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*Canada*

## Canada to Tax Florida, Delaware Partnerships as Corporations

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### BNA Snapshot

**Development:** Canada Revenue Agency concludes that LLPs established in Delaware and Florida will be treated as corporations for Canadian income tax purposes.

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By Peter Menyasz

June 1 — Canada's tax agency will treat limited liability partnerships established in Delaware and Florida as corporations for Canadian income tax purposes, but will provide some limited relief for taxpayers that previously took a position that they qualify as Canadian partnerships.

The decision clarifies that the agency will treat LLPs and limited liability limited partnerships (LLLPs) established in those states as corporations, but still leaves them exposed to potential double taxation, as they may not qualify for some benefits under the nations' bilateral tax treaty.

Canada Revenue Agency representatives noted the decision at a May 26 conference in Montreal hosted by the International Fiscal Association, with full details expected to be published in a statement in the coming weeks, Claire Kennedy, a partner in the Toronto office of law firm Bennett Jones LLP—which co-chaired the conference session with CRA officials—said June 1.

The decision wasn't unexpected, as Canadian tax officials had indicated in 2015 that they were conducting a detailed study of their characterization of U.S. LLPs and LLLPs and were likely to maintain the position that they meet Canadian criteria for treatment as corporations, Kennedy told Bloomberg BNA in an e-mail.

“It is consistent with the Canada Revenue Agency's overall approach to foreign entity classification,” she said. “This is a continuation of CRA's overall interpretive position. What is new is that they have decided to treat Florida and Delaware LLPs and LLLPs like fiscally transparent limited liability corporations.”

The CRA confirmed June 1 that its officials announced the treatment of U.S. LLPs and LLLPs at the IFA conference, as well as the transitional measures that will apply. “In accordance with its usual practice, the CRA's Income Tax Rulings Directorate will issue more detailed written answers to the IFA conference questions within a few weeks,” agency spokesman David Walters told Bloomberg BNA in an e-mail.

### Hybrid Corporate Entities

The revenue agency's decision resolves some uncertainties about its policy, but doesn't solve ongoing problems for hybrid corporate entities that do business in both the U.S. and Canada, which is an “acute” issue given the volume of cross-border flows, Kennedy said.

The provisions in Article IV of the U.S.-Canada tax treaty that address hybrid entities, allowing access to benefits such as reductions to withholding tax rates in certain cases and denying them in others, don't provide an "elegant" solution to dealing with those problems, she said.

The tax agency's position makes the Delaware and Florida LLPs and LLLPs functionally equivalent to limited liability corporations for Canadian income tax purposes, Kennedy said. Assuming those entities don't make a check-the-box election to be taxed in the U.S. as corporations, they are "fiscally transparent" in the United States but are treated as corporations in Canada, she added.

"This means that, from a Canadian perspective, they would not be entitled to treaty benefits in their own right and the treaty entitlement of the members would be analyzed under Article IV:6 and IV:7 of the treaty," she said. "Article IV:6 is the relieving rule, but requires that the 'same treatment' condition for the income be satisfied."

If that condition isn't met, there would likely be double taxation in the U.S., as a 25 percent withholding tax applied by Canada probably wouldn't be fully creditable in the U.S., she said.

Kabir Jamal, an associate in the Toronto office of Goodmans LLP, agreed the decision wasn't surprising considering the tax agency's indication in November 2015 that it was "heavily leaning" toward that approach, and that it raises "thorny" issues similar to those for U.S. limited liability corporations.

In addition to lack of clarity on benefits under the bilateral tax treaty, it raises questions about the eligibility of such entities for Canadian foreign tax credits for taxes paid outside Canada and their tax treaty residency for Canadian tax purposes, Jamal told Bloomberg BNA in an e-mail.

"It remains to be seen how the Canada Revenue Agency will respond to these issues," he said.

### **New Transitional Relief Available**

Canadian tax officials also confirmed that the agency will provide limited administrative relief for taxpayers that have taken a position in previous tax filings that they qualify as partnerships in Canada, Jamal said.

He said they indicated that the agency will treat those entities as partnerships in Canada, retroactive to the date of their formation, if they meet the following four conditions:

- neither the entity nor its members have ever claimed the entity is anything other than a partnership for Canadian tax purposes;
- clear demonstration that the entity's members are carrying on business for profit and intend the entity to be treated as a partnership in Canada;
- the entity was formed and started business before July 2016; and
- the entity converts to a partnership recognized by the CRA—for example, a general partnership or limited partnership—before 2018.

The relief wouldn't apply to entities that were originally formed as a limited liability or other corporation and later converted to a limited liability partnership, and where no substantive change was made in the entity's legal context, Jamal said.

Kennedy stressed the importance of the transitional relief, particularly the requirement to convert to an entity that meets Canada's definition of partnership. "I suspect that the outcome here is that anyone who has one of these entities will transition out of it," she said.

To contact the reporter on this story: Peter Menyasz in Ottawa at [correspondents@bna.com](mailto:correspondents@bna.com)

To contact the editor responsible for this story: Rita McWilliams at [rmcwilliams@bna.com](mailto:rmcwilliams@bna.com)