Does GST or HST apply to Medical Marijuana?

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[David M. Sherman (www.davidsherman.ca) is one of Canada's leading authorities on the Goods and Services Tax (GST) and HST Harmonized Sales Tax (HST). He is the author of numerous technical publications used by tax professionals including the 21-volume looseleaf Canada GST Service; the Canada GST Cases; the newsletters GST & HST Times and GST & HST Case Notes; and the books The Practitioner's Goods and Services Tax Annotated and GST Memoranda, Bulletins, Policies and Info Sheets, as well as The Lawyer's Guide to Income Tax and GST/HST. He was co-counsel in the Gerry Hedges appeal at the Tax Court of Canada and Federal Court of Appeal in 2014-2015, described below.]

OVERVIEW / SUMMARY

The Federal Court of Appeal ruled on January 25, 2016, in *Gerry Hedges v. The Queen*, 2016 FCA 19 <http://canlii.ca/t/gn3b7> that GST and HST apply to medical marijuana that is "not lawfully sold". Thus, sales by unlicensed growers and medical cannabis dispensaries have been held to be taxable.

An application for leave to appeal this decision was dismissed by the Supreme Court of Canada on June 30, 2016 (file 36925).

There remains uncertainty in my view as to whether medical marijuana is taxable when it is "lawfully sold" under the regulations governing the sale of marijuana for medical purposes, or even in circumstances where the sale is clearly protected by the *Charter of Rights*.

The Tax Court of Canada had ruled in September 2014 in *Gerry Hedges v. The Queen*, 2014 TCC 270 <http://canlii.ca/t/g903k> that tax applies, but the Federal Court of Appeal declined to address the issue when it decided the appeal of that decision.

The view of the Canada Revenue Agency (CRA) and the Tax Court of Canada is that medical marijuana is taxable. In my view, there is a reasonable possibility that the Tax Court of Canada or the Federal Court of Appeal could conclude in a

future case that medical marijuana that is "lawfully sold" is not subject to GST or HST.

The result will depend on the technical meaning of certain words in the *Excise Tax Act* that can be interpreted in more than one way. The article below explains the technical issue.

INTRODUCTION

Do GST and HST apply to sales of medical marijuana (medical cannabis) that are lawful under the *Marihuana for Medical Purposes Regulations*?

The discussion in this article applies to:

- GST (Goods and Services Tax), which applies throughout Canada (5%)
- HST (Harmonized Sales Tax), which combines the GST and a provincial component, and applies in place of the GST in Ontario (13%), New Brunswick (15%), Nova Scotia (15%), Newfoundland & Labrador (15%) and Prince Edward Island (14%, to be 15% starting October 2016).
- QST (Quebec Sales Tax), which follows the same rules as GST/HST, and applies at 9.975% in addition to the 5% GST in Quebec.

This discussion does *not* apply to provincial retail sales taxes in Saskatchewan, Manitoba, and in British Columbia. However, in those provinces, this discussion still applies to the 5% GST.

If GST/HST apply to sales of medical marijuana, then cultivators are required to collect these taxes when selling marijuana to Medical Cannabis Dispensaries, and Medical Cannabis Dispensaries are required to collect these taxes when selling marijuana to their members (patients). Both cultivators and Medical Cannabis Dispensaries will be liable to the Canada Revenue Agency for not collecting and remitting the taxes and filing GST/HST returns, and will also be subject to interest and penalties.

Note that I express no opinion on whether sales of medical marijuana to or by Medical Cannabis Dispensaries are legal. This article discusses only the sales tax issues.

THE LEGISLATION

The GST and HST are created under the *Excise Tax Act* (ETA), which is legislation passed by Parliament and amended each year.[1]

In general, all goods sold in Canada are subject to GST or HST unless there is a provision excluding them. Schedule VI to the ETA lists goods that are **"zero-rated"**, meaning free of GST or HST.[2]

ETA Schedule VI, Part I, section 2, paragraph (d) lists the following as being zero-rated:

> 2. A supply of any of the following drugs or substances:
>
> .....
>
> (d) a drug that contains a substance included in the schedule to the *Narcotic Control Regulations*, other than a drug or mixture of drugs that may, pursuant to the *Controlled Drugs and Substances Act* or regulations made under that Act, be sold to a consumer with neither a prescription nor an exemption by the Minister of Health in respect of the sale,
>
> but not including a supply of a drug or substance when it is labelled or supplied for agricultural or veterinary use only.

If medical marijuana falls into the above description, then no GST or HST applies. Otherwise, GST or HST applies.

INTERPRETING THE LEGISLATION

The legislation quoted above breaks down into several conditions. If each one of them is satisfied, medical cannabis is zero-rated.

(a) Drug

The first condition is that the supply be a **"drug"**. While it may seem obvious that marijuana is a drug, the Tax Court of Canada ruled in *Hedges v. The Queen* that the term has its meaning under the *Food and Drugs Act* — sold or represented for for use in the diagnosis, treatment, mitigation or prevention of a disease, disorder or abnormal physical state. Thus, marijuana sold for recreational use, including illegal street sales, is not a "drug".

The issue was not in dispute at the Federal Court of Appeal, and so the Court of Appeal did not address it. In the *Hedges* appeal, the marijuana in question was sold to a Medical Cannabis Dispensary, and so it met the test of being a "drug".

(b) Substance included in schedule to the NCA

The second condition is that the drug contain a "substance included in the schedule to the *Narcotic Control Regulations*".

Section 17 of the Schedule to the *Narcotic Control Regulations*[3] lists the following:

> 17. Cannabis, its preparations, derivatives and similar synthetic preparations, including:
> (1) Cannabis resin
> (2) **Cannabis (marihuana)**
> (3) Cannabidiol (2- [3-methyl-6- (1-methylethenyl- 2-cyclohexen-1-yl]-5-pentyl-1, 3-benzenediol)
> (4) Cannabinol (3-n-amyl-6, 6, 9-trimethyl-6-dibenzo-pyran-1-ol)
> (5) Nabilone ((±) -trans-3- (1, 1-dimethylheptyl) -6, 6a, 7, 8, - 10, 10a-hexahydro-1-hydroxy-6, 6-dimethyl-9H-dibenzo [b, d] pyran-9-one)
> (6) Pyrahexyl (3-n-hexyl-6, 6, 9-trimethyl-7, 8, 9, 10- tetrahydro-6-dibenzopyran-1-ol)
> (7) **Tetrahydrocannabinol** (tetrahydro-6, 6, 9-trimethyl-3- pentyl-6H-dibenzo [b, d] pyran-1-ol)
> (7.1) 3- (1, 2-dimethylheptyl) -7, 8, 9, 10-tetrahydro-6, 6, 9-trimethyl-6H-dibenzo [b, d] pyran-1-ol (DMHP)
> but not including
> (8) Non-viable Cannabis seed, with the exception of its derivatives
> (9) Mature Cannabis stalks that do not include leaves, flowers, seeds or branches; and fiber derived from such stalks

This section specifically includes cannabis (marijuana) and THC, which marijuana contains. The Tax Court agreed, in the *Hedges* appeal.

Thus, the second condition is clearly satisfied.

(c) "May be sold with neither a prescription nor an exemption"

The third condition can be summarized as follows ("CDSA" refers to the *Controlled Drugs and Substances Act*):

> The supply is not of a drug or mixture of drugs that **may**, pursuant to either
> — the CDSA, or
> — regulations made under the CDSA
> **be sold to a consumer with neither**
> — **a prescription**, nor
> — **an exemption** by the Minister of Health in respect of the sale.

This is the condition that was in dispute in the *Hedges* appeal to the Federal Court of Appeal, but which the Court of Appeal declined to address.

Since April 2014, certain vendors can sell marijuana to certain people under the *Marijuana for Medical Purposes Regulations* (MMPR). In the view of the CRA and the Tax Court of Canada, this means that *all* sales of marijuana are taxable. This is because the MMPR permit marijuana can be sold under the CDSA to *some* consumers with neither a prescription nor an exemption from the Minister of Health.

Put another way, the Tax Court ruled that the third condition cannot be satisfied because there are *some* (albeit relatively few) consumers who can buy marijuana without a prescription or an exemption from the Minister of Health.

It is my view that the Tax Court's view was incorrect. The words "may be sold to a consumer" mean "may be sold to *any* consumer", so that the "without a prescription" wording refers to **over-the-counter drugs that anyone can legally buy**, such as bezitramide, piritramide and propylhexedrine.[4] This is consistent with another provision of the ETA that clearly applies to over-the-counter drugs[5], and is consistent with the French wording of the legislation ("peuvent être vendus **au consommateur**").[6] It is also consistent with subsection 36(1) of the *Narcotic Control Regulations*, which describes a way in which codeine may be sold to any consumer. The Tax Court's interpretation is that these words are satisfied if there are *any* circumstances under the CDSA that permit marijuana to be sold to a consumer without a prescription or exemption. In my view, this interpretation is inconsistent with the other provision and is inconsistent with the French wording.

This issue was argued forcefully at the Federal Court of Appeal in November 2015 in the *Gerry Hedges* appeal. However, **the Court of Appeal did not answer this question, as it concluded that sales that are not "lawful" cannot be zero-rated**, and did not take the analysis further. (Mr. Hedges' sales were not made under the authority of any regulations, so the Court of Appeal held they were taxable.)

The Federal Court of Appeal's decision in this respect was consistent with many other cases over the past 20 years where the Court has "ducked" or refused to address a legal issue brought to it, because it could decide the particular appeal on narrower grounds. Notably, the Court of Appeal did *not* address the arguments based on the French text of the legislation, the application of a parallel rule to over-the-counter sales, and the role of subsection 36(1) of the *Narcotic Control Regulations* as demonstrating the origin of the wording in question. It resolved the appeal *only* with respect to "unlawful" sales.

(A secondary argument, that an Authorization to Possess under the former *Marijuana Medical Access Regulations* constituted an "exemption" so that all

medical marijuana remains zero-rated, was rejected by the Federal Court of Appeal and thus is no longer tenable.)

An application for leave to appeal the Federal Court of Appeal's decision was dismissed by the Supreme Court of Canada on June 30, 2016 (file 36925). This does *not* mean the Supreme Court agrees with the decision. It means only that the Supreme Court did not consider the matter to be of sufficient national public importance to warrant that Court's attention.

(d) Not solely for agricultural or veterinary use

The fourth condition is in the closing words of ETA Schedule VI, Part I, section 2, as quoted above: "not including a supply of a drug or substance when it is labelled or supplied for agricultural or veterinary use only".

This condition is clearly satisfied, as medical marijuana is not labelled or supplied for either agricultural use or veterinary (animals) use.

CONCLUSION

In my view, the position I have set out above is correct, and no GST or HST applies to sales of medical marijuana that are "lawful" under the MMPR.

However, this is a technical question of legal interpretation, and the Tax Court's decision on this point in the *Hedges* case, which is currently the only statement by a Court on the issue, could be ruled correct in a subsequent appeal. This issue is thus not yet finally resolved. In the meantime, the CRA is clearly of the view that such sales are taxable. A "lawful" vendor that disagrees can expect to be assessed by the CRA for unremitted GST/HST, and would be able to appeal this issue to the Tax Court of Canada and subsequently to the Federal Court of Appeal.

Vendors that sell medical cannabis where the sale is "unlawful" must charge and collect GST or HST on these sales, and remit that GST to the government. This is clear from the Federal Court of Appeal decision. However, it can still be argued that a vendor that can show that its customers are buying cannabis under the protection of the *Charter of Rights* is selling cannabis "lawfully".

Both the Tax Court and the Federal Court of Appeal recommended in the *Hedges* case that the legislation be amended to state clearly how it applies to marijuana, as it is unclear. If the new Liberal government moves to legalize and regulate marijuana sales, as it has promised to do, one can expect amendments to make it clear that recreational marijuana is taxable. It will be up to the government to decide whether to make *medical* marijuana taxable or zero-rated.

ENDNOTES

1 The ETA and all other legislation, regulations and case law cited in this article can be found at www.canlii.org. For a copy of the ETA with detailed annotations, notes, explanations, citations and cross-references, see David M. Sherman, *The Practitioner's Goods and Services Tax, Annotated* (33rd edition June 2016), published twice a year by Carswell (www.carswell.com).

2 Technically, this is different from being "exempt". Where a supplier sells goods that are zero-rated, the supplier does not collect GST or HST, but can claim input tax credits (ITCs) to recover the cost of all GST or HST paid on the costs of producing and selling the goods (e.g. office rent). Where a supply is "exempt", such as medical services, the supplier does not charge GST or HST but also cannot claim ITCs, so that tax on those costs is being paid and is effectively built into the price charged. A "zero-rated" supply is technically taxable, so that ITCs can be claimed, but is taxable at 0%. Zero-rated goods include basic groceries, many medical devices, many farm products and goods exported from Canada.

3 Consolidated Regulations of Canada, chapter 1041.

4 *Regulations Exempting Certain Precursors and Controlled Substances from the Application of the Controlled Drugs and Substances Act*, SOR/97-229, s. 1: "The substances set out in Schedule I [to the Regulations] are exempt from the application of the *Controlled Drugs and Substances Act*."." Schedule I lists these substances along with their chemical descriptions.

5 ETA Schedule VI, Part I, paragraph 2(b). This exception applies to Levonorgestrel, also known as the "morning after pill", because it "is now available to consumers without a prescription": CRA, *Excise and GST/HST News* No. 57 (Summer 2005).

6 Under the *Official Languages Act*, both versions of the legislation are equally authoritative. The CRA's interpretation would require the French wording to be "à des consommateurs" or "à un consommateur".