PARTNERSHIPS

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MAURICE ARSENAULT
arsenault.maurice@rcgt.com

RAYMOND CHABOT GRANT THORNTON
Membre du réseau Grant Thornton International
Tour de la Banque Nationale
600, rue de La Gauchetière Quest
Bureau 1900
Montréal (Québec)
H3B 4L8

Telephone: (514) 878 - 2691
Facsimile: (514) 878 - 2127
www.rcgt.com

ROBERT G. KREKLEWETZ
rgk@tradeandtaxlaw.com

MILLAR KREKLEWETZ LLP
Tax & Trade Lawyers
BCE Place – Bay Wellington Tower
28th Floor, P.O. Box 745
181 Bay Street
Toronto, Ontario
M5J 2T3

Telephone: (416) 864 – 6200
Facsimile: (416) 864 – 6201
www.taxandtradelaw.com

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PROFESSIONAL PROFILE

ROBERT G. KREKLEWETZ – LL.B, M.B.A.

MILLAR KREKLEWETZ LLP
is a boutique tax law firm specializing in
Commodity Tax and Customs & Trade matters
including Tax & Trade Litigation.

Specialized Practice Area

Commodity Tax – Millar Kreklewetz LLP's Commodity Tax practice encompasses all Canadian indirect taxes, and includes all matters relating to Canada's Goods and Services Tax (GST) and Harmonized Sales Tax (HST), and all matters relating to Canada's various provincial sales taxes – like the Ontario, Manitoba and Saskatchewan retail sales taxes (RST), the British Columbia social services tax (SST), and the Quebec sales tax (QST). Our Commodity Tax practice also encompasses a variety of other indirect taxes, like the Employer Health Tax (EHT), and a range of excise taxes applying to goods like tobacco, alcohol, jewellery, gasoline and other motive fuels.

Customs & Trade – Millar Kreklewetz LLP's Customs & Trade practice encompasses all matters involving customs and trade. On the Customs side, this includes Tariff Classification, Origin, Valuation, Marking, Seizures, Ascertained Forfeitures, and Administrative Monetary Penalty (AMPs) related matters. On the Trade side, this includes North American Free Trade Agreement (NAFTA) matters – including NAFTA Origin, Exporter Verification, and Government Procurement issues – as well as Anti-dumping / Countervail (SIMA), World Trade Organization (WTO) and GATT matters.

Related Matters & Industry Specific Advice – Millar Kreklewetz LLP also specializes in a number of other tax and trade related areas, and advises on matters like Transfer Pricing between multinational enterprises; employee vs. independent contractor status under Canada's various federal and provincial tax legislation; tax and customs considerations arising on the establishment of a business in Canada; transfers of business personnel to Canada; and on all other matters relating to the cross-border movement of goods, services and labour.

Extensive Litigation Experience

Where necessary, we litigate tax and trade matters before all relevant bodies, tribunals and courts, including the Tax Court of Canada, Canadian International Trade Tribunal, Federal Court, Federal Court of Appeal, and Canada's various provincial Superior Courts and Courts of Appeal, and the Supreme Court of Canada. Rob acts as lead counsel on all litigation matters he prosecutes.

Planning & presentation

Given our view that most matters can be successfully resolved without litigation, we also concentrate on providing a full range of planning and representation services in these areas.

Blue Chip Client Base

Millar Kreklewetz LLP continues with some of the best tax and trade files in Canada, and our broad client list includes a large number of blue chip corporate clients, who are national and international leaders in the following industries:

- chemicals & petrochemicals
- oil & gas
- forestry products
- steel
- airlines, avionics & aerospace
- software & IT
- financial services
- drugs & pharmaceuticals
- medical testing
- health services
- manufacturing
- wholesaling
- retailing
- direct mail
- direct selling

Millar Kreklewetz LLP also provides cost effective solutions for small to medium-sized businesses, and high net wealth entrepreneurs.

Speaking ngagements

Rob has published over **250 articles and papers**, and spoken at over **100 conferences**.

Accordingly, Rob regularly addresses the Tax Executive Institute (TEI) – at its Annual Canadian and International Conferences and at various provincial Chapter Meetings – and also speaks frequently before other organizations on like the Canadian Tax Foundation (CTF), Canadian & Ontario Bar Associations (CBA/OBA), Canadian Institute of Chartered Accountants (CICA), and Certified General Accountants (CGA).

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Rob also regularly addresses industry-specific associations like the Canadian Association of Importers & Exporters (CAIE), American Petroleum Institute (API), and the American Toy Industry Association (TIA), the Canadian Finance and Leasing Association (CFLA), and the Canadian and U.S. Direct Sellers Associations (DSA), while speaking annually at other Professional Conferences held by organizations like the Strategy Institute, Infonex, IIR and Federated Press.

Rob is also a regular contributor on commodity tax and customs & trade in the CTF's *Tax Highlights* publication, and a number of other publications, including Carswell's *GST and Commodity Tax Reporter,* the OBA's *Tax Newsletter,* Federated Press' *Sales and Commodity Tax Journal*, and the CAIE's *Tradeweek* publication.

Rob is a member of the OBA's Tax Executive, a member of the CFLA's Tax Committee, and Chair of the DSA's Taxation Committee. Rob is also a member of several federal and provincial consultation groups, consulting both with the federal Department of Finance, and the Ontario Ministry of Finance.

The Real Important Stuff

nfortunately Left to the Bottom

Rob is married to **Franceen**, has a beautiful 6 1/2 year-old boy named **William** (the "Conqueror"), who has a one year-old brother named **Richard** (the "Lion-Hearted").

While Rob concedes that Commodity Tax, Customs & Trade is truly scintillating, what he really enjoys is spending time with his family, playing golf with William, and attempting to finish at least one woodworking project he starts.

PROFESSIONAL PROFILE

MAURICE ARSENAULT – LL.M., M. FISC.

Partner in the Commodity Tax Department of Raymond Chabot Grant Thornton in Montreal, Maurice is involved day by day in tax work for the major clients of the firm: tax reviews, planning, research, analysis, appeals, refund claims, presentations, negotiations, etc. He serves as a key resource for commodity tax issues and coordinates commodity tax services and tax reviews.

Lawyer, with a Master Degree in Taxation, he has over 25 years of sales tax practice, with the industry (Air Canada) and with major CA firms. He worked as a consultant for Revenue Canada on the implementation of the GST (1990), for the Quebec Department of Finance on the QST reform (1992) and for the Department of Finance of Canada on the HST harmonization (1996-1997). He is a lecturer at the "Graduate Diploma in Taxation" of McGill University and at the Master Degree in Taxation of Sherbrooke University. He is also a frequent speaker in Canada and the USA (TEI, ERASTA, IATA, ATA, APFF, EQUINET, CICA Symposium, etc…)

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INTRODUCTION

While it is a business relationship that dates back to Roman times, the "partnership" is a relationship that raises many commodity tax issues, and remains an area within commodity taxes that is surprisingly difficult to fully understand.

Part I of the Paper will provide a rounded discussion of the basic tenets of the business relationship that is a "partnership", and will examine the relationship from both a common law and Quebec Civil Code perspective. Since it is provincial law which ultimately governs whether a "partnership" exists, the distinction between common law and civil law principles can be critical. Understanding the basic legal implications of a partnership is also important to understanding the basic legal challenges and inherent limitations facing federal and provincial commodity tax regimes, when attempting to tax at the "partnership" level.

Part II of the Paper discusses partnerships in the context of the federal Goods and Services Tax ("GST") legislation.[1] We first consider the application of the legislative rules and administrative policies to common partnership transactions (e.g., transactions between partners and the partnership, and transactions between the partnership and third-parties), next consider the application of the parallel rules in the Quebec Sales Tax (the "QST"), and finally identify and provide commentary on some recent changes and current issues in the GST and QST contexts.

Part III of the Paper discusses partnerships in the context of provincial retail sales tax ("RST") legislation.[2] We again follow the same general format as Part II, and begin with a provincial survey of the legislative rules and administrative policies related to common partnership transactions, and then identify and provide commentary on recent changes and current issues.

Understanding how partnership transactions are dealt with under Canada's various commodity tax systems is a challenging, but not impossible endeavor. Readers of this Paper should take away a solid understanding of the legal structure that is called a "partnership", a useful primer in the application of federal and provincial commodity taxes to that structure, and an up-to-date understanding of recent changes and current issues in the area.

PART I – WHAT IS A PARTNERSHIP ?

I - 1 OVERVIEW

I - 1.1 Why this is Important

While most tax advisors will be familiar with the either the GST system or the RST system, or both, the word "partnership" (and the business relationship it represents) is not defined in either the *Excise Tax Act* ("*ETA*"), nor is it defined in provincial RST legislation.

Rather, and as we will discuss below, the existence of a "partnership" relationship can only be determined with reference to (1) provincial legislation, (2) Canadian common law or civil law principles, and (3) the ultimate agreement that exists between the parties to the business relationship.

For tax advisors, understanding just what a partnership is – as a matter of law – becomes an important first step in determining how a particular commodity tax applies to any potential partnership transaction. And as we shall see, even determining whether or not that relationship exists can be a complex-yet-critical first step towards the proper application of both GST and RST. Indeed, most complex commodity tax questions involving partnerships can only be properly addressed after understanding the basic legal definition and tenets of the partnership relationship, and the legal implications that the existence of a partnership will have on the transactions between the various parties.

I - 1.2 Sections that Follow

The sections that follow will (1) establish these basic legal definitions and tenets and (2) identify the implications of partnership, in both common law and civil law jurisdictions.

I - 2 PARTNERSHIPS AT COMMON LAW

I - 2.1 Introduction

I - 2.1(a) The Evolution of the Common Law Definition

The concept of partnership evolved as early as Roman times, with the partnership relationship then being known as *societas* under Roman law.[3] The concept was, however, much slower to develop under the common law.[4] In fact, it was not until the English *Partnerships Act* of 1890 that any agreed-upon principles were codified,[5] although by that time a "partnership" was generally accepted to be the relationship between one or more persons, who agreed to carry on business together, with a view to profit.

I - 2.1(b) Canadian Codification of Partnership

In Canada, each of the provinces (except Quebec, see below)[6] have since adopted similar codifying legislation, which is patterned on the English approach.

In fact, Canadian provincial partnership legislation is virtually identical in every common law province,[7] and almost invariably titled the "Partnership Act".[8]

I - 2.1(c) Canadian Statutory Definitions

In Ontario – whose *Partnerships Act* [9] is perhaps a typical example of the Canadian approach (at least outside of Quebec) – section 2 of the *Partnerships Act* now defines a partnership as "the relation that subsists between persons carrying on a business in common with a view to profit":

> **2.** Partnership is the relation that subsists between persons carrying on a business in common with a view to profit, but the relation between the members of a company or association that is incorporated by or under the authority of any special or general Act in force in Ontario or elsewhere, or registered as a corporation under any such Act, is not a partnership within the meaning of this Act.
>
> (emphasis added)

While now codified in this sort of provincial legislation, in practice one finds that the underlying tenets of the partnership relationship (e.g., the carrying on of a "business", "in common" and with a "view to profit") have generally be interpreted and explained in the jurisprudence.[10]

Note that the wording that follows the basic tenets of partnership, in the definition above, serves to confirm that a "corporation" is not a partnership in and of itself. However, a corporation can be a partner in a partnership by virtue of the definition of "person" in the Ontario *Interpretation Act*, which affords a "corporation" the status (and rights and obligations) of a "person".[11]

It is also notable that the Ontario *Partnerships Act* – like its other provincial counterparts – does *not* define a "partnership" to be a person, nor give it status as a legal person. We will see that this has been held to have important commodity tax implications, especially in the RST context, and has perhaps also necessitated a special definition of "person" in the *ETA*, ensuring that "partnerships" are "persons" for GST purposes (see *infra*).

I - 2.1(d) *Partnership as a Creature of Statute, Common Law & Agreement*

While the definition of "partnership" is legislated in Canada, and while most provincial legislation also includes a general framework for the operation of a partnership, this same provincial legislation allows for much flexibility in how a partnership is formed, operated and dissolved. Accordingly, one finds that a partnership is not governed by a complete statutory code, but through a combination of legislation, common law and equity principles,[12] as well as the contractual agreement upon which the partners establish the relationship between them.[13]

Under this hybrid approach, it can be seen that a partnership is not completely a 'creature of statute' (like, for example, a corporation is), nor is it completely dependent on a contractual arrangement (like, for example, a trust, joint venture or pure agency-principal relationship are).[14]

Rather a partnership "is a result of a contractual agreement within statutory guidelines".[15]

The challenge in any partnership transaction is, therefore, to marry the statutory and common law requirements with the provisions in the partnership agreement (if any), in order to determine the true nature of the relationship between the parties, and the impact, if any, on commodity taxation.

We now turn to an examination of the basic tenets of the "partnership" relationship, which is a critical first step to the partnership analysis, whether in the tax or non-tax context. If it cannot first be demonstrated that the basic tenets of partnership exist (i.e., an agreement to carry on business, with a view to a profit), the legal relationship formed will be held to be something other than a "partnership".[16]

I - 2.2 Formation & Existence of a Partnership

There are three basic tenets of a partnership that must be satisfied before a "partnership" will be recognized to exist at law: (1) there must be a "business", (2) "carried on in common", and (3) with a "view to profit".[17]

I - 2.2(a) *The Existence of a Business*

The term "business" is usually defined in the provincial partnership legislation. For example, section 1 of the Ontario *Partnerships Act* defines "business" in very broad terms:

Definitions

1.--(1) In this Act,

"**business**" includes every trade, occupation and profession ….

Notwithstanding the breadth of the definition of "business", it does impose an important and inherent limitation on what a "partnership" is as a matter of law: unless there is a "business" motive, a "partnership" cannot legally exist. Thus, two stamp collectors getting together to purchase stamps in common, as a hobby, perhaps only for the enjoyment of their mutual collection, and not towards any particular business purpose, would not amount to a "partnership" at law.[18]

Where a "business motive" exists, however, it appears that most activities carried on by two or more persons with that business motive in mind, will be capable of being considered a "business".

I - 2.2(b) ***Carried on in Common***

Even to the extent a business exists, the second requirement for a legal partnership is that the business be carried on by the partners "in common".

The words "in common" have been held to suggest the existence of some sort of agreement between the partners, or in the least, an assumed comity of interests based on their conduct.

Accordingly, a partnership can be formed by either written or oral agreement,[19] and may even be found to exist (i.e., "implied") by the conduct or actions of the parties themselves.[20] (See Figure 1)

Figure 1: ***Written, Oral and Implied Agreements***

Tip: One of the first things a law student will learn, an agreement – whether a "partnership agreement" or most other contractual agreements – does not have to be in writing in order to be legally effective: an "agreement" can be oral, or it can even be implied from the manner in which two or more people carry on.

Where an "agreement" is found to exist, each form of agreement will be as binding on the parties as the other, meaning that it will not matter at that point whether the "agreement" was written, oral or implied.

Example 1 – Written Agreement: Jack Millar and Rob Kreklewetz enter into a written agreement to practice law in partnership. Millar takes 98% of the profits; Kreklewetz – much less sharper than Millar – happily agrees to 2%.

The parties will be held to operate in partnership, and for all purposes, a partnership exists.

Example 2 – Oral Agreement: Millar and Kreklewetz, over a beer, talk about practicing law together. Millar offers to practice law with Kreklewetz if Kreklewetz takes 2% of the profits, and gives Millar 98%. Kreklewetz says: "I happily agree".

Assuming no issue as to Kreklewetz's mental capacity at the time, the parties will be held to operate in partnership, and for all purposes, a partnership exists.

Example 3 – Implied Agreement: Millar and Kreklewetz again talk about practicing law together. Millar again offers to practice law with Kreklewetz if Kreklewetz takes 2% of the profits, and gives Millar 98%. Kreklewetz this time says nothing, but thereafter the parties rent space, hire employees and begin practicing together, under the firm name Millar Kreklewetz LLP.

The parties will likely be held to operate in partnership, and for all purposes, a partnership exists.

This means that even absent a written agreement (or evidence as to an oral agreement), the courts can look to the conduct of the parties to establish their intention, and determine whether, in law, a partnership exists.

This is quite significant, since even in circumstances where the putative 'partners' have no knowledge of a partnership (or have expressed a contrary intention), if the basic tenets of a partnership exist, the Courts are able to find that a partnership exists, and make that partnership subject to the legal consequences that follow.[21]

In determining whether or not a partnership exists, the Courts have considered the following factors:

- stating the intention to form a partnership
- sharing profits
- sharing responsibility for losses
- guaranteeing partnership debts
- jointly owning property
- contributing capital
- firm having its own personnel and address
- controlling the partnership business
- participating in management
- full-time involvement in the business
- accessing partnership information
- maintaining signing authority
- holding oneself out as a partner
- use of firm name (i.e., advertising)

I - 2.2(c) A View to Profit

Finally, and in order to be considered a "partnership", a business that is carried on in common must also have a "profit" motive. The profit requirement really serves two purposes.

First, it excludes from the legal nature of "partnership" most activities that are charitable, social or cultural. In these situations, if there is no profit motive, the resulting relationship, whatever it is, will not amount to a partnership.[22] This is not to say, however, that the momentary lack of profits would obviate the existence of the partnership. Rather, the requirement is for a "view to profit", which means that actual profits need not exist. Recent jurisprudence has also suggested that the "view to profit" requirement ought to be determined with reference to the *intentions of the parties*, and will not be stymied by less-than-expected results.[23]

Second, the "profit" motive confirms that an agreement to merely share gross returns will *not* amount to a partnership.[24] Thus, for example, a group of persons sharing the payment of a royalty might not, without more, amount to a partnership at law.

I - 2.3 Implications of Partnership

Once a "partnership" is found to exist, certain legal implications follow.

I - 2.3(a) The Firm as a Collection of Partners, Without Separate Legal Status, & Operating under Agency Principles

Where two or more persons carry on business together, with a view to profit, the relationship will be called a "partnership", and the members of the partnership will be properly referred to as "partners", and the partnership, per se, is generally referred to as a firm.

What is not bestowed on a partnership, however, is a "separate legal status". Thus, a "partnership", absent a special legislative definition, is not a "person" for legal or tax purposes.

Instead, one finds that the "partnership" relationship is merely a convenient way of referring to the common business undertaking of separate individuals (or persons) who are the partners. The word "partnership", then, is the legal shorthand for the group of persons undertaking the common business enterprise, based on agency principles. And in this sense, the "partnership" has no separate or legal existence from its partners. The partners also become, in effect, one in the same with the partnership.[25] [26]

This principle, and the others that follow from it below, become critical to the understanding of the inherent challenges and limitations facing the GST and RST systems below.

I - 2.3(b) Partners as Agents for Each Other

Central to the concept of "partnership", and indeed to the law governing the relationship that partners and third-parties enjoy with the "partnership", is the principle that *each partner is an agent of the partnership*.

This common law principle has been enshrined in provincial partnership legislation, and illustrated by section 6 of the Ontario *Partnerships Act*:

> 6. Every partner is an agent of the firm and of the other partners for the purpose of the business of the partnership, and the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which he or she is a member, bind the firm and the other partners unless the partner so acting has in fact no authority to act for the firm in the particular matter and the person with whom the partner is dealing either knows that the partner has no authority, or does not know or believe him or her to be a partner.

The invocation of the "agency" principle stands for the following simple proposition: anything done by a partner for the purposes of the business of the partnership is like a thing done by the partnership directly.[27] In even simpler terms: the partner *stands in the shoes of* the partnership.

Thus, a particular partner's actions, when acting for the purposes of the business of the partnership, are ascribed to *each of* the partners of the partnership, and binding on them, as if they had acted themselves.

Accordingly, under this theory, one partner's actions, when acting within the scope of the firm's normal business activities, will serve to bind the partnership, and by definition, each of the other partners – all pursuant to the general laws of agency.[28] [29] (See Figure 2a.)

I - 2.3(c) *Transactions Between Partners* [30]

Provincial partnership law generally provides a default framework governing the relationship and transactions between partners, but can be displaced by agreement between the partners.[31]

The rules are "default rules" since they are typically modified, supplemented and replaced by rules agreed upon by the partners in their "partnership agreement" – whether written or oral. A partnership void of a partnership agreement, however, is governed by the default provincial rules.

Figure 2a: ***Partners as Agents of the Partnership & Each Other – Ability to Bind the Partnership and Each Other***

Example 1: Kreklewetz is a 2% partner in Millar Kreklewetz LLP, with Jack Millar being his other partner, enjoys 98% of the profits. Kreklewetz steps downstairs to Grand & Toy and purchases a pad of paper for use in his law partnership, using a personal cheque.

Legal Result: As a matter of law, the proper conception is that the purchaser of the pad of paper is Millar Kreklewetz LLP, not Kreklewetz personally. It is Millar Kreklewetz LLP that has been "bound" by the actions of one of its partners, Kreklewetz.

(Figure 2b below discusses who the actual owners are of the pad of paper, given the fact that Millar Kreklewetz LLP is not a separate legal person.)

Example 2: Millar provides GST advice to a client of Millar Kreklewetz LLP, signing the letter himself, but sending it on Millar Kreklewetz LLP letterhead.

Legal Result: As a matter of law, the proper conception is that Millar Kreklewetz LLP has just provided a legal opinion to the client.

(Figure 2c below discusses who is actually liable for the advice, given the fact that Millar Kreklewetz LLP is not a separate legal person.)

I - 2.3(d) *Liability of the Partners for Debts and Obligations of the Partnership*

As introduced above, each general partner[32] in a partnership is jointly liable to the other partners to the full extent of its *personal* assets for all debts and obligations the firm incurred while it was a partner.[33] [34] (See Figure 2b.)

I - 2.3(e) *Contractual Liability to Third-Parties*

Consistent with the agency principle referred to above, each partner is liable to perform all contractual obligations agreed to by the other partners in connection with the partnership business, even if the partner did not consent to the obligation.

Contractual liability is thereby joint, whereby judgment against or release of one partner bars action against the others.[35]

I - 2.3(f) *Tort and Other Wrongs re Third-Parties*

All partners are also liable for all torts[36] committed by partners in connection with the business and are vicariously liable for the torts of employees of the partnership committed in the course of their employment.

I - 2.3(g) ***Rights & Beneficial Interest in Partnership Property***

– "Partnership Property"

Although a partnership is not a separate legal entity from the partners, all property contributed by the partners to the general partnership or purchased in the course of business is called "partnership property".

The right to partnership property, as a default, is general a right shared equally amongst the partners, but the proportionate interests of the partners in the partnership property can be varied by agreement. Thus, if A and B had no written agreement on the point, and A contributes a truck to the partnership, the truck becomes "partnership property". B becomes, on the contribution, a 50% beneficial owner in the truck, as does A. A and B would be free, however, to determine what respective interests they would enjoy in partnership property.

– A Partner's Undivided Ownership Interest

While it may be subject to debate for income tax purposes,[37] we believe that it is clear at common law that a partner owns a beneficial undivided property interest in partnership property.

Figure 2b: ***Partners as Agents of the Partnership & Each Other – Liability Amongst the Partners***

Example 1: Consider the same facts as in Example 1 in Figure 2a, with Kreklewetz purchasing the pad of paper at Grand & Toy.

Further Legal Result: While we indicated above that "[a]s a matter of law, the proper conception is that the purchaser of the pad of paper is Millar Kreklewetz LLP, not Kreklewetz personally", and that "[i]t is Millar Kreklewetz LLP that has been "bound" by the actions of one of its partners, Kreklewetz." – it is important to peel one additional layer off the onion, as follows.

As a matter of law, it is not in fact the "partnership" that is liable. The "partnership" is not a legal entity; rather, it is the individual partners who are liable for the purchase of the pad of paper by Kreklewetz, which includes Millar. In effect, Kreklewetz (as agent) has succeeded in binding Millar (as principal).

Accordingly, if Kreklewetz's cheque bounces, both Millar and Kreklewetz are technically jointly and severally liable for the payment to Grand & Toy.

For convenience, one often refers to the "partnership" as being liable, and indeed, provincial rules of court often allow the "partnership" to be named in law suits rather each individual partner, but the following legal reality remains: it is the individual partners that are jointly and severally liable.

Example 2: Consider the same facts as in Example 2 in Figure 2a, with Millar providing the GST opinion on Millar Kreklewetz LLP letterhead.

Further Legal Result: While we indicated that "[a]s a matter of law, the proper conception is that Millar Kreklewetz LLP has just provided a legal opinion to the client", it is again important to peel an additional layer off the onion.

As a matter of law, and subject to any special rules regarding the firm's LLP status, and any other limitations in the retainer agreement, Kreklewetz and Millar can be seen to now be jointly and severally liable for the advice given in Millar's letter – as Millar (as agent) has now succeeded in binding Kreklewetz (as principal).

This is most clear in the earlier case law, which focused on whether a partner's property interests in partnership property were capable of being seized by creditors. The answer was generally "yes", and was made clear by the Supreme Court of Canada in *Boyd v. The Attorney-General for British Columbia*:[38]

> Some light is thrown upon the question of the nature of the partner's legal status with reference to the real property assets of the partnership during the existence of the partnership, by a consideration of the practice existing prior to the passing of the "Partnership Act" as regards the taking in execution of a partner's share for his separate debt. Before the passing of that Act partnership property could be seized under a writ of fi. fa. upon judgment against one of the partners for his separate debt, the sheriff seizing such of the partnership effects as might be requisite and could be seized under the writ and selling the undivided share of the judgment debtor in them. The legal effect of such seizure and sale is described in Lindley on Partnership (5 ed.), at page

> 358. The purchaser being a stranger unconnected with the firm acquired for his own benefit all the judgment debtor's interest in the property comprised in the sale and became as regards such property tenant in common with the judgment debtor's co-partners. The purchaser, however, held this interest subject to all the equities which the co-partners had upon it and subject therefore to their right to have all the creditors of the firm paid out of the assets of the firm and consequently pro tanto out of the property seized by the sheriff.
>
> It is clear, therefore, notwithstanding the fact that a suit in equity was formerly necessary or might have been necessary in such a case to have the partnership accounts taken and to have the partnership property correctly applied, that each of the partners had an interest in specific assets of the partnership which could be seized and sold under a judgment against him for his separate debt.
>
> (emphasis added)

This line of reasoning has led the British Columbia provincial Court of Appeal to conclude that absent a very clear regime aimed at deeming a partnership to be a separate legal entity (or, perhaps, other special provisions governing the treatment of partners and partnerships like under the *Income Tax* Act), all partners maintain their "individual interests" in the partnership property, such that when it is acquired or sold, it is to be viewed as an acquisition of sale of each of the individual undivided interests in it.[39]

Figure 2c: ***Partners as Agents of the Partnership & Each Other – Ownership of Partnership Property***

Example: Consider the same facts as in Example 1 in Figure 2a, with Kreklewetz purchasing the pad of paper at Grand & Toy.

Further Legal Result: While we indicated above that "[a]s a matter of law, the proper conception is that the purchaser of the pad of paper is Millar Kreklewetz LLP, not Kreklewetz personally", it is important to peel one additional layer off the onion, as follows.

As a matter of law, it is not actually Millar Kreklewetz LLP that owns the property. Rather, and applying the "agency" analysis, what has occurred is as follows: (1) there were two purchasers of the pad of paper, with Kreklewetz acquiring a 2% interest in it, through his own actions, and (2) Millar acquiring a 98% interest in it, being bound by the actions of his agent Kreklewetz.

Thus, as a matter of law, Kreklewetz becomes a 2% beneficial owner in the pad of paper, and Millar becomes a 98% beneficial owner.

For convenience, one often refers to the "partnership" as purchasing the pad of paper, which is fine, but the legal reality is that beneficial ownership of the pad of paper is held by both Kreklewetz and Millar.

Historically, Kreklewetz would be free to pledge that property interest to creditors, and creditors (subject to certain constraints) would be free to seize that property interest on default.

In the context of commodity tax legislation, this reasoning appears to suggest that unless the particular taxing legislation defines a "person" to include a "partnership" (or provides some other similar legislative mechanisms), partners will be viewed as owning direct interests in the partnership property. It also seems that indirect references to the status of a partnership as a person (as for example, through a provincial or federal "Interpretation Act") will not be viewed as sufficiently displacing the common law principles above.[40] (See Figure 2c).

– Other Principles Regarding Partnership Property

Once property becomes "partnership property", it must be held exclusively for the purposes of the partnership and in accordance with the terms of the partnership agreement.

Furthermore, the property is non-divisible until dissolution of the partnership,[41] which suggests, in our view, that individual partners are not permitted unfettered access to their portions of the property, and that a partner has only restricted rights with respect to the partnership property. For example, one

partner cannot simply reach into the partnership unilaterally and remove or change a partnership asset. In concert, however, the partners may sell a partnership asset, at which time the property would constitute a sale by the partners of their individual interests in the specific property.[42]

I - 2.3(h) Fiduciary Duties & the Good Faith Requirement

Another characteristic of the partnership relationship – which is sometimes unfortunately overlooked – is fiduciary duty. Specifically, partners owe a fiduciary duty to each other, and must deal with the partnership and each other in the utmost of good faith.

Common law and statutory tests exist to ensure this hallmark principle is upheld.

I - 2.4 The Operation of a Partnership

Partnerships operate like any other business, often with the actions of the partners playing integral roles in the business. Sometimes partnerships will employ persons other than the partners to perform work, although there is some question as to whom the precise employer is in these situations – albeit presumably the various partners, jointly.

I - 2.5 Dissolution of a Partnership

The dissolution of a general partnership is also governed by provincial partnership law.[43]

Generally speaking, a partnership is dissolved (a) when the fixed term of the partnership's existence expires, (b) at the termination of the single adventure or undertaking for which it was entered into or, (c) by a partner wishing to dissolve the partnership. In the latter respect, notice is not required. A partnership will also generally dissolve upon death or insolvency of a partner, or in a number of other special instances, as for example, if a particular event arises which makes it unlawful for the business of the firm to be carried on, or for the members of the firm to carry it on in partnership. A court may also order the dissolution of the partnership for specific grounds, including the mental incompetence of a partner, conduct prejudicial to the business, or on the determination that the partnership can only be carried on at a loss.

Where a partnership dissolves, the debts and liabilities of persons who are not partners are paid first, then debts are paid to the partners (other than advances of capital), and finally, capital is returned to the partners.

Any remaining funds are distributed to partners in accordance with their entitlement to profits.

I - 2.6

Types of Partnerships – General or Limited

Our discussion would not be complete without reference to "limited partnerships".

For purposes of our discussion, there are two basic types of partnerships:[44] (1) a "general partnership" and (2) a "limited partnership".[45] The fundamental difference between the two involves the ultimate "liability" of the various partners for the affairs of the partnership.

In a "general partnership" all of the partners are "general" partners and each jointly and severally liable for the affairs of the partnership, including the actions of the partners.[46]

In a "limited partnership", which is created under statute, certain partners (called the "limited partners") are able to trade their right to manage and operate the partnership, for liability limited to their monetary interest invested in the limited partnership.[47] All other remaining partners are "general" partners, and remain saddled with unlimited liability with respect to the partnership's affairs, but also the right to fully manage and operate the partnership on a day-to-day basis.

A limited partnership is generally viewed as a specialized vehicle designed to fulfill the needs of particular investors who want to be able to share in the partnership profits but limit their liability for partnership losses. In this sense, a limited partner can be characterized as a passive investor rather than an active participant in the operation of a limited partnership. The limited partners' share in the profits is in proportion to their contributions, unless the partnership agreement provides otherwise.

Unlike general partnerships, limited partnerships do not generally come into existence simply by virtue of persons carrying on business. Rather, various provincial legal requirements must be met. In Ontario, for example, a form known as a "declaration" must be filed with the registrar appointed under the *Business Names Act*.[48] Even once created, however, and as the case with a "general partnership", the limited partnership will not have a separate legal existence.

In the balance of this paper, where we refer to "partnerships", we refer to partnerships of the "general" variety, and where we express views as to the commodity tax implications on "partnerships", we mean to express these views as to "general partnerships" only.

Given their specialized nature, the application of commodity taxes to "limited partnerships" may, in certain instances, be different than the same application to general partnerships, and some of the issues inherent in limited partnerships are discussed in separate sections below.

I - 2.7 Partnership as Distinct from Other Business Relationships

Finally, it is perhaps useful to review what we now know about partnerships by juxtaposing the "partnership" with other legal forms of carrying on a business.

A partnership appears to be, as we have seen, a substantially different relationship from other legal arrangements for commercial activities, like sole proprietorships[49] and corporations, although there are some similarities.

I - 2.7(a) In Contrast to Sole Proprietorships

As indicated, in a partnership, the persons who have agreed to be partners are referred to collectively as a "firm", and the name under which their business is carried on is called the firm name, as opposed to a sole proprietorship which functions under its own personal name or under a registered business name.[50]

Like the situation in a sole proprietorship, however, partners in a partnership carry on business directly and with personal liability; however the profits are shared.

Lastly, and unlike the sole proprietorship, a partnership requires more than one person – which perhaps only restates the obvious.

I - 2.7(b) In Contrast to Corporations

In contrast to a corporation, a partnership is *not* a legal entity, separate and distinct from its partners.

This single consideration probably results in some of the most complex issues involving the treatment of "partnerships" for commodity tax purposes, and is the singular reason for the specials "partnership" rules found in the GST system, and in some RST systems (see *infra*).

One consequence of the "lack of separate legal entity" status is the legal conclusion that a person cannot be both a partner and an employee of the partnership at the same time – which follows from the basic contractual principle that one cannot enter into a contract with oneself.[51]

A further consequence is that all benefits of the partnership business accrue directly to the partners, and all partners are personally liable for the obligations and debts of the business.

However, it should be noted that the *Rules of Civil Procedure* enable partners carrying on business in Ontario to sue or be sued in the firm name, thus making the partnership more like a separate legal entity in such instances.[52]

I - 2.7(c) ***In Contrast to Joint Ventures***

While it was once true that all unincorporated joint ventures were considered partnerships,[53] joint ventures have now been recognized in common law provinces as capable of distinct contractual formation. (For the situation in Quebec, which is different, see the section just below.)

While difficult to describe what a joint venture really is in technical terms, it is perhaps useful to describe a joint venture for what it is not: it is not a partnership, and by that we mean that it is not a business conducted in common with a view to a profit.

In practice, many joint ventures operate almost identically to partnerships, but confine their sharing to the "gross revenue" level. After that, however, the question for joint venturers is what other differential characteristics remain.

I - 3 PARTNERSHIPS UNDER CIVIL LAW

I - 3.1 Civil Law - Basic Definition & Tenets

The articles of the Civil Code of Quebec[54] dealing with partnerships are found under Title II "NOMINATE CONTRACTS" of Book V "OBLIGATIONS" of the Code. Thus, in Quebec, a partnership is based on contract. As such, it is subject to both the general rules applicable to all contracts (i.e., Articles 1371 to 1707 of the Code dealing with Obligations), and also to the specific rules applicable to this specific nominate contract (i.e., Articles 2186 to 2266 of the Code).

As with other contracts, a partnership is formed by the sole consent of the parties.

While there are no required formalities under the Civil Code,[55] in the context of tax planning, it is safe to say that the parties will simplify their future dealings with the tax authorities by confirming their relationship in a written contract.

I - 3.2 Definition & Framework

The Civil Law definition of a contract of partnership is found at Article 2186 of the Civil Code:

> "A contract of partnership is a contract by which the parties, in a spirit of cooperation, agree to carry on an activity, including the operation of an enterprise, to contribute thereto by combining property, knowledge or activities and to share any resulting pecuniary profits.
>
> A contract of association is a contract by which the parties agree to pursue a common goal other than the making of pecuniary profits to be shared between the members of the association."

The first point to note is that Article 2186 also includes a definition of a contract of association. Such contracts address the situation where the parties have a "common goal other than the making of

pecuniary profits". This is the most important criterion that distinguishes an association from a partnership.

As for a partnership, the definition identifies three conditions of existence: (i) the agreement to carry on an activity or enterprise in a spirit of cooperation, (ii) the combining of contributions and (iii) the sharing of pecuniary profits.

One can see almost a direct parallel to the approach taken when the common law was codified.

I - 3.2(a) Carrying on an Activity or Enterprise in a Spirit of Cooperation

The "spirit of cooperation" requirement is a subjective element and may be described as the partners' intention to cooperate in a common enterprise, to be in partnership – much like the "in common" requirement in the common law provinces.

In his commentaries,[56] the Justice Minister refers to the "affectio societatis" is notion infers for partners a spirit of cooperation which unites them and incites them to pursue in common the carrying out of a social objective.

I - 3.2(b) The Combining of Contributions

In civil law, the contribution by the partners of property, knowledge or activities is an essential requirement.

While this obligation applies to each partner, the contribution of each one may differ. One partner may bring money, while another may bring his knowledge and a third one may promise to perform work.

I - 3.2(c) The Sharing of Pecuniary Profits

It is also of the essence of a partnership that the partners share in the profits. Any stipulation whereby a partner is excluded from participation in the profits is without effect.[57] The share of each partner in the assets, profits and losses is assumed to be equal, unless otherwise fixed in the partnership agreement.[58]

I - 3.3 Types of Partnerships – General, Limited or Undeclared

For purposes of our civil law discussion, there are three basic types of partnerships.[59]

Some general rules apply to the three types of partnership (art. 2186 to 2197 of the Code), and some specific rules apply only to a given type: general (art. 2198 to 2235), limited (art. 2236 to 2249), and undeclared (art. 2250 to 2266).

The first two, general partnerships and limited partnerships, are of the registered type (i.e., they have to make declarations under *The Act respecting the legal publicity of sole proprietorships, partnerships and legal persons*).[60] As with the situation under the common law, the fundamental difference between the two involves the ultimate "liability" of the various partners for the affairs of the partnership.

The third one, the unregistered partnership, is not subject to any publicity rule. Because of this, they are often secret partnerships (i.e., only the partners know about them). Third-parties will contract with the manager to whom the task has been given to manage the partnership, without knowing about the existence of the partnership. A general or limited partnership that has failed to register automatically becomes an undeclared partnership and is subject to the rules applicable to such partnerships.

I - 3.4 Formation and Existence of a Partnership

The partnership is created upon the formation of the contract, unless another date is indicated in the contract.[63] Where a declaration is required, the date of the declaration does not determine the date of the existence of the partnership, it is still the date of the contract that counts.

It is of the essence of the partnership that at least two persons are present to form the contract. But once we have a partnership, the uniting of all the shares in the hands of a single partner does not entail dissolution of the partnership, provided at least one other partner joins the partnership within one hundred and twenty days.[64] The partners may also be physical or moral (e.g., corporate) persons.

I - 3.5 Implications of Partnership

I - 3.5(a) The Firm as a Collection of Partners, Without Separate Legal Status, & Operating under Agency Principles

Notwithstanding their numerous legal attributes, the view of the majority is that Quebec partnerships are not separate legal persons. In view of the existence of many legal attributes, many authors refer to the concepts of patrimony by appropriation and division of patrimony, to explain the patrimonial autonomy of partnership outside the framework of legal personality.

I - 3.5(b) Partners as Agents for and of Each other

Each partner is a mandatory (i.e., the civil law equivalent of an agent) of the partnership in respect of third-parties in good faith and binds the partnership for every act performed in its name, in the ordinary course of its business.[65]

Accordingly, an obligation contracted by the partner in his own name binds the partnership when it comes within the scope of the business of the partnership or when its object is properly used by the partnership.[66]

I - 3.5(c) Transactions Between Partners

Under the Code, the partners may enter into such agreements between themselves as they consider appropriate "with regard to their respective powers in the management of the affairs of the partnership".[67] They may appoint one or more fellow partners, or even a third person, to manage the affairs of the partnership.[68] Failing such appointment, the partners are deemed to have conferred the power to manage on one another.[69]

The Code also states that a "partner is a debtor to the partnership for everything he promises to contribute to it".[70] Further, it indicates that a partner may not compete with the partnership or take part in an activity which deprives the partnership of the property, knowledge or activity he is bound to contribute to it.[71] A partner is also entitled to recover the amount of the disbursements he has made on behalf of the partnership, as follows:[72]

> A partner is entitled to recover the amount of the disbursements he has made on behalf of the partnership and to be indemnified for the obligations he has contracted or the losses he has suffered in acting for the partnership if he was in good faith.

Each partner may use the property of the partnership, provided he uses it in the interests of the partnership.[73]

A partner may associate a third person with himself in his share in the partnership without the consent of the other partners.[74] But in such case, the third-party does not become a member of the partnership and the other partners may, upon becoming aware of the situation, exclude the person by reimbursing him for the price of the share and the expenses he has paid.

I - 3.5(d) Contractual Liability

Under Article 2221 of the Code, the partners are jointly liable for the obligations contracted by the partnership, as follows:

> In respect of third persons, the partners are jointly liable for the obligations contracted by the partnership but they are solidarily liable if the obligations have been contracted for the service or operation of an enterprise of the partnership.
>
> Before instituting proceedings for payment against a partner, the creditors shall first discuss the property of the partnership; if proceedings are instituted, the property of the partner is not applied to the payment of creditors of the partnership until after his own creditors are paid.

Further, a person who gives a third-party reason to believe that he is a partner, although he is not, may be held liable as a partner toward third-parties acting in good faith.[75] In such cases, the partnership is not liable, unless it gave the third-party reason to believe that such person was a partner.

I - 3.6 Dissolution of a Partnership

The dissolution of the partnership is governed by Article 2230 of the Code, as follows:

> A partnership is dissolved by the causes of dissolution provided in the contract, by the accomplishment of its object or the impossibility of accomplishing it, or by consent of all the partners. It may also be dissolved by the court for a legitimate cause.
>
> Liquidation of the partnership is then proceeded with.

The power of the partners to act on behalf of the partnership cease upon its dissolution, except in respect of acts which are a necessary consequence of business already begun. But something done by a partner unaware of the dissolution of the partnership and acting in good faith will bind the partnership and the other partners.

I - 3.7 Partnership as Distinct from Other Business Relationships

From a Quebec perspective, we will address our comments to corporations and joint ventures.

I - 3.7(a) In Contrast to Corporations

In common law, it is clear that partnerships are not legal persons.

In Civil Law, there was a debate before the revision of the Code in 1994 and it seems that this old debate is not over. Some quote the following segment of Article 2188 "*Partnerships may also be joint-stock companies, in which case they are legal persons.*" To conclude "a contrario" that a partnership that is not a joint-stock company is not a legal person. What is clear, however, is that a partnership may sue and be sued in a civil action under the name it declares[76].

In her Report on the Legal Nature of Partnerships: Comparative Law Study, Charlaine Bouchard indicated as follows:

> Since 1994, about 15 decisions have, with varying degrees of eloquence, dealt with the question of the legal personality of partnerships. Only a few of them are consistent. Most of them recognize the legal attributes of partnerships – they may sue and be sued, and they have an autonomous patrimony – without exploring the rationale therefore any further. Unfortunately, other decisions rely on Allard and deny partnerships patrimonial autonomy on the contention that they are not legal persons.[77]

In a recent presentation at a Canadian Tax Foundation Seminar,[78] Brian Bloom, while indicating that the debate is still on-going in Quebec, stated his conclusion that a partnership is not a legal person. This is based upon an interpretation "a contrario" of Article 2188 of the Code; and upon the difficulty of understanding how a relation that was born only out of the consent of private parties could constitute a person under the law, unless a law (including the Civil Code of Quebec) states expressly that this relation constitutes a person.

I - 3.7(b) ***In Contrast to Joint Ventures***

Another debate taking place in "La belle province" is whether it is in legally possible to create a "joint venture" in Quebec.

The GST Policy P-171R[79] includes the following statement:

> The *Civil Code of Lower Canada* and the *Civil Code of Québec* do not, and never have, recognized the existence of joint ventures ("coentreprise") as such. The courts have, however, recognized the possibility of joint ventures existing in the province of Québec in very restricted circumstances.

In her above-mentioned Report, Ms. Bouchard also had these words of caution:

> The participants in a joint venture will have to be extremely clear and precise in drafting their agreement to express their intention not to form an undeclared partnership. This is because joint ventures draw upon the criteria for the creation of such partnership.

And if we consider the fact that section 346 of the Quebec Sales Tax Act allows a "joint venture election", it would seem fairly clear that a "joint venture" is now recognized in Quebec.

On the other hand, a joint venture relation is so close to an undeclared partnership that few people in practice may characterize them correctly, or be able to tell them apart.

Clearly, both offer the advantage of confidentiality, flexibility and lack of formalism. But this lack of formalism complicates the task of characterizing the relationship. Such task is further complicated by the fact that a partnership may be created to carry on a single activity.[80] We know of persons wishing to cooperate in a given project who specifically state in their written contract that they are not creating a partnership. Have they succeeded?

It appears not if the conditions of the contract otherwise make it a partnership contract, and the courts have been clear on that point in civil law cases as well. [81]

PART II – PARTNERSHIPS & THE GST

Canada's federal value-added taxing system is called the Goods and Services Tax (the "GST"), and is provided for in Part IX of the *Excise Tax Act* (the "*ETA*").

The balance of this Part assumes a sophisticated understanding of the GST system.

If further reference material is required, please contact either the authors, or the CICA.

II - 1 OVERVIEW

II - 1.1 Partnership as a "Person" for GST Purposes

Unlike the case under the *Income Tax Act*, where a partnership is not considered a separate person, a partnership is generally considered a "person" for GST purposes.[82] This follows from the special definition of "person" in subsection 123(1) of the *ETA*, which defines it to mean, among other things, a "partnership":

> "**person**" means an individual, a partnership, a corporation, the estate of a deceased individual, a trust, or a body that is a society, union, club, association, commission or other organization of any kind;
>
> (emphasis added)

This has led most commentators to conclude that for GST purposes, partnerships have a separate legal status, although the implications for that status of GST purposes still likely remain to be fully identified.

Notwithstanding, the separate legal status that appears to have been afforded "partnerships" for GST purposes is different from the treatment generally afforded partnerships in the RST context (i.e., most notably in British Columbia), where a "partnership" is not considered a separate "person", with often problematic results.

While the *ETA* has defined a "partnership" to be a person, we will see that determining whether a "partnership" exists is a question that must be addressed under applicable provincial law.

II - 1.2 What is a "Partnership" for GST Purposes?

We concluded in Part I that whether a "partnership" exists, becomes a question determined with reference to provincial legislation, the common (or civil law) jurisprudence, and the agreement in place between the parties.

Given that there is no special definition of "partnership" in the *ETA*, this general framework also applies where the question arises for GST purposes. Thus the base question of whether a partnership exists must be determined with reference to the analysis we undertook in Part I.

The CRA seems to accept this in the limited GST guidance on this question, although not without some potential hitches. GST Policy P-171R (*Distinguishing Between a Joint Venture and a Partnership for the Purposes of the Section 273 Joint Venture Election*, Revised February 24, 1999),[84] which is generally unremarkable as a policy document, does contain the following statement which might cause some concern:

> The Excise Tax Act does not define either "partnership" or "joint venture". Therefore, the rules of statutory interpretation require that the common meaning of "partnership" and "joint venture" apply.

At best, the statement probably represents some loose language; at worst, it probably represents a misstatement of the law. As we reviewed in Part I, "partnerships" are now provided for in provincial statutes, and are thus within the jurisdiction of the provinces. A "partnership" will be what the provincial legislatures say it is. The "common" or "ordinary" meaning of the word will not factor into the analysis. While this type of criticism might seem trivial, the question of whether or not a partnership exists is fundamental to the application of the GST, and that question will have nothing to do with the common or ordinary meaning of the word "partnership", but everything to do with the sort of regimented analysis presented in Part I.

Finally, and given that GST Policy P-171R was last revised on February 24, 1999, well prior to the Supreme Court's recent musings on "partnerships", one should probably approach this commentary regarding the tenets of a "partnership" with some caution, in any event.

II - 1.3 Partnership Juxtaposed with Joint Venture

While special joint venture rules are also provided for in the *ETA*, the rules are often not that useful, as only certain prescribed joint ventures may use them.

In practice, that means that where a "joint venture" structure is used instead of a "partnership" (or another structure recognized as a "person"), each participant must account separately for the GST payable on its purchases, and collectible on its supplies – whether they are made directly by the participant or through the joint venture operator acting as its agent. The technical reason is that section 240 of the *ETA* only permits "persons" to register for the GST, and based on the definition of "person" in subsection 123(1), a "joint venture" have traditionally not been regarded as qualifying as "persons", unless operating in the form of a corporation, a partnership or a trust.[86]

Where applicable, section 273 simplifies the administration of the GST for prescribed joint ventures – permitting the operator of a qualifying joint venture to elect with any participant to designate the operator as the person responsible for GST accounting, and allowing the joint venture's operation to mirror, from a GST perspective, the operation of a partnership.

II - 1.4 **Survey of Relevant Provisions**

The status of a "partnership" as a separate person for GST purposes occasions some special rules for the treatment of "partnerships". A survey of the applicable rules finds them in, among some others, the following sections of the *ETA*:

Subsection 123(1)	Definition of "person", to mean, among other things, a partnership
Subsection 123(1)	Definition of "financial instrument", includes partnership interest
Subsection 126(3)	Deeming partners to be related to partnership
Subsection 127(3)	Associated Persons rules for partners
Paragraph 132(1)(b)	Residency rules for partnerships
Paragraph 132.1(2)(c)	Permanent Establishment rules for partnerships
Section 156	Closely Related Canadian Partnership rules
Section 172	Appropriate of, among others, partnership property
Section 173	Taxable Benefits to, among others, partnerships
Section 174	Allowances and reimbursements for, among others, partnerships
Section 175	Among others, partner reimbursements
Section 253	Partner Rebates
Section 272.1	Partnership Rules

By far, the most significant of these rules is found in section 272.1 of the *ETA*, which forms a principal part of the discussion of how the GST applies to common partnership transactions, in the section below. For convenience, and given that much of the discussion that follows revolves around the specific legislation in section 272.1, we have reproduced it in its entirety in Figure 3. As the application of subsections 272.1(1) and (2) also depends heavily on the "partner reimbursement" rules in section 175, we have also reproduced that section in Figure 4.

Figure 3: ***Section 272.1 of the ETA*** – 1 of 2

272.1(1) **Partnerships** — For the purposes of this Part, anything done by a person as a member of a partnership is deemed to have been done by the partnership in the course of the partnership's activities and not to have been done by the person.

(2) **Acquisitions by member** — Notwithstanding subsection (1), where property or a service is acquired or imported by a member of a partnership for consumption, use or supply in the course of activities of the partnership but not on the account of the partnership, the following rules apply:

(a) except as otherwise provided in subsection 175(1), the partnership is deemed

(i) not to have acquired or imported the property or service, and

(ii) where the property was brought by the member from a non-participating province into a participating province, not to have so brought it into that province;

(b) where the member is not an individual, for the purpose of determining an input tax credit or rebate of the member in respect of the property or service and, in the case of property that is acquired or imported for use as capital property of the member, applying Subdivision d of Division II in relation to the property, subsection (1) does not apply to deem the member not to have acquired or imported the property or service and the member is deemed to be engaged in those activities of the partnership; and

(c) where the member is not an individual and the partnership at any time pays an amount to the member as a reimbursement and is entitled to claim an input tax credit in respect of the property or service in circumstances in which subsection 175(1) applies, any input tax credit in respect of the property or service that the member would, but for this paragraph, be entitled to claim in a return of the member that is filed with the Minister after that time shall be reduced by the amount of the input tax credit that the partnership is entitled to claim.

(3) **Supply to partnership** — Where a person who is or agrees to become a member of a partnership supplies property or a service to the partnership otherwise than in the course of the partnership's activities

(a) where the property or service is acquired by the partnership for consumption, use or supply exclusively in the course of commercial activities of the partnership, any amount that the partnership agrees to pay to or credit the person in respect of the property or service is deemed to be consideration for the supply that becomes due at the time the amount is paid or credited; and

(b) in any other case, the supply is deemed to have been made for consideration that becomes due at the time the supply is made equal to the fair market value at that time of the property or service acquired by the partnership determined as if the person were not a member of the partnership and were dealing at arm's length with the partnership.

(4) **Deemed supply to partner** — Where a partnership disposes of property of the partnership

(a) to a person who, at the time the disposition is agreed to or otherwise arranged, is or has agreed to become a member of the partnership, or

(b) to a person as a consequence of that person ceasing to be a member of the partnership,

the following rules apply:

(c) the partnership is deemed to have made to the person, and the person is deemed to have received from the partnership, a supply of the property for consideration that becomes due at the time the property is disposed of equal to the total fair market value of the property (including the fair market value of the person's interest in the property) immediately before the time the property is disposed of, and

(d) subsection 172(2) does not apply in respect of the supply.

(5) **Joint and several liability** — A partnership and each member or former member (each of which is referred to in this subsection as the "member") of the partnership (other than a member who is a limited partner and is not a general partner) are jointly and severally liable for

(a) the payment or remittance of all amounts that become payable or remittable by the partnership under this Part before or during the period during which the member is a member of the partnership or, where the member was a member of the partnership at the time the partnership was dissolved, after the dissolution of the partnership, except that

(i) the member is liable for the payment or remittance of amounts that become payable or remittable before the period only to the extent of the property and money that is regarded as property or money of the partnership under the relevant laws of general application in force in a province relating to partnerships, and

(ii) the payment or remittance by the partnership or by any member thereof of an amount in respect of the liability discharges the joint liability to the extent of that amount; and

(b) all other obligations under this Part that arose before or during that period for which the partnership is liable or, where the member was a member of the partnership at the time the partnership was dissolved, the obligations that arose upon or as a consequence of the dissolution.

Figure 3: ***Section 272.1 of the ETA*** – 2 of 2

(6) **Continuation of partnership** — Where a partnership would, but for this subsection, be regarded as having ceased to exist, the partnership is deemed for the purposes of this Part not to have ceased to exist until the registration of the partnership is cancelled.

(7) **Continuation of predecessor partnership by new partnership** — Where

(a) a partnership (in this subsection referred to as the "predecessor partnership") would, but for this section, be regarded as having ceased at any time to exist,

(b) a majority of the members of the predecessor partnership that together had, at or immediately before that time, more than a 50% interest in the capital of the predecessor partnership become members of another partnership of which they comprise more than half of the members, and

(c) the members of the predecessor partnership who become members of the other partnership transfer to the other partnership all or substantially all of the property distributed to them in settlement of their capital interests in the predecessor partnership,

except where the other partnership is registered or applies for registration under section 240, the other partnership is deemed to be a continuation of and the same person as the predecessor partnership.

Figure 4: ***Section 175 of the ETA***

175.(1) **Employee, partner or volunteer reimbursement** — Where an employee of an employer, a member of a partnership or a volunteer who gives services to a charity or public institution acquires or imports property or a service or brings it into a participating province for consumption or use in relation to activities of the employer, partnership, charity or public institution (each of which is referred to in this subsection as the "person"), the employee, member or volunteer paid the tax payable in respect of that acquisition, importation or bringing in and the person pays an amount to the employee, member or volunteer as a reimbursement in respect of the property or service, for the purposes of this Part,

(a) the person is deemed to have received a supply of the property or service;

(b) any consumption or use of the property or service by the employee, member or volunteer in relation to activities of the person is deemed to be consumption or use by the person and not by the employee, member or volunteer; and

(c) the person is deemed to have paid, at the time the reimbursement is paid, tax in respect of the supply equal to the amount determined by the formula

A x B

where

A is the tax-paid by the employee, member or volunteer in respect of the acquisition, importation or bringing into a particular province of the property or service by the employee, member or volunteer, and

B is the lesser of

(i) the percentage of the cost to the employee, member or volunteer of the property or service that is reimbursed, and

(ii) the extent (expressed as a percentage) to which the property or service was acquired, imported or brought into the province, as the case may be, by the employee, member or volunteer for consumption or use in relation to activities of the person.

(2) **Exception** — Subsection (1) does not apply to a reimbursement in respect of property or a service acquired, imported or brought into a participating province by a member of a partnership where paragraph 272.1(2)(b) applies to the acquisition, importation or bringing in, as the case may be, and the reimbursement is paid to the member after the member files with the Minister a return of the member under section 238 in which an input tax credit in respect of the property or service is claimed.

II - 2 APPLICATION OF THE GST TO COMMON PARTNERSHIP TRANSACTIONS

II - 2.1 Asset Transfers on the Creation of a Partnership

While the discussion in Part I spent much time on the fundamental tenets of partnership, the practical first steps in the creation of a partnership often involve the contribution by the partners of money, assets or labour, as well as an agreement as to the sharing of profits.[87]

What is the legal character of these transactions, and how does the GST apply?

II - 2.1(a) Legal Character

At law, the transfer of property to a partnership on its formation involves a transfer of the property from the contributing partner to each of the other partners, such that after the contribution, beneficial ownership of the property contributed is shared by each of the partners of the partnership, in their respective shares.

For example, A and B form a 50-50 partnership, with A agreeing to contribute land worth $100,000, and B agreeing to contribute equipment worth $100,000. On the formation of the partnership, and after the contribution of the property, A becomes a 50% beneficial owner of both the land and the equipment (i.e., giving up 50% beneficial ownership in the land, but gaining 50% beneficial ownership in the equipment). B also becomes a 50% beneficial owner of both the land and the equipment (i.e., gaining the 50% beneficial ownership in the land, but giving up 50% beneficial ownership in the equipment).[88]

At law, then, certain of the beneficial interest in the property is seen to be "sold" by the contributing partner to each of the other partners, with the contributing partner retaining a certain percentage, commensurate with its respective interest in partnership property.

What occurs for GST purposes?

II - 2.1(b) Application of the GST – First Principles

Given that a "partnership" is a separate person for GST purposes, it is likely that the GST character of the transaction differs from the legal character. Here, one supposes that given its status as a "person", the "partnership" is seen to take ownership of the property, with the initial contribution of the property by the partners being regarded as a complete disposition of all property interest in it (for GST purposes), perhaps in exchange for some intangible interest in the partnership.[89]

If that is the case, the initial contribution of property to the partnership by the partners would appear to be a potentially taxable transaction, and absent special relieving rules, the property contributed subject to GST.[91]

Relieving rules worth consideration include sections 156 or 167 or, in the context of two exempt users of property (i.e., partner and partnership), subsection 200(3) and paragraph 141.1(1)(b) of the *ETA* – which closely parallel each other, and are in many respects duplicative of each other. Consideration might also be given to the possible application of the small supplier rules, if the prospective partners were not previously GST registrants.

If the assets being transferred to the partnership were used in commercial activities, however, and no GST relieving rule applied, the GST would apply to the contribution. This may be a surprise to non-commodity tax practitioners, as unlike under subsection 97(2) of the *Income Tax Act*, which provides (subject to certain conditions) for a tax-free transfer of property from a partner to a partnership, there is no similar non-recognition provision for GST purposes.[92]

To the extent that the partners are viewed as obtaining an "interest in the partnership" as a result of the partnership's formation, or in return for their contribution of property, if any, the supply of that interest – which is presumably being "issued" from the partnership to the partner – would be an exempt supply of a financial service. This follows from the definition of "financial instrument", "financial service" and the general exemption for supplies of financial services in Schedule V of the *ETA*. [93]

Finally special rules in subsection 272.1(3) determine the value on which the partnership must pay the GST, as discussed in the section below.

II - 2.1(c) ***Application of the GST – Subsection 272.1(3) – Special Valuation Rules***

While not displacing the GST analysis above, special rules in subsection 272.1(3) deal with situations where the partner (or prospective partner) supplies property or services *otherwise* than in the course of the partnership's activities.

It is not completely certain whether these rules would apply to property contributed on the formation of the partnership, although their application would likely be redundant in any event (i.e., the related party rules in subsection 155(1) of the *ETA*, and the special deeming rule in subsection 126(3) of the *ETA* – which deems a partner to be related to the partnership – would appear to do the same thing).

Either way, the *ETA* operates to ensure that the consideration established for the supplies by the partner to the partnership are, in circumstances where the partnership is not entitled to a full input tax credit ("ITC"), deemed to occur at fair market value ("FMV").

It is notable that the rules in subsection 272.1(3) deem the value of the consideration to be FMV at the time it becomes due, not the time the contribution is made. There may be some unintended effects here, especially to the extent the timing differences result in different values.

II - 2.2 'Supplies' by Partner to Partnership – In the Course of Partnership Activities

There will be many instances where a partner will, acting on its own account and with its own funds, acquire property for use in the partnership, and be reimbursed for the same by the partnership.

What is the legal character of these transactions, and how does the GST apply?

II - 2.2(a) Legal Character

Based on our discussion in Part I, it should now be clear that where a partner acts for the purpose of the business of the partnership, the partner acts as an agent of the partnership, making the partner's actions the firm's actions (or peeling back the onion, the actions of each and every other partner).

Thus, when a partner acts in the course of partnership activities, it would generally be expected, from a first principles analysis, that no supply is capable of occurring from the partner to the partnership, because the two are in an agent and principal relationship, one in the same, and inseparable as a matter of law.

One sees the same legal result for GST purposes, albeit, with the benefit of a special (and possibly redundant) deeming rule.

II - 2.2(b) Application of the GST – Subsection 272.1(1) – General Partnerships Rule

Where a partner acts in the course of partnership activities, the general rules for the operation of partnerships in the *ETA* (found in section 272.1) deem the partners actions to be the actions of the partnership – paralleling the legal reality of the situation based on provincial partnership law.

As a consequence, no supply is deemed to exist as between a partner acting in the course of the partnership activities, and the partnership itself.

The general rule is found in subsection 272.1(1) of the *ETA*, and can be seen to parallel the "agency" language in provincial partnership legislation, as follows:

> 272.1(1) **Partnerships** — For the purposes of this Part, anything done by a person as a member of a partnership is deemed to have been done by the partnership in the course of the partnership's activities and not to have been done by the person.

This short subsection thus both encapsulates the agency principle underlying partnership, and provides a broad and powerful deeming rule for the application of the GST to partner and partnership transactions. Specifically, the GST effect of the rule is to deem what would otherwise have been a potentially taxable supply from partner to partnership, to be a "nothing" for GST purposes, with no GST effect at all – with

the admitted intent of the rule being to obviate the need for partners to register separately for GST purposes.[94]

One wonders, however, whether that would really have been the case had proper legal principles been applied, and provisions like section 6 of the Ontario *Partnerships Act* applied.[95]

The CRA has recently finalized its long-awaited policy document GST Policy P-244, *Partnerships – Application of subsection 272.1(1) of the Excise Tax Act*, August 9, 2004 ("GST Policy P-244"). GST Policy P-244 explains the CRA's dividing line on partnership activities, and is the subject of discussion in section II-4.1 below, entitled "Recent Changes - New GST Policy P-244".

Finally, and while the general rule in subsection 272.1(1) is sometimes displaced by a separate set of rules in subsection 272.1(2), the subsection 272.1(2) exceptions are generally aimed at relatively narrow situations, where a partner acquires "partnership property using its own funds, and registers to claim the ITCs, rather than being reimbursed directly by the partnership. Subsection 272.1(2) is discussed further below in section II - 2.9, entitled "Acquisitions by Partners on their Own Account".

II - 2.3 Supplies by Partner to Partnership – Otherwise than in Course of Partnership Activities

Partners often provide personal services or personal property to their partnerships, which do not fall strictly within the ambit of the partnership's business.

What is the legal character of these transactions, and how does the GST apply?

II - 2.3(a) Legal Character

Juxtaposed with the situation where a partner acts in the course of partnership activities, as "agent" for the partnership (i.e., where no "supplies" between the two can exist, being inseparable as a matter of law), is the situation where a partner acts *otherwise* than in the courses of the business of the partnership.

In these instances an agency analysis would not apply, as the partner would be seen to be acting in its personal capacity and *not* as agent of the partnership. The partner's actions would not bind the partnership, and to the extent the actions involved the acquisition and resupply of property or services to the partnership, the sale of property or the provision of the services would be viewed as separate legal transactions.

Special rules in the *ETA* are also aimed at ensuring the same result for GST purposes.

II - 2.3(b) Application of the GST – Subsection 272.1(3) – Special Valuation Rules

Unlike the situation where a partner acts in the course of partnership activities – such that subsection 272.1(1) deems the actions to have been the actions of the partnership – where a partner makes supplies to the partnership *otherwise* than in the course of the partnership's activities, the special rules in subsection 272.1(3) apply.[96]

First, like the situation underlying the formation of a partnership, potentially taxable supplies exist as between the partner and the partnership in this situation. Here, no relief is available under subsection 272.1(1), since the partner is plainly not acting in the course of partnership activities.

Second, the special valuation rules in subsection 272.1(3) are triggered to ensure that in those instances where the partnership would not be entitled to a full ITC, the consideration paid by the partnership for such supplies is based on FMV.

Figure 5: ***Example –Subsection 272.1(3)***

Example 1: Kreklewetz, a partner at Millar Kreklewetz LLP, decides to transfer his vast collection of borrowed beer mugs from storage at home to a front-and-centre display in his office downtown – believing the same will "just have to improve" his chances of getting work.

Millar Kreklewetz LLP agrees to purchase the same for $10,000, a seemingly exorbitant price, and credits Kreklewetz's drawings for the same.

GST Effect: Assuming no issues as to whether the beer mugs are properly for use in the partnership's activities, paragraph 272.1(3)(a) deems the consideration for the same to be $10,000; it does not matter whether the price is exorbitant or not.

If Kreklewetz is a registrant he is required to charge and collect GST on the amount, with Millar Kreklewetz LLP entitled to an off-setting ITC.

Example 2: Medical Co., a registrant, transfers $5,000,000 worth of assets to Health Partnership, an exclusively exempt supplier, of which it is a partner. To minimize the GST, the parties agree to a price of $1, but agree to adjust Medical Co.'s share of the partnership profits in years to come. Medical Co. last used the assets in commercial activities.

GST Effect: Paragraph 272.1(3)(b) deems the consideration for the assets to be their fair market value, or $5,000,000. Medical Co. is required to charge and collect $350,000 in GST; the cost becomes a hard cost to Health Partnership.[†]

[†] Note that if Medical Co.'s use of the assets had been exempt (i.e., such that GST had been paid initially, special sections may come into play to relieve the further charging and collecting of GST (e.g., section 141.1, subsection 200(3)).

In situations where the partnership is involved exclusively in commercial activities – and where the value of its inputs is, for GST purposes, not really important, since the GST paid on the inputs will be fully recoverable anyway – paragraph 272.1(3)(a) deems the consideration for the supply to be the amount "paid or credited" to the partner, whether that be in cash or in the form of an increase in the supplying partner's interest in the partnership.

The consideration is also deemed to become due when the amount is so paid or credited.[97]

In situations where the partnership is not involved exclusively in commercial activities – and where the GST paid on its inputs now matters, because it will not be fully recoverable by way of an ITC – paragraph 272.1(3)(b) deems the consideration for the supply to be the FMV of the supply made.

Note that the FMV is determined as though the partner and partnership were dealing at arm's length, and is intended to represent the value of the *entire property or service*, including the supplying partner's interest in it.[98]

Figure 5 provides an example of how the rules in subsection 272.1(3) work.

II - 2.4 The Operation of the Partnership

A partnership in action can take many forms, including the simple purchase and resale of property, or the rendering of professional services. Much more complex operations also exist.

What is the legal character of a partnership in action, and how does the GST apply?

II - 2.4(a) Legal Character

Recall Figures 2a through 2c, which provided examples of the convoluted approach to understanding the underlying relationships and beneficial ownership of the paper pad purchased by one partner in a two person partnership, and the convoluted character of a partnership in action.

Equally as convoluted is the legal character of the supplies that a partnership receives or makes to third-parties, and the overall operation of a partnership in action.

If one wanted to carefully analyze what happens in an operating partnership as a matter of law, one would have to peel our metaphorical onion back to the partner layer, and review each transaction on the basis of the "agent and principal" relationship that is the partnership.

Thankfully, the situation is much more straight-forward for GST purposes, in large part to the status of the "partnership" as a separate person for GST purposes.

II - 2.4(b) Application of the GST – First Principles Analysis

Given that a partnership is a "person" for GST purposes, partnerships are able to act as recipients and acquire supplies from any third-party, just as any other individual or corporate person could. Partnerships are also liable to pay the GST on the acquisition of property or services taxed under Divisions II, III and IV. Where eligible, partnerships can claim ITCs.

In short, the convoluted characterization of a partnership in action for legal purposes is short-coursed by the special status that a partnership enjoys for GST purposes, making the application of the GST to the actual operation of a partnership quite straight-forward.

II - 2.4(c) ***Application of the GST – Subsection 272.1(5) – Joint & Several Liability re GST Obligations***

While the operation of a partnership is straight-forward for GST purposes, subsection 272.1(5) of the *ETA* establishes a special rule that imposes joint and several liability on every general partner for the GST obligations of the partnership.[99]

Under this rule, the liability for GST obligations includes a joint and several liability for "all amounts that become payable or remittable by the partnership before or during the period in which the person is a member of the partnership". The section also clarifies that there is no liability for obligations arising before the person became a partner, although those GST obligations can be satisfied from the existing property and money of the partnership. Where the person was a partner at the time of the dissolution, the joint and several liability in subsection 271.1(5) will extend to amounts payable or remittable after the dissolution.

Figure 6: ***Partnership to Partner***

In the Course of Partnership Business

Example 1: Millar Kreklewetz LLP purchases a notebook computer and gives it to Millar for his use exclusively in business activities of the partnership, for the entire economic life of the computer.

Legal Effect: Nothing has been provided to Millar personally. The physical use of the notebook is a use by the partnership, not Millar personally.

Example 2: Raymond Chabot Grant Thornton ("RCGT") provides translation services to Arsenault in conjunction with the preparation of his 2004 Commodity Tax Symposium Paper, which he undertook as part of RCGT's general business activities.

Legal Effect: Nothing has been provided to Arsenault personally. The provision of the services by the RCGT translators is, in effect, to RCGT itself, and no separate legal transaction takes place.

OTHERWISE than In the Course of Partnership Business

Example 3: RCGT decides to provide all of its partners with new gold watches for their spouses, purchasing and transferring ownership of the same.

Legal Effect: The transactions are not likely in the course of the partnership business, and transfers of ownership between the partnership and the partners will be seen to occur.

Example 4: Kreklewetz is embroiled in a nasty custody dispute. Millar advises him on certain aspects of the problem, and next best steps, but charges him a fee.

Legal Effect: Millar is (likely) not acting in the course of partnership business, and Millar Kreklewetz LLP cannot be seen to be acting in the course of its business activities. There is a separate legal transaction between the two partners.

Consistent with the principles of joint and several liability, if one partner pays the liability, the other partners are off the hook, although still subject to an action for contribution from the partner paying the debt.

One also sees that subsection 272.1(5) works hand in hand with paragraph 296(1)(e) of the *ETA*, the latter of which permits the CRA to assess the partners for their partnership's GST, notwithstanding that the partnership may not have been assessed first.[100]

The Tax Court confirmed the same in the *Janelle* case,[101] and more recently, in *Beaupre v. R.*, [2004] GSTC 34 (TCC).

II - 2.5 Supplies from Partnerships to Partners

From time to time, a partnership will find reason to supply property or services to one or more of its partners.

What is the legal character of these transactions, and how does the GST apply?

II - 2.5(a) Legal Character

Like the situation where a partner provides property or services to a partnership, it is important to understand in the context of the situation, and whether the property or services being provided to the partner are in the context of the partnership business.

If in the context of the partnership business, and bearing in mind that the partnership is merely a collection of the partners, then agency principles would suggest that there is no supply from the partnership to the partner. (See Figure 6.)

How does the GST apply?

II - 2.5(b) Application of the GST – Subsection 272.1(4) – Special Valuation Rules

– *Property*

Subsection 272.1(4) deals with the application of the GST in situations where the partnership decides to dispose of partnership *property* by supplying it to a partner, whether existing, prospective, or departing.

The section works to deem subsection 172(2) not to apply,[102] and deem the partnership to have made a supply of the property to the partner for the FMV of the property.

The use of "dispose" is interesting, and one wonders about the ambit of the word. Neither the words "dispose" nor "disposition" are defined in the *ETA*, although "disposition" is defined quite broadly in subsection 248(1) of the *Income Tax Act*. Generally speaking, however, "disposition" for income tax purposes does not include most situations where there is no transfer of "beneficial ownership" in the underlying property. This also appears to accord with other definitions of the word.[103]

What this probably means is that for GST purposes, so long as partners are not being transferred ownership of the underlying property, the transaction will not attract GST under subsection 272.1(4) – although to the extent a "benefit" was conferred on the partner, subsection 172(2) could still well apply.

Perhaps the use of the word "dispose" is meant to help ensure that in those instances where exclusive use of property is conferred to a partner in the course of partnership activities (e.g., the notebook, the

PDA, the cell phone), there is no application of GST unless the same amounts to a "benefit" within the meaning of subsection 172(2).

Either way, it would appear that there is some symmetry here between the application of the GST to "property" provided to partners by the partnership, and what we have posed would otherwise be the legal reality of the transactions.

– ***Services***

It is noteworthy that subsection 272(4) does not apply to the provision of "services". However, it would appear that other provisions in the *ETA* operate to ensure that where services are provided outside of normal business activities, the GST will apply. (See Figure 7.)

Figure 7: ***Tip –Subsection 272.1(4)***

It is notable that the FMV rule in subsection 272.1(4) does *not* apply with respect to supplies of "services" from the partnership to a partner.

To the unwary, that might suggest that a partnership is capable of providing services to its partners at below FMV prices, with no GST effect.

That is not a correct assumption, however, as even in the absence of subsection 272.1(4), the general rules in subsections 126(3) and 155(1) would kick in to deem the provision of cut-rate services to be at FMV as well – at least to the extent the partner was not a registrant acquiring the supply for exclusive consumption, use, or supply in commercial activities (i.e., and able to recover any GST paid anyhow).

Furthermore, to the extent the provision of the services amounted to a benefit (see Example 4 in Figure 6), subsection 172(2) would also have application.

II - 2.6 Transfers of Partnership Interests

II - 2.6(a) Legal Character

Assuming one is past the creation of the partnership, a transfer of a "partnership interest" can appear to mean a number of different things.

It could mean an agreement to change profit sharing ratios. It could also mean a change in the interest in the partnership's underlying capital. It could (and often does) mean a combination of both. It could also refer to the dissolution of one partnership, and the creation of another, with one retiring partner transferring its interest to a new partner.

For GST purposes, however, it would appear that the concept underlying the "transfer of an interest in a partnership" is rather straight-forward.

II - 2.6(b) Application of the GST – First Principles Analysis

Because a partnership is deemed to be a separate person for GST purposes, it appears that a transfer of an "interest in a partnership" does not have to do so much with the legal changes occasioned in the sharing of partnership property or partnership profits, as it has to do with a transfer of the same as between partners. This is because no matter the dealings of the partners when it comes to ownership of partnership property, or entitlement to partnership profits, 'the partnerships' ownership' of the partnership property remains the same for GST purposes.

Thus, for GST purposes the transfer of the partnership interest appears no different than the transfer of any other equity interest, or the issuance of the partnership interest discussed above: it is again an exempt financial service.

II - 2.6(c) ***Commentary***

One can again see some of the difficulties that arise given the GST fiction that a partnership is a separate legal person. Commercially, a transfer of a partnership interest can be an incredibly difficult exercise, perhaps involving transfers of assets, or reapportionment of a partner's rights to the partnership profits. The legal character of the transactions is clearly different than the GST character – which reduces to the almost over-simplistic.

One wonders whether in this apple and oranges dichotomy between the legal nature of the transactions, and their character for GST purpose, lays some real unintended difficulties.

For example, suppose commercially, a partnership between A and B was changed by increasing A's percentage in the partnership by 10%, from 50% to 60%, and by decreasing B's percentage by the same amount (e.g., from 50% to 40%). If B transferred its 10% interest to A for $1000, the supply would be presumably exempt.

But what if B's 10% represented both a 10% right to participate in profits, and a 10% beneficial ownership in the underlying capital of the partnership? What if the underlying capital was property? Has B supplied property to A?

The answers appear to be "probably yes" for legal purposes, but "no" for GST purposes.

At law, a transfer in the beneficial ownership of the property has probably occurred. However, for GST purposes, the real property transaction has likely been shielded from any GST effect by a combination of the (1) separate status of the partnership as a separate person (leading to the initial conclusion that the partnership remains in complete ownership of the underlying property, thus there could have been no supply of it for GST to attract), and (2) the exempt status afforded to transfers of "partnership interests" – which would be all that B would have to supply to A once the "partnership" is deemed to be a separate person.

Yet none of this is completely clear either.

It appears that what the *ETA* has done quite clearly is to deem a partnership to be a separate person; but what it has not done – or perhaps what it has done *less clearly* – is deem a partner's interest in the underlying capital of a partnership to be a "nothing" for GST purposes. That is, while the *ETA* has

defined an "interest in a partnership" as a "financial instrument", capable of being supplied on an exempt basis, it probably should have added a provision clarifying just what an "interest in a partnership" is – which is not self-evident.[104]

Confusing? It should be, as there are certainly some mental gymnastics at play in understanding the nature of partnership transactions, and then translating the same for GST purposes.[105]

II - 2.7 Dissolution of the Partnership / Retirement of Partner

When a partnership ends, it is said to be "dissolved". That, strictly speaking, also occurs when any of the partners leave, as a new partnership is required to be formed as a technical matter of law.

What is the legal character of these transactions, and how does the GST apply?

II - 2.7(a) Legal Character

On the dissolution of the partnership, partnership property is often transferred to the partners. Depending on the nature of the property, and the amount of the partnership property left after satisfying the partnership's proper debts, the property remaining distributed may be distributed in accordance with each partner's underlying beneficial interests in it, or may be distributed in any other fashion agreed to by the partners.[106]

However distributed, the legal effect is a transfer of beneficial ownership from the existing partners, to the particular partner(s) taking ownership of the property.

There is generally no issue that the transfer is otherwise than in the course of the partnership business, because the business it as an end.

A number of special rules are provided for GST purposes.

II - 2.7(b) Application of the GST – First Principles

From a first principles analysis, the transfer of property on the dissolution of the partnership is no different than the transfer of partnership property while the partnership is in existence. Accordingly, the supply of the property is subject to GST unless relieving rules can be found to apply.

II - 2.7(c) Application of the GST – Subsection 272.1(6) – Partnership Continues Until Deregistered

The conclusion that the transfer of property on the dissolution of the partnership is no different than the transfer of partnership property while the partnership is in existence may be supported by the special rule in subsection 272.1(6).

While subsection 272.1(6) was enacted to, in the words of the Explanatory Notes, "clarify the rules applicable to a partnership upon the addition or departure of a partner" – and is necessary in light of the fact that as a matter of law, when a partner is added or departs, a *new* partnership is legally created – it is of broad scope, and potentially covers dissolution situations as well.

According to the rule, a partnership that would, but for the subsection, cease to exist, is deemed to continue to exist until its registration is cancelled. That suggests that notwithstanding the fact that a partnership dissolves, if its registration remains intact, the distribution of its assets would still remain to be taxed on a first principles basis.

An open issue arises as to what the legal effect would be if the partnership's GST registration were cancelled prior to the distribution of surplus assets contemplated on dissolution. Adding to the complexity is the knowledge that the CRA will normally cancel a registration under section 242 of the *ETA* on a "point-in-the-past" basis, and usually the date on which the registrant last carried on business. It remains to be seen what legal effect these rules will have.

II - 2.7(d) Application of GST – Subsection 272.1 (4) – Valuation Rules Still in Effect

A technical reading of subsection 272.1(4) also suggests that this provision, and the FMV valuation rules it represents, may also apply to the dissolution scenario, particularly if the partnership continues to exist under the rule in subsection 272.1(6) above.

II - 2.7(e) Application of the GST – Transfer of the "Partnership Interest" to the Partnership

The December 1991 edition of *Excise News* raised the following interesting perspective on the dissolution of a partnership for GST purposes:

> Generally, when a partnership is terminated and a partner receives property that was used in the activities of the partnership, two transfers are considered to have taken place: 1) the partner is considered to have transferred its interest in the business to the partnership; and 2) the partnership is considered to have transferred property to the partner.

To the extent the "partnership interest" can be seen to flow from the partner to the partnership – recall our concerns about whether the *ETA* has adequately deemed a partner's interest in the underlying capital of a partnership to be a "financial instrument" – it will likely be regarded as an exempt supply of a financial instrument.

The parallel transfer of property to the partner will be potentially taxable, in accordance with the first principles analysis above, and possible in accordance with the special rule in subsection 272.1(4) – to the extent it can be seen to operate in the dissolution situation.

II - 2.7(f) ***Application of the GST – Subsection 272.1(7) – Continuation by New Partnership***

Subsection 272.1(7) establishes a special rule applicable to partnership reorganizations such as the dissolution of a partnership into two separate partnerships, and is necessary in light of the conclusion, at common law, that the retirement of a partner, and the continuation of the former partnership results in the dissolution of the former partnership, and the creation of a new partnership.

Under the rule, unless the new partnership applies for a new registration, it is deemed to be a continuation of the predecessor where the majority of the partners of the new partnership also formed a majority of the partners of the predecessor, and together had more than a 50-per-cent interest in the capital of the predecessor. Furthermore, those partners must have transferred to the new partnership, all or substantially all of the property distributed to them in settlement of their capital interests in the predecessor.

Figure 8: ***Example –Subsection 272.1(1) and (2)***

Example 1: Arsenault, a partner in RCGT runs out of pencils at the office. Desperate to finish his 2004 Symposium Paper on time, he rushes to the nearest Business Depot and purchases a box, paying on his own credit card.

RCGT ultimately reimburses Arsenault for the entire amount that he paid when he puts in his monthly reimbursement slip.

GST Effect: Section 175 deems RCGT to have received the supply of the pencils from Business Depot (i.e., notwithstanding that the sales slip may reference Arsenault's personal information), and Arsenault's consumption and use of the pencils in writing the paper is deemed to have been the consumption and use of RCGT. Finally, RCGT is deemed to have paid the GST.†

† A special formula exists in subsection 175(1) aimed at ensuring that the ITC available to RCGT is limited to either the amount of GST that is ultimately reimbursed (e.g., if Arsenault is reimbursed only 25% of the cost, RCGT gets only 25% of the ITC), and the extent to which the pencils were actually used by Arsenault in partnership activities (e.g., if Arsenault uses half the pencils to finish off his personal tax return, RCGT gets only half of the ITC).

Example 2: Same situation, but Arsenault does not put in for reimbursement.

GST Effect: Paragraph 272.2(a) displaces the general rule in subsection 272.1(1), and clarifies that the supply of the pencils is made to Arsenault and not the partnership. In this particular situation,† Arsenault may claim the GST paid in an annual rebate claim under section 253.

† This is because Arsenault is an *individual*. If Arsenault were a corporate partner, or another 'non-individual' partner, the rules in paragraphs 272.1(2)(b) and (c) would afford the partner the ability to register for the GST and claim ITCs for the expense, to the extent they were available (i.e., to the extent the partnership's activities were commercial in nature).

Note that in situations where there is a partial reimbursement, the rules in these paragraphs operate to limit the partner's ITC eligibility by the ITC eligibility of the partnership (e.g., if RCGT reimbursed a corporate partner for 70% of the expense incurred, RCGT would be entitled to a 70% ITC, and the corporate partner, if registered, would be entitled to a 30% ITC).

II - 2.8 **Distribution of a Partnership's Profits**

The legal character of a distribution of partnership profits is a distribution of money, pursuant to contractual right. There is no GST supply, as the supply of money is not a supply recognized for GST purposes.[107]

II - 2.9 **Acquisitions by Partners on Own Account**

The main exception to the application of the general partnership rule in subsection 272.1(1) is set out in subsection.

The exception is aimed at situations in which partners acquire property or services for partnership activities, but on their own account (i.e., paying for the same with their own funds, and not with a

"partnership credit card", or the partnership's funds, etc.),[108] and can be simplified as providing the following option:

> (1) If the partnership wants to reimburse the partner, it can, and in that case, the rules in section 175 of the *ETA* combine with the general rule in subsection 272.1(1), to deem the acquisition to have been made by the partnership only, and certain other things – with the result being that only the partnership (and not the partner), would be entitled to GST ITCs in respect of the property or services acquired, while also deeming the potential supply from the partner to the partnership of the property or service that was acquired to be a nothing for GST purposes;[109] and
>
> (2) If the partnership does not reimburse the partner, the general rule in subsection 272.1(1) is supplanted, and the partner is left with the ability to register for the GST, and claim the ITCs available in respect of the property, if any.

Subsection 272.1(2) thus allows partners in the form of corporations, trusts and other partnerships, to register for the GST and obtain ITCs for GST paid on inputs intended for partnership activities.[110]

For *individual* partners, who are excluded from much of the application of subsection 272.1, relief for instances where they are *not* reimbursed by the partnership, would be found in the section 253 partners' rebate rules. Where individual partners *are* reimbursed, the rules in sections 175 and 272.1 combine to deem the partnership eligible for an ITC, and eliminate any 'supply' from the partner to the partnership.

Figure 8 provides two plain vanilla examples of this rule. As it will be seen, the rule is complex even in its plain vanilla flavour.

Special rules also exist in paragraphs 272.1(2)(b) and (c) for partial reimbursement situations, and are aimed at ensuring that there is no possibility of double-counting ITCs as between the partner and the partnership. Furthermore, subsection 175(2) works hand-in-hand with these anti-avoidance provisions.[111]

An interpretative issue arises in terms of the ultimate effect of the deeming rule in paragraph 272.1(2), which deems the partner "to be engaged in those activities of the partnership". The issue is to what extent that allows a partners to register and begin claiming input tax credits. The wording does not deem the activities to be "commercial activities", and ITCs would appear only available to the extent that the particular activities of the partnership to which the partner is deemed to be engaged are in fact "commercial" in nature. Further, the general scope of the wording in the paragraph also appears aimed at ensuring that the activities to which the partner is deemed to engage assist it in claiming ITCs only for the property of services acquired or imported by the partner for consumption, use or supply *in the course of activities of the partnership*. Apparently some taxpayers have been suggesting to the CRA that the deeming provision is capable of creating "ITCs" for other property and services acquired in the taxpayers other (and presumably non-commercial) activities. A good try, but not likely to succeed.

II - 3 APPLICATION OF THE QST TO COMMON PARTNERSHIP TRANSACTIONS

II - 3.1 Government Position: No Significant Differences

The discussion above regarding the application of the GST to common partnership transactions should also generally apply for QST purposes.

While there are some differences between the common law and civil law treatments of "partnerships", the GST and QST systems (in creating separate legal status for "partnerships" and operating in parallel in most other respects) appear to have ensured that despite the differences at law, a "partnership" will be affected in the same manner under each.

Upon contacting the Quebec tax authorities, both Finance and the MRQ indicated that the clear intent was to harmonize the QST partnerships rules with those for the GST, and that no "special rule" was included with a view of distinguishing between the QST and the GST.[112]

Finally, a close review of the Quebec legislation[113] will confirm that all the GST rules relevant to partnerships have also been included in the QST legislation.

But does that end the matter?

II - 3.2 Commentary on Possible Differences

Despite the willingness of Quebec to concede that there are no significant differences between the application of the GST and the application of the QST, to partnership transactions, three points are worthy of mention.

II - 3.2(a) Different Wording could lead to Different Interpretations

First, and as for the GST in general, while Quebec wished to harmonize with the GST, it also chose to draft and implement its own legislation.

The risk is that different wording, coupled with a given factual situation that we may not even imagine today, will in the future allow some people to read differences, where none were intended.

II - 3.2(b) Unique Terminology and Systems

Second, the fact remains that in Quebec, its partnerships rules are found in the Civil Code and while co-existing with Canada's other common law systems, Quebec with its unique terminology does provide a different legal system for the governance of partnerships, and remains an autonomous legal system from other provinces.

Again, the risk is that the separate governance structure could conceptually lead to a different application of the GST or QST rules, in the province of Quebec.[114]

Could we see a situation where common law partnerships would be treated differently for GST purposes in the rest of Canada and QST purposes when they do business in Quebec? While not a particularly welcomed result, the theoretical possibility may exist, and even appears recognized in GST Policy P-244 (discussed in greater detail in the section below):

> The determination of whether a general partner does something as a member of a partnership for the purposes of subsection 272.1(1) depends on the particular provincial partnership law and the facts of a particular situation. Factors to consider…

For its part, the MRQ has indicated that they are still considering the matter, in an attempt to establish if there are indeed distinctions to be made because of the Civil Code. For the time being, we understand that none have yet been identified.

II - 3.2(c) Different Judicial Jurisdiction

Finally, and as discussed further below in section II-5.4 below (*GST- QST Differences: The Saucier Decisions*), the fact of the matter is that administrative action on the QST will be appealed to the Quebec provincial courts, whereas administrative action on the GST will ultimately go to the Tax Court of Canada.

Given that the two Courts will have mutually exclusive jurisdiction over essentially identical matters, it is possible (and probably quite likely in our view) that we may begin to see contradictory decisions arising from the same factual (and legislative) background.

II - 4 RECENT CHANGES

II - 4.1 New GST Policy P-244

II - 4.1(a) Overview of the New Policy

Probably the most significant "partnership" development in the last year is the CRA's finalization of GST Policy P-244.

GST Policy P-244 is long-awaited, and provides the CRA's views on the meaning of the phraseology used in subsection 272.1(1), and in the CRA's view, "whether something is done by a general partner as a member of a partnership, or something is done by a general partner for its own purposes and supplied to a partnership of which it is a member".

Figure 9 replicates the substantive portion of GST P-244, and the first of its three examples. The policy establishes a short list of criteria that the CRA will use in order to determine whether a particular partner's actions are actions as a member of the partnership.

II - 4.1(b) ***Commentary - Substantive Commentary in GST Policy P-244 Materially the Same as Draft Policy***

This portion of GST P-244 does not differ markedly from what the draft that the CRA released in April 2002 for consultation purposes, and entitled *The Application of Subsection 272.1(1) of the Excise Tax Act* (the "Draft Policy").

While the substantive portion of GST Policy P-244 does not differ materially from the Draft Policy, some changes in the commentary may be of concern. For example, under the heading "The nature of the action taken by the partner", the CRA considers the following to be relevant:

> Did the partner acquire property or a service on its own account and did the partnership reimburse the partner such that section 175 of the Act applies (e.g. is the partnership deemed to have received a supply of the property or a ser vice)?

The question appears to go to the possible application of subsection 272.1(2) – which in itself is an *exception* to the general rule in subsection 272.1(1) (and to which GST Policy P-244 is aimed at in the first place). There seems to be a *non sequitur* in the CRA's logic, or perhaps an attempt to short-course the exercise before it.

The potential flaw in the logic is that the exceptions in 272.1(2) are only relevant *if the partner's actions fall into subsection 272.1(1) in the first place*. The CRA's approach is a bit like trying to define the phrase with reference to what it is not – instead of focusing on what the phrase encompasses in the first place – perhaps a bit like saying, 'well, the situation is ultimately caught by the exceptions to 272.1(2), so we are inclined not to consider it as falling in subsection 272.1(1) in the first place'.

Figure 9: ***GST Policy P-244 -*** *Partnerships – Application of subsection 272.1(1) of the Excise Tax Act,* August 9, 2002

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…

Issue and decision

The issue is the interpretation of the phrase "anything done by a person as a member of a partnership" in subsection 272.1(1) of the Excise Tax Act (the Act). Specifically the determination of whether something is done by a general partner as a member of a partnership, or something is done by a general partner for its own purposes and supplied to a partnership of which it is a member.

The determination of whether a general partner does something as a member of a partnership for the purposes of subsection 272.1(1) depends on the particular provincial partnership law and the facts of a particular situation. Factors to consider include, but are not limited to, the following.

The terms of the partnership agreement

If there is a written partnership agreement, what are its terms? For example, is the partner clearly responsible for taking the action under the terms of the agreement? Is the partner's conduct consistent with the terms of the agreement?

If there is no written partnership agreement, does the conduct of the parties imply a partnership agreement? Do the facts indicate that there was agreement among the partners that the partner was responsible for taking the action?

Does the partner receive separate consideration for a supply of property or a service provided to the partnership under the agreement?

The nature of the action taken by the partner

Does the action taken by the partner relate to the purpose of the partnership's business?

Who is liable for the action of the partner? Did the partner acquire property or a service on its own account for use in the partnership's activities such that subsection 272.1(2) of the Act applies (e.g. is the partnership deemed not to have acquired the property or service)?

Did the partner acquire property or a service on its own account and did the partnership reimburse the partner such that section 175 of the Act applies (e.g. is the partnership deemed to have received a supply of the property or a service)?

Did the partner supply property or a service to the partnership such that subsection 272.1(3) of the Act applies (i.e. is the property or a service supplied by the partner to the partnership otherwise than in the course of the partnership's activities)?

The partner's ordinary course of conduct

Is the partner doing the activity only for the partnership? Is the partner engaged in a separate business?

Examples

EXAMPLE NO. 1

Facts

1. A limited partnership was created to construct and operate a retirement residence in Ontario.
2. It was agreed under the written limited partnership agreement that the general partner, A Co., would be the sole manager of the retirement residence. Under the limited partnership agreement A Co. will be paid x% of the partnership's profits.
3. A Co.'s conduct in performing the management services is consistent with the related terms of the written limited partnership agreement.
4. A Co. does not provide services to any other persons.

Issue

Does subsection 272.1(1) of the Act apply to the management services performed by A Co. so that they are deemed to have been done by the limited partnership?

Comments

The general partner is clearly responsible for managing the residence under the terms of the written limited partnership agreement and does not receive any separate consideration for doing so. Managing the residence is directly related to the business purpose of the partnership. A Co. only manages the retirement residence for the limited partnership. Generally subsection 272.1(1) would apply to the management services performed by A Co. Where subsection 272.1(1) applies, the services would be deemed to be done by the partnership so there would be no supply of the management services from the partner to the partnership for GST/HST purposes.

II - 4.1(c) ***Commentary - Not Enough Emphasis on Terms of Partnership Agreement***

Perhaps a more general concern with the application of GST Policy P-244 is the lack of emphasis placed on the legal relationship created by the parties – which would normally be established in the written partnership agreement.

If the proper characterization of legal arrangements is the legal relationships that the parties have created (see the discussion regarding *Shell Canada, supra*), then one would have thought that the responsibilities of the partners – as established and delineated in the partnership agreement – would be of paramount importance in considering whether a partner's actions are "as a member of the partnership". In short, if the partner's actions are provided for in the partnership agreement, then one would have thought that the partner would be taken to be acting as a member of the partnership in that respect, and that would be the end of the discussion.

GST Policy P-244 is not entirely clear on this point.

Yet the parameters of the "agreement" may well be the most important criteria in considering if a partner's actions are as a member of the partnership – perhaps to the point of making the others irrelevant if the particular actions are in fact delineated in the partnership agreement, and otherwise legally permissible actions of a partner to take.

Yet, we might not want to be too rash to criticize the CRA's approach, as in circumstances where a partnership agreement is silent, or otherwise lacking, reference to the CRA's other criteria will surely be beneficial.

II - 4.1(d) ***Material Differences***

While much of the "substantive text" and Example 1 of GST Policy P-244 remain essentially as stated in the Draft Policy, it is notable that Examples 2 and 3 differ significantly from the Draft Policy – to the point that one might suggest that there may have been a policy shift between the two versions.

The implications of these changes are discussed in the next section below.

II - 5 CURRENT ISSUES

II - 5.1 How Broad is Subsection 272.1(1)?

II - 5.1(a) Introduction & Examples of Problem

One of the most important implications of subsection 272.1(1) is the extent to which it can be used to shelter a partner's "services" to the partnership from GST.

In virtually all partnerships, some of the profits will be attributable to the hard work of the various partners (think of a law partnership, or an accounting partnership). Partners in these sorts of situations work for the partnership on a daily basis. Yet pursuant to general partnership law, the partner's actions are actions "as agent", meaning that there is no supply of services between the partner and the partnership.

The general rule in subsection 272.1(1) now effectively codifies that common law result for GST purposes.

When all of the partners are individuals, and working toward the same common goal as the partnership (i.e., all the lawyers work in a law partnership, or all the accountants work in an accounting partnership), it is easy to conceive that the proper result is the application of a rule like subsection 272.1(1); no one would suggest that in this simple partnership, any particular partner's actions are a separate taxable supply.

As the example changes, however, the analysis becomes a bit more difficult.

Consider, for example, the situation where one of the partners is a corporation, and its employees are used to perform the requisite services. Does subsection 272.1(1) operate in that instance ? What if the partner's bare cost of the employees is reimbursed by the partnership ?

What if the services being performed by one individual partner are a bit "out of the norm" (e.g., at Millar Kreklewetz LLP, Kreklewetz designs the firm's website; at RCGT, Arsenault prepares draft accounting statements for the partnership) ? [115] These become difficult questions – and that is the very point to which GST Policy P-244 is aimed.

The potential problem with GST Policy P-244 is that the breadth of subsection 272.1(1) may not warrant the restrictive approach that is implicit in the examples in the Policy.

For purposes of the following discussion, let us focus the question as follows: what is the extent to which subsection 272.1(1) can be used to shelter employee labour provided by a corporate partner, to a partnership, from the application of the GST.

II - 5.1(b) ***Focused Example & Analysis***

The example we pose involves a corporate partner (or other non-individual partner) providing services to the partnership, through its employees. This is a common situation wherever corporate or other non-individual partners form a partnership. In those situations, if the partner is to perform any services, those services will have to be performed through its employees or officers.

In our situation, assume that D Co. is a partner in a financial services business and agrees in the written partnership agreement to provide the backroom accounting and financial services for the partnership's business. In order to do that, D Co. may have to acquire certain property and services, and will use its existing employees to work on the partnership's statements and financial issues. The partnership will reimburse D Co. for the cost of any property or services acquired, and the salaries of the people working on the partnership's business.

Does the GST apply to the reimbursement of the employee costs ? Has there been a separate supply ?

In this example, it seems clear that D Co.'s actions are those of a "partner". Accordingly, one would think that the breadth of subsection 272.1(1) would deem the employment of the personnel ("anything done") to be a thing done by the partnership, with the resulting effect being a "non-supply" of the employee services from the partner to the partnership. (A more detailed and technical reading of the rules, and the exception in subsection 272.1(2), also confirms this conclusion, as the exception fails to displace the general rule.)[116]

In the result, no GST would apply to the partnership's reimbursement of the employee costs – which would have some important implications if the partnership's business were, say, less than exclusively commercial.

So what is the problem ?

The problem is that between the Draft Policy and its final form, the CRA appears to have changed its mind on the example above – which was in fact derived from an example in the Draft Policy. In the finalized version of GST Policy P-244, however, the D Co. example has been so fundamentally changed, that it no longer stands for the same proposition.

Figure 10: *Draft P-244 - Draft Policy Statement on the application of subsection 272.1(1) of the Excise Tax Act*, June 28, 2002

…

Example 2

Facts

1. D Co. is engaged in a manufacturing business and is a partner in a financial services business.
2. Under the written partnership agreement, D Co. will provide certain accounting services to the partnership's business.
3. D Co. will acquire property and services for consumption and use in the partnership's business. D Co. will employ personnel who will work on the partnership's business. The partnership will reimburse D Co. for the cost of the inputs consumed or used, and the salaries of the people working on, the partnership's business.
4. D Co.'s conduct in providing the accounting services and requesting reimbursement of its costs is consistent with the related terms of the written partnership agreement.

Issue

Do subsection 272.1(1) and/or subsection 272.1(2) apply to the actions of D Co.?

Comments

D Co. is responsible for providing the accounting services under the terms of the written partnership agreement. The activities are related to the business purpose of the partnership. Generally subsection 272.1(1) would apply to the accounting services provided by D Co.

However where D Co. acquires property or a service that is for consumption, use or supply in the partnership's activities but not on the account of the partnership, the rules in subsection 272.1(2) would apply to those inputs.

Under paragraph 272.1(2)(a), if subsection 175(1) does not apply, the partnership is deemed not to have acquired the property or service, and under paragraph 272.1(2)(b) for the purpose of determining an ITC in respect of the property, or in applying subdivision d of Division II in relation to the property, D Co. is deemed to be engaged in those activities of the partnership.

Subsection 175(1) applies where D Co. acquires property or a service for consumption or use in relation to the activities of the partnership, D Co. pays the tax payable in respect of the acquisition, and the partnership pays an amount to D Co. as a reimbursement in respect of the property or service. As a result, the partnership is deemed to have received a supply of the property or service, and any consumption or use of the property or service by D Co. in relation to the activities of the partnership is deemed to be consumption or use by the partnership and not D Co., and the partnership is deemed to have paid tax according to the formula in paragraph 175(1)(c).

Subsection 175(1) does not apply if paragraph 272.1(2)(b) applies and the reimbursement is paid to D Co. after D. Co. has filed a return claiming an ITC in respect of the property or service.

With respect to the cost of D Co.'s employees used in the course of the partnership's activities, paragraph (c) of the definition of "service" in subsection 123(1) of the *ETA* excludes "anything that is supplied to an employer by a person who is or agrees to become an employee of the employer in the course of or in relation to the office or employment of that person". Subsection 272.1(2) applies "where property or a service is acquired or imported by a member of a partnership ..." Therefore it would generally not apply where anything (other than property) is acquired by employers from their employees.

Since subsection 272.1(2) would generally not apply to the cost of D Co.'s employees used in the course of the partnership's activities, that cost would generally not be excluded from subsection 272.1(1). Generally subsection 272.1(1) would apply to the accounting services provided by these particular employees of D Co. Where subsection 272.1(1) applies to the action of the partner, it is deemed to be done by the partnership so there is no supply of that action to the partnership for GST purposes.

II - 5.1(c) ***CRA Position***

Figure 10 provides the CRA's position on our simple example as of June 28, 2002. The excerpt is Example No. 2 from the Draft Policy, and a careful reading of it will confirm that the CRA was then of the view that no GST ought to apply to the situation, and was "on-board" in terms of the analysis presented above. Figure 11 provides the CRA's position as of August 9, 2004. The excerpt is Examples No. 2 and 3 from GST Policy P-244.

Figure 11: ***GST Policy P-244 –*** *Examples 2 and 3*

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…

EXAMPLE NO. 2

Facts

1. D Co. is engaged in a manufacturing business and is a partner in a trucking business. D Co. is registered for GST/HST purposes.
2. Under the written partnership agreement, D Co. contributes to the partnership and receives partnership profits in an equal proportion with the other partners. Also under the partnership agreement, D Co. provides certain property and services for the partnership's business and the partnership reimburses D Co. for the cost of the inputs acquired for consumption or use in the partnership's business.
3. D Co. acquires property and services for consumption and use in the partnership's business. D Co.'s conduct in providing the property and services and requesting reimbursement of its costs is consistent with the related terms of the written partnership agreement.
4. D Co. does not claim any ITCs for the GST/HST paid on the property or services it acquired for consumption or use in the partnership's activities.

Issue

Does subsection 272.1(2) of the Act apply to the property and services acquired by D Co.?

Comments

Where D Co. acquires property or a service for consumption or use in the partnership's activities but on its own account, does not claim any ITCs for the GST/HST paid on those inputs, and is reimbursed by the partnership, subsection 272.1(2) and section 175 of the Act would apply. As a result of section 175, the partnership is deemed to have received a supply of the property or a service and to have paid GST/HST according to the formula in paragraph 175(1)(c) of the Act, and the consumption or use of the property or service by D Co. in the partnership's activities is deemed to be consumption or use by the partnership and not by D Co.

EXAMPLE NO. 3

Facts

1. A partnership is engaged exclusively in a logging business.
2. One of the partners, Mr. T, is an accountant who operates an accounting business and is registered for GST/HST purposes.
3. Under the written partnership agreement, Mr. T contributes to the partnership and receives partnership profits in an equal proportion with the other partners. Also under the partnership agreement, Mr. T provides accounting services to the partnership and is paid a monthly fee based on his normal rate per hour for those services.
4. Mr T's conduct in providing the accounting services and invoicing for those services is consistent with the terms of the written partnership agreement.

Issue

Does subsection 272.1(3) of the Act apply to the accounting services provided by Mr. T to the partnership?

Comments

The accounting services are included in the written partnership agreement, but Mr. T is receiving a separate fee for the accounting services, and he is carrying on an accounting business as a separate business. Mr. T is providing the accounting services in the course of his accounting business which is otherwise than in the course of the partnership's activities. Subsection 272.1(3) applies to the accounting services supplied by Mr. T to the partnership and GST/HST applies to the consideration for the supply.

Notably, the CRA has changed Example No. 2 to the point that it may no longer stand for the proposition it once did. Perhaps more troubling, Example No. 3 in GST Policy P-244 has been tweaked to the point that it may just suggest the contrary position !

Nonetheless, and in the right circumstances, we believe that the analysis as presented above, and supported at least initially by the Draft Policy, is likely the correct analytical approach for GST purposes.

II - 5.2 Partnership Distributions & Special Relieving Rules

II - 5.2(a) Section 156 Relief

As indicated above, where a partnership distributes partnership property to a partner, there is potential GST, and the supply is deemed to have been made at FMV under subsection 272.1(4).

There has recently been some question as to whether the section 156 election is capable of being relied on to deem the supplies to be for no consideration.

The question was posed at a meeting of the Canadian Bar Association's Sales and Commodity Tax Section and the CRA in February 2001, with the CRA taking the position that subsection 156(2) – which, if applicable, would have the effect of deeming the supply to be made for no consideration – could apply in the partnership context (i.e., deeming the supplies made from the partnership to the partner to be made for no consideration, notwithstanding the FMV provision in subsection 272.1(4)), but raising doubts as to situations in which the election could be properly made.

While a complete discussion of section 156 is beyond the scope of this paper, suffice it to say that the CRA was concerned with the status of the partners under section 156, who would have to qualify as resident Canadian corporations or partnerships, and closely related to the subject partnership,[117] and specified members of the closely related group.

Also note the requirement in section 156 that all or substantially all of a specified person's supplies be taxable supplies. Like for the general application of section 156, this required poses problems in the partnership where corporate shell partners are used, or "new" partners for that matter. IN these cases, the CRA takes the position that if no "supplies" have been previously made, the section 156 election is unavailable

In practice, then, many partnership distribution situations will not qualify for section 156 relief.

II - 5.2(b) Section 167 Relief

For sometime now there has also been a question as to whether the distribution of partnership property from a partnership to the partners on a dissolution of the partnership could qualify for section 167 relief.

To date the answer appears still to be "no", since the CRA takes the position that "the supply by a partnership of an undivided interest in the partnership property" to the partners "would not be considered to be a supply *of a business or part of a business"* and, accordingly, not eligible for relief under subsection 167(1) of the *ETA*.[118]

The CRA's rationale appears to be that if the disposition relates only to partnership property, that is not enough to operate a business. On the other hand, one reading of GST Policy P-103R, *Transfer of an Undivided Interest in a Joint Venture*, might suggest that section 167 should be potentially available on the wind-up of a partnership. To date, however, CRA has rejected this analysis.

The CRA's current position may still leave the door open to suggest that where a partnership is concluded and *everything* (e.g., physical property, intangible property, goodwill) is transferred to a single partner, that subsection 167(1) may still have some life.

II - 5.3 Mis-Documentation & Over-Documentation of Partnership Relationships

This issue will be addressed in the oral presentation only.

II - 5.4 Draft GST Policy on Subsection 272.1(7) - Having its Cake and Eating it Too

Recall the discussion above[119] regarding the apples and oranges interrelationship between the "legal character" of transactions, and the GST character – which arises from the apparent decision, for GST purposes, to treat partnerships as separate legal persons.

A draft GST Policy on Subsection 272.1(7), entitled *Draft Policy Statement on the GST/HST Implications of the transfers of property referred to in paragraph 272.1(7)(c) of the* Excise Tax Act (as released April 2003, GST Policy P-XXX) has apparently taken the view that some partnership transactions can be "looked through" for GST purposes.

II - 5.4(a) Overview

The issue in GST Policy P-XXX is the interaction between subsection 272.1(7) – which deems certain successor partnerships to be the continuation of, and same person as, the former partnerships and, among other things, capable of using the same GST number as the former partnership – interacts with the legal character of the transaction (i.e., where the partnership property of the former partnership can been seen to be transferred from the old partners to the new partners).

The specific example posed in GST Policy P-XXX was as follows:

> **Facts**
>
> 1. Mr. A, Ms. B, and Mr. C are partners in a retail store which is engaged exclusively in commercial activity. Each has a 33.3% interest in the capital of the partnership. The partnership is registered for GST/HST purposes.
> 2. Mr. A dies. The partners had no agreement concerning the continuation of the partnership where one partner dies.
> 3. The partnership dissolves and the partnership property is distributed equally among Mr. A's estate, Ms. B, and Mr. C.
> 4. Immediately thereafter, Ms. B and Mr. C each buy half of Mr. A's estate's interest in the partnership property.
> 5. Immediately thereafter, Ms. B and Mr. C each transfer all their interest in the property of the former partnership, at the same cost that they acquired them, to a new partnership and it carries on the business.
> 6. The new partnership is not registered separately from the original partnership and does not apply to register under section 240 of the *ETA*.
>
> **Issue**
>
> Does subsection 272.1(7) of the *ETA* apply in this example? Are the transfers of property from the original partnership to the surviving partners and the partner's estate, from the partner's estate to the other two partners, and from the two partners to the new partnership subject to the normal GST/HST rules in the *ETA*?

The CRA concludes that subsection 272.1(7) does apply, and the new partnership is deemed to be a continuation of the original partnership, but also concluded that even though these rules deem the new partnership to be the same person as the old partnership (capable of evening using the same business number for GST/HST purposes as the original partnership), that there are in fact GST supplies underlying the dissolution.

II - 5.4(b) ***Commentary***

In our view, the effect of GST Policy P-XXX is to give credence to the legal character of the partnership transaction, with the aim of creating taxable transactions where none need to exist.

If ownership of the partnership property is in the hands of the partnership for GST purposes, and if under subsection 272.1(7) nothing has changed (the new partnership being deemed to be the same person as the old partnership), then this position appears to be blatantly incorrect. At most, what has been transferred to and from Mr. A's estate <u>for GST purposes</u> is an exempt "partnership interest".

The underlying commercial and legal realities should not matter, as the GST legislation has ascribed already to the false reality that the partnership is a legal person. And viewed in this light, the CRA's position in GST Policy P-XXX is a bit like having one's cake and trying to eat it too.

Either a partnership is a separate person for GST purposes, and displaces the common law in that respect, or it is not and does not. Further, and to the extent GST Policy P-XXX is correct, and it is appropriate to look beyond the GST fiction that has been created to consider the underlying legal ownership of the partnership property, then other results should also follow. For example, what is the *amount* of tax that should apply on the transfer of Mr. A's former assets ? Following the *Seven Mile Dam* ratio, if all that Ms. B and Mr. C end up transferring to their new 50-50 partnership is ½ of their respective interests in the property, retaining as beneficial owners the other half, then perhaps the GST ought only to apply to that ½ interest transferred.[120]

If that is the conclusion, then we are all off to the races, because the application of the GST to partnership transactions would now appear to be completely up in the air.

For all of these reasons, we view GST Policy P-XXX is wrong-headed in a number of directions, and ought to be significantly revised.

II - 5.4(c) Is Legislative Amendment Necessary

Some commentators appear to suggest that subsection 272.1(7) may be deficient due to the absence of a provision which deems no supply of assets from the dissolved partnership to the partners or to the new partnership, indicating as follows:[121]

> As a result, GST may be payable from the new partnership to the dissolved partnership (or perhaps the partners) for the assets that were subject to a rollover for income tax purposes. A technical reading suggests that there are likely two supplies of all assets because as a factual matter (and absent an adequate deeming provision), the better view is that the assets are first transferred from the old partnership to the partners and then subsequently contributed by the continuing partners to the new partnership. Absent an administrative concession, this deficiency may require a legislative amendment. Until then, subsection 272.1(7) may be a trap for the unwary.

If legislative reform is necessary, it would be necessary in our view for it to encompass a top down restructuring of the partnership rules, to clarify once and for all the separate legal status of the "partnership" in the GST context, and the full ramifications of that special notional status.

If it is already clear enough that "partnerships" have separate legal status for GST purposes, then it may be that legislative reform is not necessary after all. Subsection 272.1(7) deems the new partnership to be the same person as the old partnership; and if as we have supposed ownership of the partnership property lies in the partnership (with the partners owning only a "financial instrument" known as the "partnership interest"), then the ownership of the partnership property would, for GST purposes, appear to have remained the same throughout (one being unable to transfer something to oneself).

It will be interesting to monitor CRA's position here as its current approach may be leading it down a very slippery slope.

II - 5.5 GST- QST Differences: The Saucier Decisions

Despite the stated intent on the part of Quebec to harmonize with the GST rules, and given our trepidation about potential difficulties given its discreet legislation, two seemingly conflicting decisions by the courts[122] may give us a taste of what may be to come. The decisions, concerned the same taxpayer in the factual situation; one was a Quebec provincial court decision, while the other was a Tax Court decision. Together, they appear to highlight the difficulties that may be ahead for partnerships in the Quebec context.

II - 5.5(a) The Facts

On January 1992 the taxpayer, Vital Saucier ("V"), and his nephew Robin Saucier ("R") began carrying on business as a partnership. V brought money ($3,000) to the partnership and R's obligation was to operate the business.

On January 1, 1995, the two partners agreed to dissolve the partnership, and after that date R continued the business by himself. The dissolution agreement was not registered with provincial registry, however, but on October 24, 1995 a more formal dissolution agreement was signed before a notary public (chosen by R). That agreement indicated that the partnership had been dissolved effective January 1, 1995, and the evidence was that V thought that the notary would take all necessary legal steps to dissolve the partnership.

It took more than a year for R to cancel the QST registration, however.

Subsequently a QST assessment was issued against R and V, "of the partnership 'Le Maître de l'aubaine'" for QST unremitted by the partnership. The assessment covered the period *before and after* January 1, 1995. A similar GST assessment was also issued against R and V, and covering the same period of time.

The two discreet assessments led to the litigation in both the Quebec and federal courts, with V challenging the assessments against him as a partner for all period following January 1, 1995.

II - 5.5(b) The Cour du Quebec Decision

In the Quebec courts, V admitted his liability for the period before January 1, 1995 but contested it thereafter, as in his view the partnership had been dissolved on that date.

The MRQ's position was, not surprisingly, based on the Quebec counter-part to subsection 272.1(6) of the *ETA*, which holds that for purposes of the QST, a general partnership is deemed to cease to exist *only when its registration is cancelled.* Specifically, section 345.6 of the Quebec Sales Tax Act provides as follows:

> Where a partnership would, but for this section, be regarded as having ceased to exist, the partnership is deemed not to have ceased to exist until the registration of the partnership is cancelled.

In dealing with the provision, the court noted that section 345.6 was assented to in 1997 and was effective as of April 24, 1996, well after the dissolution of the partnership on January 1, 1995.[123] He also pointed to the fact that section 345.6 was aimed at the existence of the partnership, not at the ultimate liability of the partners.

Taking into account the evidence before it, the Court allowed the appeal, and held that the partnership had in fact been dissolved on that date. The Court had the following significant points in dealing with the application of the Quebec Sales Tax Act in the context of the Civil Code:

- The Court indicated its view that in view of the definition of partnership at Article 2186 of the Code, it was possible to conclude that a partnership was a person;
- Speaking of the relation of agent and principal for GST and QST purposes, the Court indicated that the MRQ is not a third-party in relation to its registered agent or a person obliged to be a registrant;[124]
- Taking into account the rules on evidence in the Civil Code, it is appropriate to conclude that the norm is stated at Article 2804, i.e. the predominance of the evidence:

  > Evidence is sufficient if it renders the existence of a fact more probable than its non-existence, unless the law requires more convincing proof.

Thus, based on the "predominance of the evidence", the Court was able to conclude that the partnership was dissolved on January 1, 1995 and allowed the appeal accordingly.

(V was still held liable for the period prior to January 1, 1995, as he had admitted his liability, and would have been liable in any event as a member of the partnership).

II - 5.5(c) The Tax Court Decision

In the parallel GST appeal, the Tax Court was made aware of the Cour du Quebec decision, a copy having been produced by the taxpayer.

In a shorter decision than the one rendered by the Cour du Quebec, however, the Tax Court rejected the appeal by V – so much for judicial comity ! – identifying the issue as whether the taxpayer was "liable for the debt of the partnership between January 1, 1994 and December 31, 1996".

The Court indicated that the partnership had no legal personality, noting as well that a partnership may sue and be sued (Art. 2225 of the Civil Code of Quebec) and that a decision obtained against a partnership is also a decision against each individual partner.[125] The Court then concluded that on the evidence it was clear that as far as the two partners were concerned, the partnership was dissolved on January 1, 1995 – a conclusion also supported by Article 2230 of the Civil Code.

Given that the M.R.Q. was not advised of the cancellation, however, or at least not until December 13, 1996, the Tax Court applied subsection 272.1(6) of the *ETA* to conclude that the dissolution was ineffective – relying also on Articles 2234 (cited above) and 2196 (cited below) of the Civil Code:

> If the declaration of partnership is incomplete, inaccurate or irregular or if, although a change has been made in the partnership, no amending declaration has been made, the partners are liable towards third persons for the resulting obligations of the partnership; however, special partners who are not otherwise liable for the obligations of the partnership are not liable under this article.
>
> (emphasis added)

II - 5.5(d) ***Commentary***

The Tax Court's decision is putatively based on the Civil Code provisions applying to partnerships. We believe this was likely the correct path to follow, although the Tax Court's path had already been partially hoed, it having had the benefit of reading the decision of the Cour du Quebec before giving its own.

It ought to be noted that the Tax Court did not comment on the position taken by the Cour du Quebec which, referring to the relation of agent and principal for GST and QST purposes, concluded that the MRQ was not a third-party in relation to its registered agent. That would have been a relevant point for its consideration however, as the provisions of Article 2196 above ought not to have applied to V's situation, if that were the case.

The decisions stand as the first examples of the difficulties that might be ahead for partnerships in the Quebec context, especially given the mutually exclusive jurisdiction of the Quebec provincial courts and the Tax Court of Canada.

PART III – PARTNERSHIPS & THE RST

Apart from Quebec, Canada has five remaining provinces employing retail sales tax ("RST") regimes, being British Columbia, Saskatchewan, Manitoba, Ontario, and Prince Edward Island.

The balance of this Part also assumes a sophisticated understanding of the RST systems in these provinces, and RST in general.

If further reference material is required, please contact either the authors, or the CICA.

III - 1 OVERVIEW

III - 1.1 Partnership as a "Non-Person" in Certain Jurisdictions

When it comes to how each commodity tax system addresses partnerships, one of the critical difference between the GST and RST systems is the status of the partnership as a "person".

We have already seen that a "partnership" is a person for GST purposes, and have seen how the application of the GST to rather complex legal realities was simplified by that GST construct.

The same is not entirely true of all RST systems in Canada.

In fact, one sees that in three of the five remaining RST systems, namely British Columbia, Manitoba and Prince Edward Island, partnerships may not be persons for RST purposes. In Ontario and Saskatchewan they likely do constitute "persons", although these provinces have not adopted the sort of all-encompassing codification approach that we have seen enacted for GST purposes.

The manner in which the RST applies to partnership transactions will be seen to differ accordingly.

III - 1.2 Seven Mile Dam Case – Partnership Status Explained

The *Seven Mile Dam* case[126] is the seminal Canadian RST case in this area, and serves to explain the importance of the "status" of the partnership when it comes to the application of the RST.

III - 1.2(a) Case Brief

While we will simplify the case for purposes of our discussion, the facts of the case can be understood as follows. *Seven Mile Dam* involved a transfer of tangible personal property ("TPP") between two partnerships, "Partnership 1" to "Partnership 2". Each partnership had two common partners, "Partner

A" and "Partner B". In Partnership 1, Partner A had a 70% interest and Partner B had a 30% interest. In Partnership 2, Partner A had a 40% interest and Partner B had a 10% interest – with two other partners holding the remaining 50% interest ("Partners C and D").

The British Columbia tax authorities argued that Partnership 2 – which received the property from Partnership 1 – was required to pay RST on fair value of all of the TPP that was transferred, since they viewed a partnership to be a separate person for purposes of the British Columbia *Social Services Tax Act* [127] (the "S*STA*"). This argument was based on the fact that British Columbia's *Interpretation Act* defined a "person" to include a partnership.

III - 1.2(b) Court of Appeal's Reasoning

Unfortunately for the tax authorities, the British Columbia Court of Appeal rejected that argument, concluding that for the purposes of interpreting the application of the RST to partnerships under the *SSTA*, the general law of the general law of partnership was not going to be displaced merely by a definition of "person" in the British Columbia *Interpretation Act*.

Apparently the view was that if such a change was to have been intended, the definition of "person" would have been inserted in the *SSTA* itself.[128]

Accordingly, Partnership 1 and Partnership 2 were *not* considered to be separate persons, apart from their respective partners, for purposes of RST, and the Court concluded that the approach for RST purposes required it to look through the partnerships to determine what had occurred. After applying the "look-through" test, it was apparent that the legal result of the transaction (and therefore the result on which RST ought to apply) was a transfer of only 50% of the assets from Partnership 1 to Partnership 2 – that being the portion Partnership 1's assets that remained, at the end of the day, under new ownership.

Ultimately, the Court held that the RST was only payable by the partners of Partnership 2 who were not partners in Partnership 1 (i.e., Partners C and D), and only then, on the 50% of the assets that were sold. [129]

The Court summarized its reasoning as follows:

> Accordingly the tax is payable on the value of the 50 per cent interest in the equipment acquired by HBZ and AJ [the "outside" partners who were not partners in Partnership 1] and not on the value of the 50 per cent interest retained by GFA and CC [the Partnership 1 partners].

III - 1.2(c) Implications

Thus in provinces where RST legislation does *not* define a "person" to include a "partnership", it has been commonly considered that the *Seven Mile Dam* ratio ought to apply – requiring a "look-through" analysis to the actual legal consequences of the partnership transactions.

III - 1.3 What Provinces do What?

A survey of the legislation in the five remaining RST regimes suggests that the *Seven Mile Dam* ratio ought to govern the RST regimes in British Columbia, Manitoba and Prince Edward Island – none of which define a person to include a "partnership" in their respective RST legislation.

Ontario and Saskatchewan do have either RST legislation (Ontario) or regulations (Saskatchewan) which define a "person" to include a partnership and, accordingly, could well be seen to have different approaches to RST transactions.

Figure 12 summarizes the disparate treatments.

Figure 12: ***Legal Status of Partnerships – Province-by-Province***

Province	Partnership a Legal Person for RST ?
British Columbia	No
Saskatchewan	Yes †
Manitoba	No
Ontario	Yes
Prince Edward Island	No

† Somewhat Uncertain

III - 1.4 Partnership Transactions that are Relevant for RST purposes

Finally, and in the context of surveying the RST treatment of common partnership transactions in the five RST provinces, it is worth recalling that the RST systems are not comprehensive taxing systems.

Accordingly, and by definition, the partnership transactions that will be relevant for RST purposes will generally be transactions involving transfers of taxable TPP, or the provision of "taxable services".

III - 2 RST SURVEY OF COMMON PARTNERSHIP TRANSACTIONS

III - 2.1 British Columbia

III - 2.1(a) Status as a Legal Person

As discussed, the *SSTA* still does not define a "person" to include partnership for RST purposes.

Accordingly, the *Seven Mile Dam* ratio continues to apply, resulting in the partnership receiving no status as a legal person, and the court-mandated "look-through" approach will apply to partnership transactions.

Not surprisingly, much[130] of British Columbia's administrative policy proceeds on that basis.

III - 2.1(b) State of Administrative Policies

For the most part, British Columbia's administrative policies on the application of its RST to partnerships are found in various parts of its "Tax Interpretation Manual" ("TIM").

III - 2.1(c) Transfers of TPP on the Formation of the Partnership

British Columbia acknowledges that because a partnership is not a separate legal entity for RST purposes, it is not viewed as an entity capable of owning assets. Accordingly, British Columbia applies its RST on the basis that each partner individually owns a pro-rata share of the partnership assets in relation to the equity interest in the partnership. A transfer of assets to a partnership is therefore, a transfer to each partner.[131]

Thus, where TPP is transferred by a partner to a partnership at the time of forming a new partnership, there is a sale of interest in the TPP to each of the other partners in the partnership equal to their capital ratio interest in the new partnership. Each purchasing partner is required to pay RST on the value of the TPP represented by its interest in the new partnership.

Fortunately, British Columbia affords some relief in these situations by extending the application of its "trade in" rules, in section 10 of the *SSTA*. The effect of these rules is to minimize the RST that is payable on the formation of a partnership. A partner will only be liable for RST if it is acquiring TPP worth in excess of the TPP that it contributed (e.g., M and K each put in $100,000 in TPP to the MK partnership, but M takes a 60% interest, which would be equal to beneficial ownership of $120,000 of TPP ; M would be taxed on the excess, being the additional $20,000 that he has beneficially acquired).

One can see that the amount of RST payable on the interest acquired by each partner is allowed to be offset by the amount of RST attributable to the interest given up by the same partner.

British Columbia's TIM describes the approach as follows:

> **R.6 Application of Trade-In Provision to Contribution of TPP on Partnership Formation**
>
> When persons contribute tax-paid tangible personal property to a partnership, tax applies to the contributions as outlined in the following example.
>
> A and B each own tax-paid TPP worth $100,000. They form a partnership (AB) in which A will hold a 60% interest and B will hold a 40% interest. Both contribute the TPP to the partnership. Therefore, A acquires a 60% interest in B's property and B acquires a 40% interest in A's property.
>
> Section 10 applies to the transaction as follows.
>
> - A sells (trades in) an interest in property worth $40,000 on his acquisition of an interest in property worth $60,000. Therefore he has a trade in credit of $40,000 on a purchase of $60,000. As a partner in AB, tax is due by A on the difference of $20,000.
> - B sells (trades in) an interest in property worth $60,000 on his acquisition of an interest in property worth $40,000. As B's trade-in credit is greater than the purchase price, no tax is due.

Note that the trade-in policy does not apply unless the property being contributed to the partnership is tax-paid.

III - 2.1(d) Purchase & Sale of a Partner's Interest

The purchase by an outside party of an interest in an existing partnership is considered to be a purchase of an interest in the TPP of the partnership, equal to the capital ratio interest acquired in the partnership by that new partner.

The purchasing partner is required to pay RST on the portion of the value of partnership's TPP equal to the capital ratio interest purchased by the partner.

III - 2.1(e) Transactions Between Partnerships and Partners

Given that a "partnership" has no legal status in British Columbia, the concept of a transaction between a partnership and its partners also does not exist. Rather, the legal character is as described above.

III - 2.1(f) Treatment of Limited Partnerships

British Columbia does recognize transactions respecting limited partnerships.

In doing so, however, British Columbia emphasizes that the "default rules" in the British Columbia *Partnership Act* indicate that in the absence of an agreement, the general partner of a limited partnership is considered to hold title to, and be liable for, the assets of the limited partnership. Therefore, in British Columbia's eyes, where business assets are owned by the general partner and transferred to the limited partnership, the limited partners are *not* required to pay RST on the assets being transferred (i.e., because title to the assets is still held by the general partner).

Where the agreement between the parties does provide for the limited partners to own partnership assets, however, and if the general partner contributes TPP to the limited partnership, British Columbia would regard the limited partners as acquiring a share of the assets transferred, and require RST to be paid on the transfer, unless the general partner and the limited partners otherwise qualify as related corporations.

III - 2.1(g) Dissolution of a Partnership

The transfers of TPP between partners that occur as a result of the dissolution of a partnership are also treated under the same general principles as described above.

III - 2.1(h) Registration Issues

For administrative convenience, British Columbia accepts registration by partnerships, albeit, with the requirement that each of the partners be listed in the registration package. The likely legal effect being that the partners remain ultimately liable for all RST obligations.

British Columbia is also willing to issue RST assessments in the name of the partnership (allowing the partners to allocate payment of the accounts to the individual partners concerned), provided that the partnership agrees to this procedure. Where the partnership does not agree to this procedure, British Columbia will generally issue separate assessments to each partner.

III - 2.2 Saskatchewan

III - 2.2(a) Status as a Legal Person

Saskatchewan defines a "person" to include a "partnership", but does that in its Regulations,[132] and not in its *Provincial Sales Tax Act*.[133]

It is not completely certain whether this would be sufficient to take Saskatchewan out of the ratio in *Seven Mile Dam*, but we believe that is a possible conclusion.[134]

III - 2.2(b) State of Administrative Policies

Saskatchewan's administrative policies are found in Saskatchewan Information Bulletin PST-60, *Information on Transfers of Business Assets Between Closely Related Parties*, August 2003 ("SK-PST-60").

III - 2.2(c) Transfers of TPP on the Formation of the Partnership

While recognizing the separate existence of a partnership, Saskatchewan takes the following administrative position when it comes to transfers of TPP on the formation of a partnership.

Saskatchewan Information Bulletin PST-14 confirms that in the context of oil and gas production, the transfer of assets to a partnership where an election is filed under subsection 97(2) of the *Income Tax Act (Canada)* will be treated as an exempt supply for Saskatchewan RST purposes.[135] It is not completely certain whether this amounts to a policy of general application.

SK-PST-60 confirms that the transfer of tax-paid assets by a partner to a new or existing partnership is exempt from RST when the contributing partner retains an equivalent ownership interest in the assets of the partnership.

III - 2.2(d) Purchase & Sale of a Partnership Interest

SK-PST-60 also provides that RST will apply to the value of consideration paid by an individual partner to acquire an additional ownership interest in a tax-paid asset, and that when the consideration includes an exchange or trade of a tax-paid asset, RST will not apply to that portion.

III - 2.2(e) Transfers from a Partnership to a Partner

SK-PST-60 also indicates that the transfer of assets to a partner from the partnership will be exempt from RST when the ownership interest in the assets received is equal in value to the partnership interest that is being removed.

III - 2.2(f) Dissolution of a Partnership

Like the situation for TPP provided from a partnership to a partner generally, SK-PST-60 confirms that upon dissolution of a partnership, the transfer of tax-paid assets is exempt from RST when the partner receives an ownership interest in an asset in satisfaction of the existing partnership interest.

III - 2.2(g) Treatment of Limited Partnerships

Saskatchewan does not have any formal administrative policies with respect to the treatment of limited partnerships.

III - 2.3 Manitoba

III - 2.3(a) Partnership as a Non-Entity

Like the situation in British Columbia, Manitoba's *Retail Sales Tax Act* [136] does not define a "person" to include a "partnership".

Accordingly, the *Seven Mile Dam* ratio would appear to apply, resulting in the partnership receiving no status as a legal person, and the court-mandated "look-through" approach will apply to partnership transactions.

III - 2.3(b) State of Administrative Policies

At the time of writing, Manitoba did not have a published position on partnership transactions. The balance of this section is based on our understanding of their administrative approach, and readers are cautioned to verify the same.

III - 2.3(c) Transfers of TPP on the Formation of the Partnership

On formation of a partnership, we believe that the general approach provided for in the *Seven Mile Dam* case would apply with the following results.

If A and B form a 50-50 partnership, with each contributing $100,000 of TPP to the partnership, A would be liable to pay Manitoba RST in respect of the $50,000 of B's assets that A has beneficially acquired, and B would be liable to pay the same amount of RST on the $50,000 of A's assets that B has beneficially acquired.

Manitoba has indicated that unlike the situation in British Columbia, they will not extend any sort of "trade in" relief to further alleviate RST from this situation.

III - 2.3(d) Transfers from a Partnership to a Partner

Manitoba appears to allow partners to withdraw TPP from a partnership on a tax-free basis, provided that the value of the TPP withdrawn is commensurate with the partner's actual interest in the partnership. If the partner's actual interest is less than that TPP withdrawn, the partner is liable to pay RST on the proportion that they did not own.

III - 2.3(e) Transfers from a Partner to a Partnership

Transfers from a partner to a partnership are treated the same way as transfers of TPP on the formation of the partnership. That is, if A and B have a 50-50 partnership, with each having previously contributed 100,000 of TPP to the partnership, and A transfers another $50,000 of TPP to the partnership, thereby increasing A's interest in the partnership to a 2/3rd interest and decreasing B's interest to a 1/3 interest, A is liable to pay RST on 2/3rds of the $50,000 and B is liable to pay RST on 1/3rd of the $50,000.

III - 2.3(f) Purchase & Sale of a Partner's Interest

Manitoba takes that position that the entry of a new partner into a partnership, perhaps by purchasing an existing partner's interest, results in the formation of a new partnership, leaving the existing partners liable to pay RST on the value of any new property acquired. For example, if C joined A and B above, and contributed $100,000 of property for a 1/3 interest, A and B would be liable for Manitoba RST on each $33,333 portion of property they beneficially acquire, while C would be liable for RST on the $66,666 of property that is beneficially acquired from A and B.

If, however, C replaced A by purchasing A's interest in the partnership, the acquisition of A's interest would not be subject to RST, provided there is no TPP involved in the transaction.

This is somewhat of an extraordinary position for Manitoba to take, and would suggest that notwithstanding *Seven Mile Dam*, they appear content to treat a partnership as a separate legal person.

III - 2.3(g) Dissolution of a Partnership

Our understanding is that Manitoba takes the administrative (and unpublished) position that partners may receive their proportion of tax-paid property upon dissolution of a partnership, without further RST implications.

III - 2.3(h) Registration Issues

Like British Columbia, Manitoba administratively allows registration at the partnership level. Special rules again exist to ensure that the partners are ultimately liable.

III - 2.3(i) Treatment of Limited Partnerships

Manitoba does not have any formal administrative policy with respect to the treatment of limited partnerships.

III - 2.4 Ontario

III - 2.4(a) Status as a Legal Person

Ontario is the only RST province to define a "person" to include a "partnership" in its *Retail Sales Tax Act* (the "Ontario *RSTA*").[137]

Accordingly, Ontario, like the GST system, appears enabled to establish a legislative or regulatory system to administer its RST regime at the partnership level. Historically, however, Ontario has not taken advantage of this power, and has continued to deal with partnerships through administrative policy.

Very recently, however, on July 20, 2004, Ontario announced plans to modernize its related party rules in section 13 of Regulation 1013, and for the first time, to issue regulations dealing with the application of RST to certain partnership transactions.

The discussion that follows deals with Ontario's current administrative practices, which are in effect until the new regulations are promulgated. In section III-3.1 below, under "Recent Changes", we introduce the newly proposed Ontario regulatory rules.

III - 2.4(b) State of Administrative Policies

Ontario's administrative policies on the application of the Ontario RST to partnerships are found in Ontario Sales Tax Guide No. 210: *Partnerships*, March 2001 ("ON-STG-210").

III - 2.4(c) Transfers of TPP on the Formation of the Partnership

ON-STG-210 provides that on the formation of a partnership, the Ontario RST is not payable by the partners on taxable assets transferred to the partnership, provided each partner paid the applicable RST when the assets were purchased.

This appears to be subtlety, but significantly, different than the policies in some of the other RST provinces, as Ontario would appear to allow a tax-free rollover even to the extent that the transfer of taxable TPP was made disproportionately to the interest retained by the partner in the partnership.

Also note the requirement that the taxable assets be transferred "on formation" of the partnership. To the extent the assets are to be transferred at a time fairly contemporaneous with, but not necessarily on, formation, some RST planning may be required to take advantage of Ontario's current administrative policy.

III - 2.4(d) Purchase & Sale of a Partnership Interest

ON-STG-210 also provides that RST will not apply on the purchase of an interest in an existing partnership, so long as the transfer of underlying TPP is a transfer of TPP that had already been subject to RST.

ON-STG-210 provides as follows:

> **Partnership Purchase**
>
> One or more persons or corporations may purchase an interest in an existing partnership. For RST purposes, this results in the formation of a new partnership.
>
> RST is not payable by the former partnership, the continuing partners, and the new partner(s) on the taxable assets transferred into the new partnership provided these parties paid the applicable RST when the assets were originally purchased.

III - 2.4(e) Transfers from a Partnership to a Partner

ON-STG-210 provides that subsequent to its formation, a partnership may enter into a sale transaction with one of its individual partners.

Treatment of Assets Originally Contributed by the Partner Now Acquiring

Where the partner is re-acquiring the taxable assets that were previously transferred to the partnership, the TPP may be acquired completely tax-free if the partner can demonstrate that it paid the applicable RST when originally purchasing the assets (i.e., prior to contribution to the partnership).

If the partner did not pay the RST originally, then RST must be paid when the assets are re-acquired, equal to "the portion of the partnership not owned by the partner". The example provided suggests that "if the partner owned 40% of the partnership, the partner must pay RST on 60% of the fair value of the assets".

The rule appears aimed at ensuring that on a subsequent distribution to the partner (albeit, not in the dissolution context), the only TPP that may be removed completely tax-free is TPP that the particular partner originally bought and *contributed* to the partnership.

Treatment of Assets Purchased by the Partnership

ON-STG-210 also indicates that if a partner "acquires taxable assets that the partnership originally purchased from a supplier" (i.e., presumably TPP that was not *contributed* by a partner), the Ontario RST must again be paid by the partner, but may be reduced in proportion to the partner's share of the partnership, provided the partnership paid the applicable RST when it purchased the assets. This is again consistent with the conception of the rule presented in the paragraph above.

Significantly, ON-STG-210 underscores that if the partnership is attempting to distribute TPP that was purchased exempt, or perhaps purchased for "resale", the partner subsequently acquiring the TPP would be required to pay RST on the *total fair value of the assets at the time of acquisition*.

Treatment of Assets Originally Contributed a Partner Other Than the Partner Now Acquiring

One might conclude, therefore, that if other partnership property is distributed to the partner (i.e., perhaps assets contributed by another partner), that another partner will be liable for the Ontario RST based on the beneficial value that the other partners had in the property. That conclusion would be incorrect.

ON-STG-210 indicates that a "partner may acquire assets that were originally transferred into the partnership by the other partner(s)", but that in this instance, Ontario "RST is payable by the partner on the total fair value of the assets at the time of acquisition from the partnership". Notably, there is no reduction offered based on the partner's share of the partnership, which was the case above, where a partner acquired property that was *purchased* by the partnership, rather than *contributed*.

We are not completely certain why this is the particular result, but the administrative rule may be an attempt by Ontario to ensure that partnership vehicles are not used for tax-avoidance purposes.

III - 2.4(f) Transfers from a Partner to a Partnership

ON-STG-210 also provides that subsequent to its formation, a partnership may enter into an acquisition transaction with one of its individual partners.

In this instance, the Ontario RST will apply to the transaction, provided the TPP is taxable, but may also be reduced in proportion to the contributing partner's share of the partnership, and provided the contributing partner paid the applicable RST when the assets were originally purchased.

III - 2.4(g) Dissolution of a Partnership

Like the situation for TPP provided from a partnership to a partner generally, ON-STG-210 provides that when a partnership is dissolved, the RST treatment of taxable assets transferred to the partners is as follows:

- No RST applies if the partners receive the same assets they originally transferred into the partnership, provided the partners paid the applicable RST when they first purchased the assets;
- If a partner receives assets that were originally transferred into the partnership by the other partner(s), RST is payable by the partner on the fair value of the assets at the time of dissolution;
- If a partner receives assets that were acquired by the partnership from suppliers, the partner must pay RST, although that may be reduced in proportion to the partner's share of the partnership, provided the partnership paid the applicable RST at the time of purchase; and
- If the partnership did not pay RST when the assets were originally purchased, the partner must pay RST on the total fair value of the assets at the time of dissolution.

III - 2.4(h) Treatment of Limited Partnerships

Ontario does not have any formal administrative policy with respect to the treatment of limited partnerships.

III - 2.5 Prince Edward Island

III - 2.5(a) Status as a Legal Person

Like the situation in British Columbia and Manitoba, Prince Edward Island's *Revenue Tax Act, 1988* [138] does not define a "person" to include a "partnership".

Accordingly, the *Seven Mile Dam* ratio would appear to apply, resulting in the partnership receiving no status as a legal person, and the court-mandated "flow-through" approach will apply to partnership transactions.

III - 2.5(b) State of Administrative Policies

At the time of writing, Prince Edward Island did not have any published position on partnership transactions. The balance of this section is based on our understanding of their administrative approach, and readers are cautioned to verify the same.

III - 2.5(c) Transfers of TPP on the Formation of the Partnership

We understand that administratively, Prince Edward Island will afford a tax-free treatment of TPP transferred to a partnership on the formation of the same, provided tax has been previously paid on the property.

III - 2.5(d) Transfers from a Partnership to a Partner

The amount of tax payable on transfers from a partnership to a partner will depend on the number of partners involved and their respective interest in the partnership. For example, if the partnership involved 4 partners, each with a 25% interest in the partnership, the partner to whom the transfer is directed will be responsible to pay tax on 25% of the fair value of the transferred property.

III - 2.5(e) Transfers from a Partner to a Partnership

Similar to the transfer of TPP on the formation of the partnership, Prince Edward Island will afford a tax-free treatment of TPP transferred from a partner to a partnership, provided tax has been previously paid on the property.

III - 2.5(f) Purchase & Sale of a Partner's Interest

The RST payable on the purchase and sale of a partner's interest will depend on the value of the partnership interest being sold. For example, if the partnership interest is 25% of the partnership, tax on the 25% of the interest will be owed upon the purchase and sale of the interest.

III - 2.5(g) Dissolution of a Partnership

Upon dissolution of a partnership, Prince Edward Island requires each partner to pay tax on their proportion of a partnership's property. For example, if the partnership involved 4 partners, each with a 25% interest in the partnership, each partner would be responsible to pay RST on 25% of the partnership property upon dissolution.

III - 2.5(h) Registration Issues

Like the situation in British Columbia and Manitoba, and despite separate legal status for "partnerships", Prince Edward Island administratively allows registration at the partnership level. Special rules again exist to ensure that the partners are ultimately liable.

III - 2.5(i) ***Treatment of Limited Partnerships***

Prince Edward Island does not have any formal administrative policy with respect to the treatment of limited partnerships.

III - 3 RECENT CHANGES

III - 3.1 Ontario's New Rules on Related Party & Partnership Transactions

III - 3.1(a) ***Background***

Ontario has finally caught up with the twenty-first century – at least when it comes to the application of its RST to related party corporate and partnership transactions.

While promised as early as the 1998 Ontario Budget, and "re-promised" in the 2004 Budget, Ontario published draft rules on July 20, 2004 for the modernization of its related party rules in section 13 of Regulation 1013, and for the first time, regulations dealing with the application of RST to certain partnership transactions.[139]

Figure 13: ***Definition of Eligible Property***

5. Subject to subsection (6), tangible personal property is eligible property if one of the following conditions is satisfied:

1. Where the transferor of the property is an individual, it is eligible property if tax was paid under the Act,
   i. by the individual,
   ii. by a corporation that the individual wholly owns at the time of the transfer, or
   iii. by a corporation that is related to a corporation that the individual wholly owns at the time of the transfer,

   in respect of the purchase, use or consumption of the property.

2. Where the transferor of the property is a corporation, it is eligible property if tax was paid under the Act,
   i. by the corporation,
   ii. by an individual who wholly owns the corporation at the time of the transfer, or
   iii. by a corporation that is related to the transferor at the time of the transfer,

   in respect of the purchase, use or consumption of the property.

3. Where the transferor of the property is a partnership, it is eligible property if tax was paid under the Act,
   i. by the partnership,
   ii. by an individual or corporation that contributed the property to the partnership and was a member of the partnership after the tax was paid, or
   iii. by a corporation that, at the time of the transfer, is related to a corporation that contributed the property to the partnership and was a member of the partnership after the tax was paid,

   in respect of the purchase, use or consumption of the property.

6 For the purposes of subsection (5), tax is not considered to have been paid under the Act in respect of the purchase, use or consumption of tangible personal property,

a. if no tax was payable under the Act in respect of the purchase, use or consumption of the property; or
b. if no tax was payable under the Act in respect of the purchase of the property because it was purchased for the purposes of resale.

III - 3.1(b) ***New Rules***[140]

The newly proposed rules add new features to Ontario's administrative position on the treatment of partnership transaction – see *supra* – essentially converting the administrative approach into an approach consistent with transfers between related corporations.

First and foremost is the employment of an "eligible property" definition, which is essentially a requirement that property transferred under the rules be "tax-paid", and not have last been obtained on an exempt basis, or "for resale". The "eligible property" definition is thus used for both partnership and related corporate transactions.

Figure 13 reproduces the newly proposed definition of "eligible property", while Figure 14 reproduces the rules relevant to partnerships.

Figure 14: ***Ontario's New Proposed Partnership Regulations – Regulation 1013(13.6)***

13.6 **Sale between partner and partnership**

1. This section applies to a sale of eligible property after July 19, 2004,
   a. from a person to a partnership in which the person is a partner immediately after the sale; or
   b. from a partnership to a person who is a partner in the partnership immediately before the sale and the eligible property was not previously transferred to the partnership by another person who was a partner of the partnership immediately after the property was transferred to the partnership.

2. On a sale described in clause (1)(a), no tax is payable on the portion of the fair value of the eligible property that is calculated using the formula,

   A x J

   in which,

   "A" is the fair value of the eligible property,

   "J" is the person's percentage share of the income or loss of the partnership immediately after the sale.

3. On a sale described in clause (1)(b), no tax is payable on the portion of the fair value of the eligible property that is calculated using the formula,

   A x K

   in which,

   "A" is the fair value of the eligible property,

   "K" is the person's percentage share of the income or loss of the partnership immediately before the sale.

4. Despite subsections (2) and (3), no tax is payable in the following circumstances:
   1. No tax is payable on a sale of eligible property from a person to a partnership on the creation of the partnership on the amount, if any, by which the total value of all consideration received by the person for the sale of the property does not exceed the value of the partnership interest that is received by the person.
   2. A sale of eligible property from a partnership to a person who is a member of the partnership immediately before the sale, if the partnership had acquired the property from the person in a sale described in paragraph 1.

13.7 **Transfer of interest in partnership**

No tax is payable under the Act, in respect of the value of any tangible personal property held by a partnership, on the transfer of an interest in a partnership from a member of the partnership to another person.

Under the proposed rules, no RST is payable on the portion of the value of eligible property transferred:

(1) into a partnership that relates to the percentage share of the income or loss of the partnership that the person will receive after the transfer;

(2) from a partnership to a partner that relates to the percentage share of the income or loss of the partnership that the partner holds, providing the property had not been transferred.

If the transfer of eligible property is a result of one of the following, however, no RST is payable on the transfer:

(1) from a person to a partnership on the creation of the partnership, providing the value of the consideration paid for the property does not exceed the value of the partnership interest received by the person

(2) from a partnership to a partner if that partner had originally transferred the property to the partnership on its creation.

One effect of these rules appears to limit the value of the property that may be transferred into a partnership without the payment of RST, to the value of the partnership interest that is received in exchange. That, decidedly, was not a position taken in current RST Sales Tax Guide 210, *Partnerships* – see *infra* – and may well be a new approach in Ontario.

Finally, note under proposed Regulation 1013(13.7), no RST will be payable in respect of the transfer of an interest in a partnership from a partner to another person.

Given our discussion in Part II above, with respect to what a "partnership interest" might entail for GST purpose, it remains to be seen just what this provision will entail.

III - 3.1(c) Next Steps & Effective Date

Ontario has indicated that finalization of the proposed regulations is slated for sometime in the Fall 2004, and that the effective date for the proposed amendments will be July 20, 2004 – the release date of the draft regulation.

III - 4 CURRENT ISSUES

III - 4.1 Application of Provincial Rules to Limited Partnerships

None of the provinces say much in the way of describing administrative policy on the application of their partnership rules to "limited partnerships". Yet there is every reason to do so, since when a tax advisor is faced with the application for RST to limited partnerships, a number of base questions arise, two of which follow.

III - 4.1(a) Sale of Limited Partnership Interest

Is a limited partner's sale of its interest in a limited partnership subject to RST?

We understand that Ontario takes the informal administrative position that the sale of a limited partnership interest is akin to the sale of a share in a corporation, and thus not a sale of TPP. Accordingly, the transaction would appear not to attract RST. [141]

Under Ontario's new rules – see *infra* – while not addressing specifically "limited partnerships" would appear to support this administrative approach, in that Regulation 13(13.7) seems to contemplate the transfer of any partnership interest as being a non-taxable event.

It is not completely certain whether, in the context of a limited partnership, this provision would be necessary however[142] – although it is perhaps useful for a "general partner" in a limited partnership who attempts to assign its interest in the partnership.

III - 4.1(b) Ownership of Underlying TPP

Does a limited partner own any TPP in a limited partnership?

This appears to be a question that only British Columbia has wrestled with, and the answer generally appears to be "no", meaning that absent an agreement to the contrary, transfers of TPP to and from a limited partnership would appear to have no effect on the limited partners.

General partners, however, would appear to be liable for RST under the normal administrative rules of the province.

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1 The GST legislation is found in Part IX of the *Excise Tax Act* (the "*ETA*"). While we will refer throughout this Paper to the GST, our comments and the legislative provisions cited, apply equally to the Harmonized Sales Tax ("HST") in place in the Atlantic provinces of Nova Scotia, New Brunswick, and Newfoundland and Labrador.

2 We use the term "RST" throughout this paper as both (1) a global reference to the "retail sales tax" systems in place in Canada's five remaining RST provinces, being British Columbia, Saskatchewan, Manitoba, Ontario, and Prince Edward Island, and (2) where otherwise indicated, may use the term in referring to the specific retail sales taxes imposed in a particular one of those jurisdictions.

3 See, for example, *A Practical Guide to Canadian Partnership Law*, A. R. Manzer (Aurora, ON: Canada Law Book Inc., 2003) p. 1-10.

4 The "common law" was the judge-made law that existed in England (and under Commonwealth judicial systems) prior to the establishment of legislative made laws. On the codification of much of the common law into "statute law", the common law can be understood in the modern context to be both the further interpretation of statute law, and the law that fills the holes where statute law is silent.

5 Until that time, the law of partnership was to be found almost exclusively in legal decisions and in legal textbooks.

6 While Quebec has "partnership law" as part of its Civil Code, that partnership law will also be seen to have many similarities to the legislation in these common law provinces.

7 For convenience, we have set out below a list of the codifying legislation in each Canadian province, in alphabetical order:

Alberta	*Partnership Act*, R.S.A., 2000, c. P-3. Please note that at the time of writing, Alberta had a new, unproclaimed act – being the *Partnership Amendment Act*, R.S.A. 2000, c. 25 (supp.) – which amends subsections 52(3) and 70(2) of the Alberta *Partnership Act*
British Columbia	*Partnership Act*, R.S.B.C. 1996, c. 348.
Manitoba	*Partnership Act*, C.C.S.M. c. P-30.
New Brunswick	*Partnership Act*, R.S.N.B. 1973, c. P-4. *Partnership and Business Names Registration Act*, R.S.N.B. 1973, c. P-5.
Newfoundland	*Partnership Act*, R.S.N.L. 1990, c. P-3.
Nova Scotia	*Partnership Act*, R.S.N.S. 1989, c. 334. *Partnership and Business Names Registration Act*, R.S.N.S. 1989, c. 335.
Ontario	*Partnership Act*, R.S.O. 1990, c. P.5.
Prince Edward Island	*Partnership Act*, R.S.P.E.I., 1990, c. 39.
Quebec	Please see below
Saskatchewan	*Partnership Act*, R.S.S. 1978, c. P-3.

Quebec:	Civil Code of Quebec, Q. L. 1991, c.64 And Mod.

Note that the Yukon and North West Territories have differential approaches.

8 It is noteworthy that the partnership principles that will be discussed below will apply, in most cases, to not only Canadian common law provinces, but to most other common law jurisdictions across the world: see *Joint Ventures*, B.J. Reiter & M. A. Shishler (1999), Chapter 4, Part C.

9 R.S.O. 1990, c. P.5.

10 See, for example, cases like the Supreme Court of Canada ("SCC") decision in *A.E. Lepage Ltd. v. Kamex Developments Ltd.*, [1979] 2 S.C.R. 155. For a decision discussing the basic tenets of partnerships under the Civil Law, please see *Impréglio Canada Ltée. v. Deputy Minister of Revenue for Quebec*, (1992), 5 T.C.T. 4187 (Que.C.A.).

11 See R.S.O. 1990, c. I. 11, s. 29: a "person" includes a corporation and the heirs, executors, administrators or other legal representatives of a person whom the context can apply according to law.

Notably, all other provinces have similar "Interpretation" Acts, with similar definitions of "person".

12 For example, section 45 of the Ontario *Partnerships Act* imports common law and equity principles wherever the statute does not deal with an issue, or wherever the common law does not contradict the statute:

> 45. The rules of equity and of common law applicable to partnership continue in force, except so far as they are inconsistent with the express provisions of this Act.

13 Provincial legislation also generally leaves partners free to contract in or out of particular provisions of the legislation, where the provisions govern the mutual rights and obligations between them. For example, under the heading "Relation of Partners to One Another", section 20 of the Ontario *Partnerships Act* allows partners to contract as follows:

> 20. The mutual rights and duties of partners, whether ascertained by agreement or defined by this Act, may be varied by the consent of all the partners, and such consent may be either expressed or inferred from a course of dealing.
>
> (emphasis added)

Note the distinction as between the partners ability to change the nature of their internal relationship, which is provided for in section 20, and the ability to change the legal implications of their relationships with third-parties. There is no power to effect a change in the latter, as many aspect of a partner's relationship to third-parties are provided for in the *Partnerships Act*, and not capable of change by contractual agreement.

14 A corporation is the result of a complete statutory code, which precludes contractual agreement for most of the aspects governing its formation, organization and administration: see Manzer, *supra*, note 3, p. 1-8.

15 *Ibid.*

16 Tax advisors should pay special attention to the comments of the SCC in *Shell Canada Ltd v The Queen*, [1999] 3 S.C.R. 622, where the Court made it clear that the *bona fide* legal relationship that parties create is the one that will govern them for tax purposes:

> [39] This Court has repeatedly held that courts must be sensitive to the economic realities of a particular transaction, rather than being bound to what first appears to be its legal form: *Bronfman Trust*, supra, at pp. 52-53, per Dickson C.J.; *Tennant*, supra, at para. 26, per Iacobucci J. But there are at least two caveats to this rule. First, this Court has never held that the economic realities of a situation can be used to recharacterize a taxpayer's bona fide legal relationships. To the contrary, we have held that, absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect: *Continental Bank Leasing Corp. v. Canada*, [1998] 2 S.C.R. 298, at para. 21, per Bastarache J.
>
> [40] Second, it is well established in this Court's tax jurisprudence that a searching inquiry for either the "economic realities" of a particular transaction or the general object and spirit of the provision at issue can never supplant a court's duty to apply an unambiguous provision of the Act to a taxpayer's transaction. Where the provision at issue is clear and unambiguous, its terms must simply be applied: Continental Bank, supra, at para. 51, per Bastarache J.; Tennant, supra, at para. 16, per Iacobucci J.; Canada v. Antosko, [1994] 2 S.C.R. 312, at pp.

326-27 and 330, per Iacobucci J.; Friesen v. Canada, [1995] 3 S.C.R. 103, at para. 11, per Major J; Alberta (Treasury Branches) v. M.N.R., [1996] 1 S.C.R. 963, at para. 15, per Cory J.

(Emphasis added)

In the "partnerships" context, the *Shell* decision means that before blindly applying "partnership rules" or "partnership policy" to a particular transaction, it will be incumbent upon tax advisors to first assure themselves that a legal partnership exists.

17 While the section below summarizes some of the general concepts underlying the existence of a "partnership" at law, it is not meant to be a comprehensive dissertation on the same.

For readers interested in the Canadian jurisprudence on the meaning of "partnership", consider, in addition to the authorities cited above, the following: *Continental Bank Leasing Corp. v. R.*, [1998] 2 S.C.R. 298; *Backman v. R.*, [2001] 1 S.C.R. 367; and *Spire Freezers Ltd.*, [2001] 1 S.C.R. 391. In the GST context, see also: *Loewen, et al. v. The Queen*, [1998] ETC 2816 (TCC) and *Poliacik v. The Queen*, [1999] GTC 3029 (TCC).

18 Co-ownership of property, with nothing more, does not amount to a partnership.

19 See *Foster v. Mitchell*, (1911), 20 O.W.R. 754, aff'd 22 O.W.R. 571 (C.A.).

20 See *Porter v. Armstrong*, [1926] S.C.R. 328.

21 See, for example, *Adam v. Newbigging*, (1888), 13 App. Cas. 308 (H.L.) at 315; *Weiner v. Harris*, [1910] 1 K.B. 285 (C.A.) at 290, cited with authority in Canada – *Schultz v. Canada*, [1996] 1 F.C. 423 (C.A.) at para. 25.

22 See *Wise v. Perpetual Trustee Co.*, [1930] A.C. 139 (P.C.).

23 See generally, for example, *Backman* and *Spire Freezers*, *supra*, note 17.

24 This is also confirmed by section 3 of the Ontario *Partnerships Act* which provides that "[t]he sharing of gross returns does not of itself create a partnership, whether the persons sharing such returns have or have not a joint or common right or interest in any property from which or from the use of which the returns are derived". It also follows from historic jurisprudence, like *McDougall v. Galbraith (No. 2).* (1913) 11 D.L.R. 133 (O.N.C.A.).

25 See generally Manzer, *supra*, note 3, p., 1-14.

26 While it is generally true that the partners are the partnership, as matter of convenience, most provincial partnership legislation affords a partnership the right to bring suit in its own name, and provides for the right of third-parties, to bring suit against the partnership directly.

27 Perhaps more properly, since the partnership does not exist as a separate person, anything done by one partner for the purposes of the business of the partnership is like a thing done by each and every other partner directly.

28 Sections 6 through 19 of the Ontario *Partnerships Act* establish the general rules for partners and third parties.

29 Note that there are some restrictions on the ability of a third-party to rely on actions of partners to bind a partnership. For example, if the partner does *not* have the requisite authority (i.e. due to a restriction in the partnership agreement), and the third-party knows that, the third-party will not be able to bind the partnership. In situations where the third-party lacks knowledge of the requisite authority of the partner, the partnership will generally be bound.

This discussion should also not be viewed as a comprehensive discussion of agency law, as it relates to partnership liability.

30 Sections 20 through 31 of the Ontario *Partnerships Act* establish the general rules for partners and each other.

31 See, for example, sections 20 to 31 of the *Ontario Partnerships Act*. Section 20 specifically provides that the partners may vary these partnership rules provided that the express or inferred consent of all partners is obtained.

32 "General" partner is used in contradistinction to a "limited" partner. Limited Partnerships are described in section I-2.6 below.

33 Note that the liability is only joint, and not joint and several. "Several" liability exists under section 10 only after the partner's death, where the partner's estate is also severally liable in a due course of administration for such debts and obligations so far as they remain unsatisfied – although there are certain restrictions on that liability as well.

34 Section 18 of the Ontario *Partnerships Act* also makes it clear that a partner is not responsible for liabilities of the firm which arose *prior* to the individual becoming a partner, however liability for obligations of the firm continues after the partner leaves the firm. For example, a retired partner is liable to every person who has dealt with the firm prior to their retirement for obligations of the firm, incurred after retirement unless, actual notice of the retirement is given to the person, the person never knew that the retiring partner was a partner or the partner left the firm because they died or became insolvent. See also ss. 36(1) and 36(3) of the same.

35 *Partnerships Act*, R.S.O. 1990, c. P.5, s. 10.

36 A "tort" is essentially a "wrong" against one committed by another. Examples of "torts" could include an action for solicitor's negligence, or an action for accounting fraud.

Black's Law Dictionary, Sixth Edition (St. Paul, MN: West Publishing Co., 1990), defines a "tort" as:

> **tort** –A private or civil wrong or injury, including action for bad faith breach of contract, for which the court will provide a remedy in the form of an action for damages. (Coleman v. California Yearly Meeting of Friends Church, 27 Cal.App.2d 579). There must always be a violation of some duty owing to the plaintiff, and generally such duty must arise by operation of law and not by mere agreement of the parties.
>
> A legal wrong committed upon the person or property independent of contract. It may be either (1) a direct invasion of some legal right of the individual; (2) the infraction of some public duty by which special damage accrues to the individual; (3) the violation of some private obligation by which the damage accrues to the individual.
>
> (at 1489)

37 Some commentators suggest that the jurisprudence is not entirely clear on whether a partner has an undivided ownership in the partnership property, or some other type of interest: see R.T. Hay, *How Separate Is A Partnership From Its Partners?* (2000) Business Vehicles, Federated Press, vol. 6, no. 1; see also Steven D'Arcy, *Advanced Corporate Restructuring* (1995 Symposium Papers).

That debate appears to be in the context of the federal *Income Tax Act*, however, which has special provisions dealing the treatment of partners and partnerships. Accordingly, and in our view, these cases are sufficiently skewed in their reasoning to likely distinguish their value in both the law of partnerships and commodity tax perspectives.

38 See [1917] 54 S.C.R. 532, at 559 *per* Duff J.

39 See, for example, *Seven Mile Dam Contractors v. The Queen* [1980] 5017 ETC (BCCA), and the discussion in Part III regarding the significant implications of this case for RST purposes.

40 *Ibid.*

41 *Partnerships Act*, R.S.O. 1990, c. P.5, s. 39.

42 See, again, *Seven Mile Dam Contractors*, *supra*, note 39.

43 See, for example, sections 32 to 44 of the Ontario *Partnerships Act.*

44 While out of the scope of our discussion, a third type of partnership is known as the "limited liability partnership", and it is also a creature of statute. It exists as a "sub-type" of a general partnership and is currently recognized in law by Alberta and Ontario.

Limited liability partnerships apply only to professionals, and under this type of partnership, individual partners are effectively exempted from personal liability for the professional negligence of their other partners, or of employees of the partnership, or of other persons, *unless the partner directly supervised them in the particular matter*. Beyond this limited liability, individual partners remain liable for their own negligence and for other obligations of the partnership, and in all other respects, the limited liability partnership is the same as a general partnership.

45 Prior to January 1, 1908, which coincided with the enactment of the English *Limited Partnerships Act of 1907*, the only kind of partnership know to the common law was the general partnership. That continued to exist in Canada until the enactment of Canadian provincial limited partnership acts.

46 Note that "joint" liability is defined in *Black's Law Dictionary*, Sixth Edition (St. Paul, MN: West Publishing Co., 1990), as follows:

> **joint liability** - Liability that is owed to a third party by two or more other parties together. One wherein joint obligor has right to insist that co-obligor be joined as a codefendant with him, that is, that they be sued jointly. Schram v. Perkins, D.C.Mich., 38 F.Supp. 404, 407.
>
> (at 838)

"Several" liability is defined as follows:

> **several liability** - Liability separate and distinct from liability of another to the extent that an independent action may be brought without joinder of others. Exists where each of the parties specifically promises to be individually bound, using language such as "each of us makes this promise severally, not jointly".
>
> (at 1374)

Parties that are "jointly and severally" liable, both owe the debt, in the same amount, and are liable to be sued for the whole debt individually, regardless of whether any of the other joint-debtors are sued.

47 Specifically, section 10 of the Ontario *Partnerships Act* provides that a general partner's liability for the debts and obligations of a general partnership is "unlimited".

However, section 9 of the Ontario *Limited Partnerships Act* limits a limited partner's liability for the obligations of the partnership to "the value of money and other property the limited partner contributes or agrees to contribute to the limited partnership, as stated in the record of limited partners": see the *Limited Partnerships Act*, R.S.O. 1990, c. L. 16 s. 9.

48 R.S.O. 1990, c. L. 16, s. 3.

49 A "sole proprietorship" – which is probably the oldest and simplest form of legal business – refers generally to a *single person* carrying on a business with a view to a profit. A sole proprietorship "comes into existence whenever an individual starts to carry on business for [his or] her own account without taking the steps necessary to adopt some other form or organization, such as a corporation": see, for example, *The Law of Partnerships and Corporations*, J. Anthony Van Duzer, 2nd Edition (Irwin Law, 2003), p. 1.

Accordingly, a sole proprietorship (e.g., Jack Millar, Barrister and Solicitor) would not amount to a partnership, but two sole proprietors that agree to combine their efforts, with a view to a profit, can amount to a partnership (e.g., Jack Millar and Robert Kreklewetz, independent Barristers and Solicitors, can agree to practice together in partnership; ergo, Millar Kreklewetz LLP.)

Like a partnership, a sole proprietorship is a business personal to the sole proprietorship, in the sense that since there is no distinction between the sole proprietorship and the person who is the sole proprietor, the rights and obligations flowing from the business are the rights and obligations of the sole proprietorship personally. Or in other words, the sole proprietor is the sole proprietorship.

That legal reality leads to one of the traditional disadvantages of the sole proprietorship, which is the unlimited liability of its sole proprietor – a disadvantage that the partnership also shares.

50 *Business Names Act*, R.S.O. 1990, c. B. 17, ss. 2(2).

51 This is particularly significant in the GST context, where services provided by partners to a partnership are potentially taxable, and must be closely scrutinized in order to determine whether any special rules exist to alleviate the GST burden.

52 *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, Rule 8.

53 See Reiter and Shishler, *supra*, note 8, Chapter 4, Part C.

54 We will refer freely to either the Civil Code of Quebec or the Civil Code or simply the Code.

55 We will see later that certain types of partnerships must register; if they do not, they are still a partnership, but of a different type.

56 See Commentaires du Ministre de la Justice, Tome II, Québec, Les Publications du Québec, art. 2186 : « Le premier alinéa est tiré des dispositions de l'article 1830 C.C.B.C. Il définit dorénavant directement le contrat de société tout en insistant davantage sur ses caractéristiques essentielles, à savoir l'apport des associés, la vocation aux bénéfices pécuniaires et au partage de ces bénéfices entre les associés, et l'«affectio societatis». Cette notion suppose chez les associés un esprit de collaboration qui les unit et les incite à poursuivre en commun, à l'aide des apports réciproques fournis, la réalisation de l'objectif social. »

57 See C.C.Q., art. 2203

58 See C.C.Q., art. 2202

59 See C.C.Q., art. 2188. The "Code des professions du Québec" also recognizes a "limited liability partnership" which is similar to the partnerships recognized in Alberta and Ontario and described at note 7.

60 *The Act respecting the legal publicity of sole proprietorships, partnerships and legal persons*, R.S.Q., C. P-45

63 See C.C.Q., art. 2187

64 See C.C.Q., art. 2232

65 See C.C.Q., art. 2219

66 See C.C.Q., art. 2220

67 See C.C.Q., art. 2212

68 See C.C.Q., art. 2213

69 See C.C.Q., art. 2215

70 See C.C.Q., art. 2198

71 See C.C.Q., art. 2204

72 See C.C.Q., art. 2205

73 See C.C.Q., art. 2208

74 See C.C.Q., art. 2209

75 See C.C.Q., art. 2222

76 See C.C.Q., art. 2225

77 See The Harmonization of Federal Legislation with Quebec Civil Law and Canada Bijuralism, Collection of Studies in Tax Law, APFF and Department of Justice Canada, 2002. The reference to Allard in Me Bouchard's excerpt is to Québec (Ville de) c. Cie d'immeubles Allard ltée. (1996) R.J.Q. 1566 (C.A.)

78 See Association canadienne d'études fiscals, Séminaire technique, Les Sociétés de personnes: considerations juridiques et fiscals, Le 26 mars 2004, Montréal

79 See GST Policy Statement, P-171R, *Distinguishing Between a Joint Venture and a Partnership for the Purposes of the Section 273 Joint Venture Election*.

80 See C.C.Q., aret. 2186

81 To that effect, see *Imprégilo Canada Ltée c. Québec (Sous-ministre du Revenu), supra,* note 10.

82 Note the irony that exists for income tax purposes, where much tax compliance is still effected at the partnership level, as if the partnership were a separate person, and which have led some commentators to suggest that for all intents and purposes, a partnership may well be treated as a separate person for income tax purposes.

84 In the income tax context, CRA relies on Interpretation Bulletin IT-90 (*What is a Partnership,* February 9, 1973).

86 While beyond the scope of this paper, one wonders whether a critical analysis of the final phraseology in the GST definition of "person" (i.e., "or a body that is a society, union, club, association, commission or other organization of any kind") would lead to the conclusion that a joint venture, being a collection or organization of individuals, partnerships or corporations, could register as a "person" under subsection 240(1) of the *ETA.* Absent jurisprudence to the contrary, it would seem that the word "organization" is broad enough to allow for that conclusion. Further, the *ejusdem generis* rule might also assist, since the definition of "person" includes a number of other entities that are not generally regarded as "persons" with separate legal status at common law – the most notable in that regard being the "partnership" itself.

87 Partners are able to agree (i.e., in writing, oral or implied) to hold partnership property or share in partnership profits in whatever proportions they wish, although absent such agreement, they will be deemed to share in capital and profits equally: see, among others, section 24 of the Ontario *Partnerships Act.*

88 While some commentators appear to suggest uncertainty in this area, the jurisprudence is clear that this result follows: see for example, *Boyd v. The Attorney-General for British Columbia, supra*, note 38, and *Seven Mile Dam, supra*, note 39.

89 While this result is likely the intended result under the GST legislation (especially given the definition of "an interest in a partnership" as a financial instrument), the result is not as certain as it might have been – relying, it seems, solely on the definition of "person" as meaning, among other things, a "partnership". The residual question is whether that simple definition is capable, on its own, of displacing the legal result of the transaction under provincial legislation and the common law. It could well be, for example, that while a "partnership" is a "person" for registration purposes, transactions between the partner and the partnership are still to be characterized based on the legal character of the transactions that have taken place.

For the purposes of this paper, we will generally assume that the partnerships are effective legal persons for GST purposes, and that certain other GST results follow from that status, as for example, the notional ownership of the partnership property by the partnership and not, any longer, by the partners.

Note, however, the "apples" and "oranges" complexity that one runs into as soon as one attempts to impose the GST overlay onto the legal realities of partnership.

While we will assume that for GST purposes, the proper conclusion is that partners have no "property" interest in the underlying property (which again may also logically follow from the definition of "financial instrument" in subsection

123(1) of the *ETA*, which goes out of its way to include "an interest in a partnership"), we have also concluded in Part I that as a matter of law, the partner would continue to own a beneficial interest in the property.

On the other hand, it is also probably worth noting that while an "interest in a partnership" may have been defined as a "financial instrument", the *ETA* does not clearly dispossess a partner from the beneficial ownership that the partner would have, at law, in the underlying partnership property, nor does it do a particularly good job in explaining how to properly characterize transactions between partners and partnerships for GST purposes. While specific rules are in place to deem certain results, there may well be a residual uncertainty as to the proper GST character of the transactions in the first place.

Whether that matters is probably something that only the future will tell.

91 Note the CRA's position that "[t]he making of a capital contribution to a partnership is not included under subsection 272.1(1)", but is rather, characterized as a supply by the partner to the partnership, in exchange for (and exempt) partnership interest: see for example Headquarters Ruling 11635-8, *Subsection 272.1(1) and the Eligibility of Certain ITCs Claimed by a Partnership* (September 27, 2002).

92 On this point, see Crossover with Income Tax: "A Two-Way Street", Maurice Chiasson and Donald G. Mitchener, 2000 Commodity Tax Symposium.

93 See again paragraph (d) of the definition of "financial instrument" in subsection 123(1) of the *ETA*, which includes "an interest in a partnership", as well as the definition of "financial service", and the exemptions for the same in Schedule V of the *ETA*.

94 See for example, the Explanatory Notes to the July 1997 GST amendments which added the section 272.1 rules (S.C 1997, c. 10).

95 Based on the requisite agency analysis that would follow from provisions like section 6 of the Ontario *Partnerships Act*, one might suggest that the GST result that subsection 272.1(1) deems to occur, would have been the GST result from a first principles analysis anyhow. That suggests that subsection 272.1(1) might also have some measure of redundancy to it.

96 Whether a partner acts "in the course of the partnership's activities" or "*otherwise than* in the course of the partnership's activities" is likely a question of mixed fact and law, resolved with reference to the scope of the partnership agreement, and other relevant factors.

The distinction is an important one, however, as if the partner's actions are "in the course" of the partnership's activities, the partner will likely be seen, at law, to be acting as the agent of the partnership, and the partner's actions will be binding on the partnership. Where acting "otherwise" than in the course of the business of the partnership, the legal affect is a bit more challenging to predict, but as a general proposition there would be no "agent – principal" relationship – meaning that a supply by the partner to the partnership in that situation could amount to a separate (and potentially taxable) supply to the partnership for GST purposes, on a first principles basis.

97 It is somewhat unclear whether this deeming rule is required, given the already broad meaning of the word "consideration". Perhaps the rule was thought necessary in order to capture in the value for tax, the amounts credited to the partner in the partnership's accounting records.

98 There is again some uncertainty as to whether the rule in paragraph 272.1(3)(b) was completely necessary. It may well be redundant given the related party rules that apply to partnerships by virtue of subsection 126(3) and subsection 155(1) of the *ETA*.

99 Given that joint liability, or joint and several liability, would also exist for other partnership obligations, as set out in Part I, under provincial partnership law, one again wonders whether this provision is again redundant.

100 While not entirely obvious from the wording of the section itself, the Explanatory Notes to paragraph 296(1)(e) do confirm that "paragraph 296(1)(e) is consequential to the amendments to the partnership provisions of the Act under new section 272.1, which codify the joint and several liability of partners for partnership debts", which appears to intend the result found in cases like *Janelle*, *infra*, note 101.

101 See *S. Janelle et al. v. The Queen*, [2003] 2961 ETC (TCC).

102 Subsection 172(2) provides as follows:

> 172(2) **Benefits to shareholders, etc.** — For the purposes of this Part, where at any time a registrant that is a corporation, partnership, trust, charity, public institution or non-profit organization appropriates any property (other than capital property of the registrant) that was acquired, manufactured or produced, or any service acquired or performed, in the course of commercial activities of the registrant, to or for the benefit of a shareholder, partner, beneficiary or member of the registrant or any individual related to such a shareholder, partner, beneficiary or member, in any manner whatever (otherwise than by way of a supply made for consideration equal to the fair market value of the property or service), the registrant is deemed
>
> (a) to have made a supply of the property or service for consideration paid at that time equal to the fair market value of the property or service at that time; and
>
> (b) except where the supply is an exempt supply, to have collected, at that time, tax in respect of the supply, calculated on that consideration.

The reason subsection 172(2) is deemed "not" to apply is likely to avoid double-taxation, since subsection 172(2) and 272.1(4) would appear to do the same thing; the deeming rule thus precludes their operation at the same time. One wonders again, however, why subsection 172(2) was not simply relied on to effect the same result as subsection 272.1(4) – which again appears somewhat redundant.

103 See generally, for example, *Foreman (P.M.) v. M.N.R.*, [1992] 2 C.T.C. 2619 (T.C.C.) and *Greiner v. The Queen*, [1984] C.T.C. 92 (F.C.A.).

104 A deeming provision is probably necessary, not unlike the nature of the special rule in section 136, clarifying that for GST purposes, it is not appropriate to regard the property interests that a partner has in partnership property to exist.

105 We will see in Part III of the Paper that in certain provincial jurisdictions, most notably British Columbia (where no separate deemed status for partnerships exists), these mental gymnastics must be undertaken in order to ascertain the RST effect of many common partnership transactions.

106 For example, assume that the 50-50 partnership between A and B ends, and all that is left after paying proper debts is a desk, a computer and a painting. Assume the desk and computer roughly equal the value of the painting.

While A and B each own a 50% beneficial interest in each asset, rather than cutting each in half (or otherwise liquidating the remaining property to cash), A and B could agree to distribute the desk and computer to A, and the painting to B.

107 See the definition of "supply" in subsection 123(1) of the *ETA*.

108 Some commentators have suggested that "not on the account of the partnership" refers to purchases "done in the partnership's name or as the partnership's agent": see *Canada GST Service*, D. Sherman, Editor (p. 272-217).

While not completely certain, it may simply be that the reference to "on the account of" is simply a reference to whether or not partnership resources were used to effect the purchase (i.e., was the partner using a personal cheque, credit card or funds, or was a partnership cheque, credit card or funds used ?).

The difficulty with the former proposition is that as a matter of law, a partner acting in the course of the partnership's activities, would always be acting as the partnership's agent: see again, as an example, Ontario *Partnerships Act* section 6: "Every partner is an agent of the firm and of the other partners for the purpose of the business of the partnership …".

We believe that a better interpretation of the words "on account of" is as a simple reference to whose funds were used to acquire the property or services; clearly subsection 272.2(2) is aimed only at those situations where the funds used were the partner's personal funds.

This view also seems supported, for example, by provincial partnership legislation, like section 22 of the Ontario *Partnerships Act,* which seems to use the words "on the account of" in reference to the ownership of the underlying funds or credit, as follows:

> 22. Unless the contrary intention appears, property bought with money belonging to the firm shall be deemed to have been bought on the account of the firm.
>
> (emphasis added)

109 It is in our view debatable as to whether these detailed rules are completely necessary since, it would seem, as a matter of partnership law, the partner would be seen as acting as the partnership's agent in any event, leaving the same legal result, even absent the application of the section 272.1 rules. Having said that, and in this murky area, one can still see the benefits of a codified approach in the *ETA*.

110 The CRA has published GST Policy P-216 (*Registration Of A Partner*, April 8, 1998) to further explain its administrative policies respecting the registration of a partner (other than an individual) whose only commercial activities are those of the partnership, and a partner's ability to claim ITCs.

It is also important to note that once registered, the partner will be subject to the normal obligations and entitlements of a registrant under the *ETA*.

For jurisprudence on the application of this rule prior to its 1996 amendments, see *B.J. Northern Enterprises Ltd. et al. v. The Queen*, [1995] ETC 2839 (TCC).

111 Specifically, paragraph 272.1(2)(b) gives partners (other than *individual* partners) the ability to claim an ITC for partnership expenses it incurs on its own account. This applies regardless of whether or not the partner engages in an activity separate from the partnership. Note that the ITC is only available to the extent the partnership carries on a commercial activity. The partner would also account for any changes in use of the property as required under subdivision d of Division II. As indicated, above, individuals who are partners will continue to be eligible to claim the employee-partner rebate under section 253.

Paragraph 272.1(2)(c) acts like an anti-avoidance provision in circumstances where partners are claiming their own ITCs, by ensuring that where a partner has been reimbursed in whole or in part by the partnership, any ITC that the partner can claim in the partner's separate GST return is reduced by the ITC that the partnership is entitled to claim in respect of the reimbursement. Note that under subsection 175(2), the partnership is entitled to claim an ITC for the expense only if it reimburses the partner *before* the partner files its own GST return claiming the same ITC. Thus, a partnership will not be entitled to claim an ITC for expenses reimbursed to a partner if the partner has already claimed an ITC in respect of the same expense under paragraph 272.1(2)(b).

112 See also the presentation made by Me. Serge Bouchard in 2001 at the APFF Symposium sur les taxes à la consommation, "Derniers développements en matière legislative et d'interprétation". Me Bouchard explained the rules applicable to partnership under Section 272.1 of the *ETA* and Sections 345.1 and fol. of the Quebec legislation, and made no distinction between GST and QST.

113 *An Act Respecting the Quebec Sales Tax,* R.S.Q., c. T-0.1, as am.

114 See, for example, cases like *Seven Mile Dam (supra,* note 39), where the Courts have been willing to give much credence to the particular provincial legal structures in place – to the point of making it difficult on legislators who would like to change the fundamental application of such legal systems for "tax" purposes.

115 We believe that each of these situations is capable of falling squarely within the parameters of subsection 272.1(1).

116 With respect to the cost of a partner's employees, used in the course of the partnership's activities, paragraph (c) of the definition of "service" in subsection 123(1) of the *ETA* excludes "anything that is supplied to an employer by a person who is or agrees to become an employee of the employer in the course of or in relation to the office or employment of that person". Notably, subsection 272.1(2) applies "where property or a service is acquired or imported by a member of a partnership ..." Accordingly, it would seem that subsection 272.1(2) would not apply where anything (other than property) is acquired by employers from their employees. Since subsection 272.1(2) would not apply to the cost of the employee labour, that cost would not be excluded from subsection 272.1(1). Or in simple terms: "the general rule in subsection 272.1(1) would still apply to the employee labour". That means that there would be no supply of the employee labour from the partner to the partnership for GST purposes, and no application of the GST to this particular fact pattern.

117 The closely related rules for supplies between partnerships and corporations are outlined in subsections 156(1.1) to 156(1.3).

118 See, most recently, GST Headquarters Ruling 11950-3 *Transfer of Farmland Upon Dissolution of Partnership* (March 9, 2004).

119 See again note 89.

120 Readers should note that this is the precise result that follows in the provincial context, where partnership are not viewed as "separate persons", and where the partnership property is identified as owned by the particular partners. See the discussion above in and around note 39, and below III-1.2.

121 See *Corporate Reorganizations and Partnerships*, Blair Nixon (1998 Symposium Papers).

122 See Saucier c. Quebec (Sous-ministre du Revenu) 2002 CarswellQue 1208, (2002) R.D.F.Q. 166, and Saucier c. R. 2004 G.T.C. 90 (T.C.C.).

123 Judge Rinfret similarly brushed away an argument made under *The Act respecting the legal publicity of sole proprietorships, partnerships and legal persons* that one must deposit a deregistration notice.

124 This is important when one considers Article 2234 of the Code: "Dissolution of the partnership does not affect the rights of third persons in good faith who subsequently enter into a contract with a partner or a mandatary acting on behalf of the partnership."

125 See also, for example, subsection 272.1(5) of *ETA*.

126 See, again, *Seven Mile Dam Contractors, supra*, note 39.

127 R.S.B.C. 1996, c. 431, as amended.

128 While critics might suggest that most provincial Interpretations Acts are meant to provide definitions and rules for the interpretation of all provincial legislation, and that the definition of partnership as a "person" in a particular province's *Interpretation Act* should be enough, the Court of Appeal specifically rejected that argument. Instead, the Court relied on a rule of construction that provides that new principles are not to be introduced into any branch of the law except by clear language, and citing *Craies on Statute Law* (7th ed. 1971) at p.339 for that proposition:

> If it is clear that it was the intention of the legislature in passing a new statute to abrogate the previous common law on the subject, the common law must give way and the statute must prevail; but there is no presumption that a statute is intended to override the common law. In fact the presumption, if any, is the other way, for "the general rule in exposition is this, that in all doubtful matters, and where the expression is in general terms, the words are to receive such a construction as may be agreeable to the rules of common law in cases of that nature, for statutes are not presumed to make any alteration in the common law further or otherwise than the Act does expressly declare. It is a well-established principle of construction that a statute is not to be taken as effecting a fundamental alteration in the general law unless it uses words that point unmistakably to that conclusion.

129 Note the Court may not have properly understood how the "flow through" analysis ought to have applied from the selling side of the transaction, since technically, Partner A should have been viewed as selling 70% of the assets in the following percentages: 40% to itself, 10% to Partner B and 50% to remaining partners; whereas, Partner B should have been viewed as selling 30% of the assets in the following percentages: 10% to itself 40% to Partner A and 50% to the remaining partners.

130 Note that despite British Columbia's apparent acceptance of *Seven Mile Dam*, it takes almost a schizophrenic approach for other RST purposes as, for example, the application of British Columbia's related party rules regarding "partnerships" that transfer assets to related corporations:

> R.3 **Eligibility of Partnerships**
>
> Inquiries have been received from the public regarding the use of the term "person" in Regulation 3.14.1(2). It is suggested that using "person" in the singular excludes partnerships from the exemption.
>
> As the term "person" is not defined in the Social Service Tax Act, the definition provided in the Interpretation Act applies. Under this definition, a person includes partnerships. Partnerships are therefore eligible for the exemption under the current wording of the Reg. 3.14.1(2).

We are unable to reconcile the two approaches, particularly given that the Court of Appeal in *Seven Mile Dam* was clear in its decision to overlook the application of the *Interpretation Act* definition, which it held insufficient to displace common law principles, since it was not resident in the actual *SSTA* itself. Perhaps the reason for the dichotomy lies in the fact that British Columbia's reliance on the definition is to provide an exemption, rather than attempt taxation.

131 See British Columbia's Tax Interpretation Manual ("TIM") discussion regarding Regulation 3.14, at Section 3.15, *Transfers to Partnerships*, and under General Rulings, at Section 10, *Partnerships and Joint Ventures.*

132 See *The Provincial Sales Tax Regulations*, R.R.S. c. E-3, Sask. Reg. 1, as amended, ss. 2(f).

133 See S.S. 2000, c. P-34.1

134 On the other hand, Saskatchewan, unlike British Columbia, has not defined a "person" to include a "partnership" in its *Interpretation Act*, 1995: see, S.S. 1995, c. I-11.2. This suggests that the question is far from clear.

135 Subsection 97(2) of the *Income Tax Act* provides a tax-deferred "rollover" of assets to a partnership, in certain limited circumstances.

136 R.S.M. 1987, c. R130, as amended.

137 See *The Retail Sales Tax Act*, R.S.O. 1990, c. R.31, as amended, ss. 1(1):

> "**person**", in addition to its meaning in the Interpretation Act, includes Her Majesty in right of Ontario, a partnership, a municipality, or a local board thereof as defined in the Municipal Affairs Act, and any board, commission or authority established under any Act of the Legislature;
>
> (emphasis added)

138 R.S.P.E.I. 1988, c. R-14 as amended.

139 Readers interested in the application of Ontario's new rules to "corporate" related party transactions, are commended to read *Better Late Than Never … Ontario issues Draft Regulations to Modernize RST Related Party Rules, and Transfers of Assets between Related Corporations and Partnerships*, Robert G. Kreklewetz & Karen L. Willans, Ontario Bar Association Newsletter (Fall 2004).

140 We will refer to the current rules in Regulation 1013(13) as the "old rules". Please note, however, that these rules will remain in effect until the "new rules" recently proposed by Ontario are finally promulgated. When brought into effect, the "new rules" are intended to be effective July 20, 2004; hence our relegation of the current regime in Regulation 1013(13) to "old rule" status.

141 This is probably also supported by provincial legislation, in that the Ontario *Limited Partnerships Act* may provide some legal basis for treating the assignment of a limited partner's interest in a limited partnership as a transfer of an intangible right, and not as the formation of a new partnership, or involving the transfer of ownership of the underlying TPP of the partnership – which would technically be the case on the transfer of an "interest" in a general partnership.

Accordingly, the sale or assignment of a limited partner's interest in a partnership might well be properly characterized as a disposition of shares (intangible personal property) and, as such, should not be subject to RST.

142 *Ibid.*