per person or unit. The product yielded the total for each line item.

[6] Each category was sub-totalled and then sub-totalized in aggregate near the end of the Invoice. HST was calculated on that grand sub-total. The "Gratuity (15%)" was calculated on the grand sub-total as well, excluding HST. The total amount due was comprised of the sum of the grand subtotal and HST charged on the grand subtotal and the gratuity (at 15%). For clarity, the gratuity was separately calculated and added to the grand subtotal, all less any deposit(s).

[7] If there was a dissatisfied patron, Mr. Frengos discussed the problem with the patron the evening of the event and resolved the matter amicably, usually with a price reduction to one of the items in the purchased services or food categories. He testified that he had never adjusted the gratuities from the 15% amount. Mr. Frengos views the gratuities or tips as a gift from the patrons to the manager, chef and serving staff of the Banquet Hall. Custom dictated one-half was divided among the serving staff and the remaining half split between the chef and manager. The gratuities were always paid to the staff in such a manner. According to Mr. Frengos, this occurs by custom pursuant to a verbal understanding and there are no disputes.

[8] The Minister believes that HST should have been charged on the 15% gratuity because it is coincident and part of the consideration paid regarding a taxable supply. It is mandatory, was never negotiated or varied, and was always paid with the balance of the Contract price, without contest during the reporting periods.

[9] The Appellant asserts the gratuities are not a service coincident to the supply because all services are otherwise fully accounted for in the description of the services or property provided under the Contract. There is no incremental supply; all is complete without the gratuity. The gratuities are a customary gift from the patrons directly to servers. The Banquet Hall does not own or have a claim to the gratuities. If the purchased services or food are deficient, those items are reduced, not the gratuities. Moneys paid do not *per se* create a service or property necessary for a taxable supply. The tips are a transfer of property from the patrons to the employees. The Appellant simply facilitates it.

[10] The *Excise Tax Act*, RSC 1985, c.E-15, as amended (the "*ETA*") provides the statutory basis for determining whether the gratuities are a taxable supply of services.

[11] Firstly, section 165 mandates that HST is payable on all supplies of taxable services subject, at this level at least, to inapplicable exceptions.

[12] Secondly, the definition of service is as follows:

> "Service" means anything other than
>
> (a) property,
>
> (b) money, and
>
> (c) anything that is supplied to an employer by a person who is or agrees to become an employee of the employer in the course of or in relation to the office or employment of that person

[13] Sections 133 and 153(1) were cited by both counsel and relevant to the issue:

> **Agreement as supply**
>
> **133** For the purposes of this Part, where an agreement is entered into to provide property or a service,
>
> **(a)** the entering into of the agreement shall be deemed to be a supply of the property or service made at the time the agreement is entered into; and
>
> **(b)** the provision, if any, of property or a service under the agreement shall be deemed to be part of the supply referred to in paragraph (a) and not a separate supply.
>
> **Value of consideration**
>
> **153 (1)** Subject to this Division, the value of the consideration, or any part thereof, for a supply shall, for the purposes of this Part, be deemed to be equal to
>
> **(a)** where the consideration or that part is expressed in money, the amount of the money; and
>
> **(b)** where the consideration or that part is other than money, the fair market value of the consideration or that part at the time the supply was made.

[14] As well, if a property or service is incident or coincident with other services for a single consideration, then section 138 also speaks to that:

> **Incidental supplies**
>
> 138. For the purposes of this Part, where
>
> **(a)** a particular property or service is supplied together with any other property or service for a single consideration, and
>
> **(b)** it may reasonably be regarded that the provision of the other property or service is incidental to the provision of the particular property or service,
>
> the other property or service shall be deemed to form part of the particular property or service so supplied.

Analysis

[15] While not absolutely mandatory, the Court finds the Contract and Invoice both effectively direct through practically non-existent negotiation, that the gratuity shall be no amount other than 15%. In contrast, the word "gratuity" etymologically connotes a volitional, customary reward in the nature of an unenforceable, unobligated payment by the patron to the server, maître d'or chef. Its calculation, delivery and receipt is beyond the clutch of the proprietor. Identifiably, it is the proprietor Banquet Hall in this case who effectively sets the gratuity and then pays it without deduction or abatement to various staff.

[16] The Court faces the quandary: does the near mandatory nature of the levy override the historical tradition of the customary, but unenforceable gratuity?

Little legal authority exists yet the Minister's agents have a view

[17] There is little legal Canadian authority on the issue of tips/gratuities. However, the Minister has historically argued that there is a distinction based upon volition. The Minister stated as early as April 1994: "Gratuities which customers voluntarily give to employees are not taxable. However, if you include a gratuity as a service charge in an invoice to a customer, whether mandatory or a suggested

amount, it is taxable at 7%".[1] The Minister has expressed very similar statements in many subsequent letters and publications.[2]

[18] However, this stance is unsupported by clear, Canadian authority. The Minister's support for its position is never justified beyond a general reference to the *Excise Tax Act*[3]; no specific provisions of the *ETA* nor any case law is provided, analysed, or explained. Due to this lack of justification or rationale, the Minister's position begs the Court's further analysis.

Factually, how freely given is the gratuity in this appeal?

[19] The Appellant asserts that the gratuity is not in exchange for any service and is therefore not a part of the consideration. Empirically, this is not apparent. The gratuity forms part of the total amount that is owed by the patron to the Appellant; if the invoice was for $1,150, $150 of that amount would be allocated to the gratuity. Speculatively, if a patron only paid $1000 by refusing to pay the tip, it is difficult to imagine the Banquet Hall accepting only partial payment.

[20] Legally, where a contract is signed between two parties, both parties' obligations must be performed in their entirety, unless the obligations are excused or justified in some way: "Non-performance of a contract in any way, or to any degree…amounts to a breach of contract, unless excused, justified, or otherwise dealt with by the law" (emphasis added).[4] Additionally, if an invoice includes a mandatory gratuity, it would be similar to the rest of the invoice if the invoice were completely itemized; it would belong with the food ordered, number of tables reserved, duration of reservation, etc.

[21] Similarly, the inclusion of an obligation as part of the bargain, cannot be viewed as a gift but part of the consideration. By definition, a gift cannot be something that a person is *required* to transfer to another person: it is trite law that a

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[1] Canada Revenue Agency, "G-24 -- Information for Providers of Accommodations and Meeting Facilities" (April 1994) at paragraph 19 under "Simplified method to calculate input tax credits".
[2] See, for example: Canada Revenue Agency, "T0105A -- Application of GST to Gratuities" (16 January 1995) at paragraph 7; Canada Revenue Agency, "R720-1 -- Gratuities and GST" (16 March 1995) at paragraph 4; Canada Revenue Agency, "95494 -- GST/HST on Gratuities" (19 July 2007) at para 5; Canada Revenue Agency, "RC4036 GST/HST Information for the Travel and Convention Industry" (updated 24 January 2022), online: Canada Revenue Agency<www.canada.ca/en/revenue-agency/services/forms-publications/publications/rc4036/gst-hst-information-travel-convention-industry.html#P348_26871> at paragraph 1 under "Gratuities"; Canada Revenue Agency, "2014-11-18B -- Taxable Supplies—Special Cases" (18 November 2014) at paras 1-2 under "Tips and gratuities".
[3] RSC 1985, c E-15 [*ETA*].
[4] GHL Fridman, *The Law of Contract in Canada*, 6th ed (Toronto: Carswell, 2011) at 569.

gift is the voluntary transfer of property to another without compensation.[5] A promise cannot be both an obligation and a gift. The common law distinguishes between gratuitous promises and covenants of contractual obligation.

[22] Reaching offshore to an early common law VAT jurisdiction establishes this distinction. *NDP Co Ltd v Customs and Excise Commissioners*[6] addressed the Mandatory/Voluntary Distinction early on. The tribunal found that voluntary gratuities are not subject to VAT because voluntary gratuities are: "[N]o part of the contract that the customer should pay a charge for service, and those customers who refused to pay it in full or at all were within their rights in doing so."[7]

[23] The Appellant also argues that the mandatory tips included in its invoices are not subject to HST because the Appellant does not own or have a claim over the gratuities: the Appellant is simply the middleman. VAT jurisdictions have confronted this issue. Such law does not support this argument. In *Potters Lodge Restaurant Ltd v Commissioners of Customs & Excise*,[8] the court stated:

> [T]he liability of the Company to account for tax as aforesaid is not, and cannot be, affected by any arrangements between the Company and its employees under which any part of such consideration is paid over to such employees.[9]

[24] Not inconsistent with *NDP*, the Court in *Potters Lodge*, stated that the caterer's gratuities were subject to VAT because each bill automatically charged an additional 10% for the gratuity. The *Potters Lodge* decision held:

> [T]he Company is accountable for tax on all the supplies made by it to its customers in the course of its catering business, such tax is to be calculated by reference to the consideration paid by these customers for such supplies, and such consideration included the ten per cent service charge added by the Company to all bills.[10]

[25] On the continent, the Court in *Commission v France*,[11] the Advocate General[12] had the same perspective:

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[5] *R v. Friedberg*, 92 DTC 6031(FCA).
[6] [1988] VATTR 40 [*NDP*].
[7] *Ibid* at paragraph 13.
[8] LON/79/286, No 905 (UK) [*Potters Lodge*].
[9] *Ibid* at 4.
[10] *Potters Lodge*, *supra* note 6 at 4.
[11] C-404/99, [2001] ECR I-2682.
[12] In the European Union courts, an advocate general is an independent third party who provides a non-binding opinion to the court regarding his or her view on the case. Advocates general are considered advisers to the court and do not

> [T]he final destination of the sums levied as service charges, and the way in which they are dealt with, has nothing to do with the question of whether these sums should or should not form part of the taxable amount.
>
> …
>
> The way in which the supplier provides for the remuneration of the staff whom he relies on to deliver the service which he supplies is quite immaterial in settling the taxable amount.[13]

Statutory Consistency

a) Section 133

[26] Section 133 implies the Mandatory/Voluntary Distinction. The section states [with underlining added] :

> **133** For the purposes of this Part, where an agreement is entered into to provide property or a service,
>
> > **(a)** the entering into of the agreement shall be deemed to be a supply of the property or service made at the time the agreement is entered into; and
> >
> > **(b)** the provision, if any, of property or a service under the agreement shall be deemed to be part of the supply referred to in paragraph (a) and not a separate supply.

[27] The section requires two parties to enter into an agreement—only then is the supply of any property or service under that agreement treated as being part of the same supply. Subsection 133(b) combined with subsection 138(a) (above) suggests that tips included in an agreement are part of the overall supply of prepared meals, which is subject to HST. To argue the service implicitly conveyed to patrons by the staff is not enveloped in the overall contract is illogical given its memorialized, fixed and itemized inclusion therein.

[28] The *ETA* defines "consideration" as "any amount that is payable for a supply by operation of law."[14] The almost mandatory tip is enforceable by operation of

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participate in the court's decision-making process. (see European Union, Parliament, Rafał Mańko, "The Role of Advocates General at the CJEU", *European Parliamentary Research Service* (October 2019).

[13] *AG Opinion, supra* note 2 at I-2677—I-2678.

[14] See *ETA, supra* note 13 at s 123, "consideration".

contract law whereas a voluntary tip is not "consideration" because it is not payable by operation of law—if it is paid, it is paid by operation of custom and is volitional.

What are the practical policy implications?

[29] The question remains: how can some "tips/gratuities" be taxable and others not?

Should tips be taxed?

[30] It is said that to discourage behaviour, one taxes that behaviour. If taxes were imposed on all tips, it would discourage such a practice. Tips appear to play a crucial role in the food services industry.

[31] An alternative is to impose HST on all tips. From a practical perspective, such an imposition would require even cash tips to be inclusive of HST, meaning wait staff would effectively be paying the HST (compared to when the HST was not imposed on their cash tips). However, unlike most remitters of HST, wait staff have no way to claim input tax credits to offset the HST they would remit, furthering the adverse impact the HST would have on wait staff's remuneration.

Fiscal neutrality

[32] The legal construct of volition *vis a vis* tips violates the principle of fiscal neutrality: the "avoidance of economic distortion (i) of consumer choices among various types of goods and services, and between imported and domestic goods; (ii) of choices by business firms among various methods of organization of production and distribution."[15] In the context of restaurants, fiscal neutrality…:

> Is infringed where…operators offering the same service, for the same total price, may find themselves having to pay different sums in respect of VAT depending on whether or not they indicate on their bills that they are applying a service charge, because the taxable amount differs in each case even though the service provided and the consideration given for it are absolutely identical.[16]

II. CONCLUSION

Is certainty and consistency needed?

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[15] John Whalley & Deborah Fretz, "The Economics of the Goods and Services Tax", *Canadian Tax Paper No 88* (Toronto: Canadian Tax Foundation, 1990) at 45.
[16] *Commission v France*, *supra* note 8 at I-2697—I-2698.

[33] Tips and gratuities are paid across a spectrum of circumstances. This is illustrated below:

Type of Venue/Service	Single or Small Table Service	Groups of 4 or more on one bill	Parties/ Group	Banquet Hall Settings
Calculation method	In discretion of patron	In discretion of patron	Usually pre-set fixed percentage	Pre-set amount pro rated to goods and services
Point when tip calculated	After bill received	After bill received	Frequently pre-set for larger groups	At contract formation
Recipient	Direct to Service provider	Direct to service provider or via credit card	Proprietor as conduit/agent	Proprietor as conduit/agent
Order method	À la carte from menu	À la carte from menu	À la carte or prix fixe	Pre-arranged contract
Method payment	Cash or debit/credit (with suggested options)	Cash or debit/credit (with suggested options)	Frequently calculated and added to bill	*En bloc* cheque or credit card

[34] Ultimately, a practical distinction is necessary, in this appeal and based upon these facts at least. The gratuity in this appeal is effectively non-negotiable, pre-calculated and arithmetically correlative to the taxable services. The gratuity is paid contemporaneously and indistinguishably from all other taxable services and supplies specified in the contract and included in the Invoice.

[35] The gratuity is coincidently embedded and associated with the other taxable services. Sections 133,138 and 153(1) of the *ETA* all anticipate and support this conclusion. The independent, autonomous and disjunctive payment of a cash tip directly to a server is distinct. Further, it is not a fact set before this Court in this appeal.

[36] In that regard and consistent with the key legal distinction of volition, present in cash-based, small table service and not in this appeal, HST is properly chargeable on the *en bloc*, pre calculated gratuity in this appeal.

[37] For these reasons, the appeal is dismissed without costs.

Signed at Ottawa, Canada, this 9th day of November, 2022.

"R.S. Bocock"

Bocock J.

CITATION:	2022TCC141
COURT FILE NO.:	2019-4341(GST)I
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