



Pension Investment
Association of Canada

Association canadienne des
gestionnaires de caisses de retraite

November 29, 2016

Tax Policy Branch
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario
K1A 0G5
Via email: fin.gsthst2016-tpstvh2016.fin@canada.ca

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

The purpose of this letter is to provide comments from the Pension Investment Association of Canada (“PIAC”) on the Proposals for Consultation concerning the GST/HST Treatment of Certain Limited Partnerships and Investment Plans released on July 22, 2016. We are pleased to be a part of this consultation process, and we look forward to further consultation on the matters we raise in this letter.

PIAC has been the national voice for Canadian private and public pension funds since 1977 in matters related to pension investment and governance. Senior investment professionals employed by PIAC’s member funds are responsible for the oversight and management of over \$1.5 trillion in assets on behalf of millions of Canadians. PIAC’s mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries. PIAC’s positions on public policy reflect the fiduciary framework in which member funds operate and its commitment to work in the best interests of plan members.

PIAC believes the Government of Canada should, in considering tax policy affecting pension plan investments, take into account that pension plans play an important role in Canadian society and the economy. PIAC’s membership invests contributions made by employees and employers to provide secure, stable retirement income for working Canadians.

PIAC is largely supportive of the proposals in Parts 1 and 3 of the consultation paper which expand the SLFI rules to include investment limited partnerships and provide a rebate for investment plans having non-resident investors. However, we have significant concerns with the proposals in Part 2 of the paper “Imported supplies rules for financial

institutions.” PIAC firmly believes that not going forward with the proposals in Part 2 is the preferred outcome for the pension funds it represents, and is in the best interests of our society and plan beneficiaries. However, should the government decide to go forward with the significant tax policy changes proposed in Part 2, further consultation is warranted including the release of detailed draft legislation for consultation so that the potential ramifications can be fully evaluated.

Tax Policy Commentary

Below, please find commentary from a tax policy perspective which we believe is of particular relevance to the proposals put forward in Part 2.

Impact of the Foreign LP Rule is Disproportionately Negative for Canadian Investors on the Global Stage

Part 2 of the consultation paper proposes that non-resident limited partnerships (“LPs”) be required to self-assess GST/HST in respect of their Canadian activities where the Canadian interests in the LP exceed \$10 million and equal or exceed 10% of the LP’s assets. It is our understanding that the Department of Finance Canada intends for this self-assessment to apply in all cases where the non-resident LP’s Canadian investors exceed this threshold, regardless of the LP’s degree of presence or scope of activities in Canada.

LPs are a common business vehicle in a number of foreign jurisdictions and it is common for Canadian pension funds to encounter non-resident LPs when investing in foreign jurisdictions. Given the limited size of Canadian capital markets, Canadian pension funds are looking increasingly to opportunities to deploy capital overseas and thus investment in non-resident LPs is a growing trend. There are numerous subsets and types of limited partnerships and they are used in a diverse range of investment activities including private equity investments, direct transactions and real estate structures. The potential impact of the Part 2 proposals is therefore material for a number of Canadian pension funds that invest in foreign jurisdictions that rely heavily on LPs as an investment vehicle. Moreover, foreign investment vehicles’ structures will frequently be predetermined and Canadian pension funds investing in foreign LPs generally do not have the option of investing via a different structure.

Rules are Out of Step with OECD Peers and Result in Double Taxation

PIAC submits that the proposal, which follows the approach taken under the GST/HST regime of attempting to input tax some financial service activity performed outside of Canada, is fundamentally flawed. It is important to note that no other VAT jurisdiction that we are aware of attempts to input tax financial services performed outside of its jurisdiction in the way currently done in the GST/HST regime and proposed on an expanded basis in Part 2 of the consultation paper. The financial sector, including pension funds, has become a global industry. There is a general consensus, as expressed in the OECD’s work on consumption taxes, that VATs in different jurisdictions should be aligned on some common principles so as to minimize instances of double and non-taxation. VAT jurisdictions generally exempt financial services with the result that taxable inputs used by financial institutions, including investment LPs, are subject to

unrecoverable VAT. Requiring these financial institutions who have no presence in Canada to self-assess GST/HST in respect of their “Canadian activities” would result in double taxation as inputs used in these activities would generally already be taxed in their home jurisdiction. This result is clearly contrary to the approaches taken by other VAT jurisdictions. More importantly, it is contrary to a fundamental core VAT principle in an international context, namely the avoidance of double taxation.

Unintended Cascade on Commercial Activity

We would also point out that investing in a non-resident LP is generally a zero-rated activity under the GST/HST regime when undertaken by a “financial institution”, as defined for GST/HST purposes. The proposals in Part 2 would in effect, impose an unrecoverable indirect GST/HST cost on Canadian investors in respect of a zero-rated activity.

Inequitable Taxation on Consumption Outside Canada

The proposal also raises equity issues of who should bear the burden of the proposed new self-assessment tax. Non-resident LPs may simply pass on the cost of the tax to all of its investors in proportion to their interest in the partnership. This may result in non-resident investors bearing some of the GST/HST cost, a result that is inequitable.

Changes Add Unnecessary Complexity and Will Discourage Investments

The existing self-assessment rules for cross border transactions by financial institutions are extremely complex and the application of these rules to non-resident LPs would impose significant compliance and administrative costs for both the non-resident LP and the CRA, costs that would likely be disproportionately high relative to the amount of revenue that would be raised. It is also far from clear how CRA could reasonably enforce these rules on non-resident LPs who have no presence in Canada.

Moreover, the high cost of compliance combined with the additional cost of the self-assessed GST/HST would likely be met with resistance by many non-resident LPs who currently do not need to concern themselves with the workings of the Canadian VAT system. To help illustrate the anticipated negative reaction of non-residents to a new Canadian tax compliance burden, we would remind the Department of Finance Canada of the broadly negative experience of the historic treaty clearance certificate requirements in section 116 of the Income Tax Act, and the chilling effect these had on international financial markets’ dealings in Canada.

Some non-resident LPs may simply refuse participation to Canadian pension funds in order to avoid the additional costs and compliance complexities that would be imposed by Part 2 of the proposals. Canadian pension funds need access to international investment opportunities given the need to maximize returns for Canadian plan sponsors and beneficiaries. Canadian pension funds could be disadvantaged internationally if the proposals in Part 2 of the consultation paper go forward as their standing with respect to global investment opportunities could be negatively impacted.

The above commentary provides reasons for not proceeding with the proposals outlined in Part 2 of the consultation paper.

Need for Draft Legislation

Given that Part 2 of the consultation paper provides few details on how the proposals would apply, it is not possible to provide detailed comments. PIAC firmly believes the proposals should not go forward. Should the government decide to proceed with this proposal however, there are many areas which would first require clarification and consultation. To respect the principle of certainty, the government should release detailed draft legislation for consultation in the same manner as was done with the draft legislation concerning master trusts. Such an approach would ensure that adequate time is given to PIAC to respond and for the government to consider PIAC's response before tabling any legislation.

Conclusion

PIAC strongly believes that the proposals in Part 2 of the consultation paper would negatively impact the assets that its member pension funds manage on behalf of millions of Canadians and that it is in Canadian current and future retirees' best interests that these proposals not go forward. However, should the government nonetheless decide to proceed with the proposals in Part 2, further consultation is warranted including the release of detailed draft legislation for consideration. While PIAC is generally supportive of the proposals in Parts 1 and 3 of the consultation paper, we also encourage the government to release detailed draft legislation for comment on these parts for consultation.

PIAC appreciates the opportunity for ongoing dialogue with the Department of Finance Canada on this matter. We believe the role we play as both investors in the Canadian economy and as the providers of retirement income support to Canadians warrants a significant level of transparency and dialogue in advance of any changes being made. We also believe that, should the government make changes to the rules, the changes should apply prospectively, ensuring that they are well understood and can be easily implemented in an orderly manner. We would welcome an opportunity to meet with Department of Finance Canada officials to elaborate on our comments and to answer any questions they may have.

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

Yours sincerely,



Lisa Jankov
Chair

cc. Honourable Bill Morneau, Minister of Finance