

TAX LAW BULLETIN

December 2007

HAPPY NEW YEAR! ELIMINATION OF WITHHOLDING TAX ON CONVENTIONAL INTEREST PAYMENTS TO ARM'S LENGTH NON-RESIDENTS

On December 14, 2007, amendments to the *Income Tax Act* (Canada) were enacted into law that will eliminate Canadian withholding tax on conventional interest payments made to arm's length non-residents of Canada beginning in the new year. 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](#)"). However, with the enactment of Bill C-28, Canadian withholding tax will no longer generally apply to conventional (e.g., non-participating) interest payments made to arm's length non-residents 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 STATUTORY 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 new statutory changes will reduce transaction costs as the need for additional documentation and structuring to fit within an applicable withholding tax exemption has largely been eliminated.

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