

# CRA's new position on US LLLPs and LLPs

July 2016

On May 26, 2016, the Canada Revenue Agency (CRA) announced that it will consider Florida and Delaware limited liability limited partnerships (LLLPs) and US limited liability partnerships (LLPs) to be corporations for Canadian tax purposes. Presumably, other LLPs and LLLPs will be treated similarly. Recently, US LLLPs and LLPs have been used by Canadians as a common structure for investing in US real estate. The CRA's new administrative position may make investments into US LLLPs or LLPs by Canadians unattractive, and may require additional planning for those who currently hold an interest in a US LLLP or LLP.

## Consequences

For Canadian taxpayers with an interest in a US LLLP or LLP, the tax consequences of this new administrative position may potentially result in the structure being significantly less tax efficient than intended. The interest held by a Canadian in a US LLLP or LLP is now considered by Canadian tax authorities to be an interest in a corporation, but is still considered by US tax authorities to be a flow through entity. This mismatch in entity classification creates the potential for less-than-favourable tax treatment, particularly where the entity earns passive income—such as a real estate or investment business. It raises concerns regarding tax residency of the entity, as well as the availability of foreign tax credit relief and denial of treaty benefits on the basis that a US LLLP or LLP is not subject to taxation in the US but is opaque for Canadian tax purposes.

If no action is taken prior to the end of the transitional period, the LLLP or LLP may be exposed to rules such as the upstream loan rules in a manner that it was not exposed to prior to the CRA's announcement. There may also be additional compliance issues created as the LLLP or LLP may be required to file information returns in respect of foreign affiliates and may need to file a Canadian tax return if carrying on business in Canada.

## Transitional relief

Accompanying the classification announcement, the CRA announced transitional relief that will apply to US LLLPs and LLPs that were formed before July 2016, and were carrying on business as an entity that would be treated for Canadian tax purposes as a partnership, that will permit them to continue to be classified as partnerships for Canadian tax purposes until the end 2017. Relief is not available if the US LLLP or LLP converted from a LLC or C-corp or if it would be abusive. However, these US LLLPs and LLPs must convert to an entity that the CRA recognizes as a partnership by 2018 to continue receiving partnership treatment for Canadian tax purposes.

A US limited partnership (LP), in many instances, will be the preferred business vehicle to transition to in response to the CRA's new position. Based on preliminary discussions with US legal counsel, it should be possible in most states to transition from a US LLLP or LLP to a limited or general partnership without a legal disposition of assets or partnership interests and without interruption to the legal personality of the partnership. This should be confirmed with legal counsel prior to effecting any change. Taxpayers with non-controlling or minority interests may not have the ability to reorganize the US LLLP or LLP, but may still have some alternate options to restructure their holding of the US LLLP or LLP interest to mitigate the effect of this administrative position.

### How we can help

If you have invested in a US LLLP or LLP, it will be necessary to review the implications of the new administrative position to your investment and consider which restructuring option makes sense. If you would like to learn more about this matter, please consult with your tax advisor.

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