October 08, 2013 Reference number: IBAA 2013-0001

XXX

Dear XXX:

Re: XXX

Thank you for your letter dated XXX, requesting a technical interpretation with respect to the provisions of the *International Business Activity Act* (IBA Act).

This letter responds to requests for clarification as to whether the proposed activity performed by XXX will qualify as an international financial activity under the IBA Act.

FACTS

Our understanding of the facts is as follows:

1. XXX is a British Columbia corporation XXX.

2. XXX is registered under the IBA Act. Its principal business is managing, for a fee or commission, investments for non-resident persons. This is an international financial activity under s. 2(2)(l) of the IBA Act.

3. XXX also provides financial advice to non-resident persons under s. 2(2)(i) of the IBA Act.

4. XXX.

5. XXX.

6. XXX.

7. XXX.

Our understanding of the proposed transactions is as follows:

1. A new limited partnership called XXX will be formed:
    a. XXX, or a wholly-owned subsidiary[1] of XXX, will be the general partner.
    b. XXX will be the limited partners.
    c. XXX.

[1] It is assumed that the wholly owned subsidiary will be incorporated in BC.

d. XXX's business and purpose is to invest in and trade commodity and financial futures.

2. XXX will act as investment advisor to XXX and the two will enter into an investment management agreement stipulating the fees to be paid to XXX by XXX for its advisory services. The agreement will stipulate that XXX will receive a fee that is XXX. This is the same fee that XXX charges one of its arm's length clients for such activities.

3. XXX will only invest in or trade securities that are issued by non-resident persons that are not listed on a stock exchange prescribed by section 3200 of the Income Tax Regulations (Canada).

LEGISLATION

Section 2 of the IBA Act lists the qualifying international financial activities and includes section 2(2)(m):

> "managing, for a fee or commission and for persons resident in Canada, investments in securities that are issued by a non-resident person and that are not listed with a stock exchange prescribed in section 3200 of the Income Tax Regulations (Canada)."

The prescribed stock exchanges are Tiers 1 and 2 of the TSX Venture Exchange, the Montreal Stock Exchange, the Toronto Stock Exchange and the Canadian National Stock Exchange.[2]

The IBA Act also provides that 'person' has the same meaning as in section 248(1) of the *Income Tax Act* (Canada) [federal Act] and includes a partnership.[3]

INTERPRETATION

In order for the proposed scenarios to qualify as international financial activities under section 2(2)(m) of the IBA Act, the following criteria must be met:

(1) The securities must be issued by a non-resident and must not be listed on Tiers 1 or 2 of the TSX Venture Exchange, the Montreal Stock Exchange, the Toronto Stock Exchange or the Canadian National Stock Exchange,
(2) The securities must be managed on behalf of persons resident in Canada, and
(3) XXX must receive a fee or commission for the management services.

Discussion

(1) The securities must be issued by a non-resident and must not be listed on Tiers 1 or 2 of the TSX Venture Exchange, the Montreal Stock Exchange, the Toronto Stock Exchange or the Canadian National Stock Exchange.

[2] Although section 3200 of the Income Tax Regulations (Canada), which listed the "prescribed stock exchanges", has been repealed, those same exchanges are now listed as "designated stock exchanges" located in Canada for the purpose of new section 262 of the federal Act. As a result of this change, the Ministry of Finance interprets "stock exchanges prescribed in section 3200 of the Income Tax Regulations (Canada)" to be those designated stock exchanges under section 262 of the federal Act which are located in Canada.
[3] IBA Act, s 1 "person".

Whether the investments are issued by a non-resident person is a question of fact to be determined based on all of the relevant circumstances. Similarly, whether or not the securities are listed on one of these Canadian stock exchanges is also a question of fact. For reference, where a portfolio includes securities that are listed on a prescribed stock exchange or are not issued by a non-resident, the portfolio is a mixed portfolio and this portion of the activity is not an international financial activity. If this is the case, the proportion of the fee received must be allocated between qualifying and non-qualifying activities.

(2) The securities must be managed on behalf of persons resident in Canada:

In your fact scenario, the partnership, XXX, is the person whose securities are managed. XXX is considered a person for the purposes of the IBA Act due to the definition of "person" in section 1 of the IBA Act. It reads:

> "person" has the same meaning as in section 248 (1) of the federal Act and includes a partnership;

This definition does not override the common law principle that a partnership is not a separate legal person from the partners; the partnership has no legal personhood.[4] Rather, the partnership is an agreement by the partners to conduct business in common with a view to profit.[5] Accordingly, the residency of XXX is determined by the residency of all the partners. Here, all the partners are corporations incorporated in British Columbia and are therefore residents of Canada.

(3) XXX must receive a fee or commission from managing the investments in securities:

In your letter there are two proposed transactions: (a) XXX will be both a general partner and limited partner [GP and LP respectively] in XXX and (b) XXX will only be an LP while a wholly-owned subsidiary of XXX will be the GP. Because of these differences, the two scenarios must be analysed separately.

(a) Scenario 1: XXX is both a GP and an LP in XXX

In the proposed transaction, XXX will receive XXX under an investment management agreement for managing XXX's investments in securities. As noted under (2) above, XXX is not separate from the partnership, XXX, since XXX would be a partner of XXX, both as the GP and a LP. In addition, the operation of partnership law[6] prevents a GP from receiving any remuneration from acting in the partnership business. As a result, XXX cannot contract with itself and cannot receive fees or commissions from that contract. Therefore, the XXX payments' true character would be an increased share of the partnership profits and not a fee or commission. For this reason, Scenario 1 will not qualify under section 2(2)(m) of the IBA Act.

(b) Scenario 2: XXX is only an LP in XXX. The GP is a wholly-owned subsidiary of XXX

Where XXX is an LP only, the principle that partners are not separate from the partnership is still applicable. However, LPs are permitted to lend, borrow or transact business with the partnership.[7] Notwithstanding this ability to transact business with the partnership, LPs are

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[4] *Seven Mile Dam Contractors v British Columbia*, 1980 CanLII 451 (BC CA)
[5] *Partnership Act*, s 2
[6] *Partnership Act*, s 27(f)
[7] *Partnership Act*, s 60

not permitted to manage or conduct the partnership's business.[8] When an LP manages the business of the partnership, it loses its limited liability and is treated as a general partner. In other words, an LP is permitted to transact ancillary services with the partnership but is not permitted to transact to run the business.

In the proposed scenario, XXX business is to "invest and trade commodity and financial futures". XXX is proposing to manage these investments in securities. It is our position that for XXX to manage the investments of XXX, XXX would in fact be managing or conducting the business of XXX. As a result, XXX would lose its limited liability and be treated as a general partner with regard to any amounts received from XXX. The result is the same as under Scenario 1; any amounts received by XXX would be a draw against the partnership's income and not a fee or commission and for that reason, Scenario 2 will not qualify under section 2(2)(m) of the IBA Act.

In the alternative, if XXX was not managing XXX's investments in securities, but instead providing financial advice, these services would not qualify under section 2(2)(m) of the IBA Act. In order to qualify as an international financial activity under section 2(2)(i) of the IBA Act; the recipient of the services must be a non-resident person.[9] In your scenario, not all of the partners of XXX are non-residents and therefore XXX would not be a non-resident person according to the IBA Act.

SUMMARY

In order for the proposed transaction to qualify as an international financial activity under s. 2(2)(m) of the IBA Act, XXX must receive a fee or commission for the management of the investments in securities. Due to partnership law, XXX cannot receive a fee or commission for the management of the investments in securities regardless of whether it is a GP and an LP or simply an LP.

We trust that the above comments are of assistance to you. This letter is not a ruling and consequently is not binding on the Ministry of Finance.

Yours truly,

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Director
Income Tax Advisory and Intergovernmental Relations

[8] *Partnership Act*, s 64
[9] IBA Act, s 2 (1) "non-resident person".