

New GST/HST Rules Affecting Partnerships

New draft Goods and Services/Harmonized Sales Tax (GST/HST) proposals were released by the federal Department of Finance on September 8, 2017 for public consultation. The new HST and GST proposals (“proposals”) will be effective on certain amounts payable by certain limited partnerships to their general partner(s).

Current Rules:

Under the current rules¹, any management or administration service provided by a person as a general partner of a limited partnership is generally deemed to have been done by the partnership and not by the general partner. As a result, there would be no supply of the management services from the partner to the partnership for GST/HST purposes and no tax to charge.

Furthermore, any management or administration service that is provided by the general partner to the limited partnership in the course of the partnership’s activities would also not be deemed to be a supply made to the partnership for GST/HST purposes².

To illustrate how the current rules apply, we have reproduced below a modified version of example 1 of Policy Statement P-244 issued by the Canada Revenue Agency illustrating how the current rules apply.

¹ ETA 272.1 (1)

² ETA 272.1(3)

Example No. 1

Facts

1. A limited partnership was created to manage and administer a portfolio of marketable securities, including debt and equity securities and interests in other partnerships.
2. It was agreed under the written limited partnership agreement that the general partner, A Co., would be the sole manager of the portfolio. Under the limited partnership agreement A Co. will be paid x-per cent of the partnership's profits.
3. A Co.'s conduct in performing the management services is consistent with the related terms of the written limited partnership agreement.
4. A Co. does not provide services to any other persons.

The outstanding question under the current rule is, does subsection 272.1(1) of the Act apply to the management services performed by A Co. so that they are deemed to have been rendered by the limited partnership?

Comments

The general partner is clearly responsible for managing the portfolio, under the terms of the written limited partnership agreement, and does not receive any separate consideration for doing so. Managing the portfolio is directly related to the business purpose of the partnership. A Co. only manages the portfolio for the limited partnership. Generally, subsection 272.1(1) would apply to the management services performed by A Co. where subsection 272.1(1) applies. In other words, the services would be deemed to be completed by the partnership and there would be no supply of the management services from the partner to the partnership for GST/HST purposes.

Typically, under the current rules, all of the management and administration services provided by the general partner to the particular partnership are provided in the course of that partnership's activities, and no GST/HST applies on those services.

New Proposed Rules

The new proposal³ would now exclude management or administrative services provided by a general partner to an investment limited partnership ("ILP") from the application of the above-noted current rules. As a result, GST/HST will apply to any amount that the partnership agrees to pay or to credit the general partner in respect of those services, subject to any applicable place of supply and/or zero-rated rules.

The proposals would become effective in respect of consideration for a supply of services that becomes due on or after September 8, 2017, or that is paid on or after that date without having become due⁴.

³ ETA 272.1(8)

⁴ The proposals are also retroactive to any consideration for a supply of the service that became due or was paid before September 8, 2017 unless the supplier did not, on or before that date, charge, collect or remit any amount as or on account of GST/HST in respect of the supply (i.e., a limited partnership that was charged GST/HST on those services prior to September 8, 2017 would be unable to claim a refund of tax paid in error).

General partners that were not previously registered for GST/HST purposes may now be required to do so.

“Management or administration service” is defined for GST/HST purposes to include an “asset management service,” which is also a broadly defined term for GST/HST purposes⁵ to include almost anything that a general partner would typically do in their role.

It is not clear what would constitute any amount that the partnership agrees to pay or to credit the general partner in respect of management or administration services provided by the general partner. A careful review of every existing limited partnership agreement is required to ensure that GST/HST is applied correctly on those services.

What is an ILP?

An ILP would be defined⁶ as a **limited partnership**, the **primary** purpose of which is to invest funds in property consisting **primarily** of **financial instruments** that also meets some **additional conditions** (see below).

Although the term “primary” is generally understood as meaning more than 50 per cent, it is not clear how to quantify that percentage in regard to the primary purpose and primary content of property. Again, the CRA has not yet released any guidance on those two points.

A “financial instrument” is a defined term for GST/HST purposes⁷. It includes (among others not listed here):

- A debt security (i.e., any right to be paid money and includes a deposit of money, but does not include a lease, licence or similar arrangement for the use of, or the right to use, property other than a financial instrument).
- An equity security (i.e., a share of the capital stock of a corporation or any interest in or right to such a share).
- An interest in a partnership or a trust.

A limited partnership that invests primarily in other partnerships (of any kind, general or limited) or in other type of portfolio-type of assets and/or lends money to other entities in a group, would meet the first part of the definition of an ILP.

There are additional conditions to qualify as an ILP. It is further required that the limited partnership meets the conditions of either paragraph (a) or b) as follows:

- (a) The limited partnership is, or 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 other similar collective investment vehicle, or

⁵ ETA 123(1) for both terms.

⁶ ETA 123(1)

⁷ ETA 123(1)

- (b) The total value of all interests in the limited partnership held by listed financial institutions is 50 per cent or more of the total value of all interests in the limited partnership.

Most of the key terms are not defined for GST/HST purposes. For instance, the meaning of “represented” or “promoted” in paragraph (a) is not clear. Likewise, it is not clear what “arrangement” or “structure” really mean.

In paragraph (b), we must consider the meaning of “listed financial institution”, a defined term for GST/HST purposes. In addition to a typical financial institution or insurance company, it also includes a person whose principal business is the lending of money or the purchasing of debt securities or a combination thereof⁸. As such, any partner that owns 50 per cent or more of the interest in a limited partnership and is in the business of lending money to other members of a group may have to be investigated to determine whether it falls within the definition of a listed financial institution.

The CRA has not provided any guidance on the new rules would apply yet. However, if the CRA was to use the above-stated example, their view on how the new rules work would likely result in the general partner, A Co. now providing a GST/HST taxable supply of a management service in regard to the portfolio of marketable securities.

Note that in the original example contained in the Policy Statement P-244, the general partner was managing a retirement residence instead of a portfolio of marketable securities. Under the new rules, the general partner would still not be required to charge GST/HST on the fees it receives to manage the residence given that the residence is not a “financial instrument” as that term is defined for GST/HST purposes. Clearly, a limited partnership that invests primarily in real estate would not be an ILP even if the rental income it earns from the real estate is GST/HST exempt residential rental income.

Conclusion

In conclusion, it is not clear how the proposed new rules will be applied. It will be important to review any existing limited partnership agreement to determine the potential implications of the proposed rules to the partnerships themselves, as well as the general partners.

In most cases, an ILP would not be able to recover the GST/HST payable to the general partner and the tax would result in a new unrecoverable cost of doing business for many limited partnerships.

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⁸ ETA 149(1)