

THE FIFTH AMENDMENT TO THE U.S.–CANADA INCOME TAX TREATY



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Keiter Stephens' tax department is one of the largest in the central Virginia area and is led by partners and staff with extensive experience across various industries.

On December 15, 2008, the Fifth Amendment to the Tax Treaty between Canada and the United States entered into force. It is the outcome of long-term negotiations which will have a significant impact on individuals as well as U.S. companies with operations in Canada and Canadian companies with operations in the U.S. This article outlines some of the most important, recent changes made to the Treaty.

Permanent Establishments

The Treaty provides that a country may tax the business profits of a resident of the other country to the extent such profits are attributable to business carried on through a permanent establishment within that country. The term "permanent establishment" means a fixed place of business, such as a factory or office. The new Treaty expands the Permanent Establishment provision to tax businesses that do not have a fixed place of business in that country if they provide services in the country and:

- the services are:
 - ◊ performed in the country by an individual who is present in the country for a period of 183 days or more in any 12-month period; and
 - ◊ during that period, more than 50% of the gross active business revenues of the enterprise consists of income derived from services performed; or
- the services are provided in the country for an aggregate of 183 days or more in any 12-month period with respect to the same or connected project for customers who either:
 - ◊ are residents of the country; or
 - ◊ maintain a permanent establishment in the country and the services are provided to that permanent establishment

The changes do not apply when the determination is for a building site or construction or installation project. For those activities, the 12-month threshold is preserved. These changes will generally take effect after January 1, 2010.

U.S. Limited Liability Companies and Other Fiscally Transparent Entities

For taxable years commencing after 2008, the Treaty generally extends benefits to entities considered fiscally transparent or look-through, both in the U.S. and Canada, if a member or partner is a U.S. resident for purposes of the Treaty.

Withholding Taxes

The new Treaty provides that withholding tax on cross-border interest payments between unrelated residents of the U.S. and Canada will generally be eliminated. This rule is effective for interest payments made on or after January 1, 2008. Withholding tax on cross-border interest paid between related persons will be phased out over three years beginning 2008 and totally eliminated in 2010.

Impact on Employees

For taxable years beginning after 2008, the Treaty expands the circumstances in which Canada and the U.S. may tax each other's residents who exercise employment in the other country.

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The amendment clarifies that a resident of one country may be taxed by the other country on any form of remuneration, including payments in kind, earned from employment exercised in the other country in a calendar year if the remuneration exceeds \$10,000 and the employee is present in the other country for a period exceeding 183 days in any 12-month period which commences or ends in the relevant calendar year and the remuneration is borne by any person resident in the other country or by a permanent establishment in the other country. This is much broader than the earlier provision in the Treaty where the 183-day test had to occur within the relevant calendar year and the Treaty language suggested that remuneration must be assumed by an “employer” who is a resident or has a permanent establishment in the other country.

Amendment to Exchange of Information Provision to Encourage More Requests by the CRA and IRS

For taxable years beginning after 2008, the Treaty expands the scope of exchange of information between the Canada Revenue Agency and the IRS to enable them to obtain information that “may be relevant” in carrying out their domestic laws concerning taxes to which the Treaty applies to the extent the taxation under those laws is not contrary to the Treaty.

In summary, individuals and companies should consider the possible implications of the various amendments made by the Fifth Protocol to the U.S.–Canada Income Tax Treaty and undertake necessary tax planning strategies to maximize any tax benefits as well as minimize any additional tax burden that might result from the changes to the Treaty.



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