The Joint Committee on Taxation of
The Canadian Bar Association

and

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Robert Demeter
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Dear Mr. Demeter:

Subject: August 9, 2022 Technical Amendments - Application of Part XIII tax where payer or payee is a partnership

On August 9, 2022, draft legislative proposals relating to the Income Tax Act (the "Act") and the Income Tax Regulations was released by the Department of Finance. Included in the draft legislation were proposals which would amend the withholding tax rules in Part XIII that apply to partnerships if the legislation is enacted. As discussed in a prior call, significant practical and technical concerns have been raised on these proposals by the Committee.

Proposed changes to Paragraph 212(13.1)(a)

Under the current legislation contained in the Act, paragraph 212(13.1)(a) deems a partnership to be a person resident in Canada for payments made by the partnership to a non-resident person if those payments are deductible in computing the partnership's Canadian-source income. The proposals expand the provision by focusing on the specific partners and the extent to which their partnership income is subject to Canadian tax. In particular, proposed paragraph 212(13.1)(a) would, if enacted, deem a partnership to be a person resident in Canada in respect of the portion of a particular amount paid or credited by the partnership to a non-resident person where the amount is deductible in computing a partner's share of the partnership's income or loss to the extent that the share is taxable under Part I.

It should be kept in mind that although this change has been included in the draft legislation as a technical amendment, it significantly changes the basis of the application of withholding tax to partnerships. Notwithstanding any theoretical rationale which could be argued for the proposed change, we believe that the proposals as currently drafted would create significant practical issues that will be extremely difficult to deal with.

For example, significant concerns will arise where the proposals are applied to a foreign partnership where the only connection of the partnership to Canada is the residence of certain particular partners who will often represent a very small minority of partners and who will often be passive investors. We question whether such a partnership would be aware of the rules if enacted given their lack of a connection with Canada. Also, if they do become aware of the rules, will they implement processes to deal with the rules, or will they simply prohibit Canadian ownership of partnership interests so that the compliance issues that will arise can be avoided? Similarly, we wonder how the Canada Revenue Agency can enforce the rules if the only Canadian connection is Canadian resident passive investors. Auditing such investors as a starting point would be inappropriate in our opinion as those partners do not have control, and only limited knowledge of payments made by the partnership.

If a foreign partnership is able to create processes to deal with the increased Canadian tax compliance and withholding burden, we also question whether effective tax compliance is possible due to the approach taken in the draft legislation. Continuing with a foreign partnership as an example, we believe it is impractical to expect that a foreign entity will become aware of the proposed Canadian tax rules where the Canadian investment is minor and they have no nexus to Canada.

In some cases, we believe that compliance with the proposed changes may not be possible at all. Specifically, the proposed change that applies to tiered partnership arrangements may be problematic. For example, consider a fund organized as a partnership that has a tiered partnership as an investor. These rules would appear to create a potential withholding tax obligation for the fund if there is a transfer of a partnership interest 2 or more levels up to a Canadian resident, even if such transfer occurs without the fund's knowledge. In such a case, it may not be possible for the fund to even know the potential obligation exists.

Recommendation

Given that these proposals would create significant and possibly insurmountable tax compliance issues from a practical perspective, we recommend that the Department of Finance consider the potential impact of the proposals in more depth and consult further with both tax and investment community stakeholders before the proposals move forward.

We would be pleased to discuss the practical as well as the technical issues associated with the current proposals in more detail or provide our comments on potential alternative approaches.

Yours very truly,

David Bunn
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Cc: Trevor McGowan, Associate Assistant Deputy Minister, Tax Policy Branch, Finance Canada