



PARTNERSHIPS

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INTRODUCTION

Partnerships are a popular vehicle that individuals and corporations may use to conduct business in Atlantic Canada due to their favourable tax mechanisms, liability protections, and flexibility for their partners.

This paper will cover the basics of what partnerships are, taxation of partnerships,⁵ transferring assets into and out of a partnership, withdrawal of partners and dissolution, recent Canada Revenue Agency (CRA) positions on partnerships, and finally an Atlantic Canada perspective of partnership uses. This paper is not meant to discuss the minute details of partnership planning, rather it is intended as a primer to help practitioners be aware of general planning methods and to identify when potential tax issues may arise when using partnerships.

Although common law rules in respect of partnerships apply across Canada and the provincial legislation is broadly the same among provinces and territories (except Manitoba and Quebec), this paper is limited to an overview of the legislation in the Atlantic provinces⁶ and the applicable federal tax laws in Canada.

This paper has been prepared and presented merely for educational, informational and academic purposes. It is not, and is not to be construed as, legal or tax advice. Any reader desiring legal or tax advice in respect of the topics discussed in this paper is directed to the relevant legislation and jurisprudence and is invited to consult with a professional advisor who practices in the field of tax law.

WHAT IS A PARTNERSHIP?

While the *Income Tax Act*⁷ does not define a partnership, it sets out the framework by which transactions involving partnerships and their members are treated for income tax purposes. Instead, the definition of partnership is left to provincial legislation and the related jurisprudence. In Nova Scotia, for example, the *Partnership Act* defines a partnership as “the relation which subsists between persons carrying on a business in common, with view of profit”, excluding members of a corporation or association.⁸ This definition, or a similar one, is common across Canadian common law jurisdictions. In addition to the definition, each provincial partnership act contains a set of rules that inform whether a particular arrangement is to be viewed as a partnership. The concept of a partnership as it has developed in Canada is that a partnership is a relationship and not an entity.⁹

Given this broad definition, and a non-determinative set of legislated rules, various courts have attempted to provide further guidance on when a partnership exists for the purposes of the Act.

⁵ Notwithstanding the readers' presumed familiarity with basic tax concepts of partnerships, this paper will touch on several of those concepts, albeit with a tax planning focus.

⁶ New Brunswick, Nova Scotia, Newfoundland and Labrador, and Prince Edward Island.

⁷ *Income Tax Act*, RSC, 1985, c. 1 (5th Supp), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.

⁸ *Partnership Act*, RSNS 1989, c. 334, section 4; similar definitions exist in other Atlantic Canada partnership acts.

⁹ J. Scott Bodie and Ashley M. White, “Partnerships: A Primer,” in *2018 Prairie Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2018), 13:1-27 (herein referred to as “Bodie and White”), at 2.

The three essential ingredients to a partnership, as articulated by the Supreme Court of Canada in *Spire Freezers*, are: “(1) carrying on a business, (2) in common, (3) with a view to profit.”¹⁰

A partnership does not require a written agreement to exist in law. The relevant provincial legislation is determinative of whether a legal partnership exists, and the onus is on the taxpayer to demonstrate that the legal requirements for a partnership exist. In determining whether a partnership exists, courts look to “the true contract and intention of the parties as appearing from the whole facts of the case.”¹¹

Facts that are indicative to a partnership include:

1. *Written Agreements*: A partnership does not require a written, agreement, but the presence of one can indicate the existence of a partnership, particularly when the agreement was acted upon and governed the affairs of the parties.¹²

2. *Perceptions of Third Parties*: Whether the partners do or do not hold themselves out to third parties as partners is a relevant factor.¹³

3. *Conduct as a Partnership*: Conduct - such as “the contribution of skill, knowledge or assets to a common undertaking, joint property interest in the subject-matter of the adventure, the sharing of profits and losses, [...] financial statements and joint bank accounts” are all relevant.¹⁴

4. *Authority to Make Decisions*: The authority of any partner to bind the others is a relevant factor, but partnership is not precluded where management rests with a single partner.¹⁵

Courts have established a low bar as to the level of business and expectation of profit required for a partnership to exist. The fact that a “partnership was created for a single transaction is of no consequence.”¹⁶ It is also “not necessary to show that the parties held meetings, entered into new transactions, or made decisions.”¹⁷

PARTNERSHIP OR JOINT VENTURE?

A partnership is different from a joint venture. The two share similarities in that neither are “legal persons” in their own right, but instead are legal relationships between two or more parties. The bounds of these relationships are rooted in contract law, which gives the members of each significant flexibility in the assignment of rights and obligations.

¹⁰ *Spire Freezers Ltd. v. Canada*, [2001] 1 SCR 391 at 15.

¹¹ *Continental Bank Leasing Corp. v. Canada*, [1998] 2 SCR 298 (herein referred to as “*Continental Bank*”) at paragraph 23.

¹² *Ibid.*, at paragraph 25.

¹³ *Backman v. Canada*, [2001] 1 SCR 367 (herein referred to as “*Backman*”), at paragraph 21.

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ *Continental Bank*, supra note 11, at paragraph 48.

¹⁷ *Backman*, supra note 13, at paragraph 20.

A joint venture is generally formed to pursue a single transaction. In contrast, partnerships are more long-term in nature (although they can be formed for a single transaction). In *Woodlin Developments*,¹⁸ the Court identified three requirements that must exist for a joint venture to be found:

1. A joint property interest in the subject matter of the venture;
2. A right of mutual control and management of the enterprise;
3. A limitation of the objective of the business to a single undertaking or limited number of undertakings.

There are important legal distinctions between partnerships and joint ventures, particularly in their formation, liability, and taxation. All three of the factors listed above for the formation of a joint venture can also be met by a partnership, making it sometimes difficult to distinguish between the two. Whether a particular arrangement is a partnership or a joint venture is a question of fact. Courts will look to evidence such as the intentions of the parties, the agreement governing the relationship between the parties, and the actions and interactions of the parties involved in the relationship. The presence or absence of a partnership agreement, or how the parties hold themselves out, are not in themselves determinative.¹⁹

As noted earlier, members of a joint venture are limited only by the bounds of general contract law in their agreement. Conversely, members of a partnership are governed by the provincial partnership acts and the common law principles governing partnerships (the “Partnership Rules”). The Partnership Rules provide a general framework for the relationship between the partners, and the dissolution of the partnership. However, many of these general rules may be modified by agreement of the partners or through a written partnership agreement.

Liability to third parties under both partnerships and joint ventures is unlimited. However, in a general partnership (discussed later in this paper), the partners are jointly and severally liable for the debts and obligations of the partnership, and are jointly and severally liable for the actions of other partners. Under a joint venture, members typically agree to be separately liable only for their proportionate ownership share of liabilities.

Joint ventures and partnerships are also treated differently under the law for the purposes of property ownership and disposition. Property held in a partnership is treated as if the partnership itself holds the interest, and not the individual owner. In contrast, interests in property used in a joint venture generally remain with the individual joint venturers. Joint venturers may also generally sell their interests in the joint venture without obtaining the consent of other joint venturers, subject to any agreements between the parties. Finally, while the dissolution of a partnership results in a disposition of the property of the partnership, the dissolution of a joint venture only results in a disposition of property if it involves a change of ownership in the property used in the joint venture.

¹⁸ *Woodlin Developments Ltd. v. MNR*, (1986) 86 DTC 1116, 1 CTC 2188, at 2200.

¹⁹ *Backman*, supra note 13, at paragraphs 20-24.

Similarly, a joint venture is not recognized as a taxpayer under the Act. In a joint venture, the entity is disregarded for taxation purposes, and each member computes their profit or loss from their share of the gross income.

TAXATION OF PARTNERSHIPS

Unlike corporations, partnerships are not treated as a separate legal person distinct from their partners for taxation purposes. Under subsection 96(1), a partnership is treated not as a person or taxpayer, but as a separate person resident in Canada for the sole purpose of computing income pursuant to section 96 of the Act. As a flow through entity, the partnership does not pay taxes itself. In order to calculate each individual partner's income, income is first calculated at the partnership level. This includes the calculation of both income from the partnership and allowable deductions, such as expenses and capital cost allowance. The partnership then determines the allocation of the income or loss to each partner from each source. Each member of the partnership then applies its allocated income or loss to any taxable income or loss it may have received from other sources in computing its income tax.

The Act does not have rules to determine each partner's share of income or losses, and so one of the principal advantages of the partnership structure is the latitude afforded to partners to determine how income is to be allocated for tax purposes. In most cases, this allocation will be set out in the partnership agreement.

However, despite what may be laid out in the partnership agreement, the allocation of income and loss must be "reasonable", meaning that the allocation is made in proportion to the partners' respective contributions and investments. Partnerships that fail to ensure a "reasonable" allocation risk the application of subsection 103(1), which allows the Minister of National Revenue to reallocate partnership income based on what is reasonable, having regard to all of the circumstances. When the partners are not dealing with each other at arm's length, subsection 103(1.1) confers the same result.

Subsection 103(1) can be applied where the principal reason for an allocation was to reduce or defer tax at the partner level. In the recent *Pinnacle International Realty Group II Inc.* case,²⁰ subsection 103(1) was applied to prevent an unreasonable allocation of income. In that case, a corporation with substantial tax losses (Lossco) acquired a second corporation (Buildco) that held a 95% interest in a partnership that had already realized 99% of its profit for the year. The acquisition took place a week before Buildco's year end, with Buildco's partnership interest transferred to Lossco. Buildco was subsequently wound-up into Lossco, and 95% of the partnership's income was allocated to Lossco, resulting in significant tax savings. The Court held that this allocation was unreasonable, as Lossco was not a member of the partnership during the time that the partnership carried on the activities that generated the income.

Once income has been allocated by the partnership to the partners, additional rules apply at the partner level. Partners are subject to income tax based on the nature of the income received from the partnership, which retains its source for taxation purposes. It should be noted that some items are allocated to the partner to be claimed by the partner, rather than claimed at the partnership level in the computation of income to be allocated. This includes investment tax credits, charitable and political donations, and resource expenditures.

²⁰ *Pinnacle International Realty Group II Inc. v. The King*, 2023 TCC 161.

Proceeds from the disposition of partnership interests are generally taxed as capital gains to the extent such proceeds exceed the adjusted cost base (ACB) of the interest. There are instances where the partnership interest is considered inventory, and the sale of a partnership interest would result in income treatment rather than capital gains treatment. Further discussion on this is beyond the scope of this paper.

For general partnerships, ACB is calculated according to subsections 53(1) and 53(2). At a high level, the ACB is equal to the partner's initial investment, plus its share in profits and any capital contributions the partner has made, minus the partner's share of partnership losses and any draws the partner has taken from the partnership. The difference between the ACB and the proceeds from disposition is then calculated. If the amount is positive, it is treated as a capital gain and subject to taxation at the capital gains inclusion rate. Similarly, if the amount is negative, it is treated as an allowable capital loss. One half of the capital loss can then be deducted from capital gains in previous years, or carried forward for future use.

TYPES OF PARTNERSHIPS AND THEIR PARTNERS

There are three broad categories of partnerships:

- General partnerships;
- Limited partnerships; and
- Limited liability partnerships.

A general partnership is made up of two or more general partners. A general partner is involved in the daily management of the partnership business and is jointly and severally liable for all debts and obligations of the partnership. Any order against a partnership may be enforced against the partnership assets as well as the assets of any corporation or person serving as a partner. As will be discussed below in further detail, a general partner is not subject to the same loss allocation restrictions as a limited partner.

A limited partnership is made up of at least one general partner and one "limited partner,"²¹ as that term is defined in subsection 96(2.4). Limited partnerships are governed by provincial limited partnership acts, such as Nova Scotia's *Limited Partnerships Act*.²² A limited partner's liability is limited to its capital contributed, and there is a corresponding restriction under the Act on losses that a limited partner can be allocated, being the partner's "at-risk-amount" (ARA) defined in subsection 96(2.2). Although losses are restricted, a limited partnership is more attractive as an investment vehicle due to the fact that the liability of a limited partner is limited to the amount of the capital that the partner has contributed.²³

²¹ A limited partner can also be a deemed limited partner (as that term is defined under subsection 96(2.4)) and a specified member (as that term is defined under paragraph 248(1)), each carrying specific tax rules that apply to each type of partner.

²² *Limited Partnerships Act*, RSNS, c. 259, section 1; to the extent not inconsistent with the specific provisions of the *Limited Partnerships Act*, the *Partnership Act* continues to apply to the partnership and its partners.

²³ Mary Harlow and Kelly Kolke, "Planning with Partnerships – Limited vs General, Problems/Traps, Refresh." in *2023 Atlantic Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2024), 6:1-36 (herein referred to as "Harlow and Kolke"), at 3.

If a limited partner participates in the management or control of the partnership, the limited partner may become liable as a general partner. The structure of a limited partnership is often where the general partner is a corporation with no assets other than a small interest in the limited partnership. The individual limited partners might be officers and directors or other employees of the general partner. It can often be difficult to discern as to whether the individual is acting in their personal capacity as a partner or as an officer, director or employee of the general partner. An aspect to consider is that the individual partner could lose their limited liability protection if found to be acting in a personal capacity via the control of the business.²⁴

Limited partners are subject to additional ACB rules under subsection 40(3.1). These rules apply to both dispositions of a partnership interest and when distributions from a partnership exceed the partner's ACB. Unlike general partners who may have a negative ACB and can use it to deduct partnership losses against other income in prior or subsequent years, limited partners are restricted by subsection 40(3.1). This provision deems a gain equal to the negative ACB. Generally, the result is one half of that amount included in the limited partner's taxable income as a taxable capital gain. The limited partner's ACB is then reset to zero. This is often a timing issue as current year income allocations are not added to ACB until the first day of the following taxation period (often January 1st).

A limited liability partnership (LLP) is a structure that combines the flexibility of a traditional partnership with limited liability for its partners, protecting their personal assets from the debts and negligence of other partners. In an LLP, partners are shielded from personal responsibility for the professional misconduct of their colleagues but remain liable for their own actions or actions of those under their supervision. In a professional services LLP, the legislation also requires partners to carry professional liability insurance in order to protect the public.

Only certain professions, such as accountants and lawyers, can operate within an LLP structure. LLPs allow certain types of firms, such as law firms and accounting firms, to retain their partnership structure while protecting the personal assets of partners who have no involvement in a negligence action. The overall firm is liable for the acts committed by its members in the ordinary course of the firm's business, but individual members, while continuing to maintain responsibility for their own acts and for those over which they have a direct supervisory role or knowledge, will not be liable for each other's negligent acts.

NON-RESIDENT PARTNERS

The addition of non-resident partners greatly increases the complexity of and planning considerations for a partnership. If the partnership has a non-resident partner, it will no longer qualify as a "Canadian partnership". Subject to certain exceptions in the Act,²⁵ a Canadian partnership is defined to be a partnership where all of its partners are resident in Canada.

A partnership that does not qualify as a Canadian partnership will be deemed to be a non-resident of Canada for withholding tax purposes. If the non-Canadian partnership provides services in Canada, clients who receive services for fees, commissions or other amounts of any nature whatsoever from the non-Canadian partnership will be required to deduct 15% of such amount

²⁴ Daren Baxter and Keith MacIntyre, "Business Planning With Partnerships." in *2010 Atlantic Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2010), 3:1-42 (herein referred to as "Baxter and MacIntyre"), at 8.

²⁵ See subsection 96(1.1) and section 98.1.

under Regulation 105.²⁶ As will be discussed below, if a partnership is not a Canadian partnership, property cannot be transferred to the partnership on a tax-deferred basis pursuant to subsection 97(2). A non-Canadian partnership will also be subject to section 116 Clearance Certificate requirements upon the disposition of taxable Canadian property.

In order to avoid a partnership being deemed a non-resident, a Canadian corporation could be interposed between the partnership and the non-residents. Due to the corporation being deemed to be resident in Canada, irrespective of the residency of the shareholders or directors, such a corporation would avoid deemed non-residency.

TRANSFERRING ASSETS INTO AND OUT OF PARTNERSHIPS

The Act contains various rollover provisions to allow for the transfer of assets into a partnership, transfers out of a partnership are generally taxable. It is important to note that the rollover provisions only apply to Canadian partnerships, defined above. In the context of tiered partnerships, if all partners in the top partnership are Canadian residents, the bottom partnership can qualify as a Canadian partnership, so long as all the partners are also Canadian residents. Non-resident partnerships and partners cannot avail themselves of the rollover provisions applicable to partnerships.

As a general rule, property transfers between a partner and the partnership are deemed to take place at fair market value. However, the transfer of certain types of property can occur on a rollover basis pursuant to subsection 97(2) of the Act. A partner, or an individual who is about to become one, may transfer certain property to a Canadian partnership at an amount different from its fair market value, provided that both the transferring partner and all other partners jointly elect to do so.²⁷ The elected amount will then be treated as the partnership's cost of the transferred property and as the transferor's proceeds of disposition.

Only specific types of property qualify for this rollover treatment,²⁸ and the rules governing the elected transfer amount closely mirror those applicable to transfers of property to taxable Canadian corporations under paragraphs 85(1)(a) through (f).²⁹ In addition, special provisions apply to the recognition of losses where property is transferred to a partnership by a "majority interest partner."³⁰ Losses on transfers to partnerships are denied to majority interest partners.

A partnership can transfer its property to a corporation on a tax-deferred basis using the provisions of subsection 85(2), which operate similarly to subsection 85(1), with some relatively minor modifications.

²⁶ Unless a waiver is obtained from the CRA.

²⁷ Form T2059, *Election on Disposition of Property by a Taxpayer to a Canadian Partnership*.

²⁸ Property eligible for rollover treatment to a Canadian partnership is: i) capital property (see section 54); ii) Canadian resource property and foreign resource property (see section 66(15)); and iii) inventory of the taxpayer (see subsection 248(1)).

²⁹ Taking into account the appropriate modifications for partnerships.

³⁰ A majority interest partner is a partner whose share of the partnership's income for the last fiscal period exceeds 50% or the partner's share (including affiliated persons) of the partnership distribution if the partnership were to be wound up at that time exceeds 50%.

A partnership can be wound up into a corporation under subsection 85(3). Where subsection 85(2) applies, subsection 85(3) will apply when:

- the partnership is wound up within 60 days after the disposition; and
- immediately before the winding-up there was no partnership property other than money or property received from the corporation as consideration for the disposition.

If the preceding conditions are met, the partnership transfers its assets to a corporation under subsection 85(2). The partnership is then wound up and distributes the shares of the corporation to the partners of the now dissolved partnership. This effectively transforms the partners of the partnership to shareholders of the corporation on a tax-deferred basis. The ACB of the shares will be the previous ACB of the partnership interests, less any non-share consideration received by the corporation.

The provisions of subsection 85(3) are interpreted strictly by the CRA. The reference in the subsection to a transfer to "a corporation" means that the property cannot be distributed to more than one corporation.

A partnership can also be wound up on a tax-free basis under subsection 98(5) - when a partnership is dissolved and one of the former partners continues the business as a sole proprietor. This rollover applies only to Canadian partnerships and requires that the former partner begin carrying on the former partnership's business within three months of dissolution. The rollover is limited to property distributed to the continuing partner on dissolution that is subsequently used in the ongoing business.

Due to the ease of creating a partnership and the ability to convert to a corporation under subsection 85(3) of the Act, partnerships are useful where it is desirable to first start as a partnership to allow losses incurred in the startup phase to be passed on to the partners, and then a tax-deferred incorporation is possible once the business becomes profitable.³¹

WINDING-UP A PARTNERSHIP

In general, the windup of a partnership is a taxable event, unless the rollovers under subsection 85(3) (discussed above) or the rollover under subsection 98(3) (discussed below) apply. Under subsection 98(2) the partnership is deemed to have disposed of any property distributed to the partners upon its dissolution at fair market value. The partners' tax cost of the property so distributed is equal to its fair market value. The cost base of the partner's respective partnership interest will be correspondingly increased or decreased for any gains or losses triggered.

The Act provides for an elective rollover upon dissolution of the partnership, as long as strict guidelines are followed. Subsection 98(3) is commonly relied on to provide a tax-deferred distribution of property (and, in certain cases, a cost bump) from a Canadian partnership to its partners on the dissolution of the partnership. This provision requires that all the partners be resident in Canada in order for the rollover to apply. Furthermore, all of the property of the partnership must be distributed to the partners such that each receives a pro rata undivided

³¹ Baxter and MacIntyre, *supra* note 24, at 25.

interest in each partnership property.³² All partners are required to make an election in the prescribed form³³ within the time limits set out in subsection 96(4). Otherwise, the election will not be valid.

A subsection 98(3) dissolution requires that the former partners continue to own all of the former partnership property in common; each must receive an undivided proportionate interest in each partnership property. The CRA has interpreted this requirement to apply even with identical properties, such as shares of a corporation. This will present a practical problem for partners who no longer wish to own property together.

Amendments to the Partnership Agreement

There is uncertainty over whether amendments to a partnership agreement may lead to the finding of a new partnership having been created, and the old partnership being dissolved. In *OFSC Holdings*,³⁴ the Tax Court was asked to determine, among other things, whether or not certain amendments to a partnership agreement were so significant as to cause the partnership to dissolve. The Tax Court stated the following:

I find no merit in the argument that the changes made to the terms of the partnership agreement were so extensive as to amount to the creation of a new partnership, and the dissolution of the old one. Counsel catalogued some 13 different amendments to the agreement in three pages of his written argument, which he said made the Amended and Restated Partnership Agreement not simply an amended agreement, but a new and different one. No authority was cited for this proposition. A partnership is a relationship among persons who carry on a business together with a view to a profit; its essence is the business itself. **Here it is clear that the same business was to be carried on after the sale to the Appellant as had been carried out before. I find that the partnership survived the amendment of the agreement and the sale of Standard's interest.**³⁵

[emphasis added]

This decision is good authority for the general proposition that a partnership agreement can be amended without dissolving a partnership.³⁶ However, it must be noted that the Tax Court emphasized that the business being carried on by the partnership was the same business that the partnership continued to carry on post-amendment. As such, when amending a partnership agreement, care should be taken in both drafting the purpose provisions and subsequently operating in accordance with them. If a partnership's purpose is amended to include a purpose which was not originally contemplated by the partners when the partnership was formed or if in the course of conducting its business, the partnership performed a function which was not originally contemplated, and the agreement did not contain a provision which might allow for a

³² The “undivided interest” requirement has created uncertainty, see Kim Maguire’s “Partnership Dissolutions: The Undivided Interest Condition” Canadian Tax Focus, Volume 4, Number 4, November 2014.

³³ T2060, *Election for Disposition of Property Upon Cessation of a Canadian Partnership*.

³⁴ *OSFC Holdings Ltd. v. The Queen*, 99 DTC 1044 (TCC), aff’d in 2011 FCA 260; leave to appeal to Supreme Court of Canada refused (2002) 294 NR 398 (note).

³⁵ *Ibid.*, at para 32.

³⁶ Bodie and White, *supra* note 9, at 27.

change in the purpose of the partnership, the result may be different and substantial amendments to a partnership agreement may cause a dissolution of the partnership.³⁷

NEW POSITIONS FROM THE CRA

The Excessive Interest and Financing Expenses Limitation (EIFEL) rules in subsection 18.2, effective for fiscal periods beginning on or after October 1, 2023, introduce significant reporting requirements for Canadian partnerships. Partnerships must file Schedule 130 with their T5013 partnership information return if they have any member (including indirect or “deemed” members) required to file an EIFEL schedule with their own tax return, or if the partnership is a party to any EIFEL-related election.

Exemption from filing Schedule 130 is available only if all members (direct and indirect) are not required to file an EIFEL schedule and the partnership is not a party to any EIFEL election. Each partnership is required to answer a new question on the jacket, “Does the partnership have a corporation or trust as a member or deemed to be a member under subsection 18.2 (12) and interest and financing expenses or interest and financing revenues in the period?”

A partnership answering “no” is implicitly attesting to their knowledge of ultimate end members of the partnership, including deemed members. It is anticipated given the scope of interest and financing expenses (IFE) and interest and financing revenues (IFR) that most partnerships would have a filing requirement. This is because some partnerships may have a large number of partners, and the cost of obtaining confirmation from each partner that they are not subject to EIFEL, each year, may exceed the cost of completing the reporting. The partnership has an obligation to file Schedule 130, and in turn provide necessary information on the T5013 slips, unless each partner is, throughout the year, not subject to the EIFEL reporting. Given the scope of EIFEL can be broad for private companies (specifically, the breadth of an “eligible group entity”), it may be more practical to complete the EIFEL reporting out of an abundance of caution. Smaller, closely held partnerships may still be able to avail themselves of the administrative exemptions. Guidance would indicate that the partnership should retain written confirmation from each partner supporting the exemption if it is determined that a filing requirement does not exist.

Where required, Schedule 130 must be filed with the T5013 return. The schedule requires detailed disclosure of the partnership’s interest and financing expenses and revenues, including amounts capitalized and information on relevant borrowings and derivatives. If the partnership is a party to an EIFEL election,³⁸ the relevant details must also be reported.

In the context of tiered partnerships, the CRA has issued guidance that only direct IFE and IFR should be reported on the respective T5013 Schedule 130. Any indirect IFE and IFR should be disclosed in letter format to each of its partners, referencing the allocations from the partnerships of which they are deemed to be members.

Failure to comply with these requirements, including failure to provide required information to members, may result in penalties. The EIFEL rules are complex and interact with other interest

³⁷ Ibid.

³⁸ Transitional Election Under EIFEL Rules (T2224), Group Ratio Rules Election (T2225), Election to Transfer Cumulative Unused Excess Capacity Under Subsection 18.2(4) (T2226), Excluded Interest Election (T2227), Specified Pre-Regime Loss Election Under Subsection 18.2(1) (T2228), or Election to Forgo a Foreign Accrual Property Loss Under Clause 95(2)(f.11)(ii)(E) (T2229).

deductibility provisions, and partnerships should ensure robust compliance and documentation processes.

PARTNERSHIP PLANNING IN ATLANTIC CANADA

Renewable Energy Projects

Investment tax credits (ITCs) have historically been an important tool for the federal government to provide direct financial support to particular industries or activities. In recent years, various clean economy ITCs have been introduced to support the federal government's planned transition to net-zero by 2050.³⁹

Atlantic Canada is home to one of the fastest-growing clean energy sectors in North America. The region boasts a substantial base of installed wind-energy capacity and is at the forefront of innovative projects in renewable biomass.⁴⁰

In general terms, the ITC provisions allow for projects to be conducted in a partnership in such a manner that ITC-eligible taxpayers who are members of the partnership may claim clean economy ITCs through the partnership. Essentially, each ITC has provisions that treat a partnership as a notional taxable Canadian corporation whose fiscal period was its taxation year for the purpose of determining the clean economy ITC of any particular partner in that year. These provisions cause the partnership to determine, as a notional corporation, what amount of each particular clean economy ITC it would have had for that year and allows a taxpayer that both is eligible for an ITC and was a member of the partnership during that year to add to its own corresponding ITC for that year "the portion of that amount [that is, the ITC that the partnership would have been entitled to, if it were a corporation] that can reasonably be considered to be the taxpayer's share thereof."⁴¹ This general principle is explicitly made subject to a specific set of allocation rules in section 127.47.

The general allocation limitation is set out in subsection 127.47(2), which applies if the share of the partnership's clean economy ITC agreed to by its members for any particular member "is not reasonable in the circumstances having regard to the capital invested in or work performed for the partnership by the members of the partnership or such other factors as may be relevant." In such circumstances, the clean economy ITC allocated to the particular partner is instead deemed to be the amount that is reasonable in the circumstances. As discussed above regarding limited partner's "at-risk amounts", allocation of clean economy ITCs to a limited partner cannot exceed that limited partner's at-risk amount.⁴²

Real Estate Development

General partnerships and limited partnerships are common planning tools used in real estate development. Partnership structures allow real estate developers to enter into arrangements with

³⁹ See *Canadian Net-Zero Emissions Accountability Act*, SC 2021, c. 22. See also the Carbon Capture, Utilization, and Storage ITC; Clean Technology ITC; Clean Hydrogen ITC; and Clean Technology Manufacturing ITC.

⁴⁰ Government of Canada, "Clean energy and related industries of Atlantic Canada." July 25, 2024 (<https://www.canada.ca/en/atlantic-canada-opportunities/services/clean-energy-and-related-industries-of-atlantic-canada.html>).

⁴¹ See subsection 127.48(12).

⁴² See subsection 127.47(3).

other investors who may have different skill sets, experience, or expertise. For example, a developer with expertise in developing, building and selling properties may enter into an arrangement with an investor or a group of investors to finance a project.

Generally, members of a partnership will agree to allocate profits and cash distributions based on the proportionate contributions of each partner. In some cases, however, different allocation structures can facilitate project financing and allow for the entitlement of a particular partner to a disproportionate return once certain objectives have been met. A common example of this is a “carried interest.”

The carried interest is assigned to the general partner. Limited partners are generally assigned a preferred return on their investment, up to a certain amount, meaning that the general partner may not be entitled to any returns until the limited partners have received, for example, an 8% return on their investment. Once that threshold has been met, any excess profits are split based on the waterfall, being the agreed upon distribution of funds, as dictated in the partnership agreement.

The carried interest structure achieves several important objectives. For builders, it allows access to capital that may not otherwise be available for a given project within a given timeframe. For investors, it can offer a way to access larger real estate projects, and potentially lower investment minimums than traditional real estate investment opportunities. Investors in a real estate project may also take advantage of partnership income allocation rules for tax planning purposes. A real estate investment may incur significant losses prior to completion, and these losses can be allocated to the limited partners in order to offset other income. In contrast, tax losses are “trapped” in a corporation and cannot be used to offset the income tax liability of a shareholder.

The above is just one common example of how partnerships are used for tax planning purposes in real estate development. The ability to allocate income and cash flows can be adapted in many ways to suit the objectives, circumstances, and risk tolerance of partners.

First Nation Development Projects

When structuring business ventures with First Nations, it is essential to ensure that the resulting income is earned by individuals or entities who are not subject to income tax. Partnerships offer significant flexibility in this regard, allowing investors to participate in business ventures while preserving their own tax status on the income received. This approach is especially beneficial when partners are eligible for the Public Body Exemption found in paragraph 149(1)(c) of the Act, which many First Nations fall under, and the income is generated off-reserve. In contrast, under a corporate structure, all business income would generally be taxable if off-reserve income passes a certain threshold. However, with a partnership, income allocated to a partner qualifying under paragraph 149(1)(c) of the Act would be exempt from income tax.

While partnership structures are highly effective for enabling a First Nation to benefit from the broader Public Body Exemption, they can be less advantageous in situations where substantial losses are anticipated. Ideally, income should be allocated to tax-exempt partners, whereas losses are most valuable when they can be used to offset the income of taxable partners. In business ventures involving both tax-exempt and taxable partners, it would be beneficial to allocate a greater share of losses to the taxable partner. However, this type of planning is generally not feasible within a partnership, as the partnership’s net income or loss must be allocated among the partners in accordance with their respective interests in the partnership.

Alternatively, when a taxable business partner is involved, a joint venture structure may be preferable to maximize the use of available deductions. In contrast to a partnership, each joint venturer determines their own income based on their proportionate interest in the joint venture's assets and activities. Deductions and credits are claimed in relation to the property owned by each joint venturer. This allows the joint venture to be structured so that the taxable partner holds a greater share of the property that generates deductions or credits, enabling that partner to fully utilize these tax benefits against their own income. However, it is important to note that joint ventures do not offer the same level of liability protection as experienced by a limited partner in a limited partnership, which can make them a less attractive option in certain circumstances.

CONCLUSION

The partnership remains one of the most versatile and tax-efficient vehicles under Canadian law, balancing flexibility in structure with flow-through treatment that avoids the double taxation due to imperfect integration associated with corporations. New legislative developments continue to shape the boundaries of this regime - particularly with respect to EIFEL. These developments underscore the importance of careful drafting and ongoing compliance, as the CRA's administrative stance can significantly affect both tax outcomes and business planning.

In Atlantic Canada, partnerships have proven to be particularly valuable tools for regional enterprises seeking to pool resources, share risk, and attract outside investment while maintaining local control. They are widely used in sectors such as professional services, real estate development, and natural resources, reflecting both economic necessity and the structural advantages that partnerships offer under our current tax law regime.