

# Canadian Tax Adviser

## Finance Proposes to Change GST/HST Treatment of Certain Limited Partnerships and Investment Plans

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The Department of Finance recently proposed changes to the application of GST/HST that will affect private equity, venture capital and other investment funds.

Overall, these changes should have a positive impact on the private equity and venture capital community, particularly since the industry is observing an increasing investment by non-residents of Canada. We expect that the proposals will generally reduce GST/HST costs in the industry.

Finance released these proposals in a consultation paper on July 22, 2016 and is accepting comments until November 30, 2016. Private equity, venture capital and other investment funds may want to follow developments in this area closely.

Specifically, Finance proposes to:

- Extend the application of the selected listed financial institution regime (the SLFI Rules) to investment funds (including private equity and venture capital funds) structured as limited partnerships
- Introduce a new rebate for recovering GST payable by certain investment funds to the extent attributable to non-resident investors, and
- Extend the "imported supply" rules to certain non-resident limited partnerships.

### **Extension of SLFI Rules to private equity and venture capital funds**

In general, investment funds have little or no "commercial activities" and as such are not entitled to claim input tax credits to recover GST/HST that they pay on inputs (e.g., management fees, professional services). Further, the rate of GST/HST to be applied was historically determined by the geographical location of the investment fund, such that funds

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based in non-HST provinces paid lower rates of GST/HST on their inputs.

The SLFI Rules were designed by the Department of Finance 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 investors are located rather than where the fund is located.

In general, the SLFI Rules apply to "investment plans", which includes unit trusts, mutual fund trusts, mutual fund corporations and registered pension plans that have investors situated in an HST province and in at least one other province. However, the current SLFI Rules do not generally apply to limited partnerships that are engaged in an investment activity.

The consultation paper proposes to amend the definition of "investment plan" to include "investment limited partnerships". Under the proposed changes, an investment limited partnership 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.

#### **KPMG observations**

For private equity and venture capital funds situated in HST provinces (including Ontario), the proposed changes could provide significant tax relief as they would reduce the funds' effective HST costs to the extent that they have investors resident outside of HST provinces.

However, for private equity and venture capital funds situated outside of HST provinces (including Alberta and British Columbia), the proposed changes may result in additional HST costs to the extent that they have investors situated in HST provinces. Since the Quebec Sales Tax (QST) SLFI rules are essentially the same as the GST/HST SLFI rules and may also be amended to reflect the proposed changes, investment limited partnerships situated outside of Quebec with investors in Quebec may incur additional QST costs.

Private equity and venture capital funds would also be subject to the additional compliance obligations imposed under the SLFI Rules.

#### **GST rebates for funds with non-resident investors**

The consultation paper proposes a new GST rebate for certain investment plans. Under the proposed changes, an investment plan, including an investment limited partnership, with non-resident investors may be eligible to claim a rebate

equal to the "non-resident investor percentage" of the otherwise unrecoverable GST paid or payable by the fund.

The "non-resident investor percentage" would be based on the value of units 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.

The consultation paper also proposes a deeming provision 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 GST/HST purposes and, as a consequence, may be able to benefit from the provisions in the Excise Tax Act that allow suppliers to "zero-rate" their taxable supplies (effectively changing the applicable rate of HST to 0%).

### **KPMG observations**

The proposed new GST rebate for qualifying investment plans could make Canadian-based private equity and venture capital funds more attractive for non-residents of Canada as the GST/HST costs would be reduced. Given the benefits of attracting non-resident capital, this is a positive change for the industry.

### **Change to Imported Supply Rules**

The GST/HST rules require certain financial institutions (including investment limited partnerships) 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 Imported Supply Rules generally apply to financial institutions, including "investments plans", that:

- are resident in Canada
- have a permanent establishment in Canada, or
- carry on, engage in, or conduct, an activity in Canada, where the majority of the persons having beneficial ownership of the financial institution's property are resident in Canada.

The Imported Supply Rules can also apply to certain non-resident investment plans that have no presence in Canada where the plan is a trust in which one or more Canadian resident persons have a beneficial interest.

The consultation paper proposes to extend the Imported Supply Rules to non-resident investment limited partnerships. In particular, under the proposal, a non-resident investment limited partnership could be subject to the imported supply

GST/HST self-assessment rules where one or more Canadian residents has an interest having a value that exceeds \$10 million and is equal to or exceeds 10% of the total value of the interests in the limited partnership.

### **KPMG observations**

These proposed changes to the imported supply rules were unexpected and could have an adverse impact on Canadian residents that invest in foreign (non-Canadian) investment funds.

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