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Substantial upcoming tax impact on investment funds' management compensation

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On September 8, 2017, the Minister of Finance introduced unexpected legislative and regulatory proposals regarding partnership distributions to a general partner, which will now be subject to GST/HST. On the other hand, the Québec government has yet to propose similar changes, but we believe it will follow suit, if the federal government adopts such rules.

Under the current federal and provincial (Québec) tax regimes, a general partner carrying on activities (such as management or administration) in its capacity as a general partner is generally not considered to be making a supply to the limited partnership, provided such activities are made in the normal course of the partnership's activities. As such, no GST/HST is applied to distributions made by the partnership to the general partner for such activities.

Under the proposed rules, a new tax concept known as an "Investment Limited Partnership" will be introduced into the law. In general terms, a limited partnership will be described as an investment limited partnership if its primary purpose is to invest funds in property consisting primarily of financial instruments, and if it is represented or promoted as a hedge fund, mutual fund, private equity fund, venture capital fund, or other similar collective investment vehicle. For example, this could include limited partnerships in tiered investment fund structures such as master-feeder funds or funds-of-funds.

If a limited partnership were recognized as an investment limited partnership, as described above, even if the general partner provides the management or administrative service to the partnership pursuant to its obligations as a partner of the partnership, the provision of the service would be deemed not to be done by the general partner as a member of the investment limited partnership, and the supply of such service would be deemed to have been made otherwise than in the course of the investment limited partnership's activities. Therefore, certain limited partnership distributions which are paid or became payable to general partners after September 7, 2017 may now be subject to GST/HST, and the limited partnership will normally not be able to claim input tax credits on such distributions.

The Minister of Finance will be receiving comments on the proposed rules until October 10, 2017. We are currently studying the new rules in greater detail and recommend that you contact us to discuss potential ways to reduce their negative impact on your structure.

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