

Indigenous Business Toolkit Project

Limited Partnerships

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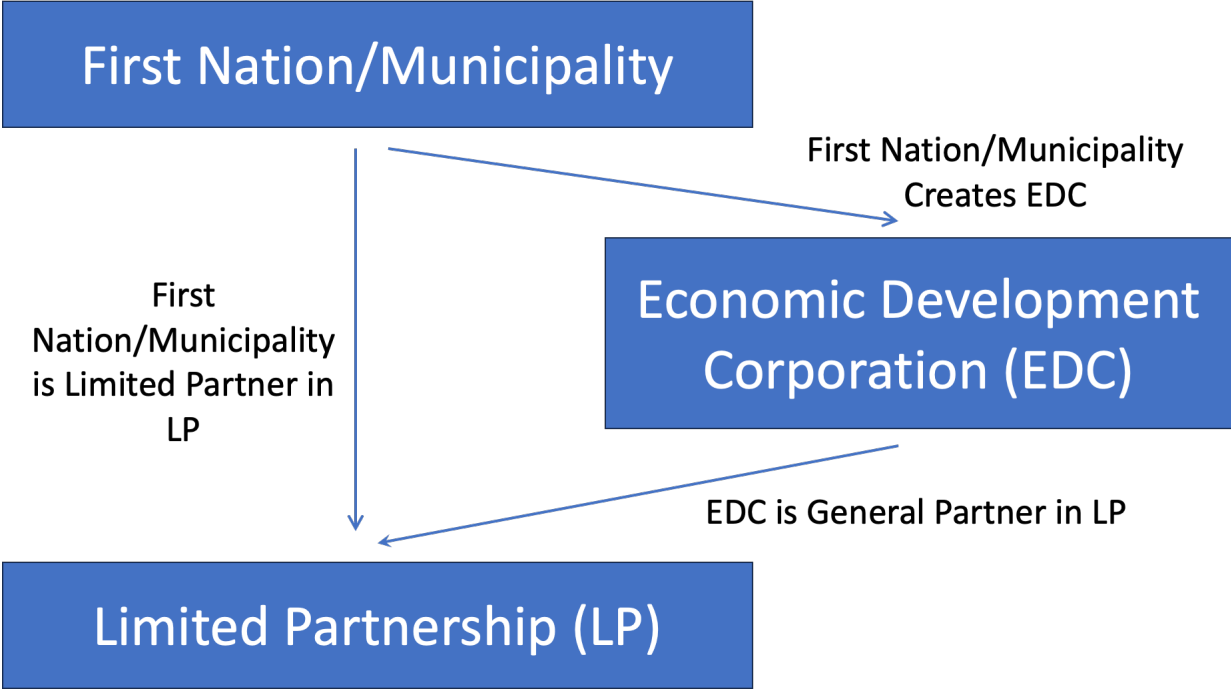
Limited Partnerships

Summary

Limited partnerships are widely used by First Nations and by a few northern municipalities to structure their businesses. Limited partnerships are used because they achieve three key goals: they allow Indigenous communities to operate businesses outside their boundaries; they allow Indigenous businesses to earn income that is exempt from taxation; and they limit the liabilities of the owners.

As illustrated in the diagram below, a limited partnership (LP) is created by a First Nation or a northern municipality through a partnership between a limited partner and a general partner. The limited partner is the First Nation or a northern municipality itself, while the general partner is an economic development corporation (EDC) created and owned by the First Nation or a northern municipality. By creating the EDC, the First Nation or a northern municipality can directly receive LP net income tax exempt while at the same time ensuring that its investment in the LP is subject to limited liability.

The purpose of this module is to describe how a limited partnership works and how it achieves these goals.



The Dilemma

When Saskatchewan First Nations first began to make business investments 30 or 40 years ago, they typically structured their companies as corporations. The corporation structure allowed First Nations to restrict financial liability to the corporation and thus to shield the Nations from liability if the business were to fail. Taxation was not a major issue because many of the businesses were not yet profitable.

As the businesses grew and became more successful, taxation became an increasingly important issue. Limited partnerships were introduced to use the tax-exempt status enjoyed by First Nations while at the same time retaining limited liability.

Under section 87 of the Indian Act, income from business that takes place on reserve is generally exempt from tax. However, if the business activities take place off-reserve, the income is taxable.¹ Thus, if a First Nation sets up a corporation that operates within reserve boundaries, the corporation is exempt from taxation. However, this exemption does not extend to First Nation-owned corporations that operate off reserve. As will be discussed below, limited partnerships provide a way for a First Nation to maintain a tax exemption even if the business operates off the reserve.

Northern municipalities face a situation like the one faced by First Nations, although for a different reason. Northern municipalities are governments and thus are normally exempt from taxation. Northern municipalities can form corporations that are exempt from taxation when they operate within the boundaries of the municipality. However, businesses that operate outside the municipal boundary are subject to taxation.

The rules governing northern municipalities are important because many municipalities (including villages) in northern Saskatchewan are populated predominantly by Métis people. These municipalities are able to use a limited partnership to operate a tax-exempt business. However, Métis Locals and Métis Regions that form corporations to get into business have no special tax-exempt status and therefore are taxable regardless of the business structure that is used.

The Solution to the Dilemma

As First Nation businesses became successful, business and community leaders asked if there was a way to use the Nations' tax-exempt status when operating off reserve. The tax professionals that were consulted indicated, after considerable investigation and research, that existing corporate and taxation law could be used innovatively to attain tax exemption on profits earned by a First Nation business while at the same time retaining limited liability protection. The solution involved the use of the limited partnership structure.

A limited partnership has a particular legal and financial structure. It is composed of one or more general partners that manage the partnership and one or more limited partners that supply the capital. The financial liability of the limited partners is limited to the investments

they make in the limited partnership. In addition, the limited partners cannot be involved in the operation of the business. Profits earned by the limited partners are taxed in the hands of each of the partners. In contrast, the general partner has unlimited financial liability and has full management control.

The legal requirement that limited partners cannot be involved in operations has important implications for how business decisions are made. In the case of a First Nation, the Chief and Council, when acting as Chief and Council, cannot make business decisions for the businesses in which they are limited partners.² Similarly, the mayor and council of a northern municipality, when acting as mayor and council, cannot make business decisions for their businesses. Elected leaders may, nevertheless, serve on the board of directors of the general partner. If they do, however, they must ensure that any business decisions they make are in their capacity as a board member and not in their capacity as an elected leader. As board members, they have the legal duty to act in the best interests of the corporation.

The limited partnership is used by First Nations in the following way. A First Nation creates a wholly owned corporation. This corporation – which typically takes the form of an Economic Development Corporation (EDC) – and the First Nation form a limited partnership. In the arrangement, the EDC is the general partner, while the First Nation is the limited partner.

As the general partner, the EDC assumes liability for the business operations. This arrangement means the First Nation does not face liability for the losses or other obligations of the business. However, as a taxable entity, the general partner is subject to taxation on its income. It also operates and manages the limited partnership.

The First Nation, in contrast, as the limited partner, cannot participate in operations. It can, however, receive the profits from the limited partnership. Since these profits are taxed in its hands and it has a tax-exemption status, the profits are tax exempt.

To maximize the tax exemption, a typical limited partnership is structured so that the First Nation owns 99.9 percent of the limited partnership; the general partnership – the EDC – owns the remaining 0.01 percent. This low ownership percentage means the general partner receives very little in profits and thus pays very little in taxes. Despite its small ownership, the EDC operates the business. Figure 1 shows an example of the structure of a limited partnership.

While the limited partnership provides a way for a First Nation to obtain both tax exemption and limited liability, the structure does carry risks for the First Nation. Perhaps the most important risk is the management ability of the general partner. While the First Nation, as a limited partner, cannot directly dictate the operations of the general partner/EDC, it does have the ability to ensure that the board of directors of the general partner/EDC has the business acumen to operate the business effectively and independently. Depending on the nature of business which it is overseeing, the board should ideally have some mix of in-depth industry knowledge, financial expertise, contract management knowledge, HR experience, and marketing knowledge. Having a highly capable general partner gives the limited partner – the

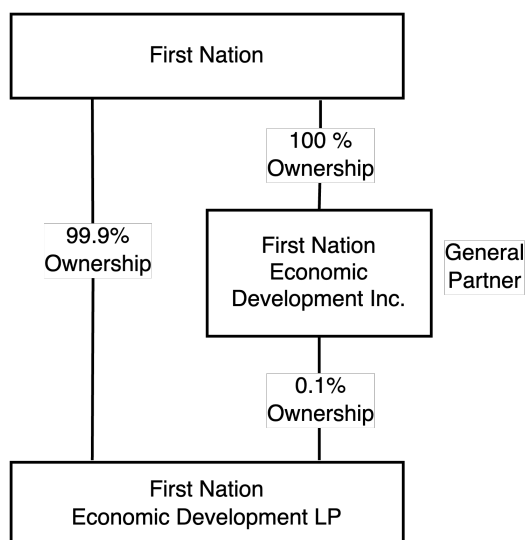


Figure 1. Basic Structure of a First Nation Limited Partnership

First Nation – confidence that proper oversight of business operations takes place and that its investment will be successful. This confidence is important because the First Nation is making an investment on behalf of its citizens and is accountable to them.

Limited partnerships can also be used by northern municipalities that wish to invest in a business on behalf of their citizens. As with First Nations, limited partnerships provide northern municipalities with a business structure for their business ventures/EDCs in a way that achieves both limited liability for the funds that are invested and tax exemption on the profits that are earned.

Table 1 presents three examples of limited partnerships – two created by First Nations and one created by a northern municipality. For example, the Mistawasis Nêhiyawak First Nation has created an EDC called Misty Ventures Inc. Misty Ventures Inc. is the general partner in the limited partnership Misty Ventures Limited Partnership. The limited partner is the Mistawasis Nêhiyawak First Nation.

Table 1. Examples of Limited Partnerships Created by First Nations and Municipalities

	First Nations		Municipality
	Beardy's & Okemasis	Mistawasis	Pinehouse
General Partner	Willow Cree Developments GP Inc.	Misty Ventures Inc.	Pinehouse Business North Development Inc.
Limited Partner	Beardy's & Okemasis Cree Nation	Mistawasis Nêhiyawak First Nation	Northern Village of Pinehouse
Limited Partnership	Willow Cree Developments LP	Misty Ventures LP	Pinehouse Business North LP

Partnering with Other Businesses

Economic development corporations often wish to partner with other businesses, be they Indigenous or non-Indigenous. There are many reasons to do so – outside partners can bring access to such things as financial resources, markets, and operational expertise. How does a limited partnership work in this case? Does it still provide the benefits of tax exemption and limited liability?

Before examining these questions, it is important to note that the limited partnership structure itself does not confer tax-exempt status – i.e., there is nothing inherent in limited partnerships that creates tax-exempt status. Instead, the limited partnership allows the income from the partnership to be divided among the partners and to be taxed in the hands of each partner. Since First Nations are exempt from paying taxes on the income they receive, the income they receive in a limited partnership is not taxed. If a limited partner is a taxable entity, it will pay taxes on the income received.

Thus, if a First Nation partners with taxable entities in a limited partnership, these entities will pay tax. Since the limited partnership structure does not change anything for the non-tax-exempt partners, it means there is no tax advantage or disadvantage for taxable entities to enter into in a limited partnership with First Nations. At the same time, First Nations are not disadvantaged from partnering with taxable entities. The result is that partnerships that make business sense and that provide benefits to all the parties are not discouraged for taxation reasons.

Figure 2 provides an illustration of how a First Nation can partner with another business and still receive the benefits of tax exemption and limited liability. In Figure 2, First Nation Economic Development LP (which is a limited partnership owned 99.9 percent by the First Nation) partners with an industry partner in a business called Business Entity LP. Assume that First Nation Economic Development LP and Industry Partner have negotiated a 51 percent/49 percent ownership in the new entity.

To achieve the flow-through of profits back to the First Nation, Business Entity LP is structured as a limited partnership owned 51 percent by First Nation Economic Development LP, 48.9 percent by Industry Partner, and 0.1 percent by Operating Entity Inc. First Nation Economic Development LP and Industry Partner are the limited partners, while Operating Entity Inc. is the general partner.

Operating Entity Inc. is owned 51 percent by First Nation Economic Development Inc. and 49 percent by Industry Partner. This ownership structure mirrors the ownership structure of the partnership between First Nation Economic Development LP and Industry Partner. Since the shareholders appoint the board of directors of Operating Entity Inc., this ownership structure ensures that First Nation Economic Development Inc. can have representation on the board

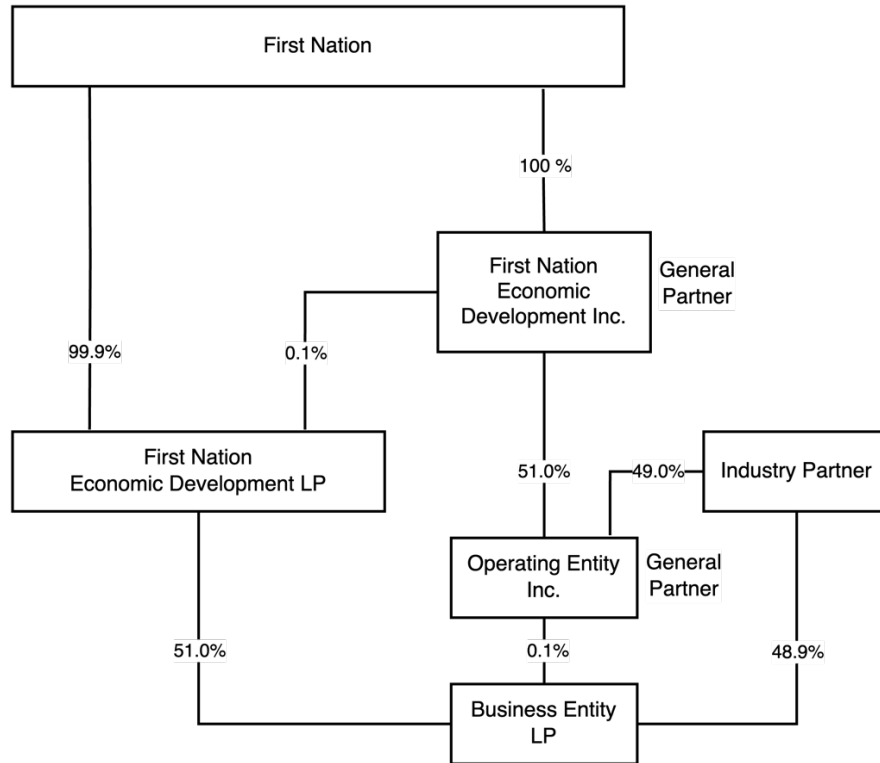


Figure 2. Structure of a Limited Partnership with an Industry Partner

members. As in the earlier discussion, First Nation Economic Development Inc. is typically an Economic Development Corporation (EDC).

With the structure outlined in Figure 2, any profits earned by Business Entity LP flow back to the limited partners based on their ownership shares. While the profits that flow to Industry Partner are taxable, the profits that flow to First Nation Economic Development LP are not taxable. The reason for the tax exemption is that these profits, in turn, flow back into the hands of the First Nation, which is the limited partner in First Nation Economic Development LP. Since the First Nation has a tax exemption, the profits are not taxed. The general partner is taxable but given its very small ownership, the tax is negligible.

The structure outlined in Figure 2 also ensures that the First Nation has limited liability in Business Entity LP. If Business Entity LP were to fail financially, Operating Entity Inc. would be liable for the debts. However, since Operating Entity Inc. is structured as a standard corporation, its owners (First Nation Economic Development Inc. and Industry Partner) are limited in their liability to the amount they have invested in Operating Entity Inc. This amount, however, is relatively small, because Operating Entity Inc. is an operating company that would typically not require a large investment to operate.

Conclusion

A limited partnership is the preferred legal structure for First Nations and northern municipalities wanting to invest in businesses that operate outside their boundaries. A limited partnership allows the First Nation or northern municipality to earn business income that is tax-exempt while also limiting investment liability. The limited partnership model can also be used to structure partnerships with industry partners in a way that does not alter the investment incentives of either party.

While limited partnerships are widely used, it is important for groups wishing to use this structure to consult experienced legal and financial advisors who are well acquainted with taxation and corporate law. Doing so will ensure the partnerships are properly structured and that alignment is achieved between the objectives of the partnership and the First Nation or municipal owners.

Disclaimer

This document is not a legal treatise, but rather a practical guide for people wishing to understand limited partnerships and how they work. Groups wishing to use the limited partnership structure should receive the appropriate legal, and other, advice necessary to ensure their specific goals and circumstances are considered and recognized.

Resources

Government of Canada. 2024. Information on the tax exemption under section 87 of the Indian Act. Retrieved March 21, 2024 from <https://www.canada.ca/en/revenue-agency/services/indigenous-peoples/information-indians.html#hdng2-1>.

Notes

¹ See Government of Canada (2024). The Supreme Court of Canada has ruled that First Nation property situated on reserves is tax exempt. The purpose of this exemption is so taxation does not erode First Nation property. An exemption for First Nation property on reserves has existed since before Confederation.

² For example, Band Council Resolutions (BCRs) are the formal tool used by First Nations to document the decisions made by Band Councils (i.e., Chief and Council). To be compliant with the terms of a limited partnership and to retain limited liability, BCRs cannot deal with the operation of a limited partnership. However, Chief and Council can make operational decisions for the limited partnership, but only if they have been appointed to the board of the general partner and are acting in their capacity as board members.

Indigenous Business Toolkit Project

The Indigenous Business Toolkit Project is designed to provide Indigenous communities and individuals with the practical tools they and their advisors can use to undertake successful economic development. Indigenous economic development is more successful when everyone – community members, community leaders, consultants, business professionals, employees, and/or potential partners – understands its many aspects.

The Toolkit provides step-by-step instructions on selected aspects of economic development based on the best practices of leaders in the field. The modules in the Toolkit cover everything from the role of economic development in nation building, to the importance of business charters, to the various legal forms that can be used to pursue economic development, to the steps needed to identify and negotiate beneficial partnerships, to the governance challenges that economic development must address.

The modules are available for free and for use by anyone. The full set of Toolkit modules can be found at: <https://www.schoolofpublicpolicy.sk.ca/research-ideas/projects-and-labs/indigenous-leadership-governance-and-development-project.php>.

The Indigenous Business Toolkit Project is part of the larger Indigenous Leadership: Governance and Development project designed to support long-term Indigenous economic development. In addition to the toolkit, the larger project involves capturing the economic development experience of Saskatchewan Indigenous communities through a series of case studies. The case studies, along with a description of the larger project, can be found at the website listed above.

Disclaimer

The information contained in this document is designed to provide an overview of a particular topic and should not replace legal and other expert advice. Groups wishing to use the concepts discussed should receive the appropriate professional advice necessary to ensure their specific goals and circumstances are considered and recognized.

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