



## Canadian indirect tax news

General partner distributions/remuneration for certain limited partnerships proposed to be subject to goods and services tax/harmonized sales tax (GST/HST)

September 28, 2017

On Friday, September 8, 2017, the Department of Finance (Finance) released draft GST/HST legislative proposals and explanatory notes (the Proposals), including proposals previously announced on July 22, 2016. In a series of two newsletters, we highlight the most significant changes. This newsletter covers the changes to the application of GST/HST to certain limited partnerships. The second newsletter covers the drop shipment rules, registered education savings plans, public sector changes and pensions.

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The Proposals expand the application of the GST/HST rules applicable to selected listed financial institutions to include investment limited partnerships (ILPs), and provide GST/HST relief to ILPs with non-resident investors in certain circumstances. However, the rules also propose to apply GST/HST to general partner distributions and remuneration for management and administration of the limited partnership activities, even though the general partner performs these functions in its role of general partner. Presumably, this is to put these certain limited partnerships on par with other investment structures such as mutual funds and segregated funds that effectively pay GST/HST on management and administrative services provided to them.

In summary, the proposed rules, which in some cases are to be effective as of the September 8, 2017 (the Announcement Date), impact ILPs as follows:

- a. Fair market value for the management and administrative functions of general partners of ILPs will be subject to GST/HST;
- b. ILPs will be “financial institutions” for GST/HST purposes; and
- c. ILPs could be “selected listed financial institutions” (SLFIs) such that they could be required to follow a special attribution method (SAM) for determining their obligations (i.e., liabilities for amounts owing and entitlement to refunds) for the provincial component of HST.

An ILP is a SLFI if:

- a. The ILP has investors resident in a participating province and investors resident in any other province (e.g., the ILP has investors resident in Ontario and investors resident in Alberta); or
- b. The ILP is “qualified” under the laws of Canada or a province to sell or distribute units in the ILP.

Based on the Comprehensive Integrated Tax Coordination Agreement between Quebec and the federal government, it is expected that Quebec will harmonize its rules with the finalized Proposals.

## **Who is impacted?**

The proposed rules impact limited partnerships that are considered ILPs. A limited partnership whose “primary purpose...is to invest funds in property consisting primarily of financial instruments” (e.g., shares, debt instruments, trust units, partnership units) is proposed to be an ILP if:

- a. It is represented or promoted as a hedge fund, ILP, mutual fund, private equity fund, venture capital fund, or other similar collective investment vehicle;
- b. It forms part of an arrangement or structure that is represented or promoted as a hedge fund, ILP, mutual fund, private equity fund, venture capital fund, or similar collective investment vehicle (e.g., this could include limited partnerships in tiered investment fund structures such as master-feeder funds or fund-of-funds); or

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- c. If listed financial institutions (e.g., such as banks, insurance companies, credit unions, broker/dealers, mutual funds, segregated funds, pension plans) hold interests representing at least 50 per cent of the total value of all the interests in the limited partnership.

The definition of ILP, as proposed, is potentially quite broad in scope, and subject to interpretative considerations.

### **Interpretative considerations**

1. How is the “primary purpose” of a limited partnership to be determined, particularly when the limited partnership is a holding limited partnership to the limited partnership that has the investment activities? Is it the “direct and immediate purpose”, the “ultimate purpose”, or some other test to determine the purpose of the limited partnership? A limited partnership that invests directly and only in non-financial instruments, for example, oil and gas properties, infrastructure assets and real estate, would not be an ILP. But a holding limited partnership of the limited partnership that invests directly and only in the limited partnership that directly holds these other assets may be an ILP.
2. What if the limited partnership invests directly in financial instruments and holds other property? What measure should be used to determine if the limited partnership invests “funds in property consisting primarily of financial instruments”? Is it value or some other measure, and at what point in time is the value to be determined?
3. What is meant by a “similar collective investment vehicle”? The proposed definition already references a hedge fund, investment limited partnership, mutual fund, private equity fund, and venture capital fund. What other arrangements potentially could be captured by this phrase?

### **How will ILPs and their general partners be impacted?**

The impact of the Proposals could be significant for limited partnerships that are now ILPs, including:

- a. Increased costs equal to the GST/HST on the fair market value of the management and administrative functions of the general partner where currently no GST/HST applies, to the extent that such GST/HST is unrecoverable;

### **Practical considerations**

Determining when the GST/HST owing by the ILP to the general partner for a management or administrative service is due to be paid to the general partner, and how much GST/HST needs to be paid, may not be an easy task in all cases.

In this regard, the Proposals rely on an existing rule for partnership transactions which deem “the supply to have been made for consideration that becomes due at the time the supply is made equal to the **fair market value** at that time of the...service acquired by the partnership”. **[Emphasis added.]**

It is the fair market value of the management and administrative service that determines the amount on which GST/HST is payable by the ILP, and not necessarily what is paid to the general partner. How and when will fair market value be determined? As facts and circumstances of each case vary from the next, there likely is no uniformity for these determinations.

- b. Depending on the residency of the investors in the ILP:
  - i. increased or reduced provincial component of the HST on taxable purchases (e.g., general partner management and administrative services, professional services, etc.) made by the ILP;
  - ii. zero rating on supplies made by the general partner; and
  - iii. GST/HST self-assessment on costs applicable to a Canadian activity; and

### **Impact with respect to non-resident limited partner investors**

#### Relief for certain ILPs

1. In some cases, the ILP may be afforded relief from paying any GST/HST. This may occur for example, where all of the limited partners of the ILP are resident outside of Canada, even though the general partner of the ILP is resident in Canada and has a permanent establishment in Canada.
2. In particular, the Proposals contain a specific rule which deems an ILP not to be resident in Canada where 95% or more of the total value of all interests in the partnership are held by non-residents. However, in calculating the 95% threshold, an investor in the ILP that is otherwise a non-resident trust or a non-resident limited partnership, having more than 5% ownership by persons resident in Canada, based on the value of the assets in the non-resident trust or non-resident limited partnership, as the case may be, is not considered to be non-resident.
3. If an ILP meets this non-resident deeming test, many supplies of services made to the ILP, including that of the general partner, will be zero-rated.

## Other

1. The Proposals do not contain the GST/HST rebate for investment plans having non-resident investors, as was announced by Finance in 2016 in its consultation paper (the Consultation Paper).
2. The Proposals also do not include the self-assessment rule Finance contemplated in the Consultation Paper applicable to activities in Canada of a non-resident limited partnership where:
  - a. investors resident in Canada hold a total value in the partnership of at least \$10,000,000; and
  - b. the value held by these investors is at least equal to 10% of the value of the assets of the limited partnership.
- c. Increased compliance and processes for ILPs that are SLFIs given that they will need to file GST/HST returns and follow the SAM, and some may wish to register for GST/HST.

## **What do ILPs need to consider?**

Impacted limited partnerships should begin now to look at the application of these proposed rules to them.

Immediate attention is required by general partners of ILPs to deal with the application of the GST/HST to the fair market value of the management and administrative services provided to the ILPs, including whether registration for GST/HST purposes by the general partners is required and when and how to collect and remit GST/HST on the management and administrative services.

### **Interest starts as of the Announcement Date**

Once the Proposals are in force, the Canada Revenue Agency (the CRA) has the ability to assess interest (along with the GST/HST that should be accounted for on the management and administration services by the general partner) starting as of the Announcement Date. However, the CRA cannot assess any penalty for periods prior to the Proposals coming into force (i.e., receives Royal Assent).

ILPs that are SLFIs should not have any SLFI compliance to follow until 2019. The processes followed by mutual funds and their managers for SLFI compliance will generally apply for ILPs. For example, such ILPs will be required to determine its provincial allocation percentage for each participating province as of September of the prior year, e.g., September 2018 for 2019. In addition, such ILPs will have to follow the look-through rules in making the determination, e.g., obtain an investor percentage for each participating province from look-through entities such as from pension plans.

### **First SLFI return**

1. The first SLFI return would apply to calendar year 2019.
2. Special rules apply for ILPs whose fiscal year straddles January 1, 2019.

For investment structures involving multiple ILPs, it may be helpful to make certain elections to streamline and consolidate GST/HST reporting and filings for ILPs.

### **Elections**

The elections (reporting entity, consolidated filing, and tax transfer adjustment) were put in place for investment plans when the SLFI rules were introduced in 2010. Most mutual fund managers, for example, have made these elections with the funds they manage. The manager does the SLFI filings for the funds on a consolidated basis and under a GST/HST registration number for a particular group of funds.

Like existing investment plans registered for GST/HST that are SLFIs, ILPs registered for GST/HST that are SLFIs will not be required to file an annual information return for financial institutions.

ILPs registered for GST/HST that are **not** SLFIs will be required to file the annual information return for financial institutions if their annual income for income tax purposes for the particular year exceeds \$1,000,000.

### **Consultation period**

Finally, the Proposals are open to further consultation with comments due to Finance by October 10, 2017. We are considering what feedback we can provide the Department of Finance to ensure that the Proposals work as intended in a fair and meaningful manner.

The Proposals and the related explanatory notes released by Finance can be found at: <http://www.fin.gc.ca/drleg-apl/2017/gst-hst-tps-tvh-eng.asp>

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