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International Tax Update

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Tax Bulletin

Below is an update for certain items discussed during the Raymond Chabot Grant Thornton international tax seminar held on April 18 and 19, and resulting from the April 26, 2017 Canada Revenue Agency (CRA) and Finance Canada (Finance) round tables of the Canadian chapter of the International Fiscal Association (2017 IFA round table). We also outline other items of interest from the 2017 IFA round table.

Unless otherwise noted, legislative references in this document are to the *Income Tax Act*, RSC, c.1 (5th Supp.) and its regulation.

Entity classification of Delaware and Florida LLPs and LLLPs

In 2016, the CRA indicated that it had completed its analysis of certain types of limited liability partnerships (LLPs) and limited liability limited partnerships (LLLPs) and concluded that they were corporations for Canadian income tax purposes. This new position created significant administrative issues.

The CRA announced administrative grandfathering at the 2017 IFA round table whereby, entities formed under these laws (or similar US laws) prior to April 26, 2017, may be treated as partnerships for all prior and future taxation periods provided that:

- No partner takes an alternative positon (i.e., treats the entity as a corporation);
- There is no significant change to the members or the activities of the entity; or,
- The entity is not being used to facilitate abusive tax avoidance.

LLPs and LLLPs formed on April 26, 2017 or later will be considered to be corporations by the CRA for Canadian income tax purposes. Additionally, the CRA indicated that such entities would benefit from paragraph IV(6) of the *United States - Canada Income Tax Convention* as they are hybrids (corporations for Canadian purposes and partnerships for US purposes).

Similarly, s. 93.2 would also apply to these entities. This provision is relevant for entities that do not have share capital such as limited liability corporations (LLCs), and makes various presumptions to ensure that the mechanics of the foreign affiliate regime are achieved.

Earnings of disregarded U.S. LLCs

During the 2016 Canadian Tax Foundation round table, the CRA indicated that it had changed its 2009 position regarding the computation of earnings for foreign affiliate purposes with respect to single-member or disregarded LLCs. In the past, the earnings of such an entity were to be computed under U.S. rules pursuant to Reg. 5907(a)(i) of the definition of earnings. Under the revised position, which was applicable for taxation years ending after August 19, 2011, earnings are to be computed using Canadian rules (i.e., as if the entity were a Canadian taxpayer) pursuant to Reg. 5907(a)(iii) of the definition of earnings. Many taxpayers and their advisors provided feedback to the CRA that such a retroactive change could have significant adverse tax consequences and increase compliance costs for them.

The CRA announced that taxpayers could use the 2009 position for taxation years ending on or before November 29, 2016, provided that this position is used for all relevant foreign affiliates of the taxpayer and for all taxpayers that are related to the taxpayer for all taxation years that ended on or before November 29, 2016. Alternatively, taxpayers can choose to apply the 2016 position and compute the earnings using Canadian rules for taxation years ending after August 19, 2011.

Where the operations of a single member LLC are significant, having to compute earnings using Canadian rules can be a significant compliance burden. By transferring one or more units to another group corporation in consideration for shares would result in the LLC being able to use the US computation to determine its earnings. Alternatively, the LLC could convert into a C corporation.

Multilateral Instrument

Finance provided limited comments on the multilateral instrument (MLI) which will impact certain key clauses of Canadian income tax treaties in the future. They did however indicate that their choices of the provisions that Canada will initially adopt will be guided by the inability to rescind these choices in the future. Hence, it is possible that Canada will choose to include only the minimum requirements under the MLI. This will allow Canada to determine what other countries are doing and, in the future, adjust the scope of the MLI provisions that Canada will later choose to follow.

We should have a clearer view of the position that Finance has decided to take with respect to the MLI at the June meeting of the Organization for Economic Co-operation and Development.

Foreign affiliate reporting (T-1134) and T106 filing

The CRA was asked if it could provide administrative relief for amalgamations of related companies or for transfers of foreign affiliate shares between related companies of a group where, within the group, the result is that foreign affiliate filing is duplicated. CRA indicated that it was not willing to provide relief.

On a more positive note, the CRA indicated that taxpayers will be able to file T-1134s electronically later this year. This will also apply for T106s (transfer pricing). One item that has not been resolved with respect to electronic filing of T-1134s is how to transmit the financial information with respect to foreign affiliates. The CRA did however indicate that it is working on the issue and hopes to resolve it soon.

Upstream loans

Many pitfalls with respect to the upstream loan provisions have been identified. These include situations where a foreign affiliate that has made a loan to its Canadian parent is sold to a third-party without having the loan repaid and loans made by lower-tier foreign affiliates that have an intermediate blocking deficit in a mid-tier foreign affiliate. Finance was asked if they would consider drafting relieving measures with respect to these types of situations. Finance indicated that at this time, they were not inclined to legislate with respect to such situations.

Other matters

- The CRA indicated that the transfer pricing provisions (s. 247) can apply notwithstanding that income has been imputed under s. 17(1). This would be the case where the loan in question did not meet the conditions outlined in s. 17(8) that require that the loan proceeds be used at all times to fund an active business or to make a loan to another foreign affiliate whose interest benefits from re-characterization to active business income pursuant to s. 95(2)(a). This comment demonstrates that the exception to the transfer pricing rules in s. 247(7) is quite limited.
- The CRA indicated that the transfer pricing provisions (s. 247) can apply to the computation of foreign accrual property income (FAPI) unless the transaction is reviewed by the taxation authority of the country in which the foreign affiliate is resident provided that the jurisdiction's transfer pricing legislation applies and that it is adopts the arm's length principle.
- The CRA confirmed that the foreign tax credit generator rules in s. 91(4.1) and following can apply to the Brazilian interest on equity provisions, provided certain facts are present.
- The CRA confirmed that all amounts paid or credited to a non-resident have to be included on information Form NR4 even if the amounts are non-taxable.
- The CRA outlined a scenario where the anti-avoidance rule in the functional currency provisions could apply.
- The CRA outlined a technical issue that could result in the s. 95(2) re-characterization rule not applying to a loan to a single member LLC where the LLC is disposed of prior to the end of the taxation year.

Your Raymond Chabot Grant Thornton advisor can help you determine which measures apply to your situation and can help you undertake the necessary steps to use them. Do not hesitate to contact us.

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