PROPOSED GST/HST CHANGES FOR INVESTMENT LIMITED PARTNERSHIPS AND OTHER INVESTMENT FUNDS

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The Department of Finance (Canada) ("**Finance**") recently released a consultation paper outlining a series of proposed reforms to the provisions of the *Excise Tax Act* (Canada) (the "**ETA**") that govern the GST/HST liability of financial institutions ("**FIs**") including many investment funds. In particular, Finance proposes to (i) extend the application of the selected listed financial institution regime (the "**SLFI Rules**") to investment funds structured as limited partnerships, (ii) extend the "imported supply" rules to certain non-resident limited partnerships, and (iii) introduce a new rebate for recovering GST payable by certain investment funds (including certain investment funds structured as limited partnerships) to the extent attributable to non-resident investors.

Extension of SLFI Rules to Limited Partnerships

Since investment funds are generally not entitled to claim input tax credits to recover GST/HST that they pay on inputs (e.g., management fees, professional services, etc.), they would have an incentive to maintain establishments in (or move to) non-HST provinces in order to only incur GST (rather than HST) on such inputs. The SLFI Rules were intended to level the playing field between investment funds situated in GST and HST provinces, by determining the GST/HST liability of such funds based on where their investors are situated (rather than where the fund is located), removing or reducing the incentive for investment funds to maintain establishments in GST provinces.

Although the SLFI Rules are quite complex, in very simplified terms, they apply to "investment plans" (currently defined to include investment entities such as units trusts, mutual fund trusts, mutual fund corporations and registered pension plans but, crucially, not partnerships) ("**SLFI Funds**") that have investors situated in an HST province[1] and in at least one other province (either an HST or non-HST province).

Under the SLFI Rules, the ultimate GST/HST liability for a SLFI Fund is determined based on the residence of its investors, not on the GST/HST actually paid (or payable) on inputs. In effect, the SLFI Rules adjust the GST/HST actually paid by a SLFI Fund to reflect the province of residence of its investors. For example, while a SLFI Fund situated in Ontario may pay 13% HST on its inputs, to the extent that it has investors resident outside of HST provinces, it would be entitled to a refund of the portion of the 8% Ontario component of such HST that is attributable to those investors. Similarly, while a SLFI Fund situated in Alberta may pay 5% GST on its inputs, under the SLFI rules it would ultimately be liable for the 8% Ontario component of the HST on the portion of the consideration for those inputs attributable to investors resident in Ontario.

An early criticism of the SLFI regime was that the definition of an "investment plan" did not include investment funds structured as limited partnerships. Since many hedge and private equity funds are structured as limited partnerships, this omission meant that such funds situated in HST provinces (such as Ontario) were at a competitive disadvantage vis-à-vis both similar funds in GST provinces and other investment vehicles situated in HST provinces that were subject to the SLFI Rules.

The Consultation Paper proposes to address the unequal treatment of investment entities structured as limited partnerships by extending and modifying the SLFI Rules to apply to certain limited partnerships. In particular, it proposes to amend the definition of an "investment plan" to include "investment limited partnerships" ("ILPs"). An ILP would generally 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.

For ILPs situated in HST provinces, this change may provide significant tax relief, as it could potentially reduce their effective liability for HST to the extent that they have investors resident outside of HST provinces. Conversely, for ILPs situated outside of HST provinces, this change may result in additional HST liabilities to the extent that they have investors situated in HST provinces. It should be noted that, in either case, such ILPs would be subject to the additional compliance obligations imposed under the SLFI Rules (including GST/HST return filing obligations and, where applicable, installment payments).

Change to Imported Supply Rules for FIs

Certain rules in the ETA require certain FIs (including SLFI Funds) to self-assess GST (and, in certain cases, HST) on certain transactions that occur (or are deemed to occur) outside of Canada (the "**Imported Supply Rules**"). The purpose of these rules is to ensure that FIs cannot avoid unrecoverable GST (and HST) by acquiring goods and services outside of Canada or from foreign suppliers.

As with the SLFI Rules, the Imported Supply Rules are quite complex, but generally apply to FIs, including "investments plans", that (i) are resident in Canada, (ii) have a permanent establishment in Canada, or (iii) carry on, engage in, or conduct, an activity in Canada, where the majority of the persons having beneficial ownership of the FI's property are resident in Canada. However, they can also apply to a non-resident investment plan that has no presence in Canada where the plan is a trust and the total value of the trust's assets in which one or more Canadian resident persons have a beneficial interest is equal to or exceeds C$10 million and 10% of the total value of the trust's assets.

The application of the Imported Supply Rules to certain non-resident investment trusts is intended to level the playing field between Canadian and foreign investment trusts. It is unclear how effective this regime is in practice. It is likely that many non-resident trusts are unaware of their GST/HST self-assessment obligations under the Imported Supply Rules (or the potential penalties for failing to comply with those obligations) and, given that such entities are outside of Canadian jurisdiction, it is unclear how the Canada Revenue Agency enforces such obligations.

Nevertheless, the Consultation Paper proposes to extend the Imported Supply Rules to non-resident ILPs to mirror the existing rules for non-resident trusts. In particular, under the proposal, a non-resident ILP would be subject to the imported supply GST/HST self-assessment rules where the total value of the ILP's assets in which one or more Canadian residents has an interest is equal to or exceeds C$10 million and 10% of the total value of the ILP's assets.

GST Rebates for Investment Plans with non-resident investors

Lastly, the Consultation Paper proposes a new GST rebate for investment plans, including ILPs, having non-resident investors.[2] In very general terms, the Consultation Paper proposes that such investment plans would be entitled to claim a rebate for the "non-resident investor percentage" of the otherwise unrecoverable GST paid or payable by the investment plan in a reporting period. For these purposes, the "non-resident investor percentage" would be based on the value of interests in the investment plan held by non-resident investors, at a particular point in time, relative to the total value of interests in such investment plan at that time.

In addition, the Consultation Paper also proposes a *de mininus* rule for investment plans whose "non-resident investor percentage" for a particular fiscal year is 95% or more. Such investment plans would be deemed to be non-residents for the purposes of Part IX of the ETA for such fiscal year and, as a consequence, would generally be able to benefit from the provisions in the ETA that allow suppliers to "zero-rate" (i.e., charge no GST/HST on) their taxable supplies. These investment plans could receive point-of-purchase GST/HST relief, alleviating the need to claim GST rebates.

These two changes may provide significant GST relief for investment plans with non-resident investors.

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Finance has asked industry stakeholders and other interested parties to provide input into the proposals contained in the Consultation Paper. Comments on any of the proposals described in the Consultation Paper should be submitted by November 30, 2016.

For more information about the Consultation Paper and the proposals contained therein, please contact the authors.

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1. For the purposes of the SLFI Rules, Quebec is treated as an HST province with the QST treated as the Quebec portion of the HST.
2. Under the SLFI Rules, the provincial portion of the HST is generally not payable in respect of non-resident investors.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.