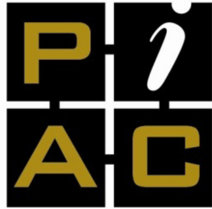

Pension Investment Association of Canada

Association canadienne des gestionnaires de caisses de retraite

October 10, 2017

Tax Policy Branch
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario
K1A 0G5

Via email: fin.gsthst2017-tpstvh2017.fin@canada.ca

Re: Legislative and Regulatory Proposals Relating to the Goods and Services Tax/Harmonized Sales Tax

Dear Sir/Madam,

The Pension Investment Association of Canada ("PIAC") is pleased to respond to Finance Canada's ("Finance" or "Department") invitation for comments on its GST/HST Draft Legislative and Regulatory Proposals released on September 8, 2017 ("Proposals"). As part of a balanced investing strategy, pension plans hold partnership interests, thus making the impact of any GST/HST on investment returns a matter of great importance. We appreciate the opportunity to be a part of this consultation process, and we look forward to further consultation on the matters we raise in this letter.

PIAC has been the national voice for Canadian private and public pension funds since 1977 in matters related to pension investment and governance. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management of over $1.8 trillion in assets on behalf of millions of Canadians. PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries. PIAC's positions on public policy reflect the fiduciary framework in which member funds operate and its commitment to work in the best interests of plan members.

PIAC believes the government of Canada should, in considering tax policy affecting pension plan investments, take into account that pension plans play an important role in

Canadian society and the economy. PIAC's membership invests contributions made by employees and employers to provide secure, stable retirement income for working Canadians.

PIAC members provide a long-term source of stable capital, which adds to the stability of the Canadian economy during periods of financial stress. PIAC is concerned the Proposals will further limit investment opportunities in Canada given that certain Canadian partnerships will incur unrecoverable GST/HST resulting in reduced investment returns for the benefit of Canadian pensioners.

Executive Summary

PIAC members invest in partnerships for a variety of commercial reasons including, but not limited to, the ability to pool capital, distribute investment risk, and allocate investment returns. As a result, the impact of GST/HST on such investment vehicles are of great importance. PIAC has reviewed the Proposals in detail and are pleased to provide comments on the following:

- Timing of Granting SLFI status
- Relieving Provisions for ILPs with Significant Non-resident Investors
- General Partner's Provision of Services
- Definition of "Investment Limited Partnerships" ("ILPs")
- Clarity around Fair Market Value Calculation
- Consideration of other Relieving rules

All references unless otherwise noted are to the Excise Tax Act ("ETA").

Timing of Granting SLFI Status

We are generally supportive of the proposed application of the SLFI rules to ILPs, however we have a concern regarding the coming into force timing. As currently proposed, ILPs would only become listed financial institutions and the SLFI rules would only begin to apply for years after 2018. Given the other proposals regarding the application of GST/HST to GP distributions, some ILPs may face an immediate incremental GST/HST cost as of September 8, 2017 ("Announcement Date") yet not begin to qualify for relief they would otherwise intrinsically be entitled to until some 16 months later in 2019. We are of the view that it is better to have the proposed rules regarding the GST/HST treatment of the GP distribution and expansion of the SLFI rules to be synchronized.

We appreciate that Finance was concerned regarding the complexity of applying the SLFI rules and wanted to give ILPs time to prepare, and we commend the Department for this sensitivity. That being said, we would recommend that the Department consider providing the option for ILPs to elect for the rules to apply one year earlier (i.e. starting in 2018 rather than 2019). This would help to strike the right balance between accommodating

taxpayers' need for time to prepare for the changes, with providing relief sooner where taxpayers choose to accelerate this.

Relieving Provisions for ILPs with Significant Non-resident Investors

Proposed subsection 132(6) deems an ILP to be non-resident where 95% of the partnership interest is owned by non-residents. We would commend the Department of Finance on this proposal, as it has the potential to reduce the Canadian tax compliance burden that otherwise falls indirectly upon non-residents. However, we are concerned that the 95% threshold may be such that the practical application of the provision remains extremely limited. In this regard, we have a few suggestions that we believe would assist in ensuring that the policy intent of the provision is realised:

1. Reduce the non-resident threshold to 90%. This would be consistent with other percentage thresholds employed throughout the ETA, and would be more likely to be achievable on a practical level.
2. Exclude the general partner's interest from the threshold calculation. Under the current proposal, it is our understanding that some funds with exclusively non-resident limited partners may fail to meet the threshold solely because of the value of the general partner's interest (i.e., in providing management and administrative duties).
3. For purpose of the "prescribed member" definition referenced in proposed subsection 136(6) and to be defined in the Financial Services and Financial Institutions (GST/HST) Regulations, the "5% test" should be changed to a "10% test", again to be consistent with the 90% threshold.

General Partner's Provision of Services

Proposed subsection 272.1(8) expands the scope of subsection 272.1(3) to include the GP's provision of management or administrative services to an ILP that would otherwise have been done as a member of the ILP and in the course of the ILP's activities.

While we appreciate the goal of these proposals is to establish neutrality from GST/HST perspective regarding different collective investment vehicles, we have some concerns regarding the application of the proposed rules and the related coming into force timeline.

ILPs are generally not engaged exclusively in commercial activities. As such, paragraph 272.1(3)(b) could apply. This provision contains complex deeming rules regarding the timing and value of supplies, which in many cases may not line up with the timing and value of payments actually made to a general partner. In addition, the fee structures within ILPs vary and in some cases GST/HST will already apply to compensation GPs receive from parties other than the partnership itself.

We understand that the intent of the proposed rule is for GST/HST to apply to GP distributions in the ordinary course in a manner similar to how GST/HST would apply to a fee charged by a management company. On this basis, we wonder whether a simpler

approach may be along the lines of that found in paragraph 272.1(3)(a), which bases the GST/HST liability upon the amount and timing of ordinary course payments to the GP.

Under the rule as currently proposed, there is uncertainty regarding the application of GST/HST to payments made after Announcement Date in respect of services that were provided prior to this date, or for service periods that began before this date. The interaction of the deeming rules in section 272.1 with other GST/HST rules result in a lack of clarity that makes compliance with the rules challenging.

Furthermore, the coming into force timing as currently proposed risks the imposition of tax on what is effectively a retroactive basis, thereby putting pressure on the tax principle of transparency.

In this regard, we would recommend that the Department of Finance consider providing some form of grandfathering relief for ILP structures in place prior to Announcement Date. This could either take the form of full exemption for existing structures (which did not contemplate GST/HST costs when implemented), or alternately the provision of pro-rata relief (similar to the provincial harmonization transition rules) that recognizes that in some cases a significant portion of services were provided prior to Announcement Date and should be outside the scope of the tax.

In addition, the structure of these plans and their business rationale can be complex. They go beyond merely quid pro quo for services provided, and include an investment component for the GP itself. As such, we are concerned that the rules as currently drafted may cause GST/HST to apply in excess of that which may be appropriate and which would be payable in comparable circumstances where the investment vehicle is not an ILP.

Definition of Investment Limited Partnerships

The proposed definition of ILP in subsection 123(1) is clearly a key provision of the proposed regime, as it serves as a gatekeeper to the expanded SLFI rules as well as the general partner rules discussed below. Given its importance, and to help facilitate compliance, we believe that the scope of the definition should be as clear and unambiguous as possible.

The preamble to the definition provides that the primary purpose of the ILP must be to "invest funds". However, no guidance has been provided on the scope of this. In general usage, the word "invest" can have quite a broad meaning, including activities that form part of the derivation of active business income. In the case of an active financial services business, the "property consisting primarily of financial instruments" test may also be met. Our understanding of the policy intent of the proposed rules is that they should apply with respect to entities that derive passive income from property, rather than active business income. We are concerned that the definition as currently drafted may not reflect this policy intent. We note that the issue of active participation in the financial services

industry was distinguished from more passive participation in the 2016 Federal Budget with respect to deminimis financial institutions.

Paragraph (a) of the definition references several types of investment vehicles; however the terms used are not defined, neither directly nor by reference to any regulatory classification. Given that the investment industry is generally subject to regulation, it may be appropriate to anchor these terms by reference to the appropriate regulatory regime.

Finally, as a drafting point, the reference in paragraph (a) to "investment limited partnership" would appear to be circular.

Clarity around "Fair Market Value" Calculation

It is recommended that the Proposals are clarified to ensure there is not risk of double taxation. Specifically, the fair market value of the management and administrative duties of the GP should not include the following:

1. Duties that are delegated to a third party that is billed to the ILP directly and that are taxable supplies made to the ILP by the third party;
2. Fees billed to pension plan trusts or portfolio companies as contemplated in the limited partnership agreement and that reduce the amount of distributions otherwise payable to the GP for the management and administrative duties of the GP; and
3. Fees that are instead billed directly to a limited partner by the GP or a third party for the management and administration of the limited partner's investment in the ILP.

As a final point we would note that where the GP of an ILP is undertaking activities other than management and administrative services in their capacity as member of the partnership, such activities will continue to be captured by subsection 272.1(1), and would thus be excluded from any fair market value calculation.

Consideration of Other Relieving Rules

If the scope of GST/HST application to partnerships is broadened, in our view it is important that ILPs benefit from particular relieving mechanisms found in the ETA. In particular, section 186 provides the opportunity for holding corporations to leverage the commercial activity of their operating subsidiaries. In order to provide equity across investment holding structures section 186 should be amended to apply to ILPs (and all partnerships for that matter) that have a controlling interest in an operating business engaged exclusively in commercial activities.

Similarly, section 150 provides closely related group relief for corporations in the financial services industry; while the parallel provision, section 156, is available to partnerships, section 150 is not and should be reviewed with respect of ILPs.

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Finally, consideration should be given to expanding the scope of the pension plan rebate found in section 261.01 to cover instances whereby an ILP incurs otherwise irrecoverable GST/HST, similar to the recent expansion to cover corporations described in paragraph 149(1)(o.2) of the *Income Tax Act* (i.e., where one or more shares are owned by a pension entity of the pension plan).

Conclusion

PIAC appreciates the opportunity for ongoing dialogue with the Department of Finance Canada on this matter. We believe the role PIAC members play as both investors in the Canadian economy and as the providers of retirement income support to Canadians warrants a significant level of transparency and dialogue in advance of any changes being made.

Given the complexities inherent in the proposed rules discussed above and the areas of uncertainty yet to be addressed, we would recommend that revised draft legislation be released for further consultation, based upon the issues raised in the current round of consultations.

We also believe that, should the government decide to proceed with the rules, the rules should apply prospectively, ensuring that they are well understood and can be easily implemented in an orderly manner. As these proposed changes are significant and will greatly impact Canadian pension plans we would welcome an opportunity to meet with Department of Finance Canada officials to elaborate on our comments and to answer any questions they may have.

Please do not hesitate to contact us if you wish to discuss any aspect of this letter in further detail, and once you are ready for further consultation on the proposed changes.

Yours sincerely,

Kevin Fahey
Chair

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