

Non-Resident Private Equity Investors and Management Fees - Some Canadian Tax Considerations - 2018

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August 23, 2018

Typically in the case where a non-resident private equity group (Non-Resident Group) acquires a Canadian target (Canco), the Non-Resident Group provides management services to Canco in exchange for an annual fee. Such management services would include consulting, financial, accounting and/or administrative-type services. Non-Resident Groups should be aware that such fees may be subject to Canadian withholding tax which would be withheld and remitted by Canco to Canada Revenue Agency (CRA).

Paragraph 212(1)(a) of the *Income Tax Act* (Canada) (the Act) provides that a 25% withholding tax shall be payable on “a management or administration fee or charge” that is paid by a Canadian resident to a non-resident, subject to certain exemptions. Management fees paid under management services agreements in the context of private equity transactions would typically fall under this provision. However, if the management services provided by the Non-Resident Group were performed in the ordinary course of its business, and Canco and the Non-Resident Group were dealing with each other at arm’s length (i.e., non-resident does not control Canco such as in a minority deal), the withholding tax should not apply.

If the management fees are not exempted from the withholding tax as provided above, the withholding tax may often be exempted under an applicable tax treaty. For example, in the case of the Canada-US tax convention, management fees are treated as business profits and as long as the business is not carried on by the US private equity group through a permanent establishment in Canada, any management fees paid to the US private equity group by Canco will generally be exempt from Canadian tax.

In addition to the management fee withholding tax mentioned above, regulation 105 of the Act provides for a 15% withholding tax to be withheld by Canco on any fee, commission or other amount paid to a non-resident person in respect of services rendered in Canada. If services are rendered in Quebec, an additional 9% withholding tax may be applicable. Accordingly, this withholding tax does not apply if no services are rendered in Canada (i.e., all services are rendered from the US).

In the event that the services are rendered in Canada, the Non-Resident Group could apply to CRA for a waiver of this withholding tax if it can demonstrate that it does not have a permanent establishment in Canada pursuant to the applicable treaty or the 15% withholding tax exceeds its Canadian tax liability after taking into account expenses to render the services. Until a waiver is obtained, Canco must withhold the tax.

To summarize, non-resident private equity groups should be aware of the Canadian tax implications

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regarding management fees that they charge to their Canadian portfolio companies, however this tax should not apply if a tax treaty is applicable, the non-resident private equity group does not have a permanent establishment in Canada and all services are rendered by the non-resident from outside Canada.

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