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Release of GST/HST proposals and consultation paper

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Legislative and regulatory proposals relating to the goods and services tax (GST)/ harmonized sales tax (HST) were released by the Department of Finance (Finance) on July 22, 2016. As well, Finance released a consultation paper that proposes changes to the GST/HST rules for certain limited partnerships and investment plans.

For the most part, the proposals provide for welcome relief in some areas, such as the rules affecting pension plans that involve master trusts or master corporations and the rules applicable to the use of drop shipment certificates. For other proposals, such as those impacting group registered education savings plans (RESPs) and certain limited partnerships, although they provide for equity with other investment plans, the impact will be favourable or unfavourable depending on the facts in each case for the impacted parties.

Both the legislative and regulatory proposals and the consultation paper offer interested parties an opportunity to provide input. For the legislative and regulatory proposals, input is required by August 31, 2016; whereas, for the consultation paper, input is required by November 30, 2016.

Below is a summary of the key proposed changes with links to the specific topics:

- **Changes to private equity investment limited partnerships**
- **Relief for pension plan structures with a master pension entity**
- **Amendments to a trust governed by a self-directed RDSP, RESP or TFSA**
- **Changes to the reporting of section 150 supplies made to a SLFI**
- **Modernization of drop shipment rules**
- **Relief for certain supplies of rights to use public passenger transportation services**
- **Other noteworthy proposed amendment**

Changes to private equity investment limited partnerships

Introduction of newly defined investment limited partnerships

The government is proposing to expand the definition of an “investment plan” in subsection 149(5) of the Excise Tax Act (ETA) to include an “investment limited partnership” (ILP). An ILP would be defined to include a limited partnership whose principal activity is the investing of funds on behalf of a group of investors through the acquisition and disposition of financial instruments. As a result, an ILP would become a listed financial institution for GST/HST purposes, and further would become a selected listed financial institution (SLFI) if at any time in the taxation year it has a

permanent establishment in an HST province and a permanent establishment in any other province.

An ILP would be deemed to have a permanent establishment in a province if:

(A) a partner holding one or more of its units (i.e., an interest in the partnership) is resident in the province; or
(B) if the ILP is able to sell or distribute its units in the province.

However, certain exclusions would apply such as when all of the units of the partnership are designed to be sold or distributed to investors in a single province. In this case, the ILP would not be a SLFI.

The imported supply rules for financial institutions would be amended to ensure that ILPs in which Canadian investors have an interest are required to self-assess GST/HST on expenses incurred outside of Canada in relation to their Canadian activities. The rules would apply to both Canadian resident ILPs and non-resident ILPs. In the case of a non-resident ILP, the rules could apply where the total value of the assets of the partnership in which one or more Canadian investors has an interest is equal to or exceeds $10 million and is equal to or exceeds 10% of the total value of the assets of the partnership.

In addition, Finance has released a consultation paper proposing that the existing rules for “distributed investment plans” (e.g., mutual funds, pension plans, unit trusts, segregated funds of an insurer) be adapted for ILPs. Finance has invited industry stakeholders and other interested parties to provide input into the proposals by November 30, 2016. A possible effective date for the proposed changes is not mentioned.

The government initially introduced SLFI rules for distributed plans in 2010 when Ontario and British Columbia became harmonized provinces. The rules were meant to address a potential incentive for these types of financial institutions to source property and services from outside an HST province for use or consumption in an HST province in order to pay only the GST and not the higher HST, which includes the provincial component. These new rules were in addition to the original SFLI rules for banks, insurers, trust companies, credit units, and other more traditional bricks and mortar financial institutions. The original rules were put in place in 1997 when New Brunswick, Newfoundland and Nova Scotia became harmonized provinces.

Under the SLFI rules, a SLFI distributed investment plan generally determines its liability for the provincial component of the HST (e.g., 8% in Ontario) using an allocation formula based on the residence of its investors, generally after looking through investors which are partnerships and trusts. Thus, for example, a mutual fund trust resident in Ontario with a heavy investor weighting in Alberta, Manitoba and Saskatchewan, would likely have an effective HST rate lower than 13% whereas a mutual fund trust resident in Alberta with a heavy investor weighting in Ontario and other HST provinces would likely have an effective HST rate much higher than 5%.

The proposed rules for ILPs are meant to ensure that *like* investment vehicles are treated in an equitable manner for GST/HST purposes. Finance had in fact announced in early 2011 that it was proposing consultations on the GST/HST treatment of “certain investment trusts and partnerships with investors in more than one province”, and did undertake consultations with certain industry groups.

It will be important for private equity limited partnerships to carefully consider the proposals and comment on Finance’s consultations as to how best the existing rules for distributed investment plans should be adapted in the private equity context. Not all concepts and rules easily apply or should apply to private equity limited partnerships. Modifications may be necessary.

With the new rules, there will likely be heighten importance in determining the place of residence of the ILP and whether the partnership is resident in Canada. This will be particularly relevant in determining whether an ILP will have to self-assess GST/HST on expenses incurred outside of Canada under the imported supply rules for financial institutions. Where the ILP is found not to be resident in Canada, it still potentially could be subject to the imported supply rules by virtue of the $10 million/10% proposed *de minimis* test. Residency is also important in determining whether supplies of services, like management services, can be zero-rated.

It appears that the proposed rules would not apply to a real estate limited partnership where all real estate holdings are held directly by the partnership and not through an investment vehicle like a corporation, trust or another partnership. The proposed rules appear only to apply to limited partnerships that invest in financial instruments (e.g., shares of a corporation, units in another partnership, and units in a trust).

The cost impact to an ILP on becoming a SLFI will depend on a number of factors, and particularly the residence of its investor population. For example, a SLFI ILP resident in an HST province with a heavy weighting of investors resident in non-HST provinces may be in a net HST refund position. Whereas a SLFI ILP in a non-HST province with a heavy weighting of investors in HST provinces, may have to pay additional HST.

Presumably, ILPs will be exempt from having to file the annual information return for financial institutions as is the case for most investment plans. However, this is not mentioned in the consultation paper.

Additional changes to existing investment plans and newly defined ILPs
The proposals include two new rules in relation to non-residents for existing investment plans and newly defined ILPs.

First, a GST/HST rebate is proposed for investment plans having non-resident unitholders, including ILPs that would become investment plans under the proposed rules. The rebate would be based on the value of the units held by non-resident investors. The consultation paper remarks that this would ensure more consistent tax treatment between Canadian managed investment plans that do business outside of Canada and their non-resident-managed competitors. The rebate would be available to SLFI and non-SLFI investment plans. It appears that rules would apply to avoid a “double” recovery of the provincial component of the HST in respect of non-resident investors, i.e., through the rebate and another means. An investment plan would not have to be registered for GST/HST in order to claim the rebate.

Second, a deemed non-residency provision is proposed. An investment plan would be deemed to be a non-resident (of Canada) for GST/HST purposes for a fiscal year if the non-resident investor percentage of an investment plan is 95% or more for the particular fiscal year. The benefit of this deeming rule would be the ability to zero-rate input costs for GST/HST that would be subject to regular GST/HST rates since the investment plan would be resident in Canada under the normal rules.

These are welcomed changes and recognize the importance of cross-border competitiveness for investment plans. For the rebate, a cost benefit analysis would likely be helpful to an investment plan in deciding whether or not to claim the GST/HST rebate.

Relief for pension plan structures with a master pension entity

Proposed amendments may offer GST/HST relief to participants in pension plan structures that involve the use of a master trust or corporation (i.e., a “master pension entity” or MPE) as a vehicle for the assets of a pension plan, or multiple pension plans sponsored by an employer or a group of related employers.

The complex rules applicable since 2009 to pension entities of registered pension plans (i.e., “pension entities”) and their related employers with MPE structures resulted in unrecoverable tax in excess of that borne by plans that held investments directly in a pension entity.

To address the resulting double taxation, the amendments relating to MPEs are proposed to be as follows:

- a participating employer of a pension plan and a MPE of the pension plan may jointly elect under subsection 157(2.1) to treat actual taxable supplies made by the employer to the MPE as being made for no consideration provided that the total percentage of units or shares of the MPE held by all of the pension entities in respect of a pension plan of the participating employer for the fiscal year of the MPE is greater or equal to 90%,
- where the above-noted election has not been made and there are actual and deemed supplies from the employer with respect to the MPE activity, a tax adjustment note (TAN) may be available to mitigate double taxation; and
- following the amendments/additions of 172.1 and 172.2, a specified/designated pension entity of a pension plan in respect of a MPE of the pension plan should now be eligible to claim the 33% rebate in respect of the tax actually paid by the MPE and/or deemed paid by the pension entities of a pension plan in respect of the MPE.

Amendments are also proposed to section 172.1 of the ETA in relation to its application to activities in respect of MPEs, among other consequential amendments.

The new rules operate prospectively (i.e., after July 22, 2016) to treat many MPE structures (and employer pension activity related to MPEs) in a manner similar to the existing rules applicable to pension entities. However, a key retroactive change is that many costs/activities related to the operation of a MPE (including management/administration of assets) are excluded from an employer’s deemed supply calculation for any fiscal year of the employer that began after September 23, 2009 and before the July 22, 2016.

Where an employer has remitted tax related to MPE activity during this prior period, the employer can submit a request in writing for (re)assessment within one year following royal assent. A consequence of the (re)assessment is that there will also be a claw back of the pension rebate that was claimed by the pension entity or a qualifying employer under the pension rebate transfer election on the amount that was not deemed to have been paid by the pension entity under the proposed amendments.

Employers and pension entities should carefully review the new rules to determine how the changes may apply to certain supplies made to MPEs and/or pension entities, including potential Quebec Sales Tax implications.

Amendments to a trust governed by a self-directed RDSP, RESP or TFSA

The definition of investment plan under subsection 149(5) of the ETA is proposed to be amended to add a trust governed by a tax free savings account (TFSA) or a registered disability savings plan (RDSP), as those terms are defined under the Income Tax Act (ITA). These proposed amendments are to apply in respect of any taxation year of a person that begins after July 22, 2016.

The Financial Service and Financial Institutions (GST/HST) Regulations (FS Regs) are also proposed to be amended to provide that RDSP, RESP and TFSA have the same meanings as under the ITA. The current rules already do this for a registered retirement savings plan (RRSP) and a registered retirement income fund (RRIF) and exist to make it clear which entities are impacted by other parts of the FS Regs.

As a result, the FS Regs are proposed to be amended, effective July 23, 2016, to include the service of arranging for the issuance, renewal, variation or transfer of ownership of a financial instrument for a trust governed by a self-directed RDSP, RESP or TFSA. The current rules already apply to self-directed RRSPs and RRIFs. This impacts which services are prescribed for purposes of subparagraph (q)(ii) of the definition of "financial service" under subsection 123(1) of the ETA.

Additionally, although it is proposed that TFSAs and RDSPs may be "financial institutions" for GST purposes, the definition of investment plan under the Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations (SLFI Regs) is proposed to be amended, firstly, to exclude TFSAs and RDSPs for purposes of the SLFI Regs. Thus, TFSAs and RDSPs will not be SLFIs. Secondly, a trust governed by an individual or family RESP is proposed to remain excluded from the definition of investment plan under the SLFI Regs, but a trust governed by a group RESP is proposed to be included in that definition. Therefore, a trust governed by a group RESP can be a SLFI and may then use the Special Attribution Method (SAM) formula to account for the provincial component of the HST based on the residency of the individual subscribers in the group RESP.

These proposed amendments address potentially unfair results from the place of supply rules. Under the existing definition of investment plan under the SLFI Regs, a trust governed by a RESP is not an investment plan and thus, cannot be a SLFI. This has the effect of applying GST/HST on services supplied to the trust based on the "normal" place of supply rules. For example, a trust resident in Ontario is subject to 13% HST irrespective of where its beneficiaries are located. Generally, for individual or family plans, this yields a fair result. However, for group plans where beneficiaries or subscribers are scattered across the country, the place of supply rules may not yield fair results.

These proposed amendments follow Finance's January 28, 2011 Backgrounder dealing with proposed amendments to the rules affecting "financial institutions", in which the determination of RESPs as SLFIs was one such issue identified for consultation.

Changes to the reporting of section 150 supplies made to a SLFI

Section 225.2 of the ETA is proposed to be amended in respect of the adjustment that a SLFI must make to its net tax in respect of the provincial component of the HST under subsection 225.2(2) and in respect of the election provided for under subsection 225.2(4). Essentially, the proposed amendments switch the effect of the current rules to recognize the fact that there likely is no situation where a SLFI would not have elected under subsection 225.2(4) to use the lower notional amount of GST in its SAM calculation.

The current default rule under the SAM is to include GST on the inter-company charge to the recipient SLFI as if the section 150 election were not in effect. This has the effect of increasing the SLFI's liability for the provincial component of the HST, which counters the benefit otherwise realized with the section 150 election. However, existing subsection 225.2(4) allows parties to a section 150 election to make a

second joint election to include a lower notional amount of GST in the recipient SLFI's SAM calculation.

Under the proposed amendments, the default rule will be to include, in the SAM calculations of the recipient SLFI, GST calculated on the cost to the other person of supplying the property or service to the SLFI. The subsection 225.2(4) election can still be made, but the election under the proposed amendments will be to use the higher notional GST (as if no section 150 election were in effect) in the SAM.

Amendments are also proposed to subsection 225.2(4) of the ETA to provide that the election is to be made solely by the recipient SLFI and therefore, is proposed to no longer be a joint election. However, the SLFI making the election is required to notify the other party that the election was made or no longer ceases to have effect.

The proposed amendments are to apply in respect of reporting periods of a SLFI that begin on or after the day that is one year after the day on which these proposed amendments receive royal assent.

Although there is likely no situation where a SLFI would not have desired to have made the subsection 225.2(4) election, we have seen several situations where the election was not filed due to an oversight or misunderstanding as to how the rules work. Given that the Minister has discretion to accept a late-filed subsection 225.2(4) election under existing subparagraph 225.2(5)(c)(ii) and in light of these proposed amendments, it may be possible for SLFIs who mistakenly failed to make the subsection 225.2(4) election in the past to obtain ministerial discretion to retroactively seek the relief available under the existing rules. Nonetheless, these proposed amendments are welcome changes.

Modernization of drop shipment rules

The proposals include amendments that are intended to revise and modernize the GST/HST drop shipment rules[1] and are summarized below.

The ETA is proposed to be amended in respect of the condition related to the acquisition of the physical possession of goods for the purposes of making a taxable supply of a commercial service in order to:

- remove the restriction that the goods not be goods of a person that is registered for GST/HST purposes, and
- clarify that the supply of the commercial service must be made in Canada.

This proposed amendment means that the rules may apply to a commercial service, supplied in Canada after July 22, 2016, that is in respect of the goods of a non-resident person that is registered for GST/HST purposes.

Additionally, new proposed subsection 179(2.1) of the ETA, which is to apply in respect of supplies made after July 22, 2016, provides that, in certain circumstances, a certificate (referred to as an "owner's certificate") may be issued that has the effect of nullifying the supply of the goods that is deemed to have been made under subsection 179(1). This will relieve the registrant from having to remit GST/HST on

[1] The purpose of the drop shipment rules, which are set out under section 179 and Division IV of Part IX of the ETA, is, firstly, to allow a person that is a non-resident of Canada and is not registered for purposes of the GST/HST to acquire in Canada goods, or commercial services in respect of goods, on a tax free basis, provided that the goods are ultimately exported or are retained in Canada by a GST/HST registrant that agrees to accept potential liability for tax in respect of a subsequent transfer or non-commercial use of the goods. Secondly, to ensure that the GST/HST applies to goods located in Canada that are supplied by an unregistered non-resident person for final consumption in Canada in the same way as tax would apply to the goods if they were acquired from an unregistered non-resident person outside of Canada and imported for final consumption in Canada.

that deemed supply. It also has the effect of deeming the supply of the goods, or the supply of a service in respect of the goods (other than a service of shipping the goods), to have been made outside of Canada. Therefore, the GST/HST is relieved on that supply by the registrant to the non-resident person.

As a consequence of the introduction of new subsection 179(2.1), new paragraph (b.01) of the definition of “imported taxable supply” in section 217 is introduced, effective for supplies made after July 22, 2016. The amended definition of imported taxable supply includes a taxable supply (other than a zero-rated supply) by way of sale of goods if:

- the taxable supply of goods by way of sale is made by an unregistered non-resident person to a registrant that issues an owner certificate in respect of the goods; and
- the registrant is acquiring the goods for consumption, use or supply otherwise than exclusively in the course of its commercial activities.

With respect to the drop shipment certificates provided for in subsection 179(2), new paragraph 179(2)(b.1) states that in order for a GST/HST registered consignee to issue a valid drop shipment certificate, it must be acquiring physical possession of the goods:

- as the recipient of a taxable supply of the goods by an unregistered non-resident person;
- for the purpose of making a taxable supply in Canada of a service of manufacturing or producing other goods to an unregistered non-resident person that is not a consumer of the service, provided that the goods are incorporated or transformed into, attached to or combined or assembled with, the other goods, or are directly consumed or expended, in the manufacture or production of those other goods;
- if the goods are not the goods of a person that is resident in Canada, for the purpose of making a taxable supply in Canada of a commercial service in respect of the goods to an unregistered non-resident person that is not a consumer of the service; or
- for the purpose of making a taxable supply in Canada of a commercial service in respect of other goods (other than goods of a person that is resident in Canada) to an unregistered non-resident person that is not a consumer of the service, provided that the goods are incorporated into, attached to or combined or assembled with, the other goods, or are directly consumed or expended, in the provision of the commercial service.

Furthermore, new subsections 179(8) to (12) set out rules that apply for the purposes of the GST/HST drop shipment rules in circumstances involving leases, which are to become effective following royal assent. These subsections apply where a registrant leases goods from an unregistered non-resident lessor and has either given a drop shipment certificate in respect of the goods or has claimed an input tax credit in respect of tax that it is deemed to have paid in respect of the goods under either subsection 178.8(2) or section 180. Generally, under these rules, the registrant lessee is deemed to have obtained physical possession of the goods at the beginning of the lease period and to have retained physical possession of them until the end of the lease period. This is true even if the actual physical possession of the goods is held during all or a part of the lease period by a third person, such as a sub-lessee. Therefore, these rules generally ensure that the registrant lessee (rather than other persons that have physical possession of the goods during the lease period) will have a potential GST/HST liability in respect of the goods due to the application of either subsection 179(1) or Division IV of Part IX of the ETA. However, proposed subsection

179(11) provides an exception in cases where another registrant has physical possession of the goods during the lease period for the purpose of making a taxable supply in Canada of a commercial service in respect of the goods to the non-resident lessor or to another unregistered non-resident person.

Relief for certain supplies of rights to use public passenger transportation services

Section 24 of Part VI of Schedule V to the ETA is proposed to be amended and new section 24.1 is proposed to clarify that supplies of rights to use certain public passenger transportation services (e.g., sales of public passenger transportation passes) are exempt, and not just supplies of the services themselves.

As a result of the amendments, a supply of a right or service is not exempt under section 24 if it is simply an input acquired by a transit authority for use in making supplies of public passenger transportation services. For example, if a transit authority pays consideration to a third party organization for a supply of a public passenger transportation service that is an input to the transit authority's overall mandate, then the input is taxable. However, the final supply of the public passenger transportation service to a member of the public, whether made by the third party or the transit authority, may be exempt under proposed section 24.1.

These proposed changes address the problem where a transit authority supplies to a third party vendor, who is not a transit authority, transit passes that allow an individual to use a public passenger transportation service. The transit authority is, under the existing rules, required to charge tax on the supplies of the passes notwithstanding the underlying service was intended to be exempt. The supply (and re-supply) of such a right is proposed to be exempt regardless of the identities of the supplier and the recipient (except if the recipient is a transit authority), provided that the underlying service is operated by a transit authority. For example, under the proposed rules, if a transit authority supplies a university with the right for the university's students to use its public passenger transportation service, then the supply of the right to the university and the subsequent supplies to the students are both exempt supplies, provided that the underlying service is operated by a transit authority.

The definitions of "municipal transit service" and “transit authority” under section 1 of Part VI of Schedule V are consequentially proposed to be amended. In particular, the “all or substantially all” condition is proposed to be removed from the definition of municipal transit service and incorporated directly into the amended definition of transit authority, which is proposed to explicitly contemplate supplies of rights to use a public passenger transportation service. As a result, it is proposed that all of the conditions that an entity must satisfy in order to be considered a transit authority under amended section 24 and new section 24.1 are described directly in the amended definition of transit authority.

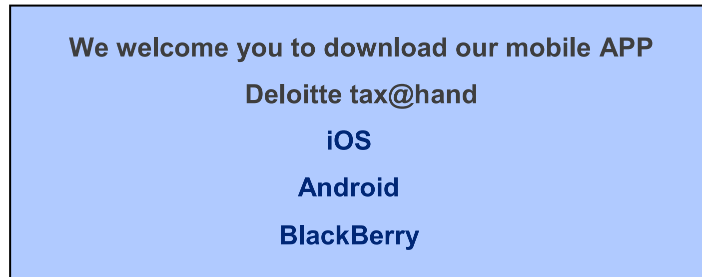
These proposed amendments are to apply to any supply made after July 22, 2016 and to any supply made on or before that day unless, on or before that day, an amount was charged, collected, or remitted in respect of the supply as or on account of tax.

Other noteworthy proposed amendment

Credit unions – The rules in the SLFI regs that govern permanent establishments of banks, is proposed to be amended so that it also applies to credit unions, effective for any reporting period that begins after July 22, 2016. These amendments, which better reflect the fact that many credit unions have expanded beyond having deposit holders

and borrowers situated in only one province, will impact the amount of the provincial component of the HST remittable by credit unions.

If you have any questions on any of these proposals, please reach out to your Deloitte representative.



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