CRA confirms US LLLPs and LLPs are indeed corporations

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At the International Fiscal Association conference held in Montréal on May 26, 2016, the CRA orally announced its conclusion that US limited liability limited partnerships (LLLPs) and US limited liability partnerships (LLPs) would be classified as corporations for Canadian tax purposes. In light of similar classification of US limited liability companies (LLCs), the CRA's conclusion is not too surprising. We applaud the CRA's announcement that it will allow transitional relief for at least some affected taxpayers as we advocated in our April 22, 2016, publication and we await the further details on the relief measures when the CRA releases its written responses in the coming weeks.

Background

By way of background, our firm made a detailed submission to the CRA arguing that, consistent with the US treatment, US LLLPs should be classified as partnerships for Canadian tax purposes. Further, we have had numerous discussions with the agency over the last two years with respect to the proper classification of these entities. A high-level summary of our thoughts in this respect can be found in our previous blog. Many practitioners will be disappointed by the CRA's announcement because from certain perspectives, a US LLLP has more similarities than differences with Canadian limited partners. Also, a US LLLP provides similar liability protection to a traditional limited partnership that uses a shell corporation to hold a nominal general partnership interest, so arguably, the use of this structure makes the additional liability protection flowing from the use of an LLLP instead of an LP quite trivial.

The issues for Canadian investors in what are now hybrid entities are significant, and this CRA interpretation may prove to be costly. As discussed previously in our June 1, 2015, and April 22, 2016, blogs, the issues faced by investors in these entities may include potential double tax resulting from mismatches on the timing of income and taxation between Canada and the US, reduced availability of foreign tax credits, implications for entities with upstream loans, as well as a potential loss of treaty benefits. Effectively this decision kills any future investment by Canadians into US LLLP or LLPs, and will create additional complexities for Canadians who are currently invested in these entities – even if they fall into the relatively narrow transitional relief provisions that were announced.

Transitional relief provisions

CRA has clearly realized that their classification of US LLLPs and LLPs as corporations will create significant hardship for many taxpayers. Consequentially, the CRA orally announced that short-term grandfathering provisions which will administratively allow taxpayers to treat US LLLPs as partnerships, provided the following conditions are met:

1. The LLLP or LLP was formed before July 2016 and it carried on business before that time;
2. The taxpayers intended the LLLP or LLP to be classified as a partnership for Canadian tax purposes;
3. The LLLP or LLP and each of its owners has treated the entity as a partnership for Canadian tax

purposes; and
4. The LLLP or LLP converts to an entity that the CRA recognizes as a partnership no later than 2018.

We welcome the news that at least some limited administrative relief will be available to a certain subset of Canadians who have invested in these entities. As we discussed in our April 22, 2016, blog it is relatively easy in the US to convert from a US LLLP to a US LP without tax consequences, and similarly, Canada has historically allowed conversion from one type of foreign partnership to another without tax implications; as it appears the CRA is contemplating. So to the extent that Canadians control a US LLLP or LLP, it appears the administrative relief contemplated may be useful. Unfortunately, unless there is more to these grandfathering provisions when they are formally released, what was announced yesterday will offer little in the way of relief for Canadian taxpayers with a minority investment into one of these entities. It is unlikely that US investors will agree to forgo the additional liability protection that is offered through an LLLP or LLP by converting to another form of partnership.

Stay tuned for our more detailed assessment of the impacts and potential solutions once the CRA makes their detailed written release in respect of the potential application of the grandfathering provisions.