
Who Has De Jure Control of a Corporation When Its Shares Are Held by a Limited Partnership?

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PRÉCIS

La Loi de l'impôt sur le revenu traite de l'« acquisition de contrôle » dans divers contextes, notamment les règles sur la minimisation des pertes du paragraphe 111(5). Bien que la Cour suprême du Canada se soit penchée sur de nombreuses questions liées au contrôle, il en demeure une qui n'a pas fait l'objet d'une décision, soit de savoir qui est propriétaire des actions d'une société détenue par une société en commandite dans le but de déterminer quand une acquisition de contrôle de la société a lieu. Les actions de la société sont-elles détenues par le commandité, les commanditaires ou la société en commandite elle-même? En s'inspirant d'une récente décision fiscale de la High Court d'Australie, ainsi que de la politique sous-jacente au paragraphe 111(5), l'auteur conclut que les actions devraient être considérées comme étant la propriété de la société en commandite elle-même, afin qu'un changement au niveau du commandité ou des commanditaires ne mène pas en soi à une acquisition de contrôle de la société.

ABSTRACT

The Income Tax Act refers to an “acquisition of control” in many contexts, including the stop-loss rules in subsection 111(5). While the Supreme Court of Canada has dealt with many issues of control, one issue that has never been decided is who owns the shares of a corporation held by a limited partnership for the purpose of determining when there has been an acquisition of control of that corporation. Are the corporation's shares owned by the general partner, the limited partners, or the partnership itself? Taking into account a recent tax decision of the High Court of Australia, as well as the policy behind subsection 111(5), the author concludes that the shares should be viewed as being owned by the limited partnership itself, so that no change of partners will, in and of itself, result in an acquisition of control of the corporation.

KEYWORDS: CONTROL ■ ACQUISITIONS ■ SHARES ■ LIMITED PARTNERSHIPS

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INTRODUCTION

While it is well settled¹ that when the Income Tax Act² uses the word “control” by itself, it means de jure or legal control,³ it is difficult to say with certainty who has control of a corporation the shares of which are owned by a limited partnership.

To take one particularly significant example, subsection 111(5) restricts the use of a corporation’s non-capital losses where, at any time, “control of the corporation has been acquired by a person or group of persons.”⁴ The meaning of “control” in this context was set out in *Duha Printers (Western) Ltd. v. The Queen*.⁵ In general, the court held that “control” means “ownership of such a number of shares as carries

1 *Duha Printers (Western) Ltd. v. The Queen*, 98 DTC 6334 (SCC).

2 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.

3 As opposed to de facto or factual control, which, as provided by subsection 256(5.1), is the relevant kind of control for any provision of the Act that uses the phrase “controlled, directly or indirectly in any manner whatever.”

4 An acquisition of control is not the same as a “change” of control, which is not a relevant concept for the purposes of the Act. This article is not intended to provide a fully articulated analysis of the stop-loss rules in general or of subsection 111(5) in particular. For a more detailed discussion of those rules, see Gerald D. Courage, “Utilization of Tax Losses and Debt Restructuring,” in *2006 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2006), 9:1-86, or Harriet Man and Tony Tse, “Tax in Troubled Times—Opportunities and Techniques for Loss Utilization,” in *2009 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 2009), 5:1-40. Nor is this article intended to be a review of all of the tax aspects of partnerships. For a broader discussion on that topic, see the articles and textbooks cited below. A discussion of how the Act sometimes treats partnerships as separate entities and sometimes as an aggregate of persons can be found in David J. Thompson, “The Partnership as a Separate Person: Opportunities and Pitfalls,” in *Corporate Tax Planning in a Changing Business Environment*, 1994 Corporate Management Tax Conference (Toronto: Canadian Tax Foundation, 1994), 5:1-21.

5 *Supra* note 1, at paragraphs 35-36.

with it the right to a majority of the votes in the election of the board of directors.”⁶ Thus, the test for “control” of a corporation is, essentially, who “owns” more than 50 percent of the voting shares of the corporation’s capital. Since the Act does not define who owns the shares of a corporation held by a partnership, one must look to general law to determine this.⁷

Where a corporation’s shares are owned by a single individual or by a single corporation, a sale by that shareholder of more than 50 percent of the voting shares will result in an acquisition of control. The same result will occur where the shares of a corporation are owned by a limited partnership and the limited partnership itself sells more than 50 percent of the voting shares. But what about when there are changes to the partners of the limited partnership? Can those changes ever result in an acquisition of control?

Consider the following example. A limited partnership registered under the partnership statute of a Canadian province—in this case, British Columbia’s Partnership Act⁸—“holds” (to use a neutral word) 100 percent of the shares of a Canadian corporation (“Subco”), which has loss carryforwards. As with many limited partnerships, the general partner is a Canadian corporation (“GPco”), which is entitled to 0.001 percent of the partnership’s profits and losses.⁹ The limited partners are entitled to the balance of the profits and losses. The partnership agreement provides that a change of general or limited partners does not dissolve the partnership automatically, and that the limited partners may, by a 75 percent vote, remove GPco as the general partner and replace it with another general partner. On Subco’s shareholder registry, the shareholder is listed as the limited partnership itself (as opposed to, say, GPco in trust for the limited partners).

The issue is this: What sorts of changes, if any, at the partner level will cause Subco to undergo an acquisition of control? Will a change of GPco for another general partner do it? Will a change of one limited partner? How about a change of limited partners who are entitled collectively to more than 50 percent of the profits

6 Ibid., at paragraph 35, quoting Jackett P in *Buckerfield’s Ltd. v. MNR*, [1964] CTC 504, at 507 (Ex. Ct.).

7 *Will-Kare Paving & Contracting Ltd. v. Canada*, 2000 SCC 36, at paragraph 31. The court in *Duba*, supra note 1, also held that, generally, leaving aside unanimous shareholders’ agreements and other matters that may detract from this rule, the corporate registry determines the shareholder to whom one looks to see if he has control as so defined. However, it seems clear that for partnership purposes, especially in the case of a limited partnership, the name registered on title to a property may be the general partner or even a nominee without affecting the issue of who owns the property. See *299 Burrard Residential Limited Partnership v. Essalat*, 2011 BCSC 996.

8 RSBC 1996, c. 348, as amended. All references in this article to “the Partnership Act” are to this statute.

9 Contrary to the views of some other commentators, in my view it is not strictly necessary for a partner to share in the profits or losses of a partnership to be a partner. See section 27(a) of the Partnership Act and R.C. F’Anson Banks, *Lindley and Banks on Partnership*, 19th ed. (London: Sweet & Maxwell, 2010) (herein referred to as “*Lindley*, 19th ed.”), at 14-15, paragraph 2-10.

and losses of the partnership?¹⁰ What about an acquisition of control of GPco—will that also create an acquisition of control of Subco?

My view, which is not shared by the Canada Revenue Agency (CRA) and some other commentators, is that the partners do not own the shares of the corporation held by the limited partnership. In this context, it is the limited partnership itself that owns those shares. Accordingly, my view is that changes at the partner level cannot result in an acquisition of control of Subco.

WHO “OWNS” THE SHARES OF SUBCO?

Given the definition of de jure control set out in *Duba*, the issue is, who “owns” the shares of Subco for the purposes of determining control? Is it GPco? Is it the limited partners? Is it the partnership itself?

Section 23(1) of the Partnership Act states:

Subject to subsection (2), all partnership property must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.

For this purpose, section 6 of the Partnership Act defines “partnership property” as follows:

“[P]artnership property” means property and rights and interests in property

- (a) originally brought into the partnership stock,
- (b) acquired, whether by purchase or otherwise, on account of the firm, or
- (c) acquired for the purposes and in the course of the partnership business.

In determining whether property has been acquired “on account of the firm,” section 24 of the Partnership Act provides that “[u]nless the contrary intention appears, property bought with money belonging to a firm is deemed to have been bought on account of the firm.” For this purpose, section 1 of the Partnership Act defines “firm” as “the collective term for persons who have entered into partnership with one another.”

Thus, the shares of Subco “belonging to” the partnership (as when the partnership uses money “belonging to the firm” to buy the shares) are required to be held and applied by the partners exclusively for the purposes of the partnership.

10 Although subsection 111(5) refers to an acquisition of control by a person or a “group” of persons, it has been held that the latter refers to persons who have some “common connection” between them: *Silicon Graphics Ltd. v. Canada*, 2002 FCA 260, at paragraph 36. While a “group of persons” could well include a partnership (see *Padmore v. IR Commrs.*, [1989] BTC 221 (CA), which held that for tax treaty purposes a “body of persons” included a partnership), it seems unlikely that the Act would intend to include the partners of a partnership in this phrase, given the hundreds of references to a “partnership” in the Act.

Reading this language by itself, one might be inclined to say that the partnership owns the shares. Thus, any change at the partner level would not result in an acquisition of control of Subco. Indeed, there is a strong indication in section 25 of the Partnership Act that a partner has no proprietary right to the assets of a partnership. By that provision, if land has become partnership property, it must, unless the contrary intention appears, be treated as between the partners as personal or movable, and not real or heritable, property. This is because the partner's share in the partnership is a chose in action, so it follows that even his "share" of the land is personalty.¹¹

But the law has developed such that many, if not most, people think that it is the partners that own the partnership's assets. Whether any partner of a partnership "owns" a partnership asset has been the subject of debate for many years and does not appear to have been definitively determined either in Canada or in other common-law countries whose partnership law is based on English common law.

A PARTNERSHIP IS NOT A SEPARATE PERSON — BOYD

Although the BC Interpretation Act defines a "person" to include a partnership,¹² that definition is subject to any contrary intention, and it has been held that the law of partnership whereby a partnership is a contractual relationship among persons rather than a separate legal entity is a contrary intention.¹³ So a partnership is not a separate legal person. This is true even for a limited partnership.¹⁴

Following on the proposition that a partnership, even a limited partnership, is not a separate legal entity, there is certainly authority for the proposition that it is the partners who have legal and beneficial ownership of the shares. Writing before the Partnership Act 1890 of England¹⁵ was enacted, Lord Lindley said, "The law, ignoring the firm, looks to the partners composing it; any change amongst them destroys the identity of the firm; and what is called the property of the firm is their property."¹⁶

Although not citing this passage, the Supreme Court of Canada appears to have agreed with it. In *Boyd v. Attorney-General for British Columbia*, Duff J quoted with approval from *Lindley*, 5th ed., the statement that "[t]he firm is not recognized by

11 See *Beale v. Trinkler*, [2007] NSWSC 1058, at paragraph 8.

12 RSBC 1996, c. 238, as amended, section 29.

13 See *Seven Mile Dam Contractors v. The Queen* (1980), 116 DLR (3d) 398 (BCCA); and *Customs and Excise Commissioners v. Glassborow and Another (Trading as Bertram & Co.)*, [1974] 2 WLR 851 (QB).

14 See *Re Lebdorff Gen. Partner* (1993), 9 BLR (2d) 275 (Ont. Gen. Div.).

15 53 & 54 Vict., c. 39.

16 Nathaniel Lindley, William C. Gull, and Walter B. Lindley, *A Treatise on the Law of Partnership*, 5th English ed., 2d American ed. (Chicago: Callaghan, 1888) (herein referred to as "*Lindley*, 5th ed."), at 112. Currently, see *Lindley*, 19th ed., supra note 9, at 36, paragraph 3-04.

lawyers as distinct from the members composing it.”¹⁷ Thus, the court held that “[t]he partners are owners [of the partnership’s property] in the fullest sense both at law and in equity.”¹⁸ Similar statements may be found in other cases.¹⁹

WHAT ABOUT PORTER?

However, there is a contrary line of authority that says, essentially, that the partners do not have any proprietary interest in the assets of the firm. Rather, they have merely an equitable right to a division of the net proceeds, if any, from a sale of the partnership property on the dissolution of the partnership. In *Porter v. Armstrong, Duff* J²⁰ said:

English law does not regard a partnership as a *persona* in the legal sense. Nevertheless, the property of the partnership is not divisible among the partners in specie. *The partner’s right is a right to a division of profits according to the special arrangement, and as regards the corpus, to a sale and division of the proceeds on dissolution after the discharge of liabilities.* This right, a partner may assign, but he cannot transfer to another an undivided interest in the partnership property in specie.²¹

Statements similar to that in *Porter* have been made in a number of Australian cases.²² Also, in *Gill v. Sandbu*, the majority of the court held, despite citing *Popat*,²³ that “the share of a partner is his proportion of the partnership assets after they have been all realised and converted into money, and all the debts and liabilities have been paid and discharged.”²⁴

Some cases, while acknowledging that a limited partnership does not have a separate legal personality, have nevertheless felt constrained to hold that the limited partnership’s property is a separate patrimony owned by the partnership. In *Marigold Holdings Ltd. v. Norem Construction Ltd.*,²⁵ the issue was whether a general partner of a limited partnership could sue for damages done to the partnership as a whole, or

17 (1917), 54 SCR 532, at 555, quoting *Lindley*, 5th ed., supra note 16, at 111.

18 *Ibid.*

19 *Seven Mile Dam*, supra note 13; *Molson Brewery BC Ltd. v. Canada*, 2001 CanLII 22132 (FC); *Cattermole Timber, etc.* (1995), 2 BCLR (3d) 108 (CA); and *Popat v. Shonchbatra*, [1997] EWCA Civ. 1966, per Nourse LJ, in what was referred to as an “uncontroversial passage” by Neuberger LJ in *Gill v. Sandbu*, [2005] EWCA Civ. 1297, at paragraph 18.

20 The same Duff J who decided *Boyd*, supra note 17.

21 [1926] SCR 328, at 330 (emphasis added).

22 See Greg Person, “The Goodwill Roll-Out Effect in Partnerships” (2000) 3:1 *Journal of Australian Taxation* 56-74, at 57-58.

23 *Popat v. Shonchbatra*, supra note 19.

24 *Gill v. Sandbu*, supra note 19, at paragraph 19; followed on this point in *Hopton v. Miller*, [2010] EWHC 2232 (Ch.), at paragraph 86.

25 1988 CanLII 3490 (ABQB).

whether it had to prove the individual loss suffered by each limited partner. The court held that the general partner or the firm itself could sue, whether any specific limited partner had suffered a loss. While the court recognized that a partnership, even a limited partnership, is not a separate legal entity,²⁶ nevertheless, after reviewing the provisions of the Alberta Partnership Act relating to limited partners, the court held that “the limited partnership, while not enjoying all the rights of a person, enjoys a statutory existence apart from the persona of the limited partner.”²⁷

This case was cited in *Devon Canada Corporation v. PE-Pittsfield, LLC*, where the court said, “Firstly, I do not agree with the Plaintiff’s argument that a limited partnership does not have a legal personality of its own.”²⁸

The most recent Canadian case on point appears to be *Ferme CGR enr., s.e.n.c. (Syndic de)*.²⁹ The court held that “[t]he property of the partnership is . . . an autonomous patrimony distinct from that of the partners, and is composed of the contribution of each partner.”³⁰ While this conclusion was based on section 2199 of the Civil Code of Québec,³¹ the language of that provision is similar to section 23 of the Partnership Act.

The current editor of *Lindley*, 19th ed., suggests that the answer to whether a partner owns partnership assets depends on whether one is asking the question from an “internal” perspective (that is, vis-à-vis the partners as between themselves) or an “external” perspective (vis-à-vis third parties),³² relying on the following quotation from *IRC v. Gray*:

As between themselves, partners are not entitled individually to exercise proprietary rights over any of the partnership assets. This is because they have subjected their proprietary interests to the terms of the partnership deed which provides that the assets shall be employed in the partnership business, and on dissolution realised for the purposes of paying the debts and distributing any surplus. *As regards the outside world*, however, the partnership deed is irrelevant. The partners are collectively entitled to each and every asset of the partnership, in which each of them therefore has an undivided share.³³

26 Ibid., at paragraph 159.

27 Ibid., at paragraph 166.

28 2008 ABQB 394, at paragraph 7; aff’d. 2008 ABCA 393.

29 2010 QCCA 719. This case came to my attention when I read Elizabeth J. Johnson and Geneviève Lille, *Understanding the Taxation of Partnerships*, 6th ed. (Toronto: CCH Canadian, 2010), at 23-26, paragraph 140. *Ferme CGR* was followed on the point of a limited partnership having separate personality in *Développement Bleury — de la Gauchetière inc. c. Lalonde*, 2010 QCCS 3359.

30 *Ferme CGR*, supra note 29, at paragraph 68 (unofficial translation).

31 SC 1991, c. 64, as amended.

32 Supra note 9, at 614, paragraph 19-03.

33 [1994] STC 360, at 377 (CA) (emphasis added).

However, so far as I can determine, that principle has not been cited in Canada,³⁴ and in a recent Australian tax case, discussed below,³⁵ the court applied the internal perspective, which suggests that that perspective also applies vis-à-vis third parties. The internal versus external principle also seems to contradict Lord Lindley's remark that "[w]hat is meant by the share of a partner is his proportion of the partnership assets after they have all been realized and converted into money."³⁶

IS A PARTNERSHIP A SEPARATE PERSON FOR THE PURPOSES OF SUBSECTION 111(5)?

Of course, if the Act itself deemed the partnership to own the shares, then that would answer the question, regardless of the common law. Subsection 96(1) provides that for the purposes of determining a partner's income, a partnership is treated as if it were a separate person and all partnership property were owned by that person. However, the application of subsection 111(5) to a corporation the shares of which are held by a partnership does not involve the determination of the partners' incomes, and therefore subsection 96(1) is not applicable.

While subsection 96(1) does not treat the partnership as a separate person for the purpose of determining whether subsection 111(5) applies to a corporation the shares of which are held by a partnership, it is interesting to note that certain provisions of the Act suggest that it is the partnership that owns the shares. For example, subsection 256(1.4) states in part:

For the purpose of determining whether a corporation is associated with another corporation with which it is not otherwise associated, where a person *or any partnership* in which the person has an interest *has a right* at any time under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently,

(a) *to, or to acquire, shares of the capital stock of a corporation, or to control the voting rights of shares of the capital stock of a corporation*, the person or partnership shall, except where the right is not exercisable at that time because the exercise thereof is contingent on the death, bankruptcy or permanent disability of an individual, be deemed to own the shares at that time, and the shares shall be deemed to be issued and outstanding at that time [emphasis added].³⁷

34 Although it was cited in *Beale*, supra note 11, at paragraph 14, where the court applied the internal perspective.

35 See infra note 53 and the related text.

36 See *Lindley*, 5th ed., supra note 16, at 340. This was written before the Partnership Act, 1890 came into force, but the law is clear that that statute merely confirmed the prior common law: *Gill v. Sandhu*, supra note 19, at paragraph 25.

37 My thanks to Tim Edgar for pointing out that under paragraph 256(1.2)(e), where shares of a corporation are "owned" by a partnership or are deemed by subsection 256(1.2) to be owned by the partnership, the partners are deemed to own the shares pro rata.

This provision states that it is the partnership and not the partners that has the right to or to acquire the shares or to control the voting rights (at least for the purposes of the association rules).³⁸

THE CRA'S VIEW

In various releases addressing the issue of control of a corporation through a partnership, the CRA has stuck to the general principle that the partners own the partnership property, so that it is the partners, or more than 50 percent of them, or the general partner of a limited partnership, that controls any shares held by the partnership. In a letter,³⁹ the CRA opined that there could be an acquisition of control if there were a change in a group of partners that controlled a partnership that owned a corporation. In a technical interpretation,⁴⁰ the CRA opined that if a partner is entitled to exercise more than 50 percent of the votes at a meeting of the partners of a partnership, then that partner controls a corporation owned by the partnership. In a technical interpretation⁴¹ and a round table response,⁴² the CRA opined that a sole general partner in a limited partnership has control of the shares of a corporation owned by the partnership.⁴³

The CRA's position is based on the following analysis:

In *Vineland Quarries and Crushed Stone Limited v. MNR* [1966] CTC 69 (Exch), 66 DTC 5092, aff'd [1967] CTC vii, 67 DTC 5283 (SCC), the court held that the word "controlled" "contemplates and includes such a relationship as, in fact, brings about a control by virtue of majority voting power, no matter how that result is effected, that is, either directly or indirectly." The court also indicated that Company 1 may control Company 3 by owning all the shares of Company 2 which in turn owns all the shares of Company 3. In our view, the principle enunciated in *Vineland Quarries* applies where the intermediate shareholder is either a corporation or a partnership. In other words, where a partnership owns more than 50% of the issued voting shares of a corporation and where a particular partner is entitled, without restriction, to exercise more than 50% of the votes that may be cast at a meeting of the partnership, it is our view that the particular partner controls the corporation.⁴⁴

38 There are regulations that assume that a partnership can control another person. See, for example, paragraph (b) of the definition of "designated shareholder" in regulation 4901(2) and regulation 8514(1)(d).

39 CRA document no. 57721, June 21, 1989.

40 CRA document no. 9710065, September 4, 1997.

41 CRA document no. 9607465, July 19, 1996.

42 CRA document no. 2000-0038055, October 6, 2000.

43 See similarly CRA document nos. 9333125, August 9, 1994, and 9018205, August 22, 1991.

44 See CRA document nos. 9018205, August 22, 1991, and 9710065, September 4, 1997.

The weakness in this analysis is that in *Duba*, the court held that control is based on ownership. So while indirect control counts as control, it counts only if the indirect control is created by ownership. One is therefore still left with the question of who owns the shares of Subco.

CANADIAN COMMENTATORS

Various writers have looked at this issue, but have reached opposite conclusions. One author has written:

I am of the view that the partners do not own a pro rata direct beneficial interest in any of the specific assets of the partnership. Rather, the partners have an interest in the partnership agreement (a chose in action).⁴⁵

However, another author has taken the opposite position:

Clearly, partners have an ownership interest in partnership property, since a partnership is not a legal entity separate from the partners; yet those ownership interests of the partners are constrained by statute (and often by the partnership agreement) such that no partner may treat partnership property or the proceeds of a mortgage or sale thereof as his own.⁴⁶

The author of the leading Canadian textbook on partnership law appears to take a somewhat compendious approach:

The final conclusion must be that partnership property, whether contributed by a partner or acquired by partnership funds, is property which remains subject to the ownership of the partners. The nature of the ownership interest changes from the entitlement to an in species direct ownership in an asset, and subject to a free right to deal and determine, to a percentage interest on a proportionate basis, as a beneficiary, subject to principal and agency principles, subject to statutory, common law and contractual restrictions on the rights to deal with the assets. That however does not eliminate the interest of a partner in the partnership property as an ownership interest on the part of that partner.⁴⁷

So far as I can determine, no court has agreed to this approach.

Accordingly, it may be said that there is no clear authority, under case law or commentary, on the issue of who “owns” the property of a limited partnership.

45 Bill Maclagan, “Partnerships: An Update,” in *Report of Proceedings of the Fifty-Seventh Tax Conference*, 2005 Conference Report (Toronto: Canadian Tax Foundation, 2006), 37:1-46, at 37:17.

46 Douglas S. Ewens, “Tax Issues Affecting Partnerships,” in *Report of Proceedings of the Forty-Ninth Tax Conference*, 1997 Conference Report (Toronto: Canadian Tax Foundation, 1998), 8:1-85, at 8:26, cited in Johnson and Lille, *supra* note 29, at 23, paragraph 140.

47 Alison R. Manzer, *A Practical Approach to Partnership Law* (Aurora, ON: Canada Law Book) (looseleaf), at paragraph 4.1020.

DOES THE ANSWER DEPEND ON THE CONTEXT?

Is it possible that the determination as to whether a partnership owns property depends on the context in which the question is asked? In *Fasken Martineau DuMoulin LLP v. British Columbia (Human Rights Tribunal)*,⁴⁸ the applicant (“Fasken”), a BC limited liability partnership (LLP), brought an application for judicial review to quash a decision of the BC Human Rights Tribunal. The tribunal had found that Mr. McCormick, an equity partner in the LLP, was an “employee” of the LLP, and therefore had standing to challenge the LLP’s policy of requiring him to retire at age 65 as discriminatory.

The court dismissed the application and found that the tribunal had reached the right conclusion. It recorded Fasken’s argument as being that a partnership is not a legal entity and therefore cannot employ one of its own partners.⁴⁹

The court agreed that, normally, a partnership is not a separate entity, but nevertheless held that a partner and a partnership were not necessarily identical:

Addressing the first argument, it is apparent that the common law and the *Partnership Act*, to a large extent, do not recognize a partnership as a legal entity distinct from its partners. The definition of “firm” in the *Partnership Act* reflects this common law principle. Section 1 of the *Partnership Act* defines “firm” as, “the collective term for persons who have entered into partnership with one another.” This concept of a partnership as a collection of persons carrying on business together is also recognized by Wedge J. in *Blue Line Hockey Acquisition Co.* at paras. 80-83. *However, both the Partnership Act and the partnership agreement governing the Fasken partners recognize a distinction between individual partners and the firm for specific purposes.*⁵⁰

Citing specific provisions of the BC Partnership Act, the court stated:

In my view, these sections of the *Partnership Act* accord a special status to a limited liability partnership *that is more reflective of a corporate entity than a partnership from the common law perspective*. While our legislation does not expressly grant a limited liability partnership legal status as a separate entity from the partners, (as in the United Kingdom), its provisions *significantly erode the common law principle that the rights and liabilities of the partnership are the rights and liabilities of the individual partners*. . . .

In light of these provisions of the *Partnership Act* and the terms of the Fasken partnership agreement, it is apparent that the partnership, *as a collective of persons, is treated as distinct from an individual partner for certain purposes*. If an individual partner is a distinct legal person for the purpose of bringing an action against the firm under the *Partnership Act* and for the purpose of adjudicating a dispute regarding the partnership pursuant to article 12 of the Fasken partnership agreement, *it is not an immutable principle of law that a partnership is merely the sum of its partners*. As a consequence, there

48 2011 BCSC 713.

49 *Ibid.*, at paragraph 55.

50 *Ibid.*, at paragraph 56 (emphasis added).

should be no legal impediment to according a partner and the firm separate legal status for the purpose of a complaint under the *Code*.⁵¹

Thus, given the context in which the question was asked, it was held that the partnership employed the partner.

The purpose and policy of subsection 111(5) is to prevent losses from being traded among taxpayers.⁵² In that context, one might ask: What sorts of changes at the partner level should attract subsection 111(5)? If, in the example described earlier, the limited partners simply replaced GPco with a new shell corporation as the general partner, one would not think that that should attract subsection 111(5). On the other hand, if all of the limited partners sold their units of the limited partnership to third parties, one might think that that should attract subsection 111(5). However, one would then have to consider the limited partners as controlling the shares of Subco owned by the limited partnership, a notion at odds with the limited role of a limited partner. If the limited partners sold all the shares of GPco to a third party, one might think that subsection 111(5) should apply; but since GPco is entitled to only 0.001 percent of the limited partnership's profits and losses, in policy there seems to be no reason to apply that provision. After looking at the various ways in which partner-level changes could occur and the possible impact of subsection 111(5) in those scenarios, I feel driven to say that most of them lead to results that seem illogical from a policy perspective, and that the better view is that subsection 111(5) should not apply until the limited partnership sells the shares of Subco to a third party.

HENSCHKE

The most recent tax authority on this issue appears to be the decision of the High Court of Australia in *Commissioner of State Taxation v. Cyril Henschke Pty Ltd*.⁵³ The issue was whether an instrument identified as a deed of retirement, whereby a partner in a general partnership retired, was a "conveyance on sale" within the meaning of section 60 of the Stamp Duties Act 1923 (SA) and thereby was charged with stamp duty pursuant to section 4 of that statute. Under section 4, stamp duty is charged in respect of the instruments specified in schedule 2 to the Stamp Duties Act. The commissioner assessed on the footing that duty was chargeable on the retirement deed as a "conveyance or transfer on sale of any property" under clause 3(1) of schedule 2. It was agreed that if the retirement deed was a "conveyance," then it was a "conveyance on sale." The term "conveyance" was defined in section 60 of the Stamp Duties Act as including every instrument "by which or by virtue of which or by the operation of which . . . any . . . personal property or any

51 *Ibid.*, at paragraphs 61-62 (emphasis added).

52 *Duba*, supra note 1, at paragraphs 86-88.

53 [2010] HCA 43.

estate or interest in any such property is assured to, or vested in, any person.” The term “interest” was defined in section 2(1) of that statute as including any inchoate equitable interest.

The court held that the retirement deed was a “conveyance,” but in contrast to the decision in *Seven Mile Dam*,⁵⁴ the court did not hold that it was a conveyance of the assets of the partnership. The court held that a partnership, although contractual in nature, is governed by the court of equity: “[D]isputes between partners and the dissolution and winding up of partnerships have always fallen within the jurisdiction of the Court of Chancery.”⁵⁵ This is because

while partnership is a consensual arrangement based on agreement, it is more than a simple contract (to use the expression of Dixon J in *McDonald v. Dennys Lascelles Ltd*); it is a continuing personal as well as commercial relationship. Neither during the continuance of the relationship nor after its determination has any partner any cause of action at law to recover moneys due to him from his fellow partners. The amount owing to a partner by his fellow partners is recoverable only by the taking of an account in equity after the partnership has been dissolved. Only the Court of Chancery was equipped with the machinery necessary to enable such an account to be taken, and the basis upon which the account was taken reflected equitable principles. These could be modified by agreement, but they did not find their source in contract.⁵⁶

Accordingly, the court held that the nature of the interest conferred by equity on each partner with respect to partnership assets as they exist from time to time and in advance of a “general” dissolution under the control of a court of equity, is *sui generis* and is best described in equity as being “a fractional interest in a surplus of assets over liabilities on a winding up and in the future profits of the partnership business.”⁵⁷ The court specifically held that partners *do not* have a so-called beneficial interest in the assets of the partnership.⁵⁸

In conclusion, the court held that the retirement deed had effected a transfer to the other partners of the retiring partner’s chose in action as described above, and hence was a “conveyance on sale”:

The Retirement Deed operated with respect to the interest of Mrs Doris Henschke, *which was a presently existing equitable chose in action against the other partners to effect an accord and satisfaction*, by her acceptance of the payment under cl 2 in place of that chose in action against the other partners. The Retirement Deed further provided for the creation of a second partnership to conduct the business previously conducted under

54 *Seven Mile Dam*, supra note 13.

55 Supra note 53, at paragraph 22.

56 *Ibid.*, quoting *Hurst v. Bryk and Others*, [2000] UKHL 19 (notes omitted).

57 *Henschke*, supra note 53, at paragraph 24, quoting *Bolton v. FC of T* (1964), 9 ATR 385, at 395 (HCA).

58 *Henschke*, supra note 53, at paragraph 25.

the 1986 Partnership Agreement and to do so upon the terms indicated earlier in these reasons. Pursuant to and by virtue of the provisions of the Retirement Deed, there were vested in the members of the second partnership the equitable choses in action representing their present partnership interests as described by Mason J in *United Builders*. As already stated, the Retirement Deed thus was a conveyance within the meaning of s 60 of the Act.⁵⁹

An Australian taxation determination that predated this case⁶⁰ anticipated this ruling. In the determination, the issue was whether section 23AJ of the Income Tax Assessment Act 1936 (ITAA 1936) applies to a dividend when it is paid by a non-resident company to an Australian-resident company that receives the dividend in its capacity as a partner in a partnership. Section 23AJ deals with “non-portfolio” dividends, defined in section 317 of ITAA 1936 to mean a dividend paid to a company where that company has a “voting interest” of at least 10 percent in the company paying the dividend. “Voting interest” is defined in section 334A as being the “beneficial owner” of shares in the other company that carry the right to exercise any of the voting power in that other company. “Beneficial owner” is not defined.

The determination ruled that a partner is not the “beneficial owner” of shares that are assets of the partnership. Relying on some of the same cases cited in *Henschke*, it ruled that there is a difference between a beneficial interest and beneficial ownership:

An interest of a partner in a partnership has been characterized as an equitable interest in the nature of a chose in action because it is a right or interest enforceable in equity. It has also been characterized as a “beneficial interest.” In *Canny Gabriel Castle Jackson Advertising Pty Ltd v. Volume Sales (Finance) Pty Ltd*, the High Court described the nature of a partner’s interest in a partnership as a beneficial interest in each of the partnership assets. *A beneficial interest in the assets does not equate to beneficial ownership of the assets because a partner does not have title to any specific asset owned by the partnership.* The beneficial interest is an interest which will not take effect in possession until the partnership is dissolved. That is, whilst the partnership exists, a partner has by virtue of holding a beneficial interest in the assets of the partnership, a right to a proportion of the surplus after the realization of the assets and payment of the debts and liabilities of the partnership. The nature of a beneficial interest in a partnership is described in *Lindley on The Law of Partnership* as the following.

First, in the situation being supposed (ie. during the continuance of the partnership) the beneficial interest, considered as a several interest, is in the nature of a future interest taking effect in possession on (and not before) the determination of the partnership (whether by change in the membership thereof or by general dissolution). The reason is that during the continuance of the partnership, each

59 Ibid., at paragraph 28 (emphasis added).

60 Australian Taxation Office, *Taxation Determination* TD 2008/24, August 13, 2008. Such determinations are binding on the commissioner because the determination relates to taxpayers generally.

partner is entitled to require the partnership property to be applied for the purposes of the partnership and no partner is entitled to the several enjoyment of his share. Secondly, when, on the determination of the partnership the several beneficial interest falls into possession, it takes effect subject to the right of the other partners to have the property of the partnership applied in payment of the debts and liabilities of the firm and otherwise in accordance with . . . the Partnership Act.⁶¹

In a forthcoming supplement to *Lindley*, 19th ed., the current editor makes it plain that he disagrees with the court's analysis in *Henschke*.⁶²

CONCLUDING ANALYSIS—TWO POSSIBLE ANSWERS (OR MAYBE THREE?)

There will be an acquisition of control of a corporation by a person within the meaning of subsection 111(5) if, but only if, that person acquires ownership of more than 50 percent of the voting shares (or if he acquires more than 50 percent of the voting shares in a corporate chain above the particular corporation). In the limited partnership situation, the ultimate question is, what is the top level of a corporate structure where all the shares of a corporation are held by a partnership? If the owner of the shares is the partnership, does that mean that there is no level above it?

There are two (or perhaps three) possible answers.

61 *Ibid.*, at paragraph 11 (notes omitted).

62 I thank the current editor for his e-mail correspondence on this point. He drew to my attention the decision of Lewison J in *Hanchett-Stanford v. Attorney General & Ors.*, [2008] EWHC 330 (Ch.), at paragraph 47 (which, however, is not cited in the forthcoming supplement), where, when talking about the property of unincorporated associations, the court said: "The thread that runs through all these cases is that the property of an unincorporated association is the property of its members, but that they are contractually precluded from severing their share except in accordance with the rules of the association; and that, on its dissolution, those who are members at the time are entitled to the assets free from any such contractual restrictions. It is true that this is not a joint tenancy according to the classical model; but since any collective ownership of property must be a species of joint tenancy or tenancy in common, this kind of collective ownership must, in my judgment, be a subspecies of joint tenancy, albeit taking effect subject to any contractual restrictions applicable as between members. In some cases (such as *Cunnack v Edwards*) those contractual restrictions may be such as to exclude any possibility of a future claim. In others they may not. The cases are united in saying that on a dissolution the members of a dissolved association have a beneficial interest in its assets, and Lord Denning goes as far as to say that it is a 'beneficial equitable joint tenancy.' I cannot see why the legal principle should be any different if the reason for the dissolution is the permanent cessation of the association's activities or the fall in its membership to below two. The same principle ought also to hold if the contractual restrictions are abrogated or varied by agreement of the members." This is, in a sense, a description of both the internal and the external perspectives and consistent with *Boyd*, supra note 17. I respectfully disagree with the editor's view that it is not inconsistent with *Porter*, supra note 21.

The CRA's Answer

The partnership is not a legal entity; in situations such as this, where section 96 does not apply, it is fully transparent. Furthermore, the cases (*Vineland*,⁶³ *Duba*) have made it clear that control is to be determined “in the long run,” so that if Mr. A owns the shares of Bco and Bco owns the shares of Cco, then Mr. A is in control of Cco. Therefore, the general partner of a limited partnership that owns the shares of Bco is in control of Bco, because the general partner has the right to vote the shares. Therefore, the top level is the partners or the shareholders of the partners, so that a change in either the partners or their shareholders creates an acquisition of control.

One may note that in a limited partnership situation, this answer is still not complete. It is not clear whether control rests

- with GPco, because under the partnership agreement only GPco, and not the limited partners, can vote the shares of Subco, even though GPco's interest is only 0.001 percent; or
- with the limited partners, even though they cannot vote the Subco shares, because they have a 99.999 percent interest and can replace GPco, and because GPco is acting as their agent when it votes those shares.

The Alternative Answer

Neither *Vineland* nor *Duba* involved partnerships. More particularly, in the circumstances considered in those cases, the top shareholder clearly owned the shares of the top entity, so that control was ultimately grounded in the ownership of shares. In the present situation, while it is true that the limited partnership is not a separate legal entity, it is the partnership that is at the top of the structure, not the partners or their shareholders. This is because of a combination of four factors:

1. The shares are “partnership property” and, as decided in *Henschke* and *Ferme CGR*, the partners do not have legal or beneficial ownership of the shares. The partners simply have a chose in action, the right to ensure that the shares are dealt with as partnership property, and the right to the net proceeds, if any, on any future sale of the shares.
2. The partnership agreement is not a constating document and therefore cannot be taken into account in deciding who owns the shares. In contrast to a trust situation, where the trustees would legally and beneficially own the shares subject to the limitations imposed on their ownership by the trust deed, partners do not own shares held by the partnership, so that the exception for trusts noted in *Duba* does not apply.
3. Under the partnership agreement and the Partnership Act, the same partnership would continue to exist even though there may be a change of partners.

63 *Vineland Quarries and Crushed Stone Ltd. v. MNR*, 66 DTC 5092 (Ex. Ct.); aff'd. 67 DTC 5283 (SCC).

4. The share register lists the partnership, not GPco, as the shareholder. So when one asks the question posed in *Duba*—Who owns the voting rights to the shares?—the answer is, the partnership.

A Third Possible Answer? Consolidated Holding

Dealing more particularly with the trust exception noted in *Duba*, in *MNR v. Consolidated Holding Co. Ltd.*,⁶⁴ the court had to determine whether two corporations were controlled by the same group of persons such that they were associated. The shares of the taxpayer corporation were owned by two brothers equally. Those two brothers were, together with a trust company, executors and trustees of their late father's estate, which held approximately 45 percent of the shares of another corporation. Under the trust deed, a decision by any two of the executors and trustees of the estate could bind the third. The taxpayer and the estate together held a majority of the shares of that other corporation. In confirming that the ownership of the shares held by the estate rested with the trustees, the court insisted on looking behind the share registry to the terms of the trust deed in order to ascertain how the voting rights attaching to those shares were to be exercised:

In determining whether a group of persons controls a company, it is not sufficient in the case of trustees who are registered as shareholders to stop the inquiry at the register of shareholders and the Articles of Association. It is necessary to look to the trust instrument to ascertain whether one or more of the trustees have been put in a position where they can at law direct their co-trustees as to the manner in which the voting rights attaching to the shares are to be exercised.⁶⁵

The court concluded that the two brothers, by combining, had the ability to control the votes of the shares held by the estate. Accordingly, the court found that the taxpayer corporation and the other corporation were controlled by the same group of persons, namely, the two brothers.

In *Duba*, at the Federal Court of Appeal, the court referred to *Consolidated Holding* and held that one must look outside the trust deed to see the true position at law.⁶⁶ However, on appeal, the Supreme Court of Canada did not agree with this analysis. The court held that “as a general rule, external agreements are not to be taken into account as determinants of *de jure* control.”⁶⁷ As an exception one may look at a trust deed, because the trustees’ “very capacity to act”⁶⁸ is limited by the trust deed.

64 72 DTC 6007 (SCC).

65 *Ibid.*, at 6008.

66 96 DTC 6323 (FCA).

67 *Supra* note 1, at paragraph 51.

68 *Ibid.*, at paragraph 50.

It is difficult to understand exactly what the court meant by saying that the trustees' "very capacity to act" is limited by the trust deed. While the trust deed may impose limitations on the trustee's power to vote shares owned by the trust, no third party is bound by those limitations; the beneficiaries may sue the trustee for breach of trust, but any vote that is contrary to those limitations is still valid.⁶⁹ But in any event, my view is that that exception may not apply to partnerships because, as noted above, while trustees own the shares held by the trust, their ownership is constrained by the trust deed and trust law. Partners do not "own" the shares held by the limited partnership, so the partners' "very capacity to act" is not determined by the partnership agreement.

As a third possible answer, the CRA could argue that even if the partnership owns the shares, there is an acquisition of control of the underlying company if there is an acquisition of control of the partnership. The counterargument is that in the cases dealing with indirect control, control changed *because* of a change of ownership of the shares. In a partnership situation, control is changed only because of an acquisition of partnership units, which does not effect a change in the ownership of the underlying shares. In *Duba*, the court said the "only" exception to the constating document rule is for trusts. It is therefore difficult to see how the third possible argument could prevail.

Accordingly, good arguments exist that the second answer is the correct one. In the context of subsection 111(5), it is the limited partnership, and not the partners, that "owns" the shares of Subco, and no change at the partner level results in an acquisition of control of Subco.

69 See Mark L. Asher, Austin Wakeman Scott, and William Franklin Fratcher, *Scott and Asher on Trusts* (New York: Aspen) (online from Lexis), at section 18.1.8.1, note 15 and related text.