Deloitte.

Canadian indirect tax news

Significant GST/HST proposals affecting investment holding entities – things you need to know

October 15, 2018

What a year it has been! It started on September 8, 2017 with proposed new rules affecting newly defined "investment limited partnerships" (ILPs) and culminated with proposals tabled on July 27, 2018 affecting the holding company rules in the Excise Tax Act (ETA) (better known as the "section 186 rules"). This special newsletter provides a summary of these proposals and their impacts on the affected structures, including key dates for consideration.[1]

Contacts:

Doug Myrden
National Indirect Tax Leader
Tel: 416-601-6197

Quebec
Michel Lagrange
Tel: 514-393-7124

Eastern Region
Michael Matthews
Tel: 613-751-5310

Toronto
Danny Cisterna
Tel: 416-601-6362

[1] At the time of publishing this newsletter, these proposals have not yet been enacted.

Investment limited partnerships

On September 8, 2017, the Department of Finance (Finance) released legislative and regulatory proposals relating to the application of the goods and services tax/harmonized sales tax (GST/HST) to ILPs (ILP proposals). The federal budget and accompanying Notice of Ways and Means Motion to amend the ETA tabled on February 27, 2018 confirmed the intention of the government to proceed with these proposals.[2]

The ILP proposals have two significant impacts on ILPs:

1. Ensuring that the GST/HST will apply to general partner (GP) distributions and remuneration for management and administration of the ILP activities, even though the GP performs these functions in its role as a partner; and
2. Expanding the application of the GST/HST rules applicable to "listed financial institutions" (LFIs) and "selected listed financial institutions" (SLFIs) to include ILPs.

These proposals aim to put ILPs 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 and are SLFIs where their investors/policyholders are resident in more than one province with one of them being an HST participating province.

In summary, the proposals affect ILPs as follows:

a. GST/HST will apply on the fair market value of the management and administrative functions of GPs of ILPs;

b. ILPs will be "financial institutions" for GST/HST purposes; and

c. ILPs could be considered SLFIs such that they could be required to follow the special attribution method (SAM) for determining their obligations for the provincial component of HST.

What is an ILP?

An ILP is defined under the proposals as follows:

Investment limited partnership means a limited partnership, the primary purpose of which is to invest funds in property consisting primarily of financial instruments, if

(a) the limited partnership is, or forms part of an arrangement or structure that is, represented or promoted as a hedge fund, investment limited partnership, mutual fund, private equity fund, venture capital fund or other similar collective investment vehicle, or

Western Region
Andrew Azmudeh
Tel: 587-293-3258

Janice Roper
Tel: 604-640-3353

Related links:
Canadian indirect tax news archive

Deloitte Tax Services

[2] See also Canada Revenue Agency, Notice 308, GST/HST and Investment Limited Partnerships, July 2018 (Notice 308). Based on the Comprehensive Integrated Tax Coordination Agreement between Quebec and the federal government, Quebec has harmonized its rules with the finalized provisions. See Information Bulletin 2018-3, May 28, 2018, "Harmonization with a sales tax measure announced in the federal budget of February 27, 2018".

(b) the total value of all interests in the limited partnership held by listed financial institutions is 50% or more of the total value of all interests in the limited partnership."[3]

The definition of an ILP comes into force on September 8, 2017.

Some considerations with respect to this definition include the reference in the preamble that requires one to consider what the primary[4] purpose of the limited partnership is. Whether the primary purpose of an ILP is to invest funds in financial instruments will generally depend on the ILP's intentions, principal business and principal activity. Helpful evidence will come from the conduct of the partnership's activities, the purpose as defined in a written partnership agreement or other legal and public documents such as a prospectus.

Further, referring to paragraph (a) of the definition, with respect to "represented or promoted", the actual conduct of the sponsors, GP or other parties should be determinative, as should the contents of any legal or public documents (e.g., partnership agreement, prospectus). For "other similar collective investment vehicle", presumably the legal principal of *ejusdem generis*, would restrict the definition of ILP to entities that are similar to a mutual fund, hedge fund, venture capital fund and private equity fund.

Finally, a limited partnership whose primary purpose is to invest in property other than primarily financial instruments will not be an ILP. For example, a limited partnership investing primarily and directly in real property is not an ILP. However, consideration must be given to tiered partnership structures whereby a "parent" limited partnership investing in another limited partnership may, in fact, be an ILP.[5]

Management and administrative duties of the GP

GST/HST application prior to the proposals

With the right facts and circumstances, GST/HST would not apply on the management and administrative duties performed by the GP of an ILP as a result of ETA subsection 272.1(1), which deems anything done by a member of a partnership to be done by the partnership itself in the course of the partnership's activities. More specifically, the management and administrative duties performed by the GP of an ILP were considered not to constitute a supply and thus were not subject to GST/HST. This proved beneficial to most ILPs, as GST/HST was likely not recoverable by them.

Ignoring other considerations, through the application of subsection 272.1(1), ILPs were in a unique situation compared to other "investment plans", such as

[3] Some additional definitions are relevant to the understanding of these proposals: "Financial instrument" is defined in ETA subsection 123(1) and includes, among other things, an "equity security", "debt security" (both defined in the ETA) and an interest in a partnership. "Listed financial institution" is defined in ETA subsection 123(1) together with subsection 149(1) and includes, among other things, a "bank", "insurer", "segregated fund" and "investment plan" (all defined in the ETA). "Investment plan" is defined in ETA subsection 149(5) and includes, among other things, registered pension plans, mutual fund trusts, unit trusts, investment corporations, mortgage investment corporations and mutual fund corporations as they are defined under the Income Tax Act (Canada) (ITA). It also includes corporations exempt from tax under the ITA by reason of paragraph 149(1)(o.1) or (o.2) (i.e., exempt pension entities).
[4] Generally, the term primary has been interpreted as meaning more than 50%.
[5] See Notice 308.

mutual funds, segregated funds and pension plans, which paid GST/HST on management and administrative services.

<u>GST/HST application pursuant to the proposals</u>

New proposed ETA subsection 272.1(8) will override subsection 272.1(1). New paragraph 272.1(8)(a) provides that where a GP of an ILP renders a management or administrative service to the ILP, the rendering of the service is deemed not to be done by the GP as a member of the ILP. New paragraph 272.1(8)(b) further provides that the supply by the GP to the ILP that includes the service is deemed to have been made otherwise than in the course of the ILP's activities.

In essence, new subsection 272.1(8) ensures that subsection 272.1(1) no longer applies to the supply by a GP to the ILP of a management or administrative service.

Subsection 272.1(8) comes into force on September 8, 2017 but also applies in respect of management or administrative services that are rendered under an agreement entered into before that day if GST/HST was, before that day, charged, collected or remitted in respect of those services or in respect of any supply made under the agreement.

<u>Timing for payment of GST/HST</u>

Under proposed amended paragraph 272.1(3)(b), the moment at which consideration for the management and administration services of the GP will become due will depend on the terms of the partnership agreement or the GST/HST reporting period of the GP. As a result of this rule, together with ETA subsection 168(1), GST/HST will be payable no later than the last day of the "billing period" (as referred to in 272.1(3)) in cases where an agreement provides for billing periods for the services.

> *<u>Example</u>:* A limited partnership agreement provides that an annual amount equal to 2% of invested capital will be payable to the GP by the ILP on the first day of each fiscal quarter (e.g., January 1, April 1, July 1, October 1). The GP is registered for GST/HST purposes and files its return on a monthly basis. Based on new subparagraph 272.1(3)(b)(i), together with subsection 168(1), if the amount due to the GP for the quarter January 1 to March 31 is not paid by the ILP before March 31, the GST/HST will be deemed to be payable on March 31. In that case, the GP will be required to remit that GST/HST in its March return which is required to be filed along with net taxes due by April 30. However, if the GP is in fact paid the amount due to it on January 1, pursuant to subsection 168(1) of the ETA, the GST/HST is payable on January 1 and must be remitted with the GP's January return that is due by the end of the following month.

In any other case, the GST/HST will be payable no later than on the last day of the reporting period of the GP.

> *<u>Example</u>:* A limited partnership agreement provides that the GP is entitled to receive annual compensation for its management and administration duties equal to 2% of invested capital. The agreement, however, does not stipulate when the compensation is required to be paid to the GP. The GP is registered for GST/HST purposes and files its return on a monthly basis. Based on new subparagraph 272.1(3)(b)(ii), the GP will be deemed to be making a separate supply of the services for each reporting period of the GP and the consideration is deemed to become due on the last day of each

reporting period. Therefore, in accordance with subsection 168(1), the GST/HST is deemed to be payable no later than the last day of the GP's reporting period, unless the consideration is paid earlier. Assuming the 2% is representative of the fair market value (see discussion below) of the management and administration duties of the GP, the GP will be required to account for GST/HST on 1/12th of the annual 2% compensation in each reporting period of the GP.

New paragraph 272.1(3)(b) applies in respect of management or administrative services that are supplied after September 7, 2017, subject to special transitional rules. The following table summarizes the timing rules:

Scenario	**When GST/HST becomes payable**
1. Services rendered prior to September 8, 2017 and GST/HST charged, collected and remitted before September 8, 2017	Earlier of the day the GST/HST was charged, collected or remitted
2. Services rendered prior to September 8, 2017 and no GST/HST charged, collected or remitted	No GST/HST payable, assuming subsection 272.1(1) applies to the services supplied by the GP[6]
3. Services rendered prior to September 8, 2017 and GST/HST charged, collected or remitted after September 8, 2017	No GST/HST payable, assuming subsection 272.1(1) applies to the services supplied by the GP. The GP should be able to obtain a refund for the GST/HST charged, collected or remitted or the ILP can claim a rebate from the CRA for the GST/HST paid to the GP.[7]
4. Services rendered on or after September 8, 2017 pursuant to an agreement entered into prior to September 8, 2017 and GST/HST charged, collected or remitted before budget day (i.e., February 27, 2018)	Earlier of the day GST/HST was charged, collected or remitted, and if the GST/HST charged, collected or remitted was less than what is required to be payable pursuant to the proposals (e.g., GST/HST that was charged, collected or remitted was based on an amount that is less than the fair market value of the management and administrative services of the general partner), the shortfall is deemed payable on budget day
5. Services rendered on or after September 8, 2017 pursuant to an agreement entered into prior to September 8, 2017 and no GST/HST charged, collected or remitted before budget day	GST/HST is deemed to have become payable on budget day
6. Services rendered on or after September 8, 2017 pursuant to an agreement entered into on or after September 8, 2017	GST/HST deemed to become payable as provided under new paragraph 272.1(3)(b), as described above

<u>Value on which GST/HST is payable</u>

Under proposed amended paragraph 272.1(3)(b), the management or administrative services are deemed to be made for consideration equal to the fair market value of the services.

How should the fair market value of the services be determined? Proposed subparagraph 272.1(3)(b)(i) states that the fair market value of the services

[6] See Notice 308. The CRA may have a different view as to whether GST/HST applied prior to September 8, 2017.
[7] Ibid.

provided by the GP must be determined as if the GP was not a member of the ILP and was dealing at arm's length with the ILP. The ETA does define fair market value; essentially, it must be determined using the ordinary meaning of the term.

The courts generally have interpreted fair market value as:

> *the highest price an asset might reasonably be expected to bring if sold by the owner in the normal method applicable to the asset in question in the ordinary course of business in a market not exposed to any undue stresses and composed of willing buyers and sellers dealing at arm's length and under no compulsion to buy or sell.*[8]

With respect to the management and administrative duties of a GP in an ILP, it is important to understand that likely in most cases the compensation to be paid to the GP for such duties was agreed to by parties who are unrelated and acting at arm's length with the GP. This is to say that whatever is agreed to under the terms of the partnership agreement as to what the GP should be paid for the management and administrative duties, should be considered the fair market value of those duties.

Ultimately, the facts and circumstances in each case will need to be analyzed and assessed for purposes of determining what the fair market value is of the GP's management and administrative duties.

<u>Relief for certain ILPs</u>

Under the proposals, new subsection 132(6) will deem certain ILPs to be non-resident persons of Canada, as follows:

> *For purposes of this Part, but subject to subsection (2), an investment limited partnership is deemed to not be resident in Canada at any time if, at that time, the total value of all interests in the partnership held by non-resident members of the partnership (other than prescribed members) is 95% or more of the total value of all interests in the partnership.*

Prescribed member for purposes of subsection 132(6) is defined in new proposed section 4.1 of the Financial Services and Financial Institutions (GST/HST) Regulations and means:

> *(a) a member that is a non-resident trust if the total value of the assets of the member in which one or more persons resident in Canada have a beneficial interest is more than 5% of the total value of the assets of the member; and*
>
> *(b) a member that is a non-resident limited partnership if the total value of all interests in the member held by persons resident in Canada is more than 5% of the total value of all interests in the member.*

---

[8] See *Henderson Estate v. M.N.R.*, [1973] F.C.J. No. 800 (QL), at paragraph 20. See also CRA, Policy Statement P-165R, wherein the CRA states that "fair market value represents the highest price, expressed in terms of money or money's worth, obtainable in an open and unrestricted market between knowledgeable, informed and prudent parties acting at arm's length, neither party being under any compulsion to transact."

This proposed amendment comes into force on September 8, 2017.

This rule affects ILPs that would otherwise be considered to be resident in Canada (e.g., where the GP is resident in Canada). Management and administrative services rendered by the GP of an ILP that is deemed under subsection 132(6) to be a non-resident of Canada may then be zero-rated supplies, as will be the case for other services supplied to the ILP by third parties. The determination of whether the deeming provision under subsection 132(6) applies to the ILP is one that must be made "at that time", which means that the determination must be made each time GST/HST becomes payable by the ILP.

ILPs as LFIs and SLFIs

Under the proposals, an ILP will be included in the definition of "investment plan" in the ETA, which results in the ILP being an LFI effective for taxation years that begin after 2018. As a result, an ILP can also be an SLFI and thus may be required to account for HST using the SAM rules.

More specifically, an ILP that is an SLFI will be treated as a "distributed investment plan" for purposes of the SAM rules. Of note, for purposes of determining its liability for the provincial component of the HST, the "permanent establishment" test for an ILP will not be based on a "brick and mortar" test (i.e., where the GP has a physical permanent establishment), but rather will deem an ILP to have a permanent establishment in a province where:

1. it is a qualified, under the laws of Canada or a province, to sell or distribute units, or
2. a person resident in the province holds one or more units of the ILP.

This is the same rule that applies currently to most mutual funds, segregated funds and certain other investment plans that are designated as distributed investment plans.

If an ILP is an SLFI, it essentially determines its HST liability based on the residency of its partners and their relative holdings in the ILP's property. Compared to the existing rules, this may result in an ILP incurring more or less HST.

As noted above, the inclusion of an ILP as an LFI is applicable in respect of any taxation year of an ILP that begins after 2018. However, an ILP may elect to be an LFI so that the rules apply to a taxation year beginning in 2018 (notably, in order to take advantage of an SLFI qualification). This election must be made in prescribed form, containing prescribed information and be filed with the Minister of National Revenue in prescribed manner on or before the day that is 60 days after the day the legislation enacting this provision receives royal assent or any later day the Minister may allow.[9]

An ILP would consider making this election if its effective rate of combined GST/HST will be less than paying GST/HST on taxable input

[9] No prescribed form is currently available. Instead, an ILP may elect by writing into the CRA providing certain information as described in CRA Notice 308.

costs based on the default place of supply rules. For example, consider an ILP that is considered resident in Ontario (i.e., because the GP is resident in Ontario) and is subject to 13% HST on its taxable input costs. If that ILP is owned 50% by Alberta partners and the other 50% by Ontario partners, it could lower its HST cost by 4% to 9% (i.e., 50% x 13% + 50% x 5%) by making this election.

Issues for consideration by ILPs and their GPs

The proposals affecting ILPs no doubt bring new obligations and considerations for ILPs, their GPs and, of course, the limited partners. Some of these obligations and considerations are listed below:

- Potentially significant additional compliance requirements (e.g., SLFI filings) and associated additional administration (e.g., determining the provincial allocation percentage for purposes of the SAM, look through requirements of the limited partners to accurately determine the provincial attribution percentage, etc.) may arise. Assuming an ILP does not adopt early (i.e., elect) to be an LFI for 2018, for 2019, an SLFI ILP will be required to determine its provincial allocation percentage as of September 30, 2018. For any investor LP that it will be required to look through, the SLFI ILP will be required to request in writing from that investor LP its provincial allocation percentage as of September 30, 2018. This information must be obtained by October 15, 2018 pursuant to the SLFI regulations. The provincial attribution percentages as of September 30, 2018 will be used in 2019 to determine the ILP's liability for the provincial component of the HST. A similar process will be required to be followed for subsequent years.
- ILPs should consider whether to adopt early (i.e., elect) to be an LFI (and thus an SLFI) for 2018 to take advantage of a lower effective GST/HST cost on taxable input costs, including those with respect to the management and administrative duties of the GP.
- If not already registered, a GP will need to register and may have had an obligation to account for GST/HST that became payable on February 27, 2018 and subsequent periods. As the proposals are not officially enacted as of yet, only interest can be assessed for late filings/remittances of GST/HST that should have been remitted on the management and administrative duties of the GP (i.e., penalties should not be assessed).
- There may be opportunities to restructure or set up new structures to take advantage of the relieving rule for deemed non-resident ILPs.
- As an LFI, ILPs may be entitled to recover some GST/HST if they supply "financial services" to non-resident persons (e.g., to investees and/or partners).

Holding companies

On July 27, 2018, Finance tabled proposals (the proposed amendments) and a *c*onsultation paper on the GST/HST holding corporation rules.

Both the proposed amendments and the consultation paper impact the rules contained in ETA section 186 which is a relieving rule for holding companies. Where certain conditions are met, section 186 permits a corporation (referred to as "parent") to claim input tax credits (ITCs) in respect of GST/HST paid on property or services that are acquired or imported for consumption or use by the parent in relation to the shares or indebtedness of related[10] corporations.

Proposed amendments

The substantive portion of the proposed amendments (i.e., where the rubber meets the road) deals with providing "greater precision as to the application of the deeming rule contained in the subsection". As a result, new subsection 186(1) will no longer apply the "reasonable" and "in relation to" tests applicable under the existing legislation.

Subsection 186(1) is being amended to apply to the acquisition, importation or bringing into a participating province of a particular property or service by a parent at a particular time if all of the following conditions are met at the particular time:

- the parent is a registrant and is a corporation resident in Canada;
- a particular corporation (i.e., the subsidiary) is an "operating corporation" of the parent[11]; and
- amended subsection 186(2) does not apply to the acquisition, importation or bringing in of the particular property or service.

Where these conditions are met, subsection 186(1) as amended will provide that the parent is deemed, for the purpose of determining an ITC, to have acquired or imported the particular property or service or brought it into the participating province, as the case may be, for use in the course of commercial activities[12] of the parent, but only to the extent that paragraph 186(1)(a), (b) or (c) describes the acquisition, importation or bringing in.

[10] As defined in subsections 251(2) to (6) of the Income Tax Act (Canada).

[11] As newly defined in proposed subsection 186(0.1), which reads: "For the purposes of this section, a particular corporation is at a particular time an operating corporation of another corporation if at the particular time the particular corporation is related to the other corporation and all or substantially all of the property of the particular corporation is property that was last manufactured, produced, acquired or imported by the particular corporation for consumption, use or supply by the particular corporation exclusively in the course of its commercial activities".

[12] "Commercial activity" of a person is defined in subsection 123(1) of the ETA to mean:
"(a) a business carried on by the person (other than a business carried on without a reasonable expectation of profit by an individual, a personal trust or a partnership, all of the members of which are individuals), except to the extent to which the business involves the making of exempt supplies by the person,
(b) an adventure or concern of the person in the nature of trade (other than an adventure or concern engaged in without a reasonable expectation of profit by an individual, a personal trust or a partnership, all of the members of which are individuals), except to the extent to which the adventure or concern involves the making of exempt supplies by the person, and
(c) the making of a supply (other than an exempt supply) by the person of real property of the person, including anything done by the person in the course of or in connection with the making of the supply".

Paragraph 186(1)(a)

New paragraph 186(1)(a) applies in circumstances where the parent acquires or imports the particular property or service or brings it into the participating province for the purpose of:

1. Selling or otherwise disposing of, purchasing or otherwise obtaining, or holding shares of the capital stock, or indebtedness, of the particular corporation by the parent, or
2. Redeeming, issuing or converting or otherwise modifying shares of the capital stock, or indebtedness, of the particular corporation by the particular corporation.

Paragraph 186(1)(b)

New paragraph 186(1)(b) applies in circumstances where the parent acquires or imports the particular property or service, or brings it into the participating province, and the following conditions are met:

1. The acquisition or importation or bringing into the participating province by the parent is for the purpose of issuing or selling shares of the capital stock, or indebtedness, of the parent;
2. The parent transfers to the particular corporation the proceeds from the issuance or sale by lending money to the particular corporation or by purchasing or otherwise obtaining from the particular corporation shares of the capital stock, or indebtedness, of the particular corporation; and
3. The proceeds are for use by the particular corporation exclusively in the course of its commercial activities.

Example from explanatory notes to the proposed amendments:

For example, consider a case where a parent acquires legal services for the purpose of issuing bonds, which generates $1,000,000 in proceeds for the parent. The parent then transfers $800,000 of those proceeds to an operating corporation of the parent through the purchase of common shares of the operating corporation. From that transfer, $750,000 of the $800,000 are for use by the operating corporation to purchase equipment used exclusively in the course of its commercial activities and the remaining $50,000 invested in money market securities.

In that case, for the purposes of the parent claiming an input tax credit in respect of the legal services, paragraph 186(1)(b) would apply to deem the extent of the use of the legal services in commercial activities of the parent to be 75 per cent. This would be dependent on all the conditions of subsection 186(1) being met.

Paragraph 186(1)(c)

New paragraph 186(1)(c) applies a property test on the parent for property or services acquired, imported or brought into the participating province. This property test is met if all or substantially all (i.e., 90% or more) of the property of the parent is shares of the capital stock of operating corporations of the parent, indebtedness of operating corporations of the parent, or a combination of such shares or indebtedness.

Where the property test is satisfied by the parent, the parent will be entitled claim an ITC as long as the property or service acquired or imported or brought into a participating province by the parent is for the purpose of carrying on, engaging in or conducting an activity of the parent other than an activity specified by new subparagraphs 186(1)(c)(i) and (ii), as follows:

- Subparagraph 186(1)(c)(i) provides that where a parent corporation uses the property or service acquired for an activity that is primarily in respect of shares of the capital stock, or indebtedness, of a person that is neither the parent nor an operating corporation of the parent, the parent corporation cannot claim an ITC.
- Subparagraph 186(1)(c)(ii) describes an activity that is carried on, engaged in or conducted in the course of making an exempt supply by the parent unless the activity is a financial service that is listed in clause 186(1)(c)(ii)(A) to (E), as follows:

  (A) the lending or borrowing of shares of the capital stock, or indebtedness, of an operating corporation of the parent,

  (B) the issue, granting, allotment, acceptance, endorsement, renewal, processing, variation, transfer of ownership or repayment of shares of the capital stock, or indebtedness, of the parent or an operating corporation of the parent,

  (C) the provision, variation, release or receipt of a guarantee, acceptance or indemnity in respect of shares of the capital stock, or indebtedness, of the parent or an operating corporation of the parent,

  (D) the payment or receipt of money as dividends (other than patronage dividends), interest, principal, benefits or similar receipt or payment of money in respect of shares of the capital stock, or indebtedness, of the parent or an operating corporation of the parent, or

  (E) the underwriting of shares of the capital stock, or indebtedness, of an operating corporation of the parent.

<u>*Example from explanatory notes to the proposed amendments:*</u>

For example, consider a parent that satisfies the property test and acquires a computer to be used 80 per cent to make exempt supplies of residential units and 20 per cent to pay dividends to its shareholders. In that case, paragraph 186(1)(c) would deem the computer to be acquired 20 per cent for use in the course of commercial activities of the parent. This is because 20 per cent is the extent to which it is acquired for use in paying dividends and neither of the exclusions described in subparagraphs 186(1)(c)(i) and (ii) would apply to that use. However, paragraph 186(1)(c) would not deem the computer to be acquired for use in the course of commercial activities of the parent to the remaining 80 per cent extent that it is acquired for use in making exempt supplies of residential units, as this use is excluded by subparagraph 186(1)(c)(ii).

The proposed amendments apply to any acquisition, importation or bringing into a participating province of property or a service **after** Announcement Date (i.e., July 27, 2018).

The consultation paper

The consultation paper released by Finance on July 27, 2018 deals with two additional proposed changes to section 186.

Proposal to move from "related" to "closely related" test

The first matter on which Finance is seeking input is regarding the relationship status between the parent and the operating corporation. Under the current rules and the proposed amendments, a parent must be related to the operating corporation rather than "closely related"[13]. Finance states in the consultation paper that applying a related test rather than a closely related test can lead to inappropriate policy outcomes in certain circumstances. For example, a parent that has a 51% interest in an operating corporation would be able to claim ITCs in respect of its investment in the operating corporation, even though such ITCs would be denied to other investors in the corporation; in this case, unlike in the case of the relieving rules referred to above, the corporations are not adequately integrated so as to effectively be a single entity.

Extending the application of section 186 to partnerships and trusts

Finance is also seeking input on whether the rules under section 186 that currently only apply to corporations should be extended to partnerships and trusts.

Issues for consideration relating to the proposed amendments and the consultation paper

It appears that the proposed amendments narrow the scope of the application of section 186 compared to the existing rule. This is particularly the case for costs that are covered by proposed 186(1)(c) due to the property test imposed on the parent. It is curious why Finance chose what is essentially an "all or nothing" approach, versus a "to the extent of" approach when it comes to the property test. In this regard, holding companies that are currently utilizing the benefits of the existing rules in section 186 should assess the impact of the proposed amendments which, once enacted, will take effect, July 27, 2018. Consideration should be given as to whether the ability to claim ITCs from July 27, 2018 onwards is impacted. If it is, taxpayers may wish to consider "holding back" the ITCs until the amendments (following consultation) are enacted and the impact on ITCs that can be claimed is made clear.

With respect to the consultation paper:

- No doubt there will be feedback on the proposals, especially regarding the shift from a related to a "closely related" test. Presumably, when the law was originally written back in 1990 just prior to the implementation of the GST, the drafters made a conscious policy determination to go with a related test. Perhaps it was felt that the bright line test should be one of control (i.e., related) whereby the parent can impose its authority to make decisions for the operating corporations over which it has control. This seems to be a reasonable policy outcome when considering ideal general policy concerning value added taxes such as the GST/HST which is to not trap VAT in "B2B" interactions especially where they do not involve passive investing. If the proposals survive the consultation process, then many holding companies will no longer be able to claim ITCs related to their investments in operating corporations.

[13] As per section 128 of the ETA. This test generally requires ownership of at least 90% of the value and number of the issued and outstanding shares, having full voting rights under all circumstances, of the other corporation.

- There are many complex and not so complex structures that use partnerships and trusts to hold and even operate businesses that carry on commercial activities. The possibility of extending the holding company rule to these other structures is a welcomed consideration.

Both the proposed amendments and the proposals in the consultation paper invited interested parties to provide feedback to Finance. In respect of the proposed amendments, the deadline was September 10, 2018. For the proposals in the consultation paper, the deadline was September 28, 2018.

Deloitte LLP
Bay Adelaide Centre, East Tower
8 Adelaide Street West, Suite 200
Toronto ON M5H 0A9
Canada