

## New Protocol to the Canada-US Tax Treaty: Corporate Continuance and Residence

The Fifth Protocol (the “**Protocol**”) to the *Canada-US Income Tax Convention* (the “**Treaty**”) introduces significant changes to the rules relating to corporate continuance and residence. Of particular note, the Protocol will provide that corporations incorporated in one country, which are continued into another, will still be treated as a resident of the first country unless that country’s internal law no longer treats it as such.

### Background

Although the *Income Tax Act (Canada)* (the “**Tax Act**”) does not define residency, it contains specific provisions that deem a corporation to be either a resident or non-resident of Canada under certain circumstances. A corporation is deemed to be resident in Canada if it was incorporated in Canada after April 26, 1965, or, in the event that it was incorporated before April 27, 1965, if it carried on a business in Canada or was resident in Canada under common-law principles (the “central management and control” test).

Both the Tax Act and US tax law generally permit a company that ceases to be resident in one country and becomes resident in another (i.e., is “continued” in the other country) to be treated on a going-forward basis as a resident of its new home country. Under the current rules, the Treaty recognizes such a change of residence and treats a company that is continued from one country to another as being thereafter resident in the other country.

The Canadian and US tax authorities have suggested that, under certain circumstances, these continuance provisions may be misused in cases where a company is continued under the laws of one country but does not terminate its residence status under the laws of the first country (i.e., the company may be entitled to claim Treaty benefits as a resident of the country into which it has continued while maintaining the entitlement to claim certain domestic tax benefits under the laws of its former jurisdiction of incorporation). Discussions between

Canadian and US officials with respect to this issue date back to as early as September 2000, when the two governments “agreed in principle” on the changes to the Treaty which are now contained in the Protocol.

### **The New Rules**

The Protocol amends the Treaty by clarifying that a dual resident company incorporated in one country and continued into another country is deemed to be a resident only of the first country, thereby eliminating any potential for related abuse of the residency article of the Treaty.

The Protocol further provides that in any other case of dual residency, the competent authorities will settle the question of residency by mutual agreement. In the

absence of such agreement, a dual resident company will not be considered to be a resident of either country for purposes of claiming the benefits of the Treaty.

Special consideration should be given to the fact that this Protocol amendment applies to continuances effected after September 17, 2000.

The preceding modifications to the corporate continuance and residency rules contained in the Treaty will not only have a bearing on the potential continuance of US or Canadian entities in the future but, given the seemingly retroactive effect of this element of the Protocol, may give rise to unexpected tax consequences in respect of historical corporate continuances.

---

### **A Cautionary Note**

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

**ABOUT McMILLAN LLP'S TAX LAW GROUP**

Our Tax Law Group ranks among the best in Canada and includes individuals who have been recognized internationally as leading advisers in The Martindale-Hubbell Legal Directory and The Canadian Legal LEXPERT Directory. Always sensitive to our clients' business objectives, we provide comprehensive and pragmatic Canadian tax advice on a wide variety of matters, including corporate reorganizations, mergers and acquisitions, securities, structured financing and derivative products, leasing, and cross-border transactions. Routinely advising clients on compliance matters, we are experienced in negotiating disputes with revenue authorities and litigating tax issues.

For further information, please contact one of the members of our Tax Law Group:

**Toronto**

Sheila Crummey	416.865.7017	sheila.crummey@mcmillan.ca
Michael Friedman	416.865.7914	michael.friedman@mcmillan.ca
Mary-Ann Haney	416.865.7293	mary.ann.haney@mcmillan.ca
Todd Miller	416.865.7058	todd.miller@mcmillan.ca
Ryan Morris	416.865.7180	ryan.morris@mcmillan.ca
Catherine Roberts	416.865.7202	catherine.roberts@mcmillan.ca
Laura Stoddard	416.865.7277	laura.stoddard@mcmillan.ca
Michael Templeton	416.865.7837	michael.templeton@mcmillan.ca
David Wentzell	416.865.7036	david.wentzell@mcmillan.ca
Jamie Wilks	416.865.7804	jamie.wilks@mcmillan.ca
Mickey Yaksich	416.865.7097	mickey.yaksich@mcmillan.ca

**Montreal**

Andrew Etcovitch	514.987.5064	andrew.etcovitch@mcmillan.ca
John Israel Galambos	514.987.5058	john.galambos@mcmillan.ca

[mcmillan.ca](http://mcmillan.ca)

McMillan LLP

Toronto | t 416.865.7000 | f 416.865.7048

Montreal | t 514.987.5000 | f 514.987.1213

Barristers & Solicitors