

# *Canada-Bermuda Tax Information Exchange Agreement*

15 September 2011

## *The Canada-Bermuda TIEA makes Bermuda subsidiaries of Canadian corporations eligible for certain Canadian tax benefits that were otherwise only available to foreign affiliates resident in countries with which Canada had a tax treaty.*

Bermuda is poised to become a more attractive jurisdiction for Canadian multinational corporations to carry on certain business activities thanks to a Tax Information Exchange Agreement signed by the two countries on June 14, 2010.

The Canada-Bermuda TIEA, which came into force on July 1, 2011, makes Bermuda subsidiaries of Canadian corporations eligible for certain Canadian tax benefits that were otherwise only available to foreign affiliates resident in countries with which Canada had a tax treaty. The entry into force of the TIEA provides incentives for Canadian investment into Bermuda through the repatriation of tax-free dividends to Canada – creating a win-win situation for both countries.

### *What is a TIEA?*

A TIEA is a bilateral agreement under which two non-treaty countries, that is, countries that are not parties to a tax treaty, undertake to exchange tax information that is relevant to the administration and enforcement of the domestic tax laws of each country. The purpose of a TIEA is to set out a framework in which two countries exchange information to help enforce tax laws and to combat tax evasion and tax havens.

Under the terms of the Canada-Bermuda TIEA, both countries will share information with each other for the purposes of determination, assessment and collection of taxes, and investigating or prosecuting tax avoidance or tax evasion. Information that can be exchanged could, for example, take the form of bank records and ownership records of corporations, partnerships, or trusts. However, the Canada-Bermuda TIEA does include provisions to protect the confidentiality of information provided between countries, whereby information requested cannot be client-attorney confidential communications, and requests for information between countries must be related to relevant tax investigations.

TIEA's were introduced in the late 1990's when the Organization for Economic Cooperation and Development (OECD) identified a lack of transparency and cooperation

between countries resulting in harmful tax practices. As a result the OECD Global Forum Working Group was established and created a standard agreement to help set up systems of tax information exchange between nations, which resulted in the creation of the OECD Model Agreement on Exchange of Information on Tax Matters, known as the OECD Model TIEA. The OECD Model TIEA was the agreement that formed the basis of the Canada-Bermuda TIEA.

### *Change in Canadian tax policy*

A legislative change in policy was announced in March 2007 to extend favourable Canadian tax treatment, that was previously only available to countries with which Canada had a tax treaty, to foreign affiliates resident in and carrying on business in countries with which Canada has concluded a TIEA (the "TIEA amendments"). However, this "carrot" does not come without the "stick." Thus, as part of the TIEA amendments, Canada introduced legislative provisions to discourage Canadian investment in jurisdictions that do not successfully negotiate TIEAs with Canada after 60 months from the commencement of negotiations.

### *Advantages for Canadian subsidiaries in Bermuda*

On July 1, 2011, the date the TIEA officially entered into force, Bermuda was granted the status of "designated treaty country" ("DTC"). A Bermuda subsidiary of a Canadian corporation that is resident in a DTC and earns profits from an active business in a DTC are eligible to include those profits in its "exempt surplus". Furthermore, certain types of passive income (including interest and royalties paid to the Bermudian subsidiary by an affiliated company also resident in a TIEA or treaty jurisdiction if, among other conditions, the payment is deductible from the active business earnings of the affiliated company) may be deemed to be active business income to the Bermudian subsidiary. This deemed

active business income may also be included in the exempt surplus of the Bermudian subsidiary. The ultimate benefit being dividends received by that Canadian parent corporation from the exempt surplus of its Bermudian subsidiary are generally not subject to further tax in Canada.

Otherwise, non-qualifying dividends may be subject to Canadian taxes of up to 26.5%.

Although tax advantages may be the primary incentive for Canadian companies to carry on business in Bermuda, there are other factors that make Bermuda an attractive jurisdiction. For example, leveraging their presence in Bermuda in managing group insurance risks can offer significant financial and operations benefits. World class expertise and capacity in Bermuda offers direct and easy access to the reinsurance and insurance markets, which is very important particularly where the group utilizes one or more captive insurance company. Furthermore, Bermuda has a well respected financial regulator - the Bermuda Monetary Authority - a common law legal system modeled on that of the United Kingdom and similar to the common law system in Canada. Bermuda has a stable economy, a local currency that is pegged to the US dollar, high quality service providers, and an international airport that provides easy access to Canada by direct and daily flights to Toronto. All of these factors combined make Bermuda a business-friendly, low-risk offshore jurisdiction for Canadian companies.

#### **Advantages for Bermuda**

Canadian companies are already well entrenched in the Bermuda business world, especially in areas such as captive insurance, hedge funds and banking. The TIEA will provide a more tax-efficient regime for Canadian companies to continue to do business in Bermuda, or to bring new business to Bermuda. Since Bermuda does not levy any corporate income tax, capital gains tax or withholding tax, Canadian corporations will realize substantial tax savings by using a Bermuda based subsidiary as part of their global structure.

This makes Bermuda a more attractive jurisdiction than certain of Canada's tax treaty partners, such as Barbados, Ireland and Cyprus, where the tax rates, while favourable, are not as low as Bermuda. For example, Barbados has been a DTC with Canada since 1980. Prior to the TIEA amendments, this provided Barbados with an advantage over Bermuda because Barbadian companies carrying on an active business or a deemed active business in Barbados could generate exempt surplus from which dividends could generally be repatriated to Canada free of further Canadian tax.

The same advantage is now extended to Bermuda under the Canada-Bermuda TIEA. The differentiating factor, however is that the government of Barbados levies corporate income taxes on foreign affiliates incorporated in Barbados with rates between 1.0% and 2.5% depending on the level on profits and gains earned. Since Bermuda does not prescribe corporate tax rates to corporations, Canadian companies will achieve greater tax savings in Bermuda as opposed to in Barbados or other double taxation treaty partners. Overall the Canada-Bermuda TIEA should result in more Canadian companies choosing to carry on business in Bermuda.

Bermuda has currently signed 28 TIEAs with various global jurisdictions, thereby creating opportunities for foreign businesses in Bermuda and ensuring Bermuda's continued success as a pre-eminent offshore domicile.

Profit-driven entities, with foreign affiliates outside of Canada generating intra-group financing and investing activities may want to consider structuring international operations so that subsidiaries generate exempt income which can be dividend back to the Canadian parent tax-free. PwC assists Canadian corporations in the planning of group structures to obtain a more tax-effective approach to managing international operations.

*For further information or assistance please visit [www.pwc.com/bermudacaptives](http://www.pwc.com/bermudacaptives).*

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