

TAX LAW BULLETIN

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ACCELERATED ELIMINATION OF NON-RESIDENT WITHHOLDING TAX ON CONVENTIONAL INTEREST PAYMENTS

A new Notice of Ways and Means Motion tabled by the Canadian government on November 13, 2007 proposes to accelerate the elimination of Canadian withholding tax on conventional interest payments made to arm's length non-residents of Canada. In the March 2007 federal budget, the government announced that withholding taxes in respect of interest payments made to arm's length non-residents would be eliminated shortly after the entry into force of the Fifth Protocol to the Canada-US Income Tax Convention (For further information on this aspect of the Fifth Protocol, please see our previous bulletin entitled "[Withholding Tax on Cross-Border Payments](#)"). The government's timeline for implementing the proposed withholding tax changes was affirmed in draft legislation released on October 2, 2007. However, this week's Notice of Ways and Means Motion proposes to accelerate the elimination of withholding tax on conventional interest payments made to arm's length non-residents by eliminating the withholding tax in respect of such payments made on or after January 1, 2008.

BACKGROUND

Under the *Income Tax Act* (Canada), non-resident lenders are generally subject to a withholding tax of 25% on the gross amount of interest they collect from Canadian resident borrowers. However, this withholding tax is generally reduced to a rate of 10% for non-resident lenders that are entitled to the benefits of an income tax treaty. The law requires the Canadian borrower to withhold any such tax from payments made to the lender and remit the tax to the Canada Revenue Agency.

BENEFITS OF THE PROPOSED CHANGE

The accelerated elimination of withholding tax on interest payments is a welcome development for both non-resident lenders and Canadian borrowers. Canadian borrowers will particularly benefit where a withholding tax exemption would not otherwise have been available because they will no longer face demands to "gross-up" interest payments to compensate for the imposition of withholding tax. Even if a withholding tax exemption, such as the exemption on certain long-term loans, was otherwise available, the proposed changes will reduce transaction costs as the need for additional documentation and structuring to fit within an applicable withholding tax exemption will be eliminated.

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The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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