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Tax Alert – Canada

CRA extends transitional relief for certain US partnerships

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

At the 26 April 2017 conference hosted by the International Fiscal Association (IFA) in Toronto, officials from the Canada Revenue Agency (CRA) provided clarification on transitional measures pertaining to the treatment of limited liability partnerships and limited liability limited partnerships (collectively, LLPs) as corporations for Canadian income tax purposes. In short, the CRA announced that it will generally consider LLPs formed under the laws of Delaware, Florida, or similar laws in the United States to be corporations for Canadian income tax purposes (consistent with prior positions). However, the CRA is prepared to accept LLPs formed prior to 26 April 2017 as partnerships for all prior *and future years* provided certain conditions are satisfied.

Background

At the 26 May 2016 IFA conference, the CRA announced its views on the entity classification of LLPs established under Delaware and Florida law. Citing the existence of a separate legal personality and the extensive limitation of liability afforded to all their members, the CRA stated it would treat these LLPs as corporations for Canadian income tax purposes.

For more information refer to the following EY Tax Alert:

- Tax Alert 2016-42, *CRA treats certain US partnerships as corporations*.

Building a better working world

Prior transitional relief

Prior to the 26 May 2016 announcements, the conventional view was that LLPs were considered to be partnerships for Canadian income tax purposes, and prior Canadian tax filings were usually prepared on that basis. As a transitional measure, the CRA previously announced its intent to treat LLPs as partnerships retroactive to the date of their formation if the following four conditions were met:

- Neither the entity nor its members had ever taken the position on any Canadian tax filing that the entity was anything other than a partnership for Canadian income tax purposes
- There was a clear indication that the entity's members were carrying on business for profit and intended the entity to be treated as a partnership in Canada
- The entity was formed and started to carry on business before July 2016
- The entity converted to an entity that the CRA recognizes as a partnership before 2018

This transitional measure was intended to provide some filing relief for taxpayers that had previously taken a position that LLPs qualified as partnerships in Canada. However, in all cases, LLPs were to be treated as corporations prospectively.

At the 2016 Canadian Tax Foundation (CTF) Annual Conference (27-29 November 2016) Roundtable, the CRA was asked whether LLPs that for business reasons were unable to convert to a recognized partnership form could nevertheless qualify for the retroactive transitional filing relief. The CRA responded that it had established an internal working group to study compliance issues related to the matter. The CRA indicated that it was open to a prospective approach whereby prior filings would, in certain circumstances, be allowed to stand, and it invited taxpayers and their representatives to make submissions in this regard.

26 April 2017 IFA Conference CRA Roundtable

When asked to provide an update on the working group activities at the 2017 IFA conference, the CRA announced that the compliance study undertaken by the working group was ongoing and that significant progress had been made. Explicitly recognizing some of the complexities involved with transitioning from partnerships to corporate filings, the CRA indicated its resolve to build on the prospective approach contemplated at the 2016 CTF conference by offering administrative grandfathering.

Administrative grandfathering

Under this prospective approach, any Delaware LLP or LLLP, Florida LLP or LLLP, as well as any entity formed under laws in other US jurisdictions with similar traits, that was formed before 26 April 2017 would be accepted as a partnership for all prior and future years provided that none of the following conditions are applicable:

- One or more members of the entity, or the entity itself, takes inconsistent positions from one taxation year to another, or for the same taxation year, as between partnership or corporate treatment;
- There is a significant change in the membership or the activities of the entity; or
- The entity is being used to facilitate abusive tax avoidance.

Per discussions with CRA officials, although it is a question of fact, for these purposes, an ordinary course addition or departure of a member to a LLP should generally not be considered a "significant change" in the membership of the entity.

However, if any of the preceding conditions are met, the CRA may assess the members and/or the entity on the basis that the entity is a corporation.

An LLP that has consistently filed as a corporation for Canadian income tax purposes may continue to file on that basis. Any LLP that had filed as a partnership, but chooses not to avail itself of the grandfathering and opts to file as a corporation, will be required to refile for all open taxation years. To this end, the CRA noted it may be required to make various adjustments to filed amounts to avoid the double counting of income or losses.

Conversely, any LLP formed on or after 26 April 2017 will automatically be treated as a corporation for Canadian income tax purposes.

Finally, the CRA expressed its view that Article IV(6) (a relieving hybrid entity clause) of the Canada-US tax treaty may apply in respect of any such LLP that is treated as a nonresident corporation for Canadian income tax purposes and as a fiscally transparent entity for US income tax purposes. As such, the CRA generally intends to treat LLPs in a manner similar to its published practices in respect of US limited liability companies (LLCs). As with LLCs, LLPs should also generally be considered to be nonresident corporations without share capital to which the provisions in section 93.2 of the *Income Tax Act* (Canada) — which deem nonresident corporations without share capital to have share capital in order to apply the foreign affiliate rules — ought to apply.

Looking forward

While the working group continues to consider and study related compliance issues, the administrative grandfathering measures announced at the 26 April 2017 IFA Conference in Toronto should provide much welcome relief and clarity for taxpayers seeking to comply with tax filing obligations.

Learn more

For more information on the above incentive or any other topics that may be of concern, please contact your EY or EY Law advisor, or one of the following professionals:

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