

## Canada Will Not Appeal Ruling on LLC's Treaty Rights

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# HIGHLIGHTS

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The Tax Court of Canada on April 8 released its decision in *TD Securities (USA) LLC v. The Queen*, in which the taxpayer successfully challenged the Canada Revenue Agency's long-standing administrative policy that a limited liability company that is fiscally transparent in the U.S. is not subject to tax in the U.S. (and therefore cannot be a U.S. resident and eligible for benefits) under the Canada-U.S. income tax treaty.

In that case, a U.S. LLC with a single U.S. member that was fiscally transparent for U.S. tax purposes earned Canadian-source income on which a branch tax of 25 percent applied, subject to that 25 percent rate being reduced to 5 percent under Article X of the treaty.

The Crown argued that the LLC could not claim the benefit of the treaty-reduced rate because the LLC, by virtue of being fiscally transparent for U.S. tax purposes, was not "liable to tax" in the U.S. and therefore could not be a U.S. resident for treaty purposes.

The court held otherwise, concluding that Canada had a long history of administratively interpreting the treaty in a liberal and purposive manner to make benefits available when doing so was consistent with the

spirit of the treaty. Based on the facts in *TD Securities*, in which all of the Canadian-source income was taxed in the U.S. (albeit not at the level of the LLC) and no abuse was occurring, the court concluded that TD Securities could be considered entitled to treaty benefits and that the treaty-reduced rate of branch tax should apply. (For the court's decision, see *Doc 2010-7938* or *2010 WTD 69-23*.)

The deadline for filing an appeal of the court's decision was May 10 but the Crown has chosen not to appeal, so the ruling will stand. Taxpayers who paid more tax than would have been due if their LLCs had not been denied treaty benefits may want to consider whether their circumstances are sufficiently similar to those in *TD Securities* to warrant taking action to claim a refund of the Canadian tax paid.

Moreover, while the fifth protocol to the treaty includes a provision (now in force) that is intended to allow treaty benefits to be claimed on income earned by a U.S. resident through an LLC, significant uncertainties remain regarding the interpretation and operation of this rule. Accordingly, taxpayers with LLCs in their existing Canada-U.S. structures will want to carefully consider the implications of this case as it applies to those current arrangements and the manner in which the fifth protocol may apply. ♦