



## Working with Partnerships: A Survey of Select CRA Positions

May 19, 2011  
Michael McLaren and Marc Ton-That

### Goal of Presentation

---

- Provide a survey of recently published CRA positions (TIs and rulings) involving partnerships in a cross-border context.
- Only relationships classified as partnerships under Canadian law are considered. That is, LLCs and ULCs are not the focus of this survey.
- Some outbound situations are covered. For other outbound aspects, please refer to previous publications on this subject.

## Overview of Presentation

---

- Structuring After the 5<sup>th</sup> Protocol
- Outbound Issues
- Other General Issues

3

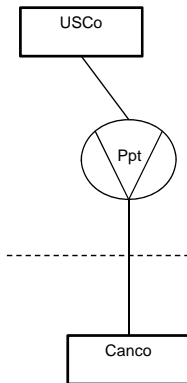
## Structuring After the 5<sup>th</sup> Protocol

### Publications Discussed:

- |   |                                   |
|---|-----------------------------------|
| - US Partnership as C-Corp                  | 2008-0272871C6, July 18, 2008     |
| - US Partnership as C-Corp- Branch Tax      | 2009-0339951E5, October 26, 2010  |
| - CDN Partnership as C-Corp - Interest      | 2009-0318491I7, November 13, 2009 |
| - CDN Partnership as C-Corp – PE Protection | 2009-0318491I7, November 13, 2009 |
| - Limitation on Benefits                    | 2007-0262141E5, April 15, 2009    |
| - Tiered Partnerships—Dividends             | 2009-0318701E5, July 13, 2009     |
| - Management Fee Paid by ULC                | 2009-0345901R3, December 15, 2009 |

4

## Post Protocol: US Partnership as C-Corp



**Document:** 2008-0272871C6 (July 18/08)

**Facts:**

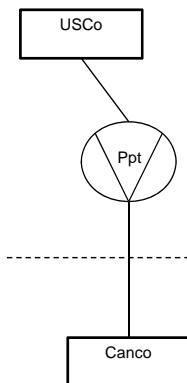
- US partnership treated for the purpose of the IRC as a US domestic corporation (i.e., it checks the box) and therefore subject to US tax on worldwide income (in accordance with *Crown Forest*).

**Issue:**

- Whether the partnership is entitled to treaty benefits?

5

## Post Protocol: US Partnership as C-Corp

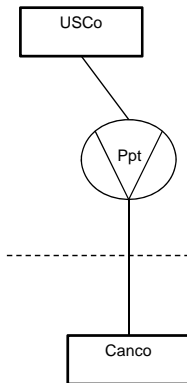


**CRA Position:**

- Partnership treated as a resident of the US pursuant to Article IV(1) since it is a "person" (Article III; body of persons) that is subject to tax on its worldwide income by reason of ...[similar criterion].
- Provided Partnership is a "qualifying person" (Article XXIX A), the partners can claim treaty benefits based on Partnership's eligibility for such benefits.
  - See also 2008-0278801C6 (2008 STEP question #18).
- Where a partner is entitled to greater benefits, the CRA will look through the partnership and allow partners to claim treaty benefits based on their own eligibility.

6

## Post Protocol: US Partnership as C-Corp



### Discussion Points:

- Reconcile partner eligibility with Article IV(7)(a)?

*An amount of income, profit or gain shall be considered not to be paid to or derived by [USCo] where...[USCo] is considered under the taxation law of Canada to have derived the amount through an entity that is not a resident of the US, but by reason of the entity not being treated as fiscally transparent under the laws of the US, the treatment of the amount under the taxation law of the US is not the same as its treatment would be if that amount had been derived directly by that person*

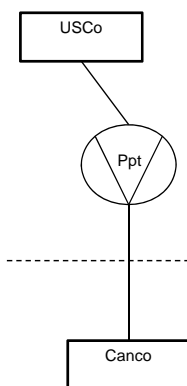
A: Yes. Ppt is a resident of the US for the purposes of the treaty, therefore IV(7)(a) not applicable

- How is a Partnership that elects to be taxed as a C-corp a "qualifying person" for the purposes of the treaty (i.e., Article XXIX(a)(2) does not list partnerships)?

A: Treated as a "company" as defined. How so? "company" defined in Article III(1)(f) as a body corporate or any "entity" treated as a body corporate.

7

## Post Protocol: US Partnership as C-Corp



### Discussion Points:

- Beneficial Ownership: 2007 Technical Explanation

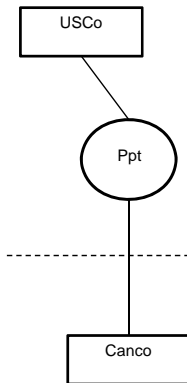
- "Beneficial owner" defined under the laws of the source state.
- If nominee recipient, look to ultimate beneficial owner

- Beneficial Ownership: dividends/interest/royalties:

- If Ppt is the beneficial owner of the payment, then the Ppt will be eligible for the reduced withholding rates
- If the Ppt is not the beneficial owner of the payment, then apply CRA position and apply the reduced withholding rates at the partner level, provided that the partner is the beneficial owner of the payments.

8

## Post Protocol: US Partnership as C-Corp

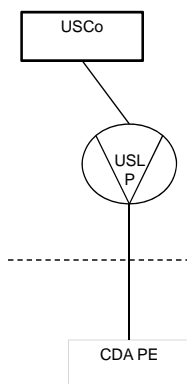


### Discussion Points- Building on the Example:

- What if Ppt is fiscally transparent under US law?
- Article IV(6) applies and deems USCo to derive the "income, profit or gain".
- USCo may qualify for relief if LOB provisions met.
- Beneficial owner (dividends, interest, royalties): 2007 TE (treaty meaning in fiscally transparent situations).
  - Canadian principles of beneficial ownership apply to determine whether USCo is beneficial owner. If USCo would not be treated under Canadian law as nominee, agent, custodian, conduit etc., then USCo will be treated as beneficial owner of the income for the purposes of the treaty.

9

## Post Protocol: US Partnership as C-Corp- Branch Tax



### Document: 2009-0339951E5 (Oct 26/10)

#### Facts:

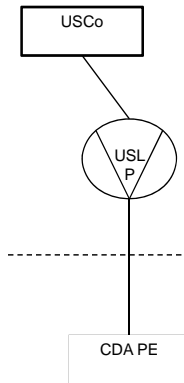
- USCo is a resident of the US and is a member of USLP that carries on business in Canada through a Canadian PE.
- USLP is a partnership for Canadian tax purposes but has elected to be taxed as a US domestic corporation for US tax purposes.

#### Issue:

- Does Article X(6) (i.e., \$500k exemption and 5% reduced rate) apply?

10

## Post Protocol: US Partnership as C-Corp- Branch Tax



### CRA Position:

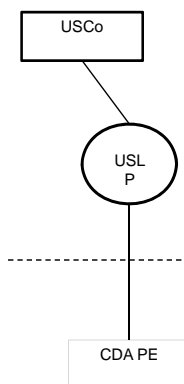
- USCo subject to Canadian tax on income earned as a member of USLP.
- USCo may qualify for Article X(6) relief if it is a qualifying person (XXIX-A(2)) or active trade or business test met (XXIX-A(3)).

### Discussion Points:

- Ignoring the partnership.
- Reason: Branch tax imposed on USCo under Canadian domestic law. Treaty treatment of USLP as a corp does not modify the domestic treatment (see e.g., *4145356 Canada Ltd.*).
- Note: Article IV(7)(a) does not apply.

11

## Post Protocol: US Partnership as C-Corp- Branch Tax

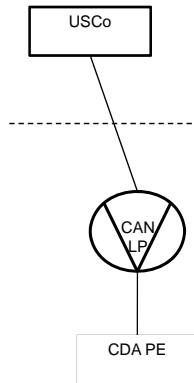


### Discussion Points:

- What if USLP is fiscally transparent?
- USCo may qualify for relief if LOB provisions met.
- Article IV(6) also applies.
- Same result is USLP is Canadian fiscally transparent LP. Article IV(6) also applies.

12

## Post Protocol: US Partnership as C-Corp- Branch Tax

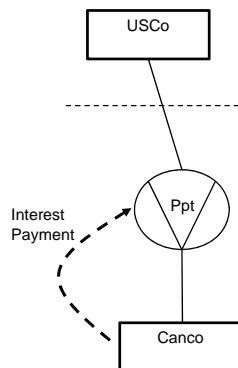


### Discussion Points:

- What of USLP is CANLP?
- Is Article IV(7)(a) relevant? (i.e., can USCO get Article X(6) relief if income not "derived by" USCO for the purposes of the treaty?)

13

## Post Protocol: CDN Partnership as C-Corp- Interest



### Document: 2009-031849117 (Nov 13/09)

#### Facts:

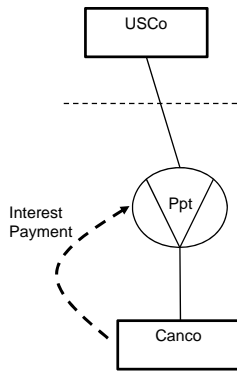
- USCo is a partner in a partnership formed under Canadian law.
- Partnership treated for the purpose of the IRC as a foreign corporation (i.e., it checks the box) and therefore is not subject to US tax at the USCo level (unless CFC rules apply).

#### Issue:

- Since Partnership is not a "Canadian partnership", 212(13.1)(b) deems it to be a non-resident; therefore, withholding tax.
- Whether treaty benefits available on payment of interest (dividends, license fee) made by Canco.

14

## Post Protocol: CDN Partnership as C-Corp- Interest



### **CRA Position:**

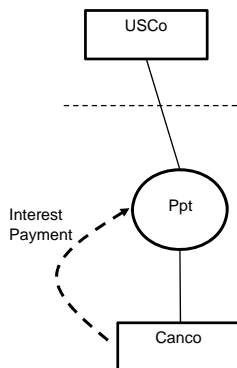
- The US tax treatment of the interest payment is not the same as it would be if USCo had derived the interest directly.
- Article IV(7)(a) applies and therefore the interest is deemed not to be derived by USCo. Treaty benefits not available (partnership not a resident of US for purposes of the treaty).
- Conclusion would not change if USCo included an amount in income by virtue of the US CFC rules.

### **Note:**

- Different from previous document since Partnership is not a resident of the US for the purposes of the treaty.

15

## Post Protocol: CDN Partnership as C-Corp- Interest



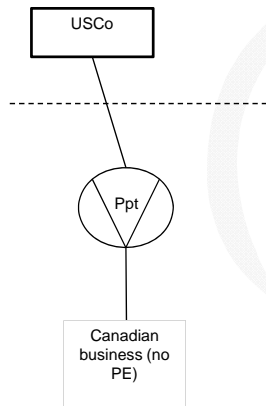
### **Discussion Points:**

- What if Ppt is fiscally transparent under US law?
- If USCo meets LOB provision and is beneficial owner of the interest income, reduced treaty rate available.
- Article IV(6) also applies.
- Article IV(7)(a) not applicable (same treatment and fiscally transparent).
- Beneficial owner: 2007 TE.
  - Canadian principles of beneficial ownership apply to determine whether USCo is beneficial owner. If USCo would not be treated under Canadian law as nominee, agent, custodian, conduit etc., then USCo will be treated as beneficial owner of the income for the purposes of the treaty.

16



## Post Protocol: CDN Partnership as C-Corp- PE Protection



**Document:** 2009-031849117 (Nov 13/09)

**Facts:**

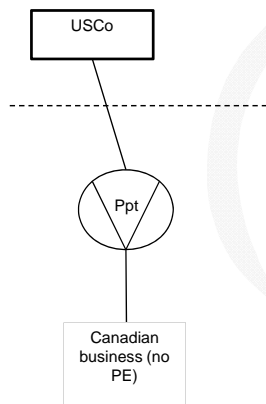
- USCo is a partner in a partnership formed under Canadian law.
- Partnership treated for the purpose of the IRC as a foreign corporation (i.e., it checks the box).
- Partnership carries on business in Canada; however, business not carried on through a PE in Canada.

**Issue:**

- USCo includes its share of partnership income under the ITA.
- Whether treaty exemption for business profits not carried on through a PE available?

17

## Post Protocol: CDN Partnership as C-Corp- PE Protection

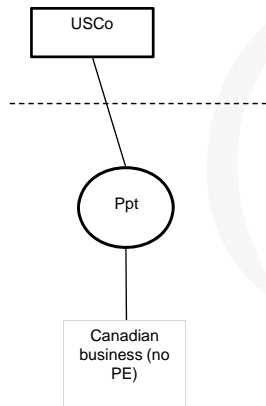


**CRA Position:**

- The US tax treatment of the business profits is not the same as it would be if USCo had derived the income directly.
- Article IV(7)(a) applies and therefore the income from the Canadian business is not considered to be derived by USCo. Treaty benefits not available.

18

## Post Protocol: CDN Partnership as C-Corp- PE Protection

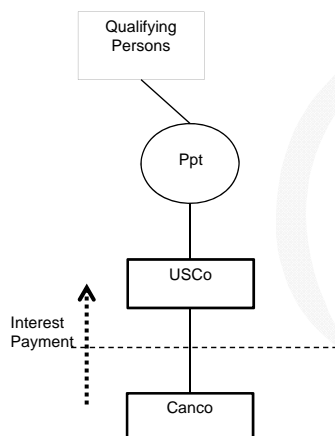


### Discussion Points:

- What if Ppt is fiscally transparent under US law?
- USCo may qualify for relief if LOB provisions met.
- Article IV(7)(a) not applicable (same treatment and fiscally transparent).
- Article IV(6) also applies.

19

## Post Protocol: Limitation on Benefits



### Document: 2007-0262141E5 (Apr 15/09)

#### Facts:

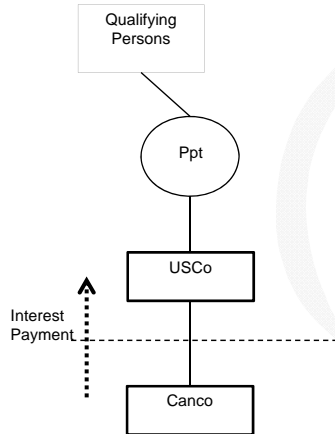
- All of the shares of USCo are held by a U.S. partnership. Each of the partners is a "qualifying person" within the meaning of paragraph 2 of XXIX A. A non-arm's length Canadian corporation will pay interest to USCo.

#### Issue:

- Whether presence of Partnership disqualifies USCo from being a qualifying person pursuant to XXIX-A(2)(e)(i) (ownership and base erosion test).

20

## Post Protocol: Limitation on Benefits

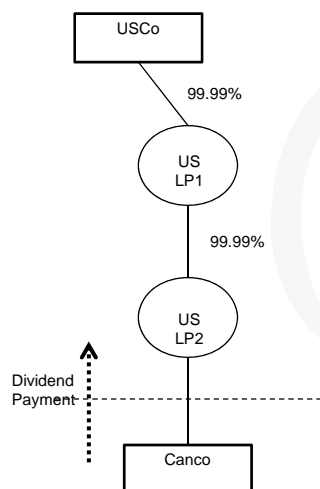


### CRA Position:

- Partnership is a "person" under Article III(1)(e)
- Article XXIX-A(2) does not list partnerships
- Under common law partners are collective owners of the partnership property
- Principles of Article IV(6) to be taken into account when applying the ownership and base erosion tests of Article XXIX-A (adoption of 2007 TE).
- Therefore, an entity that is viewed as fiscally transparent under the domestic laws of the state of residence (other than entities resident in the state of source) is to be ignored when applying the ownership and base erosion test.
- See also 2008-0278801c6 (2008 STEP, q.17)

21

## Post Protocol: Tiered Partnership- Dividends



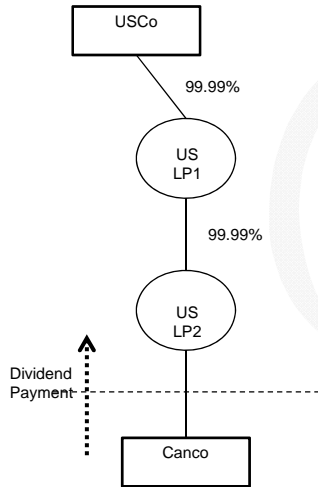
### Document: 2009-0318701E5 (July 13/09)

#### Facts:

- USCo holds a 99.99% interest in USLP1. USLP1 holds a 99.99% interest in USLP2. USLP2 owns 100% of Canco.
- Prior to Fifth Protocol, where a partner was a company, Article X(2)(a) reduced 5% rate of withholding tax "would not apply with respect to dividends beneficially owned by the company if the dividends were paid to the partnership unless the company directly owned at least 10% of the dividend payer's voting stock".
- Following Fifth Protocol, X(2)(a) now provides that a USCo which beneficially owns dividends paid by a Canco will be considered to own the voting stock of the Canco owned by an entity that is considered fiscally transparent under the laws of the United States, but not resident in Canada, in proportion to USCo's "ownership interest" in the entity.

22

## Post Protocol: Tiered Partnership- Dividends



### Issue:

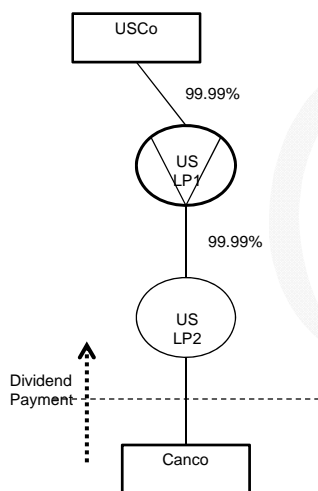
- In order for Article X(2)(a) 5% treaty rate to apply USCo needs to hold an “ownership interest” in USLP2 such that it will hold 10% of Canco.
- “Ownership interest” not defined.

### CRA Position:

- 212(13.1)(b) partnership deemed to be non-resident person—dividend subject to withholding tax.
- USCo considered to hold an “ownership interest” in USLP2 by virtue of holding an interest in USLP1.
- USCO's proportionate interest in USLP2 would be equal to 99.99% of the 99.99% partnership interest USLP1 holds in USLP2. Therefore, the 5% reduced rate of withholding will apply in respect of the dividend paid by Canco to USLP2.

23

## Post Protocol: Tiered Partnership- Dividends

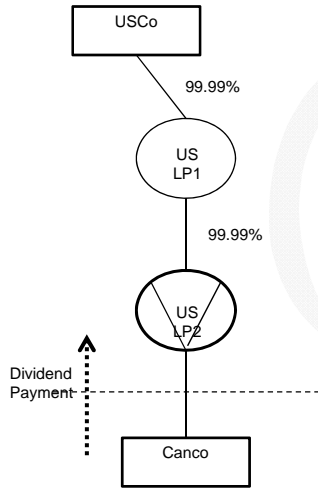


### Discussion Points:

- What if USLP1 is treated as a domestic C-Corp?
- USLP1 is the company for the purposes of Article X(2)(a) and USLP1 is deemed to own the shares of Canco. If USLP1 is the beneficial owner of the dividend, then reduced wht available b/c Article IV(6) will deem USLP1 to derive the income.
- If USLP1 not beneficial owner look to partners (2008-0272871c6).

24

## Post Protocol: Tiered Partnership- Dividends

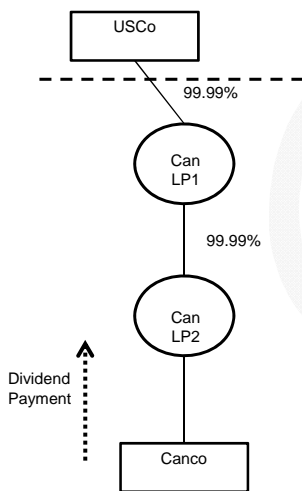


### Discussion Points:

- What if USLP2 is treated as a domestic C-Corp?
- See previous positions. If beneficial owner and qualifying person, then USLP2 entitled to treaty benefits. Otherwise look to partners.

25

## Post Protocol: Tiered Partnership- Dividends

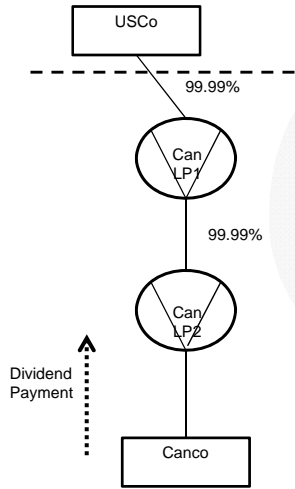


### Discussion Points:

- What if USLP1 and USLP2 both Canadian LPs and fiscally transparent?
- Based on this provision, USCO deemed to have an ownership interest in Canco.

26

## Post Protocol: Tiered Partnership- Dividends

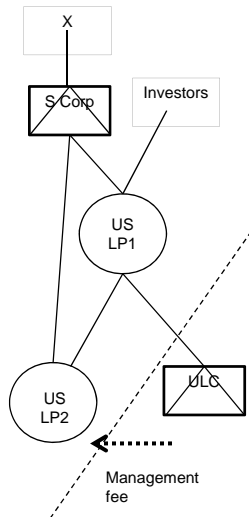


### Discussion Points:

- What if USLP1 and USLP2 are both Canadian LPs and treated as foreign C-Corps?
- Article IV(7)(a) prevents treaty relief

27

## Post Protocol: Management Fee Paid by ULC



### Document: 2009-0345901R3 (Dec 15/09)

#### Facts:

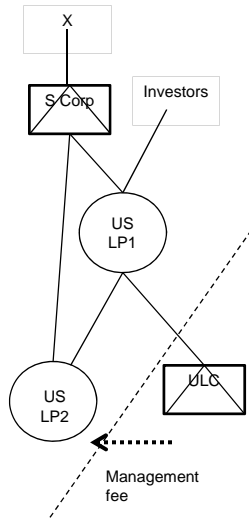
- X, a resident of the United States, owns all of the shares of S Corp. S Corp is a limited partner of USLP1 and USLP2.
- USLP1 and USLP2 both fiscally transparent under US law.
- USLP1 owns all of the shares of ULC and an interest in USLP2.
- ULC pays management fee to USLP2 in consideration for services provided by USLP2 outside of Canada.

#### Issue:

- Whether Article IV(7)(b) applies to deny treaty benefits.

28

## Post Protocol: Management Fee Paid by ULC

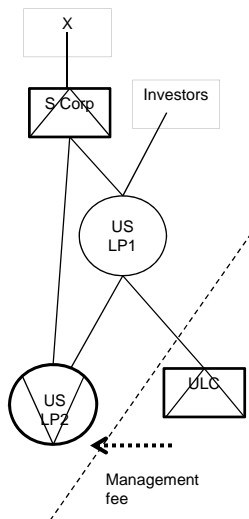


### CRA Position:

- Management fee is recognized as an item of income to USLP2 under the income tax laws of the United States in the same manner as it would if the ULC were not fiscally transparent.
- That is, quantum and character of the management fee and the timing of its inclusion in income of USLP2 (and recognition in hands of X and investors) is the same as it would be if ULC were not fiscally transparent.
- Article IV(7)(b) will not apply to the fee.
- GAAR will not apply.

29

## Post Protocol: Management Fee Paid by ULC



### Discussion Points:

- What if USLP2 were treated as a domestic C-Corp?
  - Article IV(7)(b) does not apply because same treatment test is met
  - Article IV(7)(a) not applicable because the same treatment test met and resident of the US.

30

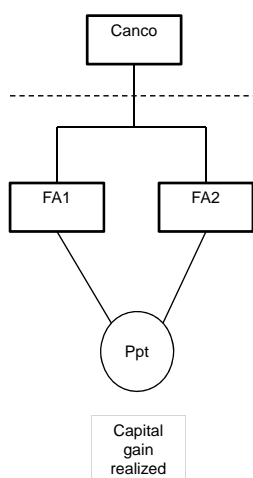
# Outbound Issues

## Publications Discussed:

- |  |                                     |
|--|-------------------------------------|
| - FA Partner and Partnership Capital Gain  | 2008-0302851E5, March 10, 2011      |
| - FAPI Imputation                          | General Principles                  |
| - Foreign Affiliate Financing              | General Principles                  |
| - Tiered Partnership and Excluded Property | 2006-016857, September 1, 2009      |
| - FTC Generators                           | 4145356 Canada Ltd., April 21, 2011 |
| - Foreign Affiliate Financing              | Futures Electronics, Pending        |

31

## Outbound: FA Partner and Partnership Capital Gain



### Document: 2008-0302851E5 (Mar 10/11)

#### Facts:

- Canco owns FA1 and FA2.
- FA1 and FA2 each hold 50% of partnership.
- Partnership disposed of capital property and realized a capital gain.

#### Issue:

- Is exempt portion of the capital gain included in FA1 and FA2 exempt earnings?

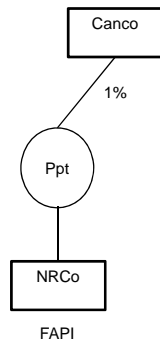
#### CRA Position:

- 96(1) is silent with respect to a partner's share of a capital gain realized by a partnership for surplus computation purposes.
- FA1 and FA2 should include their share of the capital gain in the computation of exempt earnings.

32



## Outbound: FAPI Imputation



**Document:** General Principles- see e.g., 2004-0073101E5

**Facts:**

- Canco owns 1% of Ppt.
- Ppt owns 100% of NRCo.
- NRCo earns FAPI

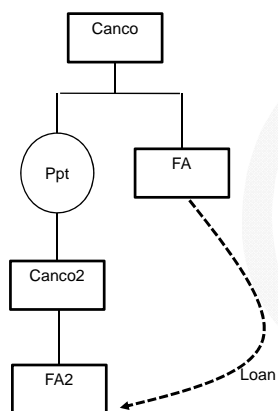
**Issue:**

- Does Canco include FAPI of NRCo in income?

**Discussion:**

- Canco includes its share of partnership income in income. This includes FAPI included the Ppt's income.
- If Canco held the shares of NRCo directly, then no FAPI imputation.

## Outbound: Tower Financing (Revised Thinking)



**Current Thinking on FA Financing**

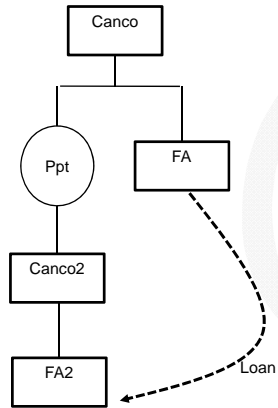
**Facts:**

- Canco holds all interests in Ppt (indirectly through GP) and all of the shares FA
- Ppt owns all of the shares of Canco2
- Canco 2 owns all of the shares of FA2
- FA lends to FA2 at interest.

**Issue**

- Application of s.95(2)(a)(ii) to the interest income received by FA

## Outbound: Tower Financing (Revised Thinking)

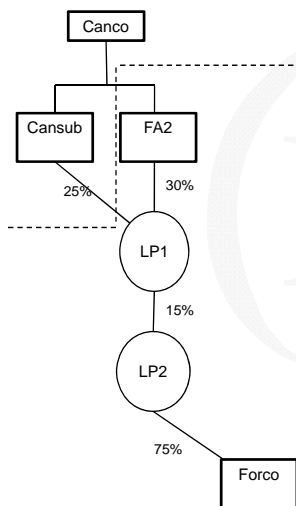


### Discussion:

- Recharacterization available. Two ways:
- First way:
  - FA2 is a foreign affiliate of Canco2 in respect of which Canco2 has a qualifying interest;
  - FA is a foreign affiliate of Canco in respect of which Canco has a qualifying interest ;
  - Canco2 is related to Canco [control through GP]; and
  - By virtue of s.95(2)(n), FA2 is a foreign affiliate of Canco in respect of which Canco has a qualifying interest.
- Second way:
  - The Canco2 shares held by Ppt are deemed to be held by Canco (s.95(2)(y));
  - S.95(2)(y) should also apply for the purpose of the definition of foreign affiliate and qualifying interest (see e.g., *Olsen* (FCA) in connected context);
  - Therefore FA2 is a foreign affiliate of Canco in respect of which Canco has a qualifying interest

35

## Outbound: Tiered Partnership and Excluded Property



### Document: 2006-016857 (Sept 1/09)

#### Facts:

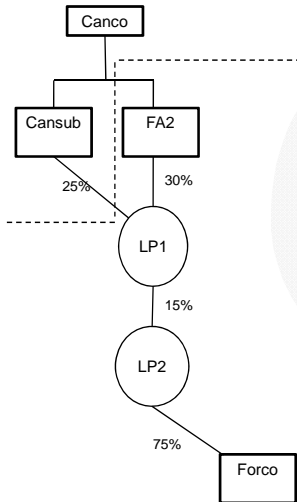
- Canco, holds 100% of FA1.
- FA1 holds 25% of the shares of Forco.
- FA2 is the GP of LP1 and holds a 30% interest.
- Cansub holds a 25% interest in LP1.
- LP1 is the sole GP of LP2 and holds a 15% interest in LP2.
- LP2 holds 75% of the shares of Forco

#### Issue:

- Will gains realized by LP2 on the disposition of Forco shares be considered to be gains from the disposition of excluded property?

36

## Outbound: Tiered Partnership and Excluded Property

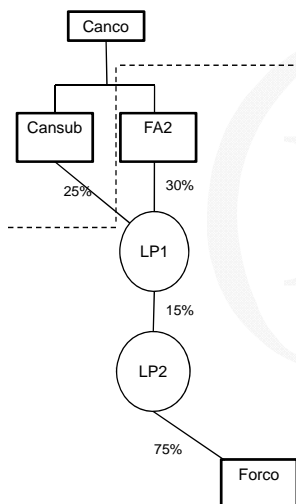


### CRA Position:

- LP1 deemed to be a non-resident corporation and FA2 deemed to own 30% of the shares of LP1. Canco, therefore, has equity percentage in LP1 of 30%, making LP1 a foreign affiliate of Canco.
- LP2 deemed to be a non-resident corporation. LP1 is therefore deemed to own 15% of the shares of LP2. Canco, therefore, has an equity percentage in LP2 that is not less than 1% (30% of 15%).
- Canco not considered on its own to have greater than 10% equity percentage in LP2. Only way would be if Canco were related to LP1.
- Deeming provisions in (d) and (e) of the definition of excluded property do not apply to treat a partnership as a corporation for the purposes of the related test.
- LP2 not a foreign affiliate of Canco and capital gains arising on a disposition of the shares of Forco by LP2 would not be gains from the disposition of excluded property.

37

## Outbound: Tiered Partnership and Excluded Property

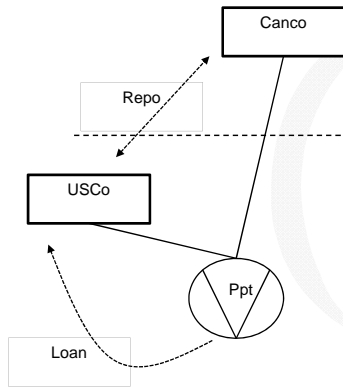


### Discussion Points:

- A partnership is deemed to be a corporation for purposes of determining excluded property status but the deeming rule does not go as far as deeming the partnerships to be related to Canco for purposes of determining the excluded property status.
- If LP1 and LP2 were corporations, LP2 and Forco would be a foreign affiliate of Canco.

38

## Outbound: Foreign Tax Credit Generator



### **Case: 4145356 Canada Ltd. (April 21/11)**

#### **Facts:**

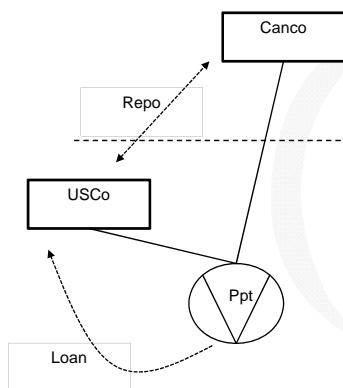
- Canco and USCo partners of Ppt.
- Ppt checks-the-box to be treated as a C-Corp for US tax purposes.
- Ppt loans money to USCo and Ppt earns interest income.
- Ppt pays US tax on the interest income.

#### **Issue:**

- Is Canco entitled to FTC under s.126(2)?

39

## Outbound: Foreign Tax Credit Generator

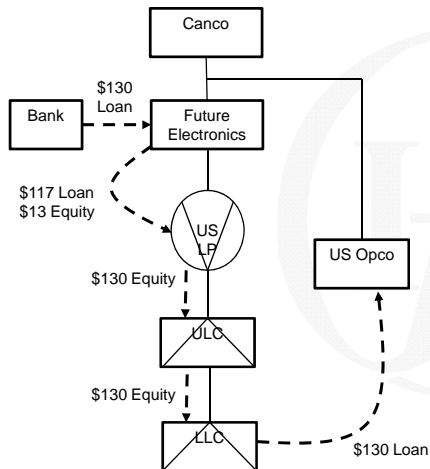


#### **TCC Decision:**

- Canco's income is to be determined under s.96 even though Ppt is a separate legal entity under US law.
- There is no distinction in s.96 between partnerships which under the laws under which the partnership was formed are separate legal entities and those that are not separate legal entities.
- Since the income of Canco is its share of the income of the Ppt, in determining whether Canco paid foreign taxes in relation to that income, the amount of foreign taxes paid by Canco should be its share of the foreign taxes paid by the Ppt in relation to the income
- The purpose of s.126 is to avoid double taxation of the same income and therefore to fulfill this purpose, Canco should be treated as having paid the taxes to the US government that were paid in relation to its income.

40

## Outbound: Tower Financing- Pending Decision



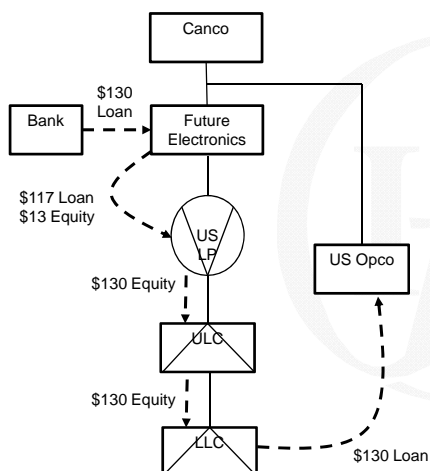
### Case: Future Electronics (Pending)

#### Facts:

- Bank lends \$130 to FE, which lends \$117 to USLP and makes a \$13 equity contribution to USLP.
- USLP treated as a domestic corporation for US tax purposes.
- USLP subscribes for \$130 in shares of ULC.
- ULC subscribes for \$130 in shares of LLC.
- LLC lends \$130 to US Opco.
- US Opco pays interest to LLC on \$130 debt.
- LLC pays dividend to ULC.
- ULC pays dividend to USLP.
- USLP pays interest to FE on \$117 debt.
- FE pays interest to Bank on \$130 debt.

41

## Outbound: Tower Financing- Pending Decision



#### Tax Impact:

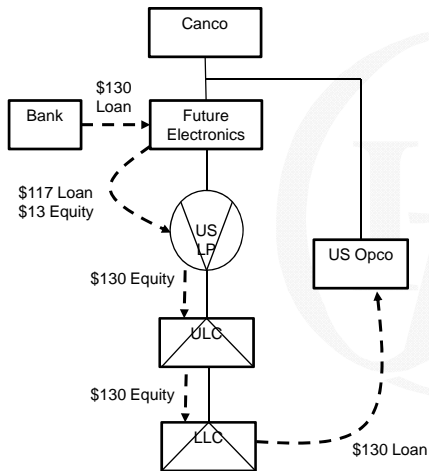
- US:
  - Interest paid by US Opco is considered interest received by USLP and deductible by US Opco
  - USLP deducts interest paid to FE and net income subject to tax at USLP.
  - Interest payment by USLP subject to wht.
- Canada:
  - LLC interest recharacterized as ABI.
  - Dividend from LLC to ULC included in income (s.90) and full deduction (s.113(1)(a)).
  - Dividend from ULC to USLP included in FE income and full deduction (s.112).
  - Interest received by FE included in FE income, interest expense by USLP deductible by FE and Interest paid by FE deducted from FE income. No net income at FE.

#### Issue:

- Is FE entitled to s.126(1) credit and s.20(12) deduction in respect of US tax paid by USLP?

42

## Outbound: Tower Financing- Pending Decision



### Minister Position:

- Did not challenge the assertion that tax paid by USLP is tax paid by FE.
- S.126(1) and s.20(12) not available:
  - Credit/deduction not applicable where the surplus regime has been utilized (i.e., "where tax can reasonably be regarded as being paid in respect of income of a share of a FA").
  - Since the flow of funds utilized the surplus regime it can "reasonably be argued that the partnership tax was paid in respect of income derived from a foreign affiliate of FE".
  - Interest income was derived (indirectly) from shares of a FA.
- GAAR
  - The funds which are ultimately received by USLP have benefited from the FA regime. Therefore, should not be eligible for additional deduction/credit in respect of income from the same funds.

43

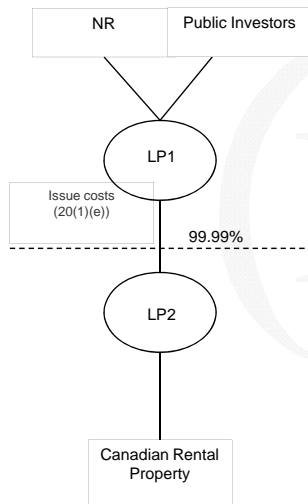
## Other General Issues

### Publications Discussed:

- |                                  |                                   |
|----------------------------------|-----------------------------------|
| - Tiered Partnerships and 216    | 2004-0075721E5, November 28, 2005 |
| - Thin Cap                       | 2005-0155331E5, December 5, 2005  |
| - Thin Cap                       | 2005-0123631R3, 2005              |
| - Conversion of LLC to LP        | 2004-0104691E5, August 14, 2008   |
| - Disposition of TCP             | 2009-0317371I7, July 16, 2009     |
| - Royalty Payments               | 2006-0188131E5, November 18, 2009 |
| - Dividend Paid by ULC           | 2009-0341681R3, December 15, 2009 |
| - 212(1)(b)(i) Arm's Length Test | 2009-0340031E5, July 21, 2010     |
| - SIFT Partnerships              | 2009-0309281E5, May 3, 2010       |
| - Thin Cap                       | 2009-0349141R3, September 9, 2010 |

44

## General: Tiered Partnerships and 216



**Document:** 2004-0075721E5 (Nov 28/05)

**Facts:**

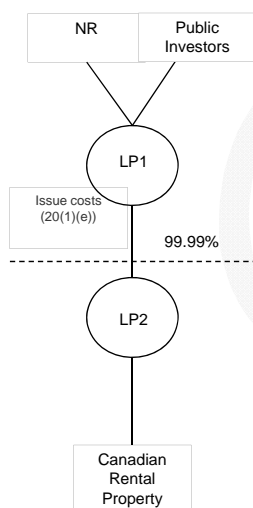
- Non-resident partner in LP1, a limited partnership formed in a foreign country.
- LP1 is the sole limited partner in LP2, a limited partnership formed under the laws of Canada.
- LP1 completed a public offering and has 20(1)(e) expenses. Cash from offering (net of issue costs) was used to acquire units in LP2 (only asset of LP1) which used the cash to acquire a rental building in Canada.

**Issue:**

- Can NR file a 216 election to file a Part I return in connection with the net rental income which is allocated to LP1 and then to NR?

45

## General: Tiered Partnerships and 216

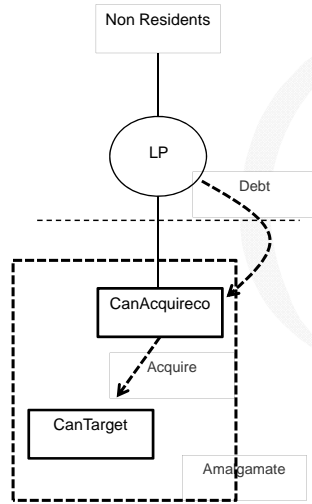


**CRA Position:**

- NR partner of LP1 can make an election under 216(1) to file a Part 1 return in connection with the rental income earned by LP2 and allocated to LP1 and then to NR.
- Issuance costs deductible by LP1 under 20(1)(e) against income allocated to LP1 from LP2.
- Consistent with CRA Doc 9225705 (general partnership structure).

46

## General: Thin Cap



**Document:** 2005-0123631R3 (Dec 5/05)

**Facts:**

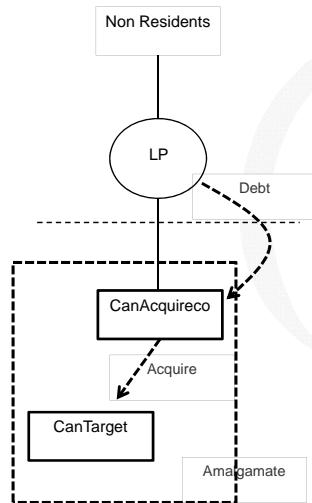
- All investors in LP are non-resident, no investor owns more than 10% of LP.
- LP intends to acquire CanTarget and 100% debt finances CanAcquireco to effect the acquisition.
- CanTarget and CanAcquireco amalgamate after acquisition.

**Issue:**

- Will 18(4) apply to deny interest deduction to Amalco?

47

## General: Thin Cap



**CRA Position:**

- 96(1) does not apply to deem LP to be a separate person for the purposes of 18(4).
- Look to partners to determine whether any "specified non-resident shareholders". If not, then no interest deduction limitation.

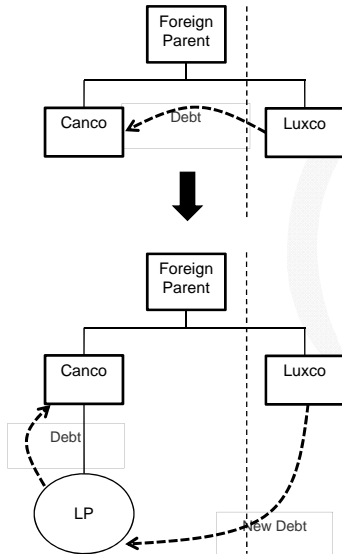
**Discussion Point:**

- Non-resident investment funds should consider this when investing in Canada. Investing through a non-resident corp will limit interest deductibility pursuant to 18(4).
- If LP in US (with US qualifying person partners) and treated as fiscally transparent under US law, s.212(13.1)(b) deems LP to be a non-resident person and interest payments to be subject to 25% wht. However, Article IV(6) would apply and potential 0% Canadian wht pursuant to Article XI(1).

48



## General: Thin Cap



**Document:** 2005-0123631R3 (2005)

**Facts:**

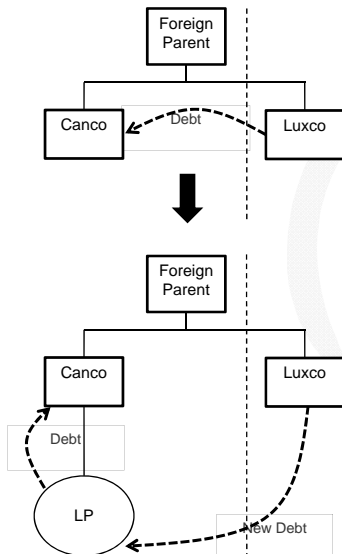
- Canco is indebted to a related Luxco (the "Debt"). Thin cap room exceeded.
- Canco forms a LP and LP purchases the Debt from Luxco. In consideration, LP issued the "New Debt" to Luxco.

**Issue:**

- Whether 18(6) applies?
- Whether GAAR applies?

49

## General: Thin Cap



**CRA Position:**

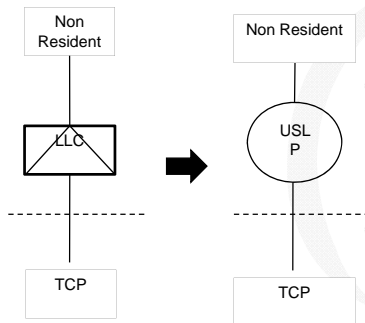
- 18(6) n/a. It does not apply to the acquisition of a loan, only the "making" of a loan.
- GAAR applies. Only purpose for the transaction (i.e., transferring foreign debt to LP) is to avoid 18(4).

**Discussion Points:**

- Contrast to 2009-0349141R3.

50

## General: Conversion of LLC to LP



**Document:** 2004-0104691E5 (Aug 14/08)

**Facts:**

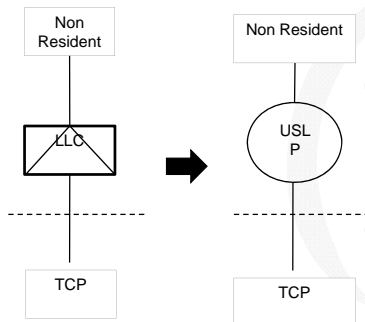
- NR owns membership interests in LLC, which owns taxable Canadian property.
- LLC converts to a Delaware LP. Under Delaware law: LLC interests converted to LP interests, LP is a separate legal entity, obligations/liabilities not affected, assets "remain vested" in LP, LLC is not considered to wind-up its affairs, LP is deemed to be the same entity as the LLC.

**Issue:**

- Is there a disposition of the TCP on the conversion?

51

## General: Conversion of LLC to LP



**CRA Position:**

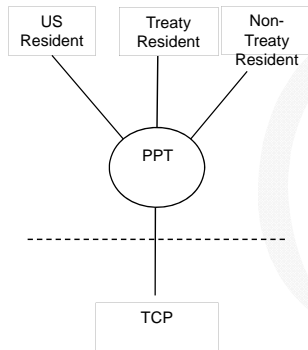
- Two-step approach adopted: determine characteristics of foreign business association; and compare to recognized categories under Canadian law.
- LP is partnership for Canadian tax purposes.
- Shareholders of LLC disposed of shares in consideration for LP interests.
- LLC disposes of its property to LP on the conversion. Post Protocol Article IV(6) would provide that NR disposes of TCP.

**Discussion Points:**

- If TCP incorporated, the conversion may not be an issue (i.e., if the value of shares not derived from real estate, resource property or timber resource property).
- If US, use of ULC will need to take into consideration Article IV(7)(b)

52

## General: Disposition of TCP and s.116



**Document:** 2009-031737117 (July 16/09)

**Facts:**

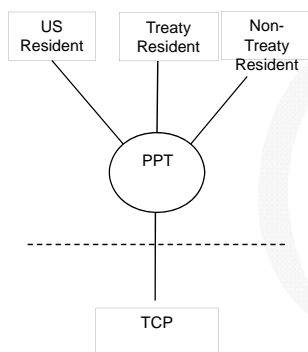
- Three partners of a partnership (fiscally transparent): US resident, treaty resident and non-treaty resident. US resident and treaty resident are each entitled to benefits under respective treaty.
- Partnership disposes of taxable Canadian property.

**Issue:**

- Does the term "non-resident person" in s.116 mean the partnership or the partners?

53

## General: Disposition of TCP and s.116

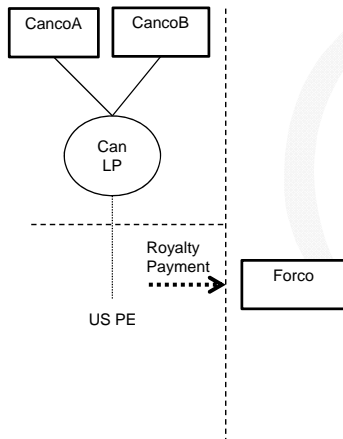


**CRA Position:**

- The term "non-resident person" in s.116 means each partner individually. Look to partners.
- Section 96 does not deem the partnership to be a separate person for purposes of the withholding requirements in s.116.
- If TCP is treaty-protected property, then purchaser completes T2062C(s.116(5)(a.1), (5.01) and (5.02)) in respect of each of the US resident and the treaty resident.
- Purchaser must withhold in respect of non-treaty resident (s.116(5)) or obtain a clearance certificate (s.116(4)).

54

## General: Royalty Payments



**Document:** 2006-0188131E5 (Nov 18/09)

**Facts:**

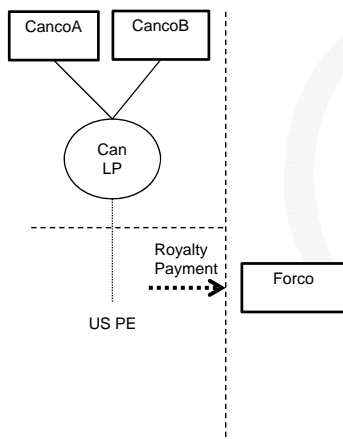
- CancoA and CancoB form CanLP that carries on business in the US through a PE.
- A related company, Forco, is resident in a country with which neither Canada nor the United States has a treaty. CanLP makes payments (described in s.212(1)(d) and XII(4)) to Forco. Payments deemed to arise in the United States pursuant to XII(6)(a) and are therefore subject to U.S. withholding tax.

**Issue:**

- Whether Canadian withholding tax is payable on the royalty paid to Forco.

55

## General: Royalty Payments

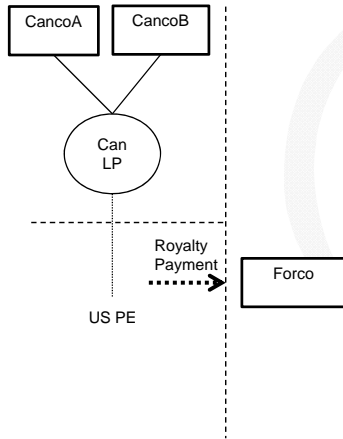


**CRA Position:**

- 212(13.1)(a) not applicable since royalties not deductible in computing income from Canadian source.
- If partners liable for payment of royalties (laws of the jurisdiction governing Partnership, the partnership agreement, or the agreement governing the royalties) partners considered to be the payers of the royalties and liable for withholding tax.
- XII(2) and (3) limit the taxation of royalties by the "source" state if the royalties arise in one of the Contracting States and are beneficially owned by a resident of the other Contracting State. Neither of these provisions applies since the royalties beneficially owned by a resident of neither state.
- XII(6) only applies to deem the royalty payments to arise in the U.S.--does not limit the taxation of the royalty payments by either State.

56

## General: Royalty Payments

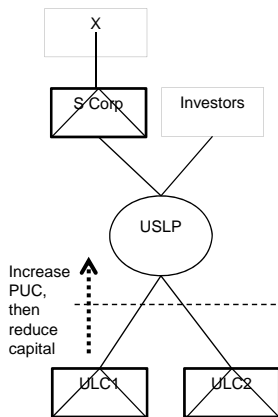


### CRA Position Cont'd:

- Article XXII(1) would not apply since the royalties are not income of a resident of one of the Contracting States.
- Thus, Canada would not be precluded from imposing tax under Part XIII of the Act on the royalty payments to Forco even though the U.S. may also impose its withholding tax

57

## General: Dividend Paid by ULC



### Document: 2009-0341681R3 (Dec 15/09)

#### Facts:

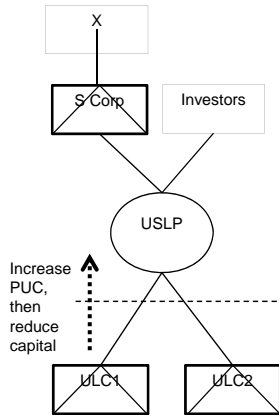
- X, a resident of the United States, owns all of the shares of S Corp. S Corp is a limited partner of USLP.
- USLP does not carry on business in Canada and is fiscally transparent for purposes of U.S. tax laws.
- USLP owns two ULCs. ULC1 increases the PUC of its shares. ULC1 then reduces the PUC of those shares by the amount that previously increased and distributes an amount in cash as a return of PUC on its shares equal to the reduced amount.

#### Issue:

- Whether Article IV(7)(b) applies to deny treaty benefits.

58

## General: Dividend Paid by ULC

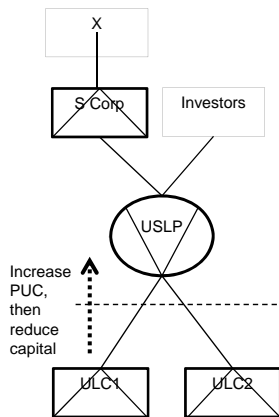


### CRA Position:

- Deemed dividend is taxable dividend; 212(2)(a).
- Dividend will be income under X(3) of the Treaty and derived by the S Corp and the investors in proportion to their respective shares of USLP (Article IV(6)).
- Each member of USLP entitled to benefits under Article X(2) that the member would be entitled to if the dividend were paid as a cash dividend and the Treaty were read without reference to Article IV(7)(b).
- Article IV(7)(b) will not apply because under US law the treatment of the increase in PUC is the same regardless of whether ULC1 is fiscally transparent or not.
- GAAR will not apply.

59

## General: Dividend Paid by ULC

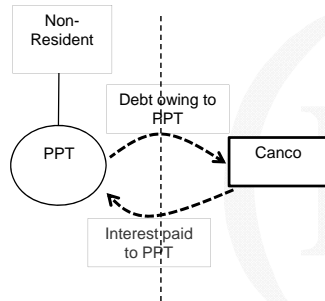


### Discussion Points:

- What if USLP were treated as a domestic C-Corp?
  - If beneficial owner and qualifying person, then entitled to treaty benefits
  - Article IV(7)(b) does not apply because same treatment test is met
  - Article IV(7)(a) does not apply because direct owner
- If USLP were treated as a domestic C-Corp and were not beneficial owner?
  - Look to partners (2008-0272871C6)
  - Article IV(7)(b) does not apply because same treatment test is met
  - Article IV(7)(a) does not apply because same treatment test is met

60

## General: 212(1)(b)(i) Arm's Length Test



**Document:** 2009-0340031E5 (July 21/10)

**Facts:**

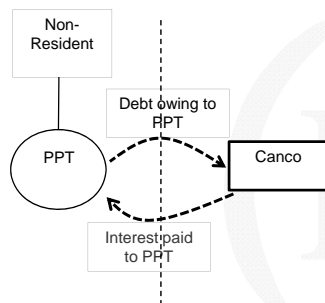
- Canco pays an amount of interest to a partnership that is not a "Canadian partnership".
- Paragraph 212(13.1)(b) deems the partnership to be a non-resident person. Therefore Part XIII applicable.

**Issue:**

- Whether the arm's length test in s.212(1)(b)(i) (no withholding tax on interest paid to an arm's length person, except "participating debt interest") applied at the partner or partnership level?

61

## General: 212(1)(b)(i) Arm's Length Test



**CRA Position:**

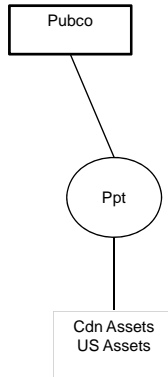
- Paragraph 212(13.1)(b) deems a partnership to be a person for the purposes of applying the arm's length test in s.212(1)(b)(i).

**Result:**

- Section 251 (definition of arm's length) applies because it addresses only "related persons".
- Related persons deemed not to deal at arm's length.
- Ex: If partnership controls Canco, they will be related.
- If withholding tax applies, then partners may invoke the benefits of a relevant tax treaty.

62

## General: SIFT Partnerships



### **Document: 2009-0309281E5 (May 3/10)**

#### **Facts:**

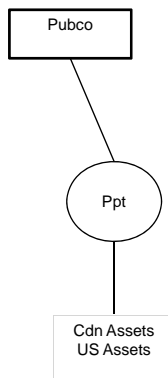
- Pubco with \$200b in assets invests \$100mm in a Ppt (does not become majority interest partner).
- Ppt is a "Canadian resident partnership" (s.248(1)); Ppt units are not listed or traded on an exchange.
- Ppt units not exchangeable into Pubco shares
- Dividends on Pubco stock do not vary depending on Pubco's share of income or capital of Ppt
- Pubco's retained earnings that fund dividends include amounts received from Ppt

#### **Issue:**

- Is Ppt a "SIFT partnership" (s.197(1))?

63

## General: SIFT Partnerships



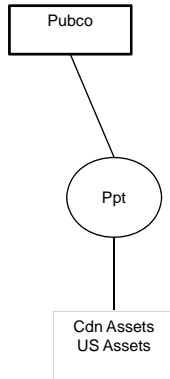
#### **CRA Position:**

- Ppt will be a SIFT partnership if "investments" (s.122.1) in the Ppt are listed or traded on an exchange or public market.
- Definition of "investment" has a security test ((a)(i)) and a replicate test ((a)(ii)).
- Security Test: Since no Ppt units listed, security test not met (note that Pubco and Ppt not affiliated so do not have to look at Pubco shares).
- Replicate Test:
  - Met if rights listed/traded on an exchange/market that replicate a return on/value of a security of the Ppt
  - Objective determination based on reasonable expectation of a hypothetical investor (Look to: what are other investments and associated return/value?, link in share terms?, other?)
  - Generally satisfied where CanPubco derives all or most of its value from the Ppt or business undertakings are represented wholly or largely by activities of Ppt.
- Ppt not a SIFT partnership.

64



## General: SIFT Partnerships

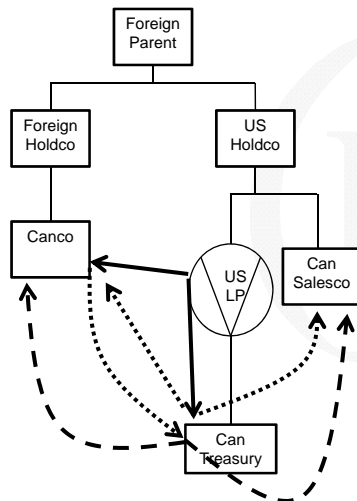


### Discussion Points:

- Pubco need not be a corporation.
- Look through potential (def'n of "investment" and "security" in s.122.1).

65

## General: Thin Cap



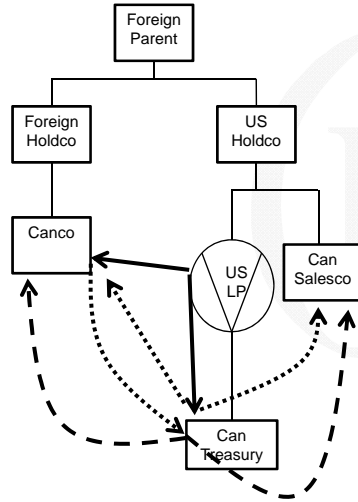
### Document: 2009-0349141R3 (Sept 9/10)

#### Facts:

- Foreign Parent wholly owns US Holdco, a limited partner in USLP (treated as corp for US tax). Not qualifying persons.
- Credit markets have made it difficult for Canadian group to raise financing from debt/equity markets.
- USLP makes primary loans to Can Treasury and Canco (18(4) n/a).
- Can Treasury makes secondary loan of the funds to Can Salesco and Canco.
- Canco makes a secondary loan to Can Treasury, which then makes tertiary loans to Canco and Can Salesco.

66

## General: Thin Cap



### Issues:

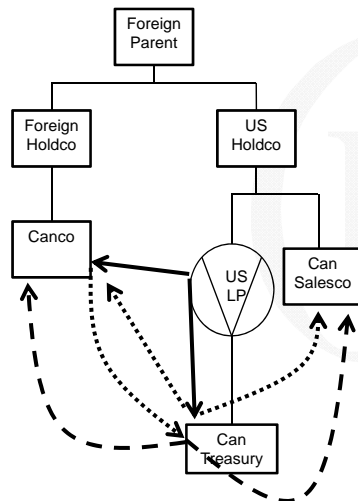
- Does Article IV(7)(a) prevent treaty rates?
- Does 18(6) apply to the secondary loans?
- Does GAAR apply (i.e., avoidance of 18(4))?

### CRA Position:

- Article XXIXA(3) applies such that Article XI(1) benefits apply to the interest derived by US Holdco (via USLP) on primary loans.
- No IV(7)(a) problem because USLP is a resident of the US for Treaty purposes (see CRA 2008-0272871C6).
- 18(6) (back-to-back loans) not applicable to secondary loans.
- GAAR not applicable.

67

## General: Thin Cap



### Discussion Points:

- US Holdco entitled to treaty benefits—CRA looks through USLP to hold that interest is beneficially owned by US Holdco for purposes of Article XI(1). This even though Article IV(6) n/a because USLP is taxed as a corporation for US tax purposes. Consistent with CRA practice (2008-0272871C6).
- LOB (Article XXIX-A(3))—CRA position is that the interest is income derived in connection with [TE- upstream, downstream or parallel] an active trade or business in the US that is substantial in relation to [TE- intended to prevent treaty shopping] the activity in Canada giving rise to the income.
- 18(6)—CRA applies its recent position (2010-0366541C6) that 18(6) will not be applied where: first loan subject to 18(4); and second loan between related Cancos.

68

---



**END**