TAIWAN – CANADA TAX ARRANGEMENT RELEASED

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On January 15, 2016, Canada and Taiwan entered into an "Arrangement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income" (the "**Arrangement**"). The Arrangement will apply to amounts paid or taxation years beginning after January 1 of the year following the year in which Canada and Taiwan confirm the domestic ratification of the Arrangement.

Broadly speaking, if ratified by both parties, the Arrangement will encourage cross-border business and investment, allow businesses and investors to better determine their cross-border tax exposure and obligations, and provide protection against tax discrimination and potential double-taxation.

For residents of Taiwan, the benefits of the Arrangement will include:

- A reduced Canadian withholding tax rate of 10% on dividends paid by a Canadian-resident corporation, if the Taiwanese dividend recipient is a company that holds, directly or indirectly, at least 20% of the capital of the dividend payer. With respect to dividends paid by other Canadian-resident corporations, the dividend will normally be subject to a reduced rate of withholding tax of 15%.
- A reduced Canadian withholding tax rate on interest payments (a withholding tax rate of 10% will generally apply in circumstances where the interest payment does not otherwise qualify for Canada's 0% statutory withholding tax rate on conventional interest paid to an arm's length lender).
- A reduced Canadian withholding tax rate of 10% on royalty payments made by a Canadian resident.
- Residency tie-breaker rules that may be of assistance to international business principals who have family or business connections in both Canada and Taiwan.

The reduced withholding tax rate of 10% on cross-border dividends is the same as the rate imposed on dividends under Canada's tax treaty with China; however, the rate reduction is less favourable than the reduction afforded under recent Canadian tax treaties, notably Canada's tax treaty with Hong Kong.

While the Arrangement provides that a resident of Taiwan should only be subject to Canadian tax on business profits attributable to a permanent establishment of that resident in Canada, it should be noted that the definition of a "permanent establishment" under the Arrangement is different (and potentially broader) than that typically contained in many of Canada's tax treaties. For example, under the Arrangement, a resident of

Taiwan would only be considered to have a permanent establishment in Canada in respect of a building site or construction or installation project if it lasts for more than 6 months (as opposed to the 12 month period required under many of Canada's tax treaties). Similarly, the Arrangement includes a so-called "service permanent establishment" rule in respect of services performed in Canada, which is unusual in most of Canada's tax treaties (with the US and China tax treaties being notable exceptions). It is worth noting that, in these and other respects, the Arrangement mirrors the provisions of Canada's tax treaty with China.

In order to access the reduced withholding tax rates provided under the Arrangement, a Taiwanese company must have a sufficient nexus to Taiwan. In this regard, consideration must be given to the potential application of anti-avoidance provisions contained in the Arrangement that deny the ability to claim the benefits afforded by the Arrangement where, among other things, steps were taken to position a particular person to qualify for benefits under the Arrangement. The special anti-avoidance rules in the Arrangement are comparable to the anti-avoidance provisions that have been included in several recent Canadian tax treaties, including the Canada-Hong Kong treaty.

For Canadian companies, one might expect that one benefit of the Arrangement would be the ability to potentially repatriate business profits from Taiwan as "exempt surplus" free from Canadian tax. However, there is at least a technical concern that the Arrangement might not be considered to be a qualifying agreement or convention for the purposes of Canada's "foreign affiliate" rules (and certain other provisions of the *Income Tax Act* (Canada)). Hopefully, the Canada Revenue Agency will provide clarity on this interpretive point in the near future.

by Michael Friedman and 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.