

## Finance announces changes to HST rules for funds client advisory

### purpose

As discussed in our prior client advisory [\*Significant Proposed HST Changes for Funds and Their Managers\*](#), on May 19, 2010, the Department of Finance ("Finance") released a backgrounder (the "May Release") describing proposed rules (the "Proposed Rules") for determining the ultimate HST liability of investment plans (including registered pension plans, mutual fund trusts, mutual fund corporations, and unit trusts) and segregated funds of insurers (collectively "Funds"). Under the Proposed Rules, as explained in our prior client advisory, the ultimate burden or cost to a Fund of the provincial portion of the HST ("PVAT") will be based on the residence of the Fund's investors.

In response to stakeholder's comments and criticisms, on June 30, 2010, Finance released a new backgrounder (the "June Release") containing a number of significant changes and improvements to the Proposed Rules for Funds. Finance also released draft regulations (the "Draft Regulations") to implement the Proposed Rules, although the Draft Regulations do not fully reflect the changes described in the June Release.

### significant changes in the June Release

The most significant changes to the Proposed Rules contained in the June Release are as follows:

- **computation of provincial attribution percentage ("PAP"):** Under the Proposed rules, the default method, in the absence of making an election, for determining a Fund's PAP would be to resort to the preceding year's values (as of September 30) to estimate PVAT instalments, if any, for the current year, with a reconciliation with the current year's values on the Fund's annual return (known as the "General Rule (with reconciliation)"). Since the alternative "Preceding Year Method" involves no reconciliation, is administratively simpler and, therefore, will be preferable to most Funds, under the June Release, it is proposed that the "Preceding Year Method" be the default rule for determining a Fund's PAP, with Funds eligible to elect to resort to the alternative "General Rule (with reconciliation)" or the "Real Time Method", where circumstances permit/warrant.
- **treatment of non-residents:** The Proposed Rules exclude the value of units held by non-resident investors in computing the PAP of a Fund. The June Release, however, provides that Funds can generally include non-residents in computing the PAP for an HST province, unless a Fund elects otherwise. Since this change can result in a larger denominator and smaller PAP percentage, this change can reduce the PVAT liability of Funds with non-resident investors.
- **election filings:** Various elections contained in the Proposed Rules have to be filed before the commencement of the fiscal year to which they are to apply. It is now proposed that the Minister of National Revenue will be provided with the discretion to establish alternative deadlines for filing such elections. Since the Proposed Rules were released more than 4 months into the current fiscal year 2010, without this flexibility, it would have been impossible for Funds to meet the election filing deadline for 2010.

- **GST/HST registration:** In a change from the May Release, the June Release provides that Funds will not generally be required to register for GST/HST purposes. Only Funds wishing to file one (or more) of the “reporting entity election”, the “consolidated filing election” or the “transfer tax election” will be required to register for GST/HST.
- **penalties:** The June Release provides further details about the penalties for institutional investors and/or distribution agents who fail to provide Funds with the information required to compute their PAP in a timely manner. An institutional investors or distribution agents who fail to provide accurate information to Funds on or before the later of (i) November 15 of the relevant year, and (ii) 45 days after the information was requested by the Fund will be subject to penalties of up to \$10,000. A distribution agent may be relieved of a penalty under a “due diligence test”. It will be interesting to see if Funds will have available to them a due diligence defence for errors and under/late-payment of PVAT resulting from reasonably relying on information provided to them by institutional investors and distribution agents.
- **unallocated units:** In the June Release, Finance provides limited relief for Funds who are unable to obtain residency information about investors representing 90 per cent or more of the value of the units of a series. Provided that a Fund can obtain information about units representing more than 50% of the value of units in a series, only the portion of the value of the series of units for which investor residency is needed to reach the 90 per cent threshold would be subject to the highest PVAT rate for the SAM formula (whereas under the May Release the entire portion of unallocated units would be subject to the highest PVAT rate). The PVAT liability for the remaining unallocated 10 per cent will be based on the proportion of PVAT liability for the units in the series for which investor information is obtained. However, where a Fund does not obtain information about investors representing more than 50 per cent of the value of the units in a series, or where a Fund fails to request investor information, the entire portion of the value of the series of units for which investor information is not available would be subject to the highest PVAT rate.
- **specified investors:** While Funds are generally required to look-through institutional investors in order to determine their PAP, they are not required to look-through so-called “specified investors”. The June Release extends the definition and scope of “specified investor” to a Fund (other than mutual fund trusts, mutual fund corporations, segregated funds, unit trusts and mortgage investment corporations) with less than \$10 million invested in another Fund (taking into account the investments of any related parties).

## other considerations

Curiously absent from the June Release and the accompanying Draft Regulations is any discussion of limited partnerships. We had anticipated that Finance would amend the Proposed Rules to ensure that private equity funds structured as limited partnerships (i.e., most private equity funds) would be covered by the Proposed Rules in order to remove any incentive for such funds to relocate to provinces without HST. It remains to be seen whether Finance still intends to make such amendments.

For further information contact

**Jamie Wilks**

Partner, Tax Group

416.865.7804

[jamie.wilks@mcmillan.ca](mailto:jamie.wilks@mcmillan.ca)

**Carl Irvine**

Associate, Tax Group

416.865.7266

[carl.irvine@mcmillan.ca](mailto:carl.irvine@mcmillan.ca)

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained. If you do not wish to receive further Tax Advisories, please click [here](#). If you do not wish to receive any further bulletins or other materials from McMillan, please click [here](#) at [unsubscribe@mcmillan.ca](mailto:unsubscribe@mcmillan.ca).

©2010 McMillan LLP