

Corporate Insights and Taxation of Partnerships

Manitoba Bar Association 2021 Mid-Winter Conference

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Speakers

Manitoba Partnerships

Bradley J. Madison - Pitblado Law

Taxation of Partnerships

Johanna C.C. Caithness - Fillmore Riley LLP

Limited Partnership - Fiduciary Duties

Kristen Wittman - Taylor McCaffrey LLP

Manitoba Bar Association Mid-Winter Conference 2021

MANITOBA PARTNERSHIPS

Bradley J. Madison
January 21, 2021

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PARTNERSHIP LAW ORIGINS

- ❑ Concept developed in English common law
- ❑ Fundamentally - mutual agency
- ❑ Codified in *Partnerships Act* of 1890

STATUTORY PROVISIONS

The Partnership Act, C.C.S.M. c. P30

- ☐ Codifies common law and rules of equity
 - e.g. fiduciary duties among partners
- ☐ mandatory provisions re: liability to 3rd parties
 - ☐ agency
 - ☐ joint and several liability
- ☐ default provisions re: as between partners
 - ☐ unless modified by agreement

SOME DEFAULT PROVISIONS

- ☐ equal shares of profit, capital and losses
- ☐ firm to indemnify partners for “ordinary and proper” conduct of business
- ☐ partner loans or excess capital - interest at 5%
- ☐ entitled to participate in management
- ☐ no remuneration for conducting partnership business
- ☐ unanimous consent required to admit partner
- ☐ ordinary business decisions – majority consent
- ☐ change in nature of business – unanimous consent
- ☐ all partners have access to books
- ☐ no majority of the partners can expel any partner
- ☐ partners to render accounts to other partners
- ☐ partners not to compete with firm
- ☐ no assignment of partnership interest (only profits)
- ☐ one partner can dissolve the partnership on notice to the others (!)

PARTNERSHIP TYPES

The Partnership Act, C.C.S.M. c. P30

- ☐ **General Partnership**
(Part I of the Act)
- ☐ **Limited Partnership**
(Part II of the Act)
- ☐ **Limited Liability Partnership**
(Part III of the Act)

WHAT IS A PARTNERSHIP?

- ❑ **not a separate legal entity apart from its partners**
- ❑ **General Partnership - chief characteristic is mutual agency:**
 - each partner may bind the other partners
 - each partner is jointly and severally liable

DEFINITION OF PARTNERSHIP

□ s.3 of the Act:

“Partnership is the relation which subsists between persons carrying on a business in common, with a view of profit...”

but not “... the relationship between members of an incorporated company or association”

PARSING THE DEFINITION

... the relation which subsists between persons ...

- ❑ “relation” – there must be a relationship
- ❑ “persons” – two or more individuals or corporations

PARSING THE DEFINITION

... carrying on business...

- ❑ “business” – defined in the Act to include *every trade, occupation or profession*
- ❑ Interpreted broadly. May include a single transaction or time-limited activity.

PARSING THE DEFINITION

... in common ...

- ☐ **written, oral, or implied agreement in relation to a business**
- ☐ **to be determined objectively**
(partners may be characterized as partners without their knowledge or contrary to their intention, so long as indicia of partnership exist)

PARSING THE DEFINITION

... with a view of profit...

- ☐ requires profit motive
- ☐ “profit” means “net returns”
- ☐ sharing of profits is one of the strongest indicia of partnership

IS THIS A PARTNERSHIP?

**s. 4 framework for determining
existence of partnership &
examples:**

(a) common property ownership (factor only)

(b) sharing of gross returns (factor only)

(c) sharing of profits

(*prima facie* proof, but not itself determinative)

PARTNERSHIP FORMATION

- ☐ written or oral agreement
- ☐ implied by conduct
- ☐ few formal requirements (GP)
- ☐ registration requirement (LP, LLP)
 - under the *Business Names Registration Act*

LIMITED PARTNERSHIP (LP)

- ☐ **Formation: requires declaration to be filed under the BNRA**
- ☐ **Name requires “Limited Partnership”**
- ☐ **Capital contributions (\$) publically set out**
- ☐ **No limited liability without registration**
- ☐ **Failure to renew – deemed to be a GP**

LIMITED PARTNERSHIP (LP)

- ❑ **Changes shall be registered within 30 days (para. 4(1)(d) of BNRA)**

... a declaration to that effect shall be registered in the proper office within 30 days of the dissolution, change or alteration, cessation or increase or decrease, as the case may be.

- ❑ **Consider: s.57 of *The Partnership Act* provides:**

...a change or alteration in a limited partnership such as is mentioned in clause 4(1)(b) or (d) and in subsection 4(2) of The Business Names Registration Act has no effect until the registration requirements of that section are complied with.

LIMITED LIABILITY PARTNERSHIP (LLP)

- ❑ available for persons carrying on business in Manitoba ...practising a profession governed by an Act of the legislature; and
- ❑ the governing Act or a regulation under *The Partnership Act* permits the profession to be practised in a limited liability partnership; and
- ❑ the governing body prescribes a minimum level of professional liability insurance

LIMITED LIABILITY PARTNERSHIP (LLP)

- ☐ **Formation: limited liability status takes effect on date of registration of the declaration**
- ☐ **Firm name must include LLP or Limited Liability Partnership**
- ☐ **s.75(1) key: partner is not liable for the debts, obligations of the partnership or another partner that arise from the negligence, wrongful act or omission, malpractice or misconduct occurring in the ordinary course of business**

LIMITED LIABILITY PARTNERSHIP (LLP)

s.75(2)

- ☐ provides exceptions if partner knew of the negligence, act or omission, malpractice or misconduct at the time it was committed and failed to take reasonable steps to prevent it; or
- ☐ where negligence, act or omission, malpractice or misconduct was committed by employee, agent or representative of the partnership for whom the partner was directly responsible in a supervisory role

PARTNERSHIP AGREEMENTS

When advising clients and drafting, consider:

- ☐ applicability of default terms
- ☐ which default terms to be modified by agreement
- ☐ managing liability imposed by mandatory terms
- ☐ reiterate some mandatory terms for reference

PARTNERSHIP AGREEMENTS

Key Drafting Provisions:

- ☐ Firm Name, rights to it, and use
- ☐ Nature and scope of business
- ☐ Management and decision making
- ☐ Capital contributions
- ☐ Profit entitlements and loss sharing
- ☐ Dealing with partnership property

PARTNERSHIP AGREEMENTS

Key Drafting Provisions:

- ☐ Restrictions on partner authority
- ☐ Indemnities
- ☐ Admissions, expulsions and retirements
- ☐ Restrictions on encumbering and assignment of partnership interest
- ☐ Death and disability
- ☐ Dissolution

PARTNERSHIP AGREEMENTS

Key Drafting Considerations:

- ☐ the “firm” itself is not an entity and is not a party to the agreement (and can’t hold property)
- ☐ a partner may not be employed by his own firm, unlike with a corporation
- ☐ a partner may not be his/her own creditor, and cannot take security against the firm
- ☐ default rule partnership interest is not assignable (except profits)

“NOT-A-PARTNERSHIP” AGREEMENTS

- ☐ **Ensure parties do not inadvertently create a partnership if not intended**
- ☐ **If clients DO NOT wish to be partners but ask you to draft a Co-Ownership Agreement, Cost-Sharing, Joint Venture or agreement, consider key factors suggesting partnership:**

KEY FACTORS

Some indicia of partnership:

- **Sharing of profits (strong indicia)**
- **Sharing loss responsibility, debt guarantees**
- **Contributions of parties to capital of venture**
- **Co-owned property, single business premises**
- **Joint employees**
- **Participation in management and control**
- **Access to information and bank accounts**
- **Signing authority**
- **Stated intention in agreements or other documents**
- **Government filings (business name registration, tax forms)**
- **Use of firm name**
- **Holding out as a partner**

THE GOOD OLD “NO PARTNERSHIP” CLAUSE

- ☐ often see “no partnership” boilerplate
- ☐ such a clause is only one factor and is not determinative
- ☐ courts will review actual substance of relationship, rights and obligations of parties

PLEASE MAKE THIS A PARTNERSHIP AGREEMENT!

- ☐ **Conversely - Express intention to form a partnership – even where a partnership would not otherwise exist - has been upheld see *W. v. M.N.R.* [1952] Ex. C.R. 416**
- ☐ **This may not be the case anymore. More recent cases have held that absence of effective control means partnership unlikely.**

Thank you.





Taxation of Partnerships

2021 MBA Mid-Winter Conference

Johanna C.C. Caithness

Lawyerly disclaimer...

- **This presentation contains general tax information only and cannot be taken as legal advice. Always consult the applicable taxing legislation or a tax practitioner.**

Agenda

- 1. Taxation of partnerships generally**
- 2. Partnership interests**
 - ACB of a partnership interest
- 3. Limited partners**
- 4. Partnership transactions**
 - Transfers of property to and by partnerships
 - Rollovers
- 5. Anti-avoidance rules**

1. Taxation of partnerships generally

- Partnership is not subjected to tax as a separate entity
- Income and losses are allocated to partners and partners are subject to tax
- “Partnership” not defined in the ITA – look to partnership statute/common law
- “Canadian partnership” defined in s. 102 ITA: all partners are resident in Canada
- Compute income/loss at partnership level and allocate based on partnership agreement within the rules of the ITA
- Do partners own legal/beneficial ownership of underlying property of the partnership OR an interest in the partnership?

1. Taxation of partnerships generally

- **Non-resident partners – be aware of withholding tax (Part XIII and Regulation 105(1))**
- **Fiscal year rules:**
 - Partnership with 1+ individuals – calendar year fiscal period
 - Partnership with only professional corporations – calendar year
 - Partnership with non-professional corporations – any fiscal period not exceeding 53 weeks

2. Partnership interests

- **Partnership interest is capital property**
- **On disposition, there is a capital gain or capital loss**
- **Disposition can occur on:**
 - Sale or transfer to another person
 - Withdrawal from the partnership
 - Death (deemed disposition)
 - Departure from Canada (deemed disposition)
- **What happens when you dispose of your interest during a fiscal year?**
 - Do you get allocated income/loss? Look to agreement.
 - See s. 96(1.01) – include income/loss for stub period in ACB
- **Sale to tax-exempt entity results in 100% of gain being taxable**

2. Partnership interests – adjusted cost base (ACB)

- **Income allocation is distinct from distributions by a partnership**
- **Distributions are not income to the partner for tax purposes but they reduce the ACB of the partner's partnership interest**
- **Issue: reinvestment by the partnership**
 - Partners have income allocation and therefore tax, but no cash distributions to use to pay that tax
 - Consider whether partnership agreement should contemplate tax distributions only (what rate to use?)

2. Partnership interests – dissolution

- **S. 99(1) ITA – allows for the inclusion of taxpayer's share of income/loss for final fiscal period in determination of ACB of the partnership interest (deems fiscal year of partnership to end immediately before the time that is immediately before the time the partnership has ceased to exist)**
- **What happens when the disposition of the interest is the cause of the dissolution – is the adjustment available? CRA says yes.**
 - Issue is that calculation of gain is based on ACB of transferred property immediately prior to disposition
 - CRA ruling was in the context of a rollover of a partnership interest by one partner to the other partner under s. 85(1) (resulting in one partner and dissolution pursuant to applicable partnership law)

2. Partnership interests – ACB

- **Starting point is purchase price (if partnership interest purchased), cash contributed or net fair market value of property contributed (i.e. property contributed less non-partnership consideration e.g. promissory note)**
- **Adjustment under s. 53 ITA**

2. Partnership interests – ACB

- **Adjustment under s. 53 ITA**
 - Additions:
 - share of partnership income for each completed fiscal period including share of capital gains (**adjust after fiscal period**)
 - contribution of capital other than by loan
 - share of “non-taxable” items like life insurance proceeds and capital dividends
 - Deductions:
 - share of losses/capital losses for each completed fiscal period (**adjust after fiscal period**)
 - amount received as distribution of partnership profits/capital
 - share of “limited partnership loss” if deducted in computing partner’s income
 - partner’s share of charitable/political donations

2. Partnership interests – ACB

- **What happens if ACB goes negative?**
- **If you are a limited partner or “specified member”, there is a capital gain and the ACB is then reset at nil**
- **See s. 40(3) ITA**
- **“Specified member” – not actively engaged on a regular, continuous and substantial basis in the activities of the partnership**

2. Partnership interests – ACB

- **Timing mismatch**
- **Distributions reduce ACB immediately, but share of allocated income is not added to ACB until after completion of the fiscal period**
- **If ACB is low, distribution of income can result in negative ACB**
- **LPs often loan funds to partners – CRA suggests that a loan could be viewed as an amount “in lieu of” distributions and result in reduction of ACB**
 - Is a limited partnership a separate legal entity that can make loans to a partner? A person cannot contract with themselves.
 - LP agreement should specifically permit such loans

2. Partnership interests – multiple classes of units

- **CRA is of the view that all units, regardless of class, form the taxpayer's partnership interest – one capital property**
- **Dividing or reclassifying an interest into different classes may not result in a disposition of the partnership interest**
- **What happens on a disposition of part of the interest – how do you allocate ACB among the various units?**

3. Limited partners

- **Negative ACB issue**
- **“At risk” rules:**
 - Can deduct a loss only to the extent of the partner’s “at risk” amount as at end of partnership’s fiscal period ending in that year
 - “At risk” amount is roughly ACB of partnership interest PLUS share of current year’s income of partnership LESS amount owing to partnership by partner LESS amount/benefit to which partner is entitled (intended to protect partner against loss of investment)
 - Can use losses in future years, but ability to do so is limited
- **See s. 96(2.4) ITA for definition of limited partner**

4. Partnership transactions – transfer to partnership

- **A transfer of property to a partnership by a partner occurs at fair market value – s. 97(1) ITA**
- **Rollover under s. 97(2) ITA:**
 - transferor is member of partnership immediately following transfer
 - partnership must be a Canadian partnership immediately following transfer
 - file an election
 - elect between (A) greater of tax cost and non-partnership interest consideration (lower limit), and (B) fair market value of transferred property (upper limit)
 - types of property that can be rolled are slightly broader than s. 85 rollover to a corporation – most capital property, Canadian resource property, eligible capital property, foreign resource property, inventory of transferor
 - real property inventory is key inclusion for s. 97(2) vs. s. 85(1)

4. Partnership transactions – transfer by partnership

- **A transfer of property by a partnership by a partner occurs at fair market value – s. 99(2) ITA**
- **S. 85(2) ITA: transfer to a corporation for shares**
 - Use with s. 85(3) to convert a partnership to a corporation (wind up partnership within 60 days)
 - S. 85(3) doesn't require a Canadian partnership or an election
- **S. 98(3) ITA:**
 - Windup of the partnership and each partner receives an undivided interest in each partnership asset (convert to co-ownership)
- **S. 98(5) ITA:**
 - Windup of the partnership and all assets are transferred to one partner who continues to carry on the business of the partnership using the assets of the partnership
- **S. 98(6) ITA: continuation of old partnership if assets transferred to a new partnership with the same members as the old one**

4. Partnership transactions

- **Formation and dissolution are easy and flexible vs. other types of business associations**
 - Corporations – cannot generally distribute out on a rollover basis
 - Trusts – cannot generally transfer to a trust on a rollover basis
 - Formation of co-ownerships/joint ventures may require taxable transfers of property
- **Caution re: dissolution of a partnership as a result of change of purpose to one not originally contemplated by the partnership agreement**

5. Anti-avoidance rules

- **S. 103(1) ITA**
 - CRA can reallocate any income/loss where principal reason for the agreement re: allocation may reasonably be considered to be reduction/postponement of tax otherwise payable
 - Reallocate in manner that is “reasonable having regard to all the circumstances including the proportions in which the members have agreed to share profits and losses of the partnership from other sources or from sources in other places”
- **S. 103(1.1) ITA**
 - Partners who are not dealing at arm’s length
 - Reallocate where agreed to allocation is not reasonable in the circumstances having regard to capital invested in/work performed by partners or any other relevant factors
- **General anti-avoidance rule (GAAR)**

MBA Mid-Winter 2021

Corporate Insights and Taxation of Partnership

Limited Partnerships
Fiduciary duties

TAYLOR McCAFFREY
L A W Y E R S

Presented by Kristen Wittman
January 21, 2021

Why form a limited partnership?

- taxes
- control
- silent investors
- liability limitation

Why a Manitoba limited partnership?

- 63(1)
- Where a limited partner takes an active part in the business of the partnership, he is liable as if he were a general partner, to any person with whom he deals on behalf of the partnership and who does not know that he is a limited partner for all debts of the partnership.
- 63(2)
- The liability of a limited partner to a person under subsection (1) extends only to liabilities incurred by the partnership to that person between the time that the limited partner first so dealt with the person and the time when the person first acquires actual knowledge that he was dealing with a limited partner.

Overview of director's fiduciary duty

- Section 97(1) of The Corporations Act (Manitoba) states that directors shall manage, or supervise the management of, the business and affairs of a corporation.
- subject to: articles, by-laws, USA

Overview - continued

- Section 117: Every director and officer of a corporation in exercising his powers and discharging his duties shall
- (a) act honestly and in good faith with a view to the best interests of the corporation
- (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances

overview continued

- A fiduciary relationship, broadly interpreted by the case law, is a relationship between parties where one party is considered to be in a special relation of trust, confidence, or responsibility to the other.

To whom the duty is owed



Partnership Act

- **Section 8** - Every partner is an agent of the firm and his other partners for the purpose of the business of the partnership; and the acts of every partner who does any act for carrying on, in the usual way, business of the kind carried on by the firm of which he is a member bind the firm and his partners

Section 23(1)

- All property and rights and interests in property originally brought into the partnership or acquired for the purposes and in the course of the partnership business, are called in this Act "partnership property", and must be held and applied by the partners exclusively for the purposes of the partnership, and in accordance with the partnership agreement.
- See Section 27 – subject to agreement

Sections 32 and 33

- accounting to all other partners for benefits derived from the partnership property, name or business connection
- duty not to compete – can't carry on another business of the same nature and competing with, that of the partnership without consent of the partners

Application of these rules in Limited Partnerships: Section 64

- **General partners liable to account**
- The general partners of a limited partnership are liable to account, both *at law and in equity*, to each other and to the limited partners for their management of the concern, in like manner as other partners are liable.
- In other words, the GP owes the same fiduciary duties as a partner of a general partnership

Section 22

- The mutual rights and duties of partners, whether ascertained by agreement or defined by this Act, may be varied by the consent of all the partners, and the consent may be either express or inferred from a course of dealing

Caselaw

- Rochwerg – fiduciary duty to account to each other
- Naramalta – duty to act in good faith
- Sinkeslak – duty ends when relationship changes
- McKnight – narrowly construed language in a partnership agreement

Typical Clauses in Partnership Agreements

- The liability of the General Partner for the debts, liabilities, losses and obligations of the Partnership is unlimited.

-
- **The General Partner is liable to the Partnership or the Limited Partners in connection with the General Partner's acts or omissions to the extent that such acts or omissions involve fraud, willful misconduct or negligence, a material breach of this Agreement that has a material adverse effect on the Partnership, the wilful violation of applicable laws by the General Partner or a breach of fiduciary duty by the General Partner in respect of the Partnership or its business**

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- **The General Partner shall exercise its powers and discharge its duties honestly, in good faith and in the best interest of the Partnership and shall exercise the care, diligence and skill of a prudent and qualified administrator.**

THANK YOU

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Kristen Wittman

204-988-0333

kwittman@tmlawyers.com



Q & A