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Tax Alert – Canada

Finance releases GST/HST draft legislation

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 8 September 2017, the Department of Finance released for public comment an extensive package of draft GST/HST legislative proposals and explanatory notes for several new measures, including the extension of GST/HST rules for selected listed financial institutions to include investment limited partnerships. This package also includes all of the draft GST/HST proposals first announced on 22 July 2016.

Revisions to the federal excise framework for beer concentrate are also included.

Interested parties are invited to provide comments on the proposals by 10 October 2017.

On the same date, the Department of Finance also released for comment a separate package of draft income tax legislative proposals and explanatory notes relating to a number of measures announced in the 2017 federal budget, as well as certain previously announced measures. For more information about these proposals, refer to EY Tax Alert 2017-36, Draft legislation for 2017 budget.

The following is a summary of the measures included in the 8 September 2017 GST/HST legislative proposals.

New GST/HST measures

Investment limited partnerships – Management or administrative service by the general partner (GP)

A new provision, which was not included in the proposals announced on 22 July 2016, is introduced with respect to management or administrative services rendered by a GP to an investment limited partnership (ILP), which has significant implications for ILPs.

Building a better working world

An ILP is defined as a limited partnership, the primary purpose of which is to invest funds in property consisting primarily of financial instruments, if:

- 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

- 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.

New subsection 272.1(8) of the *Excise Tax Act* (ETA) provides that where a GP of an ILP provides a management or administrative service to the ILP:

- The provision of the service is deemed not to be done by the general partner as a member of the ILP; and

- The GP's supply of the service to the ILP is deemed to have been made otherwise than in the course of the ILP's activities.

The provision's effect is that subsection 272.1(1) of the ETA, which deems anything done by a partner to have been done by the partnership in the course of the partnership's activities, should not apply to the service provided by the GP. Consequently, by virtue of existing subsection 272.1(3) of the ETA, in the situation where the ILP acquires the service otherwise than in the course of commercial activities, which will generally be the case, GST/HST will apply on the fair market value of the management or administrative service rendered by the GP to the ILP. Such GST/HST would then not be recoverable by the ILP. This represents a significant change, and the impact is likely to be substantial for ILPs. It should be noted that a different rule will apply where the ILP acquires the service in the course of a commercial activity.

This provision applies in respect of services where the consideration becomes due on or after 8 September 2017. This could have potential retroactive application if the consideration to the GP in respect of the management or administrative services is not due until after 8 September 2017.

Investment limited partnerships will qualify as selected financial institutions and selected listed financial institutions (SLFIs)

In accordance with the consultation paper released by the Department of Finance on 22 July 2016, the proposals released on 8 September 2017 contain various amendments that aim to "level the playing field" between investment entities structured as limited partnerships and entities that are currently treated as investment plans for GST/HST purposes.

Specifically, the Department of Finance proposes to amend the ETA to include ILPs in the definition of an investment plan. Also, the rules applicable to SLFIs that are distributed investment plans are adapted to apply to ILPs. Notably, the registration and reporting requirements for SLFI investment plans would also apply to ILPs. For example, ILPs that qualify as SLFIs would be required to apply the Special Attribution Method (SAM) to calculate

the QST and provincial component of the HST payable. Their reporting period will automatically become the calendar year commencing 1 January 2019.

These new proposals will generally apply on the taxation year that begins after 2018, with transitional rules applicable with respect to a taxation year that begins in 2018 and includes 1 January 2019.

Public services bodies – Rebate applications – Currently, a public service body that claims a rebate under section 259 of the ETA must claim the rebate in an application for the particular claim period and may not make more than one application for rebates for any claim period. New subsection 259(6.1) would provide administrative relief by allowing a public service body to claim a rebate in respect of a property or service for a particular claim period in an application for a subsequent claim period, if certain conditions are met.

This measure applies for subsequent claim periods ending after 8 September 2017.

Election under the special attribution method for SLFIs – Subsection 225.2(4) of the ETA allows a SLFI and a financial institution, SLFI or not, that are closely related and have made an election under section 150 of the ETA to treat supplies of services or of a property by way of lease, licence or similar agreement as exempt supplies, to make an election to use a cost-based method to determine the value of such supplies made by a financial institution to the SLFI for purposes of the SLFI's net tax calculation.

The original 22 July 2016 proposals included amendments with respect to the 225.2(4) election. Pursuant to these amendments, the SLFI would have been required to use the cost-based method to calculate the amount of the intercompany charge to be included into its SAM calculation, unless it made an election not to do so. However, these amendments have been removed from the 8 September 2017 proposals.

It is now proposed that an election by the SLFI to use the cost-based method in its SAM calculation would be required to be made solely by the SLFI and not jointly with the other financial institution. Also, the election would not be required to be filed with the Minister. Moreover, if the financial institution that makes the supply is also a SLFI, the SLFI (recipient) would be required to notify, in a manner satisfactory to the Minister, the other SLFI (supplier) that it has made the election and the effective date of such election.

The amendments would apply in respect of any election that becomes effective after the day on which the Act implementing this measure receives royal assent.

Previously released GST/HST proposals

Pension plans and master trusts – As originally indicated in the 22 July 2016 proposals, the use of master trusts has proven to be problematic with respect to the existing pension rebate system. More specifically, where an employer or a group of employers used a master trust to apply the same investment strategy for all the pension plans that the employer or group of employers made contributions to, it was not always possible to recover 33% of the GST/HST paid on pension costs. Various amendments are introduced to address discrepancies relating to master trusts, including the following:

- Rather than amend the existing definition of a pension entity to include master trusts, a new defined term for a *master pension entity* is added.

- The deemed supply rules under section 172.1 of the ETA are amended to account for supplies made by an employer to a master pension entity with respect to a pension activity. Moreover, the definition of *eligible amount* provided for in section 261.01 is amended to include the GST/HST that is deemed to be paid. Consequently, the pension entity would be entitled to claim the 33% rebate of the GST/HST deemed paid with respect to supplies made to the master trust.

- GST/HST that becomes payable or is paid without having become payable (other than the GST/HST deemed paid) by a master trust will generally be recoverable at 33% pursuant to new section 172.2 of the ETA.

- New subsection 157(2.1) would allow a participating employer of a pension plan and a master pension entity (i.e., a master trust) to make an election to treat actual taxable supplies by the employer to the master pension entity as being made for nil consideration. This election would be available to an employer and a master pension entity if 90% of the units of the master pension entity are owned by pension entities of the pension plan. As an alternative to a subsection 157(2.1) election, an employer could issue a tax adjustment note to a pension entity that holds units in a master trust.

For more background concerning these proposals, refer to EY Tax Alert 2016-38, Finance releases draft GST/HST amendments to pension plans and master trusts.

Drop shipment rules – The legislative proposals contain a number of technical improvements to the drop shipment rules. By way of background, a drop shipment occurs where a registrant sells goods to a non-resident or performs a service on goods owned by a non-resident, and then delivers them to a third party in Canada. The drop shipment rules allow an unregistered non-resident to acquire goods and a broad range of services respecting goods in Canada without paying GST/HST, provided the goods remain under the physical control of a registrant who has assumed responsibility to account for GST/HST through the issuance of a drop shipment certificate should the goods be released to a person who will use the goods in Canada in non-commercial activities.

Proposed amendments to the drop shipment rules include the following:

- The condition that the taxable supply and the transfer of physical possession be performed under a single agreement between the registrant and the non-resident person is removed.

- The concept of a certificate of registered owner or an "owner's certificate" is introduced. The owner's certificate would apply as the existing drop shipment certificate, but would provide more flexibility and certainty in particular situations.

- The retention of possession rules would be clarified and expanded. These rules generally apply where the Canadian registrant retains physical possession of the goods sold to the unregistered non-resident, with the effect of ensuring that the drop shipment rules continue to apply.

- New rules would apply in circumstances involving leases. The amended rules are meant to cover situations where an unregistered non-resident has imported goods into Canada, leased those goods to a registrant in Canada, recovered the use and possession of the goods at the end of the lease, and subsequently supplies the goods in Canada.

Part of the amendments to the drop shipment rules would apply in respect of supplies made after 22 July 2016, while others will apply the day on which the Act implementing these rules receives royal assent.

Extension of SLFI rules to group trusts for registered education savings plans (RESPs) – The Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations provide rules for determining the prescribed percentage for certain investment plans, which an investment plan generally uses in determining its net tax adjustment for a reporting period in respect of the provincial component of the HST. The regulations are amended to extend the application of these rules to investment plans that are governed by group RESPs. This does not include trusts governed by individual or family RESPs.

These amendments generally apply to a person's reporting periods commencing after 21 July 2016. However, they also apply for any reporting period of a person that begins after June 2010 but before 22 July 2016, if certain conditions are met.

Municipal transit services – Schedule V to the ETA is amended to clarify that the supply of a right to use certain public passenger transportation services, and not just the supply of the service itself, is exempt. These amendments would apply to any supply made after 22 July 2016, as well as any supply made on or before that date unless an amount was charged, collected or remitted as GST/HST in respect of that supply.

Other measures – In addition to the measures discussed above, the legislative proposals contain several technical improvements to the GST/HST rules applicable to certain pension plans and financial institutions, as well as a number of housekeeping amendments.

New *Excise Act* measure

Beer concentrate – Amendments to the *Excise Act* (Canada) are proposed to tax beer concentrate in a manner consistent with other beer products. These amendments would be retroactive to 5 June 2017.

Learn more

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