MILLER CANFIELD

U.S.-Canada Tax Treaty Amended

Changes Could Have Adverse Tax Effects on Certain Cross-Border Arrangements

January 15, 2009

The U.S. and Canada recently amended their income tax treaty. The changes have adverse implications for businesses with cross-border operations structured in the following manners:

- U.S. persons conducting business in Canada through Nova Scotia or Alberta unlimited liability companies, which are treated as pass-throughs for U.S. tax purposes.
- U.S. persons conducting business in Canada through Canadian partnerships, which elect to be treated as corporations for U.S. tax purposes. These cross-border arrangements will be ineligible for treaty benefits as of January 1, 2010. Payments will be subject to 25%-30% withholding tax rates, rather than the reduced 0%-10% rates that would apply if treaty benefits were available. Accordingly, it is important that any such arrangements be reviewed and, perhaps, revised.
- Canadian persons conducting business in the U.S. through LLCs, which are treated as pass-throughs for U.S. tax purposes.
- Canadian persons conducting business in the U.S. through U.S. partnerships that elect to be treated as corporations for U.S. tax purposes.

These cross-border arrangements will be ineligible for treaty benefits as of January 1, 2010. Payments will be subject to 25%-30% withholding tax rates, rather than the reduced 0%-10% rates that would apply if treaty benefits were available. Accordingly, it is important that any such arrangements be reviewed and, perhaps, revised.

The treaty has also been amended to permit treaty benefits using U.S. LLCs, so it may now be feasible for U.S. persons to invest in Canada through U.S. LLCs. Previously, treaty benefits were not available in many cases.

Cross-border operations involving U.S. LLCs, Canadian unlimited liability companies or other hybrid arrangements should be reviewed.