Clampdown on improper joint venture GST/HST S.273 election but regime to be expanded

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On February 6, 2014, the CRA issued its final warning, in the form of GST/HST Notice No. 284, to joint ventures that use bare trust nominees to file GST/HST returns on their behalf. The CRA has always maintained that such practice is inconsistent with section 273 of the *Excise Tax Act* (the "ETA") and announced that it will no longer tolerate the practice after 2014. Interestingly, as part of the 2014 Federal Budget released less than a week afterwards, the Department of Finance proposed to expand the section 273 election regime so that more commercial joint ventures can benefit from the regime.

Generally speaking, a joint venture is where two or more persons work together in a limited and defined business undertaking, which does not constitute a partnership, a trust or a corporation, the expenses and revenues of which will be distributed in mutually agreed portions. See CRA's Policy Statement on distinguishing between a joint venture and a partnership for GST purposes here – a partnership is a "person" for GST/HST purposes, while a joint venture is not.

Since a joint venture is not a person for GST/HST purposes, a joint venture is not permitted to be a GST registrant in its own right. Instead, each participant in a joint venture has the obligation to be registered for GST/HST purposes and to collect and remit GST/HST, unless the small supplier exception (or certain other limited exceptions) is met. To address this, section 273 of the ETA provides for an election under which joint venture participants elect one "participant" that is a GST/HST registrant to be the operator, who will, on behalf of the other participants, account for the GST/HST collectible on taxable supplies and claim input tax credits on expenses incurred. Currently, this election is only available if the activities of the joint venture are prescribed by regulations as eligible activities. These prescribed activities generally relate to the real estate, resources and energy sectors.

The term "participant" is not defined in the Act, but it has been a long standing policy of the CRA that for purposes of the section 273 election a "participant" means:

a. a person who, under a joint venture agreement evidenced in writing, makes an investment by contributing resources and takes a proportionate share of any revenue or incurs a proportionate share of the losses from the joint venture activities; or
b. a person, without a financial interest, who is designated as the operator of the joint venture under an agreement in writing and is responsible for the managerial or operational control of the joint venture.

Despite the CRA's published policies, it has become common place for joint ventures (particularly in the real estate and the oil and gas context) to rely on the section 273 election to make a bare trustee (usually a nominee corporation with no actual authority) the "operator" and have it report GST/HST of the joint venture on behalf of the participants. For example, a group of investors purchase land and sets up a bare trust with a corporation as trustee, whose sole duty is to covey legal title of the land on demand of the investors. If the corporate trustee becomes a GST/HST registrant and files returns in respect of the land by virtue of having been elected as the operator, this would run afoul of CRA's policy

because the corporate trustee has neither made an investment in the joint venture nor is it responsible for the "managerial or operational control" of the joint venture. Consequently, the CRA could assess the investors individually for any GST/HST owing in respect of the land.

Administratively, the CRA has held back from enforcing this policy as long as it was satisfied that the right amount of GST/HST has been reported and remitted under the nominee's returns and the joint venture participants were otherwise fully compliant. On GST/HST Notice No. 284 issued on February 6, 2014, the CRA announced that it will no longer tolerate this practice and will begin assessing joint venture participants for GST/HST owed for reporting periods ending after 2014 if the designated operator does not meet its requirements of a "participant".

In the Notice, the CRA describes what constitutes as having "managerial or operational control" of a joint venture: the person must have the authority to manage the joint venture's daily activities without requiring the input or approval of the other participants, although the scope of such authority does not necessarily need to include significant business decisions such as acquisitions and divestures of core assets. The CRA adds that where the person does not engage staff to perform the operator's duties, it is doubtful that the person would be considered to have the managerial or operational control of the joint venture.

Currently, there are many real estate joint ventures and oil and gas joint ventures that have nominee corporations registered and accounting for joint venture activities as the operator under the section 273 election. All participants in such arrangements, other than those participants qualifying for the small supplier exception, will be reassessed for GST/HST owing plus arrears interest for reporting periods ending after 2014. Additionally, the consequences of non-compliance can include failure-to-file penalties of up to 4% of the unremitted GST/HST. It is therefore important for joint ventures to review their GST/HST filing arrangements and ensure going forward that the operator is a participant who meets the CRA's criteria.

While we appreciate that the CRA is merely enforcing the words of the ETA, it is difficult to understand the policy reason against this practice given it streamlines administration from both the perspective of the taxpayers and the CRA. Perhaps the timing of this change in enforcement policy is the CRA's anticipation of the Department of Finance proposing a broadening of the section 273 election beyond the prescribed activities. Budget 2014 proposes new measures (and related anti-avoidance rules) that will allow joint venture participants to elect under section 273 as long as the activities of the joint venture are exclusively commercial and the participants are engaged exclusively in commercial activities. The draft legislative proposals will be released later in 2014. Although we applaud the expansion of the section 273 election, the actual impact of this expansion to businesses will likely be narrow since the most common uses of joint venture ownership are already contained in the list of prescribed activities. It will be ideal if the draft legislation will relax the requirements of section 273 and allow a bare trust nominee to be the operator, but we are not hopeful since the Budget documents did not hint at this issue.

Given the CRA's interpretation of what constitutes a participant, a possible solution for an existing joint venture with a nominee corporation setup may be for the nominee corporation to make a nominal contribution into the joint venture and to amend the joint venture agreement to document the contribution and provide the nominee corporation with a proportionate share of any revenue or losses from the joint venture activities. This should make the nominee corporation a "participant" under the CRA's definition and thus eligible to be an operator under the section 273 of the ETA. The nominee corporation may still be a bare trustee if it has no authority over any of the joint venture's activities.

If the plan as described above is undertaken, it will be important to maintain the relationship as a bare

trust. For purposes of the ETA, a trustee that has independent powers and responsibilities in relation to the trust property is considered to be carrying on a commercial activity and will be required to account for GST in respect of the trust property. This is in line with the intended GST/HST result. However, for purpose of the Income Tax Act (the “ITA”), subsections 75(2) and 107(4.1) may apply by virtue of the trustee having contributed to the trust so that the trust forever loses the ability to ‘roll-out’ trust property on a tax-deferred basis (normally an entitlement of a personal trust, i.e. a testamentary trust or an *inter vivos* trust in which the beneficiaries did not pay for their trust interests). The implication is that the joint venture (being the property of the trust relationship) cannot be returned to the joint venture participants without triggering the recognition of all the underlying gains for income tax purposes. In contrast, this income tax consequence would not arise if the arrangement remains a bare trust even if the bare trustee made contribution to the trust, since bare trusts are ignored for purpose of the ITA.

The impact of the CRA’s change in enforcement policy in terms of a bare trust nominee is significant to many existing joint ventures. The CRA knows this and is giving taxpayers close to a year to reorganize their affairs. Taxpayers affected by this need to take full advantage of this transition period and ensure compliance post-2014. And obviously, joint ventures which are currently not eligible for the section 273 election (but are looking forward to being eligible after the implementation of the proposed broadening of that provision) need to keep this issue in mind when structuring their affairs.