



Canada Signs Tax Information Exchange Agreements with Bermuda, the Cayman Islands and Other Tax Havens

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In the latter part of June, the federal Ministry of Finance announced that Canada had entered into tax information exchange agreements (“TIEAs”) with eight jurisdictions, the Bahamas, Bermuda, the Cayman Islands, Dominica, St. Kitts & Nevis, St. Lucia, St. Vincent & the Grenadines and the Turks & Caicos. Canada had previously entered into a TIEA with the Netherlands Antilles in August of 2009. Negotiations are underway for TIEAs with 12 other jurisdictions. TIEAs were introduced as part of the 2007 federal budget, and will play an important part in the choice of jurisdiction for offshore holding companies of Canadian multi-national corporations in the future.

A TIEA is an agreement under which Canada and a country that has not entered into a tax treaty with Canada agree to exchange tax information that is foreseeably relevant to the administration and enforcement of the domestic tax laws of each party. TIEAs are designed to facilitate the exchange of information to enforce tax laws and reduce tax evasion, particularly in low-tax or no-tax jurisdictions.

Canada has adopted both a carrot and a stick approach to encourage non-treaty countries to enter into TIEAs with it.

The carrot is to treat TIEA countries in the same manner as treaty countries with respect to the repatriation of profits to Canada by way of dividends. Prior to the 2007 amendments, active business income earned by foreign affiliates in non-treaty countries was fully taxable in Canada when repatriated to the Canadian parent corporation (with a credit for taxes paid by the foreign affiliate). Conversely, if the income was instead earned in a country that had a tax treaty with Canada, the income was exempt from Canadian income tax as an “exempt surplus”

dividend. TIEA countries will now be on equal footing with treaty countries with respect to repatriating income to Canada through exempt surplus dividends. This will make no-tax jurisdictions like Bermuda and the Cayman Islands far more attractive as locations for establishing holding companies (once their TIEAs are approved by Parliament).

The stick adopted by Canada is to treat active business income earned by a foreign affiliate located in certain non-treaty and non-TIEA countries as taxable to its Canadian parent corporation on an accrual basis, rather than a received basis. Previously, only passive investment income (known as “FAPI”) was subject to this tax treatment. This accrual taxation regime will apply if a TIEA is not concluded with the applicable jurisdiction within five years following the earlier of: (i) the start of negotiations; or (ii) the date on which Canada formally proposed negotiations with that jurisdiction. Canadian multi-nationals with subsidiaries in such countries will have to stay apprised of the status of any TIEA negotiations and will want to consider moving foreign affiliates to more favourable jurisdictions if a TIEA is not adopted in time.

This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.

If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.

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