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SUBJECT 2013 STEP Question 6 US LLCs - FAPI, FAT and FTCs
SECTION 91(1); 95(1); 20(11); 20(12); 126(1)

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA. Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: 1. Is the US tax paid by the Canadian resident owner of an LLC considered to be foreign accrual tax in respect of the LLC?
2. Would the FAPI income which arises in the hands of the taxpayer be considered foreign source income and can a foreign tax credit then be claimed by the taxpayer against the FAPI inclusion?

POSITION: 1. No. 2. Yes, if the taxpayer is an individual. No, if the taxpayer is a corporation.

REASONS: 1. In order for an income or profits tax to qualify as foreign accrual tax, the tax must be paid by the particular affiliate (or any other affiliate of the taxpayer in respect of a dividend received from the particular affiliate). 2. Any amount included in income under subsection 91(1), would be considered income from sources in the US for purposes of subsections 20(11) and 126(1). However, any US tax paid in respect of a corporation's share of the income of an LLC would be paid by the corporation in respect of income from a share of the capital stock of a foreign affiliate of the corporation.

2013 STEP CANADA ROUNDTABLE, June 10 & 11, 2013

QUESTION 6. US Limited Liability Companies ("LLCs")

Where an LLC resident in the US is a flow-through entity for US tax purposes, US tax is paid on the income of the LLC by the owners of the LLC and not by the LLC itself. Assume that the income of the LLC constitutes FAPI and that the LLC is a controlled foreign affiliate of a Canadian resident (the "taxpayer"). In these circumstances, is the US tax paid by the taxpayer considered to be foreign accrual tax in respect of the LLC?

Alternatively, would the FAPI income which arises in the hands of the taxpayer pursuant to subsection 91(1) be considered foreign source income and can a foreign tax credit then be claimed by the taxpayer against the FAPI inclusion?

CRA Response

In the above circumstances, the US tax paid is a tax paid by the taxpayer and not by the LLC and, therefore, it would not qualify as foreign accrual tax in respect of the LLC. In order for an income or profits tax to qualify as foreign accrual tax, the tax must be paid by the particular affiliate (or any other affiliate of the taxpayer in respect of a dividend received from the particular affiliate). It is implicit that any tax paid by the affiliate is, in fact, the affiliate's tax and not simply a payment on behalf of another person's tax obligation. Therefore, arranging the affairs so that the LLC actually makes the tax payment in respect of the taxpayer's obligations under the Internal Revenue Code would not cause the tax to become foreign accrual tax.

In computing the taxpayer's income, any amount included under subsection 91(1) in respect of the FAPI of the LLC would be considered income from sources in the US for purposes of subsections 20(11) and 126(1).

Therefore, if the taxpayer is an individual, he or she may deduct under subsection 20(11) the portion, if any, of the US tax paid for the year that exceeds 15% of the subsection 91(1) income included in computing the individual's income for the year from the LLC. Any excess will be eligible for a foreign tax credit under subsection 126(1) and any of the excess US tax paid that cannot be utilized by the foreign tax credit may be deducted from income pursuant to subsection 20(12).

If, however, the taxpayer is a corporation, any US tax paid in respect of the corporation's share of the income of the LLC would not be creditable for purposes of subsection 126(1) nor deductible for purposes of subsection 20(12) because the tax would be paid by a corporation in respect of income from a share of the capital stock of a foreign affiliate of the corporation. However, the CRA takes the view that a deduction under paragraph 113(1)(c) would be available in respect of the US tax paid by a corporation resident in Canada in respect of the income of an LLC where a dividend distribution out of taxable surplus is received from the LLC.

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