



The Canadian Chamber of Commerce in Japan
La Chambre de commerce du Canada au Japon
在日カナダ商工会議所

Position Paper: Canada-Japan Tax Treaty

The CCCJ believes that the Canada-Japan Tax Treaty should be amended to reduce tax barriers to trade between the two countries.

This position paper addresses certain disparities between the Canada-Japan and U.S.-Japan tax treaties. Unless the Canada-Japan Tax Treaty is amended, these disparities will have a significant negative impact on the competitiveness of Canadian businesses and individuals.

The general purpose of tax treaties is to avoid both double taxation and fiscal evasion. Reducing double taxation in turn increases trade and efficiencies between the treaty parties. Tax treaties eliminate tax barriers to trade and investment, and their corresponding inefficiencies, not only by avoiding double taxation, but also by: (1) providing greater certainty to taxpayers regarding potential tax liability in the foreign jurisdiction; and (2) ensuring that taxpayers will not be subject to discriminatory taxation in that jurisdiction.

Both Canada and Japan would gain economic benefits from eliminating and reducing their reciprocal tax barriers. These benefits include: (1) the reduction of Canadian investors' costs and the corresponding increase in their international competitiveness; and (2) the reduction of Japanese investors' costs relating to investing in Canada which would likely encourage greater investment into Canada.

The U.S.-Japan Income Tax Convention and Protocol was signed on November 6, 2003 ("U.S. treaty"), ratified by the U.S. Senate on March 9, 2004 and came into full force as at March 30, 2004. The U.S. Treaty goes significantly further than the current Canada-Japan tax regime toward achieving increased trade and efficiencies through elimination or reduction of key items of double taxation. Key differences between the U.S. Treaty and the Canada-Japan Income Tax Convention and Protocol signed on May 7, 1986, amended by a Protocol signed on February 19, 1999 ("Canada treaty"), include the following items:

1. Royalties

U.S. Treaty: Eliminates withholding taxes in relation to royalties. With the elimination of source-country withholding taxes on royalties relating to licensed intangible intellectual property, such royalties will be taxed exclusively by the country of residence on a net basis in the same manner as other business profits. Importantly, this is the first treaty in which Japan has agreed to eliminate source-country withholding taxes on royalties.

Canada Treaty: Royalties are subject to a withholding tax of a maximum rate of 10% of their gross amounts.

2. Dividends

U.S. Treaty: Eliminates or significantly reduces source-country withholding taxes with respect to cross-border dividends.

Canada Treaty: Intercompany Dividends, i.e., where the dividend is received by a company that owns more than 25% of the voting stock of the company paying the dividend, are generally subject to a withholding tax of up to a maximum rate of 5% of their gross amounts, subject to a six-month holding period requirement.

All other dividends are subject to a withholding tax of up to a maximum rate of 15% of their gross amounts.

3. Interest Payments

U.S. Treaty: Eliminates source-country withholding taxes for significant categories of interest, including interest earned by financial service companies and pension funds.

Canada Treaty: Most categories of interest, including interest earned by financial service companies and pension funds, are subject to a withholding tax of up to a maximum rate of 10% of their gross amounts. Canadian domestic law provides that certain payments of interest are not subject to withholding tax (e.g., the five-year debt exception).

4. **Gains**

U.S. Treaty: Eliminates withholding taxes relating to capital gains, with narrow exceptions relating to real property and restructured financial institutions.

Canada Treaty: Capital gains are subject to withholding taxes without limitation (other than in relation to ships and aircraft).

The above disparities, in particular, put Canadians in a weaker position than their American competitors. Without government action, those disparities will likely have a significant adverse impact upon Canadian competitiveness in international trade by reducing opportunities for Canadian businesses and individuals. The fact that the U.S. and Japan are the world's two largest economies makes the stakes high; the risk of inaction is too large to ask Canadian businesses and individuals to bear.

We urge the governments of Canada and Japan to take prompt action to eliminate the above-mentioned disparities between the Canada-Japan and U.S.-Japan tax withholding rates. Such action must be taken now to ensure that Canadians can compete in Japan on an equal footing with other major countries.

August 2004