



Treaty Series No. 4 (1942)

[Reprint of Canadian Treaty Series No. 2 (1942)]

CONVENTION AND PROTOCOL

between Canada and the United States of America

for the

Avoidance of Double Taxation

and the

Prevention of Fiscal Evasion in the case of Income Taxes

Signed at Washington, March 4, 1942

[Ratifications exchanged at Washington, June 15, 1942]

*Presented by the Secretary of State for Foreign Affairs
to Parliament by Command of His Majesty*

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CONVENTION AND PROTOCOL BETWEEN CANADA AND THE UNITED STATES OF AMERICA FOR THE AVOIDANCE OF DOUBLE TAXATION, AND THE PREVENTION OF FISCAL EVASION IN THE CASE OF INCOME TAXES.⁽¹⁾

Washington, March 4, 1942.

[Ratifications exchanged at Washington, June 15, 1942.]

I.

CONVENTION.

THE Government of Canada and the Government of the United States of America, being desirous of further promoting the flow of commerce between the two countries, of avoiding double taxation and of preventing fiscal evasion in the case of income taxes, have decided to conclude a Convention, and for that purpose have appointed as their Plenipotentiaries:

Mr. Leighton McCarthy, K.C., Envoy Extraordinary and Minister Plenipotentiary of Canada at Washington; and
Mr. Sumner Welles, Acting Secretary of State of the United States of America;

Who, having communicated to one another their full powers, found in good and due form, have agreed upon the following Articles:—

ARTICLE I.

An enterprise of one of the contracting States is not subject to taxation by the other contracting State in respect of its industrial and commercial profits except in respect of such profits allocable in accordance with the Articles of this Convention to its permanent establishment in the latter State.

No account shall be taken in determining the tax in one of the contracting States of the mere purchase of merchandise effected therein by an enterprise of the other State.

ARTICLE II.

For the purposes of this Convention, the term "industrial and commercial profits" shall not include income in the form of rentals and royalties, interest, dividends, management charges, or gains derived from the sale or exchange of capital assets.

Subject to the provisions of this Convention such items of income shall be taxed separately or together with industrial and commercial profits in accordance with the laws of the contracting States.

ARTICLE III.

1. If an enterprise of one of the contracting States has a permanent establishment in the other State, there shall be attributed to such permanent

(¹) *Cf.* the Income Tax Convention between Canada and the United States of America, signed at Washington the 30th December, 1936, and terminated the 29th April, 1941 ("Treaty Series No. 64 (1938)," Cmd. 5852).

establishment the net industrial and commercial profit which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions. Such net profit will, in principle, be determined on the basis of the separate accounts pertaining to such establishment.

2. The competent authority of the taxing State may, when necessary, in execution of paragraph 1 of this Article, rectify the accounts produced, notably to correct errors and omissions or to re-establish the prices or remuneration entered in the books at the value which would prevail between independent persons dealing at arm's length.

3. If (a) an establishment does not produce an accounting showing its own operations, or (b) the accounting produced does not correspond to the normal usages of the trade in the country where the establishment is situated, or (c) the rectifications provided for in paragraph 2 of this Article cannot be effected, the competent authority of the taxing State may determine the net industrial and commercial profit by applying such methods or formulæ to the operations of the establishment as may be fair and reasonable.

4. To facilitate the determination of industrial and commercial profits allocable to the permanent establishment, the competent authorities of the contracting States may consult together with a view to the adoption of uniform rules of allocation of such profits.

ARTICLE IV.

1.—(a) When a United States enterprise, by reason of its participation in the management or capital of a Canadian enterprise, makes or imposes on the latter, in their commercial or financial relations, conditions different from those which would be made with an independent enterprise, any profits which should normally have appeared in the balance sheet of the Canadian enterprise but which have been, in this manner, diverted to the United States enterprise, may be incorporated in the taxable profits of the Canadian enterprise, subject to applicable measures of appeal.

(b) In order to effect the inclusion of such profits in the taxable profits of the Canadian enterprise, the competent authority of Canada may, when necessary, rectify the accounts of the Canadian enterprise, notably to correct errors and omissions or to re-establish the prices or remuneration entered in the books at the values which would prevail between independent persons dealing at arm's length. To facilitate such rectification the competent authorities of the contracting States may consult together with a view to such determination of profits of the Canadian enterprise as may appear fair and reasonable.

2. The same principle applies, *mutatis mutandis*, in the event that profits are diverted from a United States enterprise to a Canadian enterprise.

ARTICLE V.

Income which an enterprise of one of the contracting States derives from the operation of ships or aircraft registered in that State shall be exempt from taxation in the other contracting State.

The present Convention will not be deemed to affect the exchange of notes between the United States of America and Canada, dated the 2nd August and the 17th September, 1928, providing for relief from double income taxation on shipping profits.⁽²⁾

(²) For the Exchange of Notes see "Canada Treaty Series No. 9, 1928."

ARTICLE VI.

Wages, salaries and similar compensation paid by the Government, or any agency or instrumentality thereof, of one of the contracting States or by the political subdivisions or territories or possessions thereof to citizens of such State residing in the other State shall be exempt from taxation in the latter State.

Pensions and life annuities derived from within one of the contracting States and paid to individuals residing in the other contracting State shall be exempt from taxation in the former State.

ARTICLE VII.

1. A resident of Canada shall be exempt from United States income tax upon compensation for labour or personal services performed within the United States of America if he conforms to either of the following conditions—

- (a) He is temporarily present within the United States of America for a period or periods not exceeding a total of one hundred and eighty-three days during the taxable year and such compensation (A) is received for labour or personal services performed as an employee of, or under contract with, a resident or corporation or other entity of Canada, and (B) does not exceed \$5,000 in the aggregate during such taxable year; or
- (b) He is temporarily present in the United States of America for a period or periods not exceeding a total of ninety days during the taxable year and the compensation received for such services does not exceed \$1,500 in the aggregate during such taxable year.

2. The provisions of paragraph 1 (a) of this Article shall have no application to the professional earnings of such individuals as actors, artists, musicians and professional athletes.

3. The provisions of paragraphs 1 and 2 of this Article shall apply, *mutatis mutandis*, to a resident of the United States of America deriving compensation for personal services performed within Canada.

ARTICLE VIII.

Gains derived in one of the contracting States from the sale or exchange of capital assets by a resident or a corporation or other entity of the other contracting State shall be exempt from taxation in the former State, provided such resident or corporation or other entity has no permanent establishment in the former State.

ARTICLE IX.

Students or business apprentices from one of the contracting States residing in the other contracting State for purposes of study or for acquiring business experience shall not be taxable by the latter State in respect of remittances received by them from within the former State for the purposes of their maintenance or studies.

ARTICLE X.

Income derived from sources within one of the contracting States by a religious, scientific, literary, educational, or charitable organization of the other contracting State shall be exempt from taxation in the State from which the income is derived if, within the meaning of the laws of both contracting States, such organization would have been exempt from income tax.

ARTICLE XI.

1. The rate of income tax imposed by one of the contracting States, in respect of income derived from sources therein, upon individuals residing in, or corporations organized under the laws of, the other contracting State, and not engaged in trade or business in the former State and having no office or place of business therein, shall not exceed 15 per cent. for each taxable year.

2. Notwithstanding the provisions of paragraph 1 of this Article, income tax in excess of 5 per cent. shall not be imposed by one of the contracting States in respect of dividends paid by a subsidiary corporation organized under the laws of such State, or of a political sub-division thereof, to a parent corporation organized under the laws of the other contracting State, or of a political sub-division thereof: Provided, however, That this paragraph shall not apply if the competent authority in the former State is satisfied that the corporate relationship between the two corporations has been arranged or is maintained primarily with the intention of taking advantage of this paragraph.

3. Notwithstanding the provisions of Article XXII of this Convention, paragraph 1 or paragraph 2, or both, of this Article, may be terminated without notice on or after the termination of the three-year period beginning with the effective date of this Convention by either of the contracting States imposing a rate of income tax in excess of the rate of 15 per cent. prescribed in paragraph 1 or in excess of the rate of 5 per cent. prescribed in paragraph 2.

4. The provisions of this Article shall not be construed so as to contravene the Tax Convention between Canada and the United States of America, effective the 1st January, 1936, to the 29th April, 1941.

ARTICLE XII.

Dividends and interest paid on or after the effective date of this Convention by a corporation organized under the laws of Canada to individual residents of Canada, other than citizens of the United States of America, or to corporations organized under the laws of Canada shall be exempt from all income taxes imposed by the United States of America.

ARTICLE XIII.

Corporations organized under the laws of Canada, more than 50 per cent. of the outstanding voting stock of which is owned directly or indirectly throughout the last half of the taxable year by individual residents of Canada, other than citizens of the United States of America, shall be exempt from any taxes imposed by the United States of America with respect to accumulated or undistributed earnings, profits, income or surplus of such corporations. With respect to corporations organized under the laws of Canada not exempt from such taxes under the provisions of this Article the competent authorities of the two contracting States will consult together.

ARTICLE XIV.

1.—(a) The United States income tax liability for any taxable year beginning prior to the 1st January, 1936, of any individual resident of Canada, other than a citizen of the United States of America, or of any corporation organized under the laws of Canada, remaining unpaid as of the date of signature of this Convention may be adjusted on a basis satisfactory to the Commissioner; Provided, That the amount to be paid in

settlement of such liability shall not exceed the amount of the liability which would have been determined if—

- (A) The Revenue Act of 1936, as modified by the Tax Convention between Canada and the United States of America, effective the 1st January, 1936, to the 29th April, 1941 (except in the case of a corporation organized under the laws of Canada more than 50 per cent. of the outstanding voting stock of which was owned directly or indirectly throughout the last half of the taxable year by citizens or residents of the United States of America) and
- (B) Articles XII and XIII of this Convention had been in effect for such year.

If the taxpayer was not, within the meaning of the Revenue Act of 1936, engaged in trade or business within the United States of America and had no office or place of business therein during the taxable year, the amount of interest and penalties shall not exceed 50 per cent. of the amount of the tax with respect to which such interest and penalties have been computed.

(b) The United States income tax liability remaining unpaid as of the date of signature of this Convention for any taxable year beginning after the 31st December, 1935, and prior to the 1st January, 1941, in the case of any individual resident of Canada, other than a citizen of the United States of America, or in the case of any corporation organized under the laws of Canada shall be determined as if the provisions of Articles XII and XIII of this Convention had been in effect for such year.

2. The provisions of paragraph 1 of this Article shall not apply—

- (a) Unless the taxpayer files with the Commissioner within two years from the date of signature of this Convention a request that such tax liability be so adjusted together with such information as the Commissioner may require;
- (b) In any case in which the Commissioner is satisfied that any deficiency in tax is due to fraud with intent to evade the tax.

ARTICLE XV.

In accordance with the provisions of Section 8 of the Income War Tax Act as in effect on the day of the entry into force of this Convention, Canada agrees to allow as a deduction from the Dominion income and excess profits taxes on any income which was derived from sources within the United States of America, and was there taxed, the appropriate amount of such taxes paid to the United States of America.

In accordance with the provisions of Section 131 of the United States Internal Revenue Code as in effect on the day of the entry into force of this Convention, the United States of America agrees to allow as a deduction from the income and excess profits taxes imposed by the United States of America the appropriate amount of such taxes paid to Canada.

ARTICLE XVI.

Where a taxpayer shows proof that the action of the revenue authorities of the contracting States has resulted in double taxation in his case in respect of any of the taxes to which the present Convention relates, he shall be entitled to lodge a claim with the State of which he is a citizen or resident or, if the taxpayer is a corporation or other entity, with the State in which it was created or organized. If the claim should be deemed worthy of consideration, the competent authority of such State may consult with the competent authority of the other State to determine whether the

double taxation in question may be avoided in accordance with the terms of this Convention.

ARTICLE XVII.

Notwithstanding any other provision of this Convention, the United States of America in determining the income and excess profits taxes, including all surtaxes, of its citizens or residents or corporations, may include in the basis upon which such taxes are imposed all items of income taxable under the revenue laws of the United States of America as though this Convention had not come into effect.

ARTICLE XVIII.

The competent authorities of the two contracting States may prescribe regulations to carry into effect the present Convention within the respective States and rules with respect to the exchange of information.

The competent authorities of the two contracting States may communicate with each other directly for the purpose of giving effect to the provisions of the present Convention.

ARTICLE XIX.

With a view to the prevention of fiscal evasion, each of the contracting States undertakes to furnish to the other contracting State, as provided in the succeeding Articles of this Convention, the information which its competent authorities have at their disposal or are in a position to obtain under its revenue laws in so far as such information may be of use to the authorities of the other contracting State in the assessment of the taxes to which this Convention relates.

The information to be furnished under the first paragraph of this Article, whether in the ordinary course or on request, may be exchanged directly between the competent authorities of the two contracting States.

ARTICLE XX.

1. The competent authorities of the United States of America shall forward to the competent authorities of Canada as soon as practicable after the close of each calendar year the following information relating to such calendar year:—

The names and addresses of all persons whose addresses are within Canada and who derive from sources within the United States of America dividends, interest, rents, royalties, salaries, wages, pensions, annuities, or other fixed or determinable annual or periodical profits and income, showing the amount of such profits and income in the case of each addressee.

2. The competent authorities of Canada shall forward to the competent authorities of the United States of America as soon as practicable after the close of each calendar year the following information relating to such calendar year:—

(a) The names and addresses of all persons whose addresses are within the United States of America and who derive from sources within Canada dividends, interest, rents, royalties, salaries, wages, pensions, or other fixed or determinable annual or periodical profits and income, showing the amount of such profits and income in the case of each addressee.

- (b) The names and addresses of all persons whose addresses are outside of Canada and who derive through a nominee, or agent, or custodian in Canada income from sources within the United States of America, and who are not entitled to the reduced rate of 15 per cent. with respect to such income provided in Article XI of this Convention, showing the amount of such income in the case of each addressee.
- (c) The names and addresses, where available, of persons whose addresses are outside of Canada and who derive dividends during the calendar year from corporations organized under the laws of Canada, more than 50 per cent. of the gross income of which is derived from sources within the United States of America, showing the amount of such dividends in each case.
- (d) The names and addresses of all persons whose addresses are within the United States of America and who beneficially or of record own stocks or bonds, debentures or other securities, or evidences of funded indebtedness, of any company taxed in Canada as a Non-Resident-Owned Investment Corporation. The term "Non-Resident-Owned Investment Corporation" shall have the same meaning as when used in the Income War Tax Act of Canada.

ARTICLE XXI.

1. If the Minister in the determination of the income tax liability of any person under any of the revenue laws of Canada deems it necessary to secure the co-operation of the Commissioner, the Commissioner may, upon request, furnish the Minister such information bearing upon the matter as the Commissioner is entitled to obtain under the revenue laws of the United States of America.

2. If the Commissioner in the determination of the income tax liability of any person under any of the revenue laws of the United States of America deems it necessary to secure the co-operation of the Minister, the Minister may, upon request, furnish the Commissioner such information bearing upon the matter as the Minister is entitled to obtain under the revenue laws of Canada.

ARTICLE XXII.

This Convention and the accompanying Protocol which shall be considered to be an integral part of the Convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

This Convention and Protocol shall become effective on the first day of January 1941. They shall continue effective for a period of three years from that date and indefinitely after that period, but may be terminated by either of the contracting States at the end of the three-year period or at any time thereafter provided that, except as otherwise specified in the case of Article XI, at least six months prior notice of termination has been given, the termination to become effective on the first day of January following the expiration of the six-month period.

Done in duplicate, at Washington, this fourth day of March 1942.

(Seal) . LEIGHTON McCARTHY.
 (Seal) SUMNER WELLES.

II.

PROTOCOL.

At the moment of signing the Convention for the avoidance of double taxation, and the establishment of rules of reciprocal administrative assistance in the case of income taxes, this day concluded between Canada and the United States of America, the undersigned plenipotentiaries have agreed upon the following provisions and definitions:—

1. The taxes referred to in this Convention are:—

- (a) for the United States of America: the Federal income taxes, including surtaxes, and excess-profits taxes;
- (b) for Canada: the Dominion income taxes, including surtaxes, and excess-profits taxes.

2. In the event of appreciable changes in the fiscal laws of either of the contracting States, the Governments of the two contracting States will consult together.

3. As used in this Convention—

- (a) the terms “person,” “individual” and “corporation,” shall have the same meanings, respectively, as they have under the revenue laws of the taxing State or the State furnishing the information, as the case may be;
- (b) the term “enterprise” includes every form of undertaking, whether carried on by an individual, partnership, corporation or any other entity;
- (c) the term “enterprise of one of the contracting States” means, as the case may be, “United States enterprise” or “Canadian enterprise”;
- (d) the term “United States enterprise” means an enterprise carried on in the United States of America by an individual resident in the United States of America, or by a corporation, partnership or other entity created or organized in or under the laws of the United States of America, or of any of the States or Territories of the United States of America;
- (e) the term “Canadian enterprise” is defined in the same manner *mutatis mutandis* as the term “United States enterprise”;
- (f) the term “permanent establishment” includes branches, mines and oil wells, farms, timber lands, plantations, factories, workshops, warehouses, offices, agencies and other fixed places of business of an enterprise, but does not include a subsidiary corporation.

When an enterprise of one of the contracting States carries on business in the other contracting State through an employee or agent established there, who has general authority to contract for his employer or principal or has a stock of merchandise from which he regularly fills orders which he receives, such enterprise shall be deemed to have a permanent establishment in the latter State.

The fact that an enterprise of one of the contracting States has business dealings in the other contracting State through a commission agent, broker or other independent agent or maintains therein an office used solely for the purchase of merchandise shall not be held to mean that such enterprise has a permanent establishment in the latter State.

4. The term “Minister,” as used in this Convention, means the Minister of National Revenue of Canada or his duly authorized

representative. The term "Commissioner," as used in this Convention, means the Commissioner of Internal Revenue of the United States of America or his duly authorized representative. The term "competent authority," as used in this Convention, means the Minister and the Commissioner and their duly authorized representatives.

5. The term "Canada," when used in a geographical sense, means the Provinces, the Territories and Sable Island. The term "United States of America," when used in a geographical sense, includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

6. The term "subsidiary corporation" referred to in Article XI of this Convention means a corporation all of whose shares (less directors' qualifying shares) having full voting rights are beneficially owned by another corporation, provided that ordinarily not more than one-quarter of the gross income of such subsidiary corporation is derived from interest and dividends other than interest and dividends received from its subsidiary corporations.

7.—(a) The term "rentals and royalties" referred to in Article II of this Convention shall include rentals or royalties arising from leasing real or immovable, or personal or movable property or from any interest in such property, including rentals or royalties for the use of, or for the privilege of using, patents, copyrights, secret processes and formulæ, goodwill, trade marks, trade brands, franchises and other like property;

(b) the term "interest," as used in this Convention, shall include income arising from interest-bearing securities, public obligations, mortgages, hypothecs, corporate bonds, loans, deposits and current accounts;

(c) the term "dividends," as used in this Convention, shall include all distributions of the earnings or profits of corporations.

8. The term "pensions" referred to in Article VI of this Convention means periodic payments made in consideration for services rendered or by way of compensation for injuries received.

9. The term "life annuities" referred to in Article VI of this Convention means a stated sum payable periodically at stated times, during life, or during a specified number of years, under an obligation to make the payments in consideration of a gross sum or sums paid by the recipient or under a contributory retirement plan.

10. The terms "engaged in trade or business" and "office or place of business" as used in Article XI of this Convention shall not be deemed to include an office used solely for the purchase of merchandise.

11. The provisions of the present Convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance accorded by the laws of one of the contracting States in the determination of the tax imposed by such State.

12. The citizens of one of the contracting States residing within the other contracting State shall not be subjected to the payment of more burdensome taxes than the citizens of such other State.

Done in duplicate, at Washington, this fourth day of March, 1942.

(Seal) LEIGHTON McCARTHY.

(Seal) SUMNER WELLES.