CANADA AND ISRAEL ENTER INTO NEW INCOME TAX CONVENTION

Posted on October 4, 2016

Categories: Insights, Publications

On September 21, 2016, Canada and Israel entered into a new income tax convention (the "**New Convention**") intended to replace the existing *Canada-Israel Income Tax Convention* (the "**Old Convention**"). The New Convention contains a number of favourable changes intended to encourage cross-border business and investment as well as a change intended to close what was perceived to be a long-standing tax loophole for Israeli investors in Canadian real property.

Specific changes contained in the New Convention include:

- A reduction of the maximum withholding tax rate on cross-border dividends from 15% to 5% where the Israeli dividend recipient is a company which directly holds at least 25% of the capital of the dividend payer. The existing 15% withholding tax rate continues to apply to dividends in all other cases.
- A reduction of the rate of branch profits tax that can be imposed by Canada on the income attributable to the permanent establishment of an Israeli corporation in Canada to 5% (from 15%).
- An exemption from withholding tax on interest for certain tax-exempt pension plans.
  Changes to the withholding tax rate on interest.In particular, the maximum withholding tax rate on interest will be reduced from 15% to 10%, generally, and to 5% where the recipient of the interest payment is a financial institution that is dealing at arm's length with the payer.
- A reduction of the withholding tax rate on certain royalties (other than exempt royalties) from 15% under the Old Convention to 10%.
- An expansion of the types of royalties that are exempt from withholding tax. Under the Old Convention, certain copyright royalties in respect of the production or reproduction of any literary, dramatic, musical or other artistic work (other than motion picture films and television broadcasting) were exempt from Canadian withholding tax. The New Convention expands this provision by exempting from
- Canadian withholding tax royalties for the use of computer software, patents or for information concerning industrial, commercial or scientific experience (other than such royalties provided in connection with a rental or franchise agreement).

These changes should make it easier for Israelis to invest in Canada and for Canadian businesses to access both

Israeli capital and technology. However, as with a number of recent Canadian tax treaties, the New Convention also includes new anti-avoidance provisions which may limit the availability of treaty relief to certain Israeli residents. Therefore, persons looking to rely on the provisions of the New Convention should obtain professional advice.

Finally, as mentioned above, the New Convention closes a loophole that had previously been available to residents of Israel under the Old Convention. Previously, Israeli residents were only subject to Canadian tax on gains derived from a disposition of shares of a corporation where the property of the corporation consisted principally of real property situated in Canada. However, this formulation allowed Israeli residents to avoid tax on the sale of such shares, where the corporation held the Canadian real property indirectly, through a subsidiary (such that the property of the corporation consisted of shares of the subsidiary, not of real property). The New Convention will eliminate this loophole by permitting Canada to tax residents of Israel on gains from the disposition of shares where the shares derived more than 50 per cent of their value directly **or indirectly fr**om property situated in Canada at any time during the 12 month period prior to and including the time of disposition.

The New Convention will apply to amounts paid or taxation years beginning after January 1 of the year following the year in which Canada and Israel confirm the domestic ratification of the New Convention. Although it is unclear at this time, it is possible that the New Convention could be ratified by both parties in 2016, such that it would come into effect on January 1, 2017. Once the New Convention comes into force, the Old Convention shall cease to have effect. As a consequence, Israeli residents looking to implement transactions on the basis of the Old Convention should effect such transactions prior to the coming into effect of the New Convention.

By Carl Irvine

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.