

Tax Memo

Canada Signs its First Tax Information Exchange Agreement (TIEA)

On August 29, 2009, Minister of Finance Jim Flaherty announced that a Tax Information Exchange Agreement (TIEA) had been signed with the Kingdom of the Netherlands in respect of the Netherlands Antilles – the first TIEA signed by Canada.

A TIEA is a bilateral agreement under which two countries that are not parties to a tax treaty (non-treaty countries) undertake to exchange tax information that is relevant to the administration and enforcement of the domestic tax laws of each country. In particular, a TIEA sets out a framework for exchanging information to help enforce tax laws and to combat tax evasion and tax havens.

Background

The 2007 federal budget proposed the following measures to encourage non-treaty countries to enter into TIEAs:

- Exempt surplus – The existing exemption for dividends received out of active business income (exempt surplus) earned by foreign affiliates resident in treaty countries will be extended to active business income earned by a foreign affiliate residing in a country that has agreed to a TIEA with Canada.
- Foreign accrual property income (FAPI) – Active business income earned by foreign affiliates in non-TIEA, non-treaty countries will be treated as FAPI (which is taxable on an accrual basis) if a TIEA with Canada is not concluded by 60 months after either:
 - the start of TIEA negotiations; or
 - the date on which Canada formally proposed TIEA negotiations.

However, for TIEA negotiations that began before March 20, 2007, negotiations must be completed before 2014 to avoid the application of the FAPI rules.

Therefore, while the exempt surplus measure provides a “carrot” for countries that conclude TIEAs, FAPI treatment is the “stick” for those that do not.

Entry into Force

The entry into force of a TIEA – not the date it is signed – is important for purposes of determining when the TIEA applies. Discussions with Department of Finance officials have indicated that, after a TIEA is signed, the following steps must occur for the TIEA to enter into force:

1. The TIEA must be tabled in Parliament, where it remains for 21 parliamentary sitting days.
2. If there are no objections by members of Parliament, the TIEA is considered to have been ratified by the government.
3. The governments that are the parties to the TIEA must notify each other of their respective ratifications.

We expect that, once a TIEA enters into force, it will be added to the Department of Finance website as being in force, just as in-force treaties are.

For purposes of determining the exempt surplus of a foreign affiliate of a corporation resident in Canada in respect of that corporation, a TIEA is considered to enter into force on the first day of the taxation year of the foreign affiliate that includes the day that step #3 (above) occurs. For example, if step #3 occurs on September 15, 2010, in respect of a foreign affiliate that has a calendar year end, the TIEA will be considered to enter into force on January 1, 2010, for exempt surplus purposes.

This delay in the ability to generate exempt surplus until the taxation year of a foreign affiliate in which a TIEA enters into force differs from the situation when there is a new tax treaty. For exempt surplus purposes, once entered into force, a treaty is deemed to have entered into force and have effect for the taxation year of a foreign affiliate that includes the day on which the treaty was signed.

It will be interesting to see how long this first TIEA takes to enter into force.

TIEA Negotiations

Canada intends to sign similar agreements with other non-treaty countries that commit to the Organisation for Economic Co-operation and Development (OECD) standard for the exchange of tax information. That standard encourages member countries to enter into TIEAs with non-tax treaty jurisdictions.

As noted above under **Background**, a critical date is the expiry of the 60-month period that triggers the application of the FAPI rules. This date depends on when TIEA negotiations start or when Canada formally proposes TIEA negotiations.

The 14 jurisdictions that Canada is in TIEA negotiations with as of August 31, 2009, and the date negotiations commenced, are listed in following table:

Jurisdiction	Negotiations started
Anguilla	August 24, 2009
Aruba	May 25, 2009
Bahamas	May 18, 2009
Bahrain	June 29, 2009
Bermuda	April 30, 2009
British Virgin Islands	December 6, 2005 ¹
Cayman Islands	June 9, 2009
Gibraltar	May 14, 2009
Guernsey	May 4, 2009
Isle of Man	October 12, 2005 ¹
Jersey	October 17, 2005 ¹
Saint Kitts and Nevis	March 30, 2009
Saint Lucia	April 2, 2009
Turks and Caicos	June 25, 2009

- For TIEA negotiations that began before March 20, 2007, negotiations must be completed before 2014 to avoid the application of the FAPI rules.

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