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Canada Revenue Agency ("CRA") Ruling/Interpretation on AFP Funding – Further Guidance to Practice Plans

Dear Dr. Rubin:

This is provided further to the conference call of November 17, 2014 and your request that we provide further guidance to AHSC AFP Chairs concerning next steps that could be taken by individual practice plans to reflect the CRA's position.

As we discussed during the call, in our view the ruling/interpretation provides much-needed clarification to confirm that GST/HST will not apply to AFP monies received either by an academic medical organization ("AMO") from the Ministry of Health and Long Term Care ("MOHLTC") or by a practice plan from an AMO, to the extent that the terms of a particular AFP agreement are consistent with those of the agreement considered by the CRA.

The CRA's letter confirmed, however, that there could be GST/HST implications when AFP funds are further distributed by a practice plan. The extent to which GST/HST will apply will be determined by the nature of the arrangement under which the monies are distributed, the purpose for which the distribution is made and the relationship between the entity making the payment and the physician that receives it.

As we discussed, the way in which AFP funding will best be handled by individual AFP practice plans can only be determined by the practice plans, in consultation with their professional advisors, as informed by the particular facts applicable to them. However the following general thoughts may be useful to practice plans and their advisors as they undertake this analysis.

- To the extent that an AFP practice plan is a partnership and that it distributes AFP funding only to partners, there should be minimal GST/HST consequences. This is because GST/HST is accounted for at the partnership level and where revenue is received by the partnership and allocated to partners in accordance with the terms of the partnership agreement, there will generally be no supply for GST/HST purposes.

However some practice plans may currently operate under partnership agreements which were structured many years ago and which may no longer reflect the business of the partnership or the mechanism under which payments are now made to partners. For the CRA, the terms of the partnership agreement are paramount and they will govern the way in which GST/HST applies. It would be therefore be opportune now for AFP partnerships to review their agreements and ensure that they reflect what is really happening in the partnership, and that their accounting records accurately capture all sources of partner revenue. This is important because a partnership can potentially be liable for GST/HST that should have applied to activities of its partners, irrespective as to whether it was even aware of those activities.

- As noted above, where AFP funds are distributed by a partnership to its partners, the funds are not viewed as consideration for services supplied by the partner to the partnership, and therefore there is no need to consider whether GST/HST applies to those services. However where AFP funds are distributed by a partnership to a non-partner (i.e. to a physician that is an independent contractor or a medicine professional corporation ("MPC")) or where the practice plan is an unincorporated association that distributes the funds to its member physicians, the CRA will typically start from the position that the payments are in fact consideration for a supply of services by the physician or MPC. It will therefore be necessary to convince the CRA that this is not the case, for example on the basis that the practice plan is simply undertaking a further distribution of the same grant funds or that if there is a supply of services by the physician, it is an exempt supply and not subject to GST/HST.

    - As regards the former position, it may be possible to argue that the practice plan is merely acting as a further "intermediary" in distributing the MOHTLC funding. Just as the CRA concluded that TOHAMO was an intermediary for this purpose, it is conceivable that the role of the practice plan could similarly be portrayed as another level of intermediary that simply serves as a conduit to flow the funds to the ultimate intended recipients, that being the individual academic physicians or their MPCs.

    - Alternatively, it may be easier to demonstrate in some cases that the funds paid to a particular physicians or MPC are directly tied to the level of clinical services they provide. Where this is the case, it could be argued that the funds are consideration for an exempt supply, with no GST/HST consequences.

    - Where funds are paid by a practice plan to a physician or MPC in support of research activities, it may be possible to demonstrate that the practice plan is itself granting the funds under its own separate granting arrangement. In order to take this approach, the arrangement between the parties would have to qualify as a grant or subsidy for GST/HST purposes in its own right and it would be necessary that it satisfy the same criteria which were considered by the CRA when it reviewed the AFP agreements. Other non-GST/HST tax considerations might also be relevant.

- For practice plans operating as corporations, dividends and employment income are not subject to GST/HST. However corporations will have to be able to demonstrate that any contracted payments to physicians and MPCs are directly tied to the supply of clinical services, so that the payments do not attract GST/HST.

- Unless a particular practice plan can demonstrate that all of its AFP funding was distributed for a single purpose that had no GST/HST consequences, it may be necessary to make different arguments in respect of different portions of the funding distributions. In this case the CRA would expect to see some reasonable quantification as to the amount of funds that fall into each type of tax treatment. This could require the use of some accountability mechanism or tracking system to demonstrate the quantum of dollars that was distributed for particular purposes.

- Irrespective as to how a particular practice plan opts to characterize its distribution of AFP funds, it will be important that the approach taken is supported by adequate documentation. Money may flow between participants in the AFP system as a matter of long-standing practice or convenience. The CRA looks to documentation both as an indication as to the intention of the parties, as well as the framework to which the taxing provisions are applied. On audit, in the absence of proper documentation, the CRA would reach its own conclusions as to the tax consequences of particular payments, and it would then fall to the practice plan to prove the assessment incorrect. It is therefore preferable for practice plans to take the time to ensure that sufficient documentation is in place before the CRA asks for it.

- Finally, practice plans should be careful not to necessarily assume that, because the CRA considered certain payments made under the TOHAMO AFP agreement were a grant or subsidy, that all payments received from a government source will similarly be considered as such. Government departments routinely purchase goods and services and it is necessary to examine each agreement under which funding is received to verify that for GST/HST purposes, it will not be viewed as an agreement for the provision of services

We hope that the above general guidance will be of assistance to AFP practice plans. Please advise us if you have any questions or require any additional assistance.

Yours sincerely,

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