
Structuring a partnership: CRA attacks GST/HST-exempt treatment of partnership distributions

July 2, 2014

In brief

Incorrectly structuring the activities of a partnership can cause GST/HST deeming rules to apply; resulting in a GST/HST liability for person's involved in the partnership's business.

In particular, a recent Canada Revenue Agency (CRA) ruling letter indicates that the CRA may not agree with the exempt status of partnership distributions, which may trigger the deeming rules.

All partnerships, but particularly those engaged in exempt activities, should consider this issue carefully.

In detail

Background

For GST/HST purposes, a partnership is considered a separate person and not merely a relationship that exists between the partners.

As a result, special GST/HST deeming rules in section 272.1 of the *Excise Tax Act* (ETA) apply with respect to activities that a partner undertakes relating to a partnership's business activities.

Subsection 272.1(1)

Subsection 272.1(1) deems anything done by a person as a member of a partnership to have been done by the partnership 'in the course of the

partnership's activities' and not by the partner.

The practical effect is that the partner is not considered to have made a supply to the partnership when it performs duties 'as a member of a partnership.' Therefore, the partner is not required to account for GST/HST in relation to activities performed as a member of the partnership.

Subsection 272.1(3)

In contrast, subsection 272.1(3) applies when a person supplies property or services to a partnership 'otherwise than in the course of the partnership's activities.'

The partner is deemed to have supplied property or a service to

the partnership for consideration that equals the fair market value of the supply when the partnership is not acquiring the supply for use exclusively in commercial activities.

PwC observations

For partnerships that are not engaged exclusively in commercial activities (e.g. partnerships whose principal activity is investing funds and partnerships that own residential real estate), whether subsection 272.1(1) applies can be important because unrecoverable GST/HST may be payable on the fair market value of the partner's contributions to the partnership.

CRA's administrative policy

The CRA's administrative policy on the meaning of 'anything done by a person as a member of a partnership' is in Policy Statement P-244: *Partnerships: Application of Subsection 272.1(1) of the Excise Tax Act*.

According to the policy, whether a partner does something as a member of a partnership depends on the partnership law of the particular province or territory and the specific facts.

The policy indicates that the following factors are relevant in making this determination:

- the terms of the partnership agreement
- the nature of the action undertaken by the partner
- the partner's ordinary course of conduct

Factors that the CRA considers important with respect to each of these include whether:

- the partner 'receives separate consideration' for its contributions
- the partner is doing the particular activity for more than one person, such that the partner may be engaged in a separate business of providing a particular type of service
- the actions undertaken by the partner relate to the purposes of the partnership's business

PwC observations

Although the Policy indicates that several factors will be considered in determining whether subsection 272.1(1) applies, recent CRA interpretations confirm that the CRA is applying that provision rather restrictively.

As a result, the CRA likely would view a separate fee or partnership allocation that is not related to the partnership's profits as being consideration for a taxable supply to the partnership.

For example, in GST/HST Ruling No. 136499 (December 30, 2013), the CRA concluded that amounts distributed by a limited partnership to its general partner were subject to GST/HST, including distributions that cover the general partner's cost of operating and administering the partnership, such as rent, overhead and employee compensation.

Similarly, a 2005 interpretation letter involved a limited partnership that had two classes of units. The general partner received 'Class B' units that entitled it to receive an amount equal to a set percentage of the net asset value of the partnership's assets.

The CRA concluded that GST/HST generally would be collectible on the fair market value of the partner's contribution.

The CRA's interpretation of subsection 272.1(1) may not be supportable if the partnership agreement is properly structured and the general partner is clearly responsible for performing its duties as a member of the partnership.

Nevertheless, the partnership and its members should realize that the CRA may not agree with the exempt status of partnership distributions and that the application of subsection 272.1(1) may ultimately need to be decided by the Tax Court.

Other deeming rules

Other deeming rules can apply independent of subsection 272.1(1), including rules that deem:

- supplies to be made for consideration that equals the fair market value of the supply
- the consideration for a particular supply to be what is reasonably attributable to the supply if consideration is being paid for one or more supplies or matters

The takeaway

Serious mistakes can be made when structuring the activities of the partnership, resulting in GST/HST becoming payable by one or more persons involved in the partnership's business.

All partnerships, particularly those engaged in exempt activities, must play close attention when structuring their affairs. The GST/HST consequences of getting it wrong could be detrimental.

Let's talk

For a deeper discussion of your GST/HST obligations and structuring partnership arrangements in a GST/HST-efficient manner, please contact any of the following:

Brent Murray*
+1 (416) 947 8960

brent.f.murray@ca.pwc.com

Audrey Diamant
+1 (416) 687 8933

audrey.j.diamant@ca.pwc.com

Lloyd McMaster
+1 (416) 687 8125

lloyd.w.mcmaster@ca.pwc.com

* Member of Wilson and Partners LLP (a law firm affiliated with PwC; see www.wilsonandpartners.ca)

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