



Mr. Pierre Bourgeois
PricewaterhouseCoopers LLP
Chartered Accountants
1250 René-Levesque Blvd. West, Suite 2800
Montréal QC H3B 2G4

Your file / Votre référence

Our file / Notre référence

Sophie Chatel
2004-007310

February 24, 2005

Dear Mr. Bourgeois:

Re: Partnership Property – FAPI

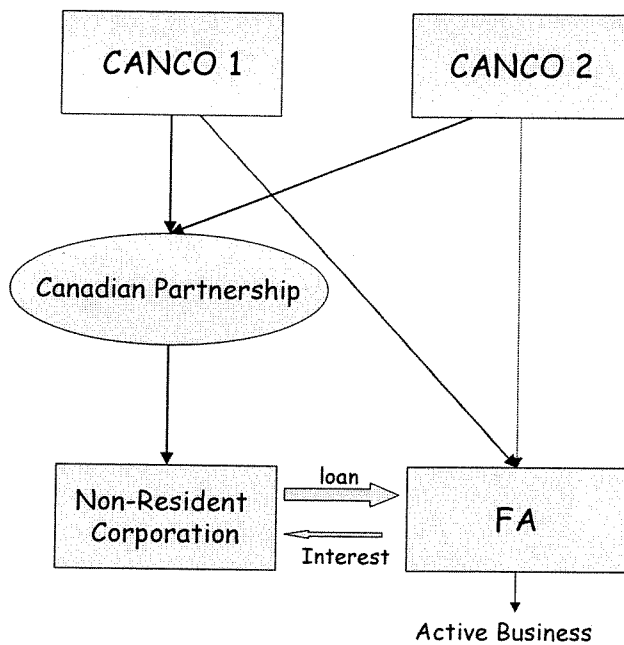
At the IFA International Tax Seminar in Montreal on May 10, 2004, the CRA was asked to answer a question in respect of section 93.1 of the Income Tax Act (Canada) as described below. At that time, our review was not completed and we were not in position to provide a response. We are now sending you our views as you were on the relevant IFA panel.

Question

Absent the provisions of section 93.1, where a Canadian partnership owns all the shares of a non-resident corporation, such corporation could not qualify as a foreign affiliate of the partners of the partnership. Section 93.1 was introduced into the Act in order to deal with partnerships in foreign affiliate structures and change this result by deeming shares owned by a partnership to be owned by corporate partners in proportion to the fair market value of such partners' respective interests in the partnership. However, subsection 93.1 applies only "for the purpose of determining whether a non-resident corporation is a foreign affiliate of a corporation resident in Canada for the purposes of ...sections 93 and 113...(and any regulations made for the purposes of those provisions), section 95 (to the extent that that section is applied for the purposes of those provisions)...".

Example

Where a Canadian partnership with Canadian resident corporate partners acquires all the shares in a non-resident corporation during a taxation year of that corporation and such non-resident corporation has income from property described in subparagraphs 95(2)(a)(i) to (iv), will section 93.1 apply for the purposes of subsection 95(2.2) and paragraph 95(2)(a) to create the result that the throughout the taxation year test is met with respect to the related and qualifying interest tests in the year that the foreign corporation becomes a foreign affiliate of the partners of the Canadian partnership for the purposes described in 93.1? Please consider the question in the context of the following example.



CRA's Answer

In this example the application of the provisions of paragraph 95(2)(a) and other rules relevant to the computation of foreign accrual property income (FAPI) would be applied to the non-resident corporation vis-à-vis the partnership to determine whether the partnership income includes income described in subsection 91(1). Many of those same rules would then be applied a second time to the non-resident corporation vis-à-vis Canco 1 and Canco 2 to determine character of the income of the non-resident corporation for purpose of computing the affiliate's surplus accounts in reference to those corporations for the purposes of Regulation 5907 and section 113. Our response deals with the latter application.

Section 93.1 applies for the purpose of determining whether the non-resident corporation is a foreign affiliate for the purposes of section 95, but only to the extent that that section is applied for the purposes of provisions 93.1(2), and 20(12), sections 93 and 113, paragraph 128.1(1)(d).

Since paragraph 95(2)(a) may be applicable to the determination of the character of the interest income of the non-resident corporation for the purpose of determining the surplus accounts of that corporation and any deduction under subsection 113(1), it is our view that section 93.1 applies for the purpose of paragraph 95(2)(a) and deems the shares of the non-resident corporation to be owned by Canco 1 and Canco 2 for the purpose of determining whether the non-resident corporation is a foreign affiliate.

However, section 93.1 is of no assistance to the other requirements of paragraph 95(2)(a) such as whether a taxpayer has a qualifying interest throughout the year in a foreign affiliate ("qualifying interest test") or whether a taxpayer and a particular affiliate are "related" to a non-resident corporation throughout the year ("related test").

(a) Qualifying Interest Test

In the above example, Canco 1 and Canco 2 must have "*a qualifying interest throughout the year*" in the non-resident corporation in order that subparagraphs 95(2)(a)(ii) may deem the interest income from the loan to FA to be active business income.

"Qualifying interest" is defined in paragraph 95(2)(m) in respect of a foreign affiliate and requires that the taxpayer owns shares of such affiliate having at least 10% of the votes and fair market value of all shares of the affiliate. For the purpose of the test in paragraph 95(2)(m), subparagraph (iv) thereof deems the shares of a non-resident corporation that are property of a partnership to be owned by each member of the partnership in proportion to the particular partner's respective share of the partnership income or loss in the relevant period.

Assuming that Canco 1 and Canco 2 do have a qualifying interest in respect of the non-resident corporation at the end of the year, they would be deemed to have had such qualifying interest “*throughout the year*” of the non-resident corporation if subsection 95(2.2) deems this to be so. Subsection 95(2.2) will apply to deem Canco 1 and Canco 2 to have a “qualifying interest throughout the year” in the non-resident corporation if “*a person*” has acquired or disposed of shares of that non-resident corporation and because of that acquisition or disposition the non-resident corporation became or ceased to be a foreign affiliate of Canco 1 and Canco 2 in respect of which they had a qualifying interest.

In this case it was the partnership that acquired the shares of the non-resident corporation. Under the common law, a partnership is not a person. For the purpose of computing a partner’s *income*, paragraph 96(1)(a) deems a partnership to be a separate person, but such deeming rule does not apply for the purpose of computing *taxable income*. In this case the objective of applying subsection 95(2.2) is the determination of the non-resident corporation’s surplus accounts for the purposes of section 113 and section 113 provides for a deduction in computing taxable income. The rule in paragraph 96(1)(a) deeming the partnership to be a person does not apply for this purpose.

Under the common law, the partners collectively own the partnership property and therefore, when the partnership in the above example acquired the shares of the non-resident corporation, the partners are considered to have acquired those shares collectively. This principle, together with the principle of statutory interpretation under which words in the singular include the plural, leads us to conclude that the persons referred to in subparagraph 95(2.2)(a)(i) for the above example would be the partners collectively. Subparagraph 95(2.2)(a)(i) says “a person [*or “persons” (i.e. the partners together)*], has [*or have*] in that year, acquired or disposed of shares”. Since in our example the partners have collectively acquired the shares of a non-resident corporation, the requirements for the application of subparagraph 95(2.2)(a)(i) have been satisfied. Therefore, assuming Canco 1 and Canco 2 have a “qualifying interest” in the non-resident corporation at the end of the year, they would be deemed to have such qualifying interest throughout the year pursuant to subsection 95(2.2).

(b) Related Test

As mentioned earlier, in cases involving the operation of subparagraphs 95(2)(a)(i) to (iv) that require a non-resident corporation to be “related” to a particular affiliate and a taxpayer throughout the year, section 93.1 would be of no assistance. However, in the above example, subsection 95(2.2) would operate to deem the non-resident corporation

to be related to Canco 1 and/or Canco 2 and FA throughout the year if as a result of the acquisition of the shares of the non-resident corporation by the partnership, the non-resident corporation became related to Canco1 and/or Canco 2 and FA.

We trust our comments will be of assistance to you.

Yours truly,

A handwritten signature in black ink, appearing to read "O. Laurikainen", followed by a horizontal line.

Olli Laurikainen
Section Manager
for Division Director
International and Trusts Division
Income Tax Rulings Directorate
Policy and Planning Branch