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Information on the United States-Canada Income Tax Treaty



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See *How To Get More Information* in this publication.

Introduction

This publication provides information on the income tax treaty between the United States and Canada. It discusses a number of treaty provisions that often apply to U.S. citizens or residents who may be liable for Canadian tax.

Treaty provisions are generally reciprocal (the same rules apply to both treaty countries). Therefore, a Canadian resident who receives income from the United States may refer to this publication to see if a treaty provision may affect the tax to be paid to the United States.



This publication does not deal with Canadian income tax laws; nor does it provide Canada's interpretation of treaty articles, definitions, or specific terms not defined in the treaty itself.

The United States—Canada income tax treaty was signed on September 26, 1980. It has been amended by protocols signed June 14, 1983, March 28, 1984, March 17, 1995, and July 29, 1997. In this publication, the term **article** refers to the particular article of the treaty, as amended.

Application of Treaty

The benefits of the income tax treaty are generally provided on the basis of residence for income tax purposes. That is, a person who is recognized as a resident of the United States who has income from Canada, will often pay less income tax to Canada on that income than if no treaty was in effect. Article IV provides definitions of residents of Canada and the United States, and provides specific criteria for applying the treaty in cases where a taxpayer is considered by both countries to be a resident.

In most instances a treaty does not affect the right of a foreign country to tax its own residents (including those who are U.S. citizens) or of the United States to tax its residents or citizens (including U.S. citizens who are residents of the foreign country). This provision is known as the "saving clause."

For example, an individual who is a U.S. citizen and a resident of Canada may have dividend income from a U.S. corporation. The treaty provides a maximum rate of 15% on dividends received by a resident of Canada from sources in the United States. Even though a resident of Canada, the individual is a U.S. citizen and the saving clause overrides the treaty article that limits the U.S. tax to 15%.

If you take the position that any U.S. tax is overruled or otherwise reduced by a U.S. treaty (a treaty-based position), you generally must disclose that position on Form 8833, *Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)*, and attach it to your return.

Personal Services

A U.S. citizen or resident who is temporarily present in Canada during the tax year is exempt from Canadian income taxes on pay for services performed, or remittances received from the United States, if the citizen or resident qualifies under one of the treaty exemption provisions set out below.

Compensation for personal services (Articles XIV, XV, and XVI). Under the treaty, the exemption from Canadian tax for personal service income of a U.S. resident depends on whether the services are performed as an employee (dependent personal services) or as an independent contractor or self-employed individual (independent personal services).

Income U.S. residents receive for the performance of independent personal services in Canada (except as public entertainers) is exempt from Canadian tax if they do not have (or have not had) a fixed base regularly available to them in Canada for the purpose of performing the services. If the U.S. residents have (or had) a fixed base available in Canada, under the treaty they are taxed by Canada only on the income attributable to the fixed base.

Income U.S. residents receive for the performance of dependent personal services in Canada (except as public entertainers) is exempt from Canadian tax if it is not more than \$10,000 in Canadian currency for the year. If it is more than \$10,000 for the year, it is exempt only if:

- 1) The residents are present in Canada for no more than 183 days during the calendar year, and
- 2) The income is not borne by a Canadian resident employer or by a permanent establishment or fixed base of an employer in Canada.

For example, assume that you are a U.S. resident employed under an 8-month contract with a Canadian firm to install equipment in their Montreal plant. During the calendar year you were physically present in Canada for 179 days and were paid \$10,120 (Canadian) for your services. Although you were in Canada for not more than 183 days during the year, your income is not exempt from Canadian income tax because it was borne by a Canadian employer **and** was more than \$10,000 (Canadian) for the year.

Pay received by a U.S. resident for work regularly done in more than one country as an employee on a ship, aircraft, motor vehicle, or train operated by a U.S. resident is exempt from Canadian tax.

Public entertainers. The exemptions for either dependent or independent personal services do not apply to public entertainers (such as theater, motion picture, radio, or television artistes, musicians, or athletes) from the United States who derive more than \$15,000 in gross receipts in Canadian currency, including reimbursed expenses, from their entertainment activities in Canada during the calendar year. However, the exemptions do apply, regardless of this \$15,000 limit, to athletes participating in team sports in leagues with regularly scheduled games in both the United States and Canada.

Compensation paid by the U.S. Government (Article XIX). Wages, salaries, and similar income (other than pensions) paid to a U.S. citizen by the United States or any of its agencies, instrumentalities, or political subdivisions for discharging governmental functions are exempt from Canadian income tax.

The exemption does not apply to pay for services performed in connection with any trade or business carried on for profit by the United States, or any of its agencies, instrumentalities, or political subdivisions.

Students and apprentices (Article XX). A full-time student, apprentice, or business trainee who is in Canada to study or acquire business experience is exempt from Canadian income tax on remittances received from any source outside Canada for maintenance, education, or training. The recipient must be or must have been a U.S. resident immediately before visiting Canada.

Pensions, Annuities, Social Security, and Alimony

Under Article XVIII, pensions and annuities from Canadian sources paid to U.S. residents are subject to tax by Canada, but the tax is limited to 15% of the gross amount (if a periodic pension payment) or of the taxable amount (if an annuity). Canadian pensions and annuities paid to U.S. residents may be taxed by the United States, but the amount of any pension included in income for U.S. tax purposes may not be more than the amount that would be included in income in Canada if the recipient were a Canadian resident.

Pensions. A pension includes any payment under a pension or other retirement arrangement, and payments under a sickness, accident, or disability plan. It includes pensions paid by private employers and the government for services rendered. Pensions also include payments from individual retirement arrangements (IRAs) in the United States, registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs) in Canada.

Pensions do not include social security benefits.

Annuities. An annuity is 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 return for adequate and full consideration (other than services rendered).

Social security benefits. Benefits paid under the Canada Pension Plan (CPP), Quebec Pension Plan (QPP), and Old Age Security (OAS) program to a U.S. resident are taxable only in the United States.

These Canadian benefits are treated as U.S. social security benefits for U.S. tax purposes. If your total income is above certain limits, a maximum of 85% of your benefits will be subject to U.S. tax. See Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*, for more information on the tax on U.S. social security benefits. Any benefit under the social security legislation of Canada that would not be subject to Canadian tax if paid to a resident of Canada is not subject to U.S. tax.

1996 and 1997. If you are were a U.S. resident who received Canadian social security benefits during 1996 and 1997, your benefits were generally subject to Canadian tax (not U.S. tax). The 1997 protocol changed this rule. The change was made retroactive to January 1, 1996. For 1996 and 1997, you may choose to be taxed in the United States under the new rules or remain taxed in Canada under the old rules.

You should figure and compare the taxes under both sets of rules. If the U.S. tax is less

than the Canadian tax paid, you are generally entitled to a refund of the Canadian tax.

You should have received a letter from Revenue Canada that contains instructions and an election form that you should use to claim a refund. If you are entitled to a refund and did not receive a letter, you should contact Revenue Canada. You have until December 16, 2000, to apply for a refund of Canadian tax. You can contact Revenue Canada in any of the following ways.

- Call 1-800-661-7896.
- Send a fax to 613-941-6905.
- Write to:

International Tax Services Office
2204 Walkley Road
Ottawa, Ontario K1A 1A8.

After you receive your refund, you will have to file U.S. income tax returns for those years to report the Canadian social security benefits as if they had been U.S. social security benefits. You must file a return even though you would not otherwise be required to file. If you have already filed a U.S. income tax return, you must file an amended return (Form 1040X). At the top of the return (or amended return), you should print or type "CANADIAN TREATY — SOCIAL SECURITY."

For more information, see Notice 98-23, in Internal Revenue Bulletin 1998-18.

Note: Revenue Canada has also set up procedures for determining which Canadian residents who paid U.S. tax on U.S. social security benefits are entitled to refunds.

Alimony. Alimony and similar amounts (including child support payments) from Canadian sources paid to U.S. residents are exempt from Canadian tax. For purposes of U.S. tax, these amounts are excluded from income to the same extent they would be excluded from income in Canada if the recipient was a Canadian resident.

Investment Income from Canadian Sources

The treaty provides beneficial treatment for certain items of Canadian source income that result from an investment of capital.

Dividends (Article X). For Canadian source dividends received by U.S. residents, the Canadian income tax generally may not be more than 15%.

A 5% rate limit applies to intercorporate dividends paid from a subsidiary to a parent corporation owning at least 10% of the subsidiary's voting stock. However, a 10% rate applies if the payer of the dividend is a nonresident-owned Canadian investment corporation.

These limits do not apply to dividends arising from a business carried on in Canada through a permanent establishment or fixed base of the recipient if the holding on which the income is paid is effectively connected with that permanent establishment or fixed base.

Interest (Article XI). For Canadian source interest received by U.S. residents, the Canadian income tax generally may not be more than 10%.

This limit does not apply to interest arising from a business carried on in Canada through a permanent establishment or fixed base of the recipient if the debt on which the income is paid is effectively connected with that permanent establishment or fixed base.

Gains from the sale of property (Article XIII). Gains from the sale of personal property by a U.S. resident having no permanent establishment or fixed base in Canada are exempt from Canadian income tax. However, the exemption from Canadian tax does not apply to gains realized by U.S. residents on Canadian real property, and on personal property belonging to a permanent establishment or fixed base of the taxpayers in Canada.

If the property subject to Canadian tax is a capital asset and was owned by the U.S. resident on September 26, 1980, not as part of the business property of a permanent establishment or fixed base in Canada, generally the taxable gain is limited to the appreciation after 1984.

Royalties (Article XII). For Canadian source royalties received by U.S. residents, the Canadian income tax generally may not be more than 10%. The following are exempt:

- 1) Copyright royalties and other like payments for the production or reproduction of any literary, dramatic, musical, or artistic work (other than payments for motion pictures and works on film, videotape, or other means of reproduction for use in connection with television),
- 2) Payments for the use of, or the right to use, computer software,
- 3) Payments for the use of, or the right to use, any patent or any information concerning industrial, commercial, or scientific experience (but not within a rental or franchise agreement), and
- 4) Payments for broadcasting as agreed to in an exchange of notes between the countries.

The limit or exemption does not apply if the right or property on which the royalties are paid is effectively connected with the U.S. resident's permanent establishment or fixed base in Canada.

Charitable Contributions

United States income tax return. Under Article XXI, you may deduct contributions to certain qualified Canadian charitable organizations on your United States income tax return. Besides being subject to the overall limits applicable to all your charitable contributions under U.S. tax law, your charitable contributions to Canadian organizations (other than contributions to a college or university at which you or a member of your family is or was enrolled) are subject to the U.S. percentage limits on charitable contributions, applied to your Canadian source income. If your return does not include gross

income from Canadian sources, charitable contributions to Canadian organizations are generally not deductible.

Example. You are a U.S. citizen living in Canada. You have both U.S. and Canadian source income. During your tax year, you contribute to Canadian organizations that would qualify as charitable organizations under U.S. tax law if they were U.S. organizations.

To figure the maximum amount of the contribution to Canadian organizations that you can deduct on your U.S. income tax return, multiply your adjusted gross income from Canadian sources by the percentage limit that applies to contributions under U.S. income tax law. Then include this amount on your return along with all your domestic charitable contributions, subject to the appropriate percentage limit required for contributions under U.S. income tax law. The appropriate percentage limit for U.S. tax purposes is applied to your total adjusted gross income from all sources.

Qualified charities. These Canadian organizations must meet the qualifications that a U.S. charitable organization must meet under U.S. tax law. Usually an organization will notify you if it qualifies. If you are unable to get this information from the organization itself, you may write to the Internal Revenue Service, Assistant Commissioner (International), Attn: CP:IN:D:CS, 950 L'Enfant Plaza South, S.W., Washington, D.C. 20024, for information about the organization's status as a charitable organization.

For further information on charitable contributions and the U.S. percentage limits, see Publication 526, *Charitable Contributions*.

Canadian income tax return. Under certain conditions, contributions to qualified U.S. charitable organizations may also be claimed on your Canadian income tax return if you are a Canadian resident.

Income Tax Credits

The treaty contains a credit provision (Article XXIV) for the elimination of double taxation. In general, the United States and Canada both allow a credit against their income tax for the income tax paid to the other country on income from sources in that other country. For detailed discussions of the U.S. income tax treatment of tax paid to foreign countries, see Publication 514, *Foreign Tax Credit for Individuals*.

See paragraphs (4) and (5) of Article XXIV for certain provisions that affect the computation of the credit allowed by the United States for Canadian income taxes paid by U.S. citizens residing in Canada.

Competent Authority Assistance

Under Article XXVI, a U.S. citizen or resident may request assistance from the U.S. competent authority when the actions of Canada, the United States, or both, potentially result in double taxation or taxation contrary to the treaty. The U.S. competent authority may then consult with the Canadian competent authority to determine if the double taxation

or denial of treaty benefits in question can be avoided.

It is important that your request for competent authority assistance be made as soon as you have been notified by either Canada or the United States of proposed adjustments that would result in denial of treaty benefits or in double taxation. This is so that implementation of any agreement reached by the competent authorities is not barred by administrative, legal, or procedural barriers. Revenue Procedure 96-13 explains the information that you should include with your request for competent authority assistance.

The request should be addressed to:

Assistant Commissioner (International),
Attn: Tax Treaty Division,
Internal Revenue Service,
P.O. Box 23598,
Washington, D.C. 20026-3598.

In addition to a timely request for assistance, you should take the following measures:

- 1) File a timely protective claim for credit or refund of U.S. taxes on Form 1040X, Form 1120X, or amended Form 1041, whichever is appropriate. This will, among other things, give you the benefit of a foreign tax credit in case you do not qualify for the treaty benefit in question. For figuring this credit, attach either Form 1116 or Form 1118, as appropriate. Attach your protective claim to your request for competent authority assistance.
- 2) Take appropriate action under Canadian procedures to avoid the lapse or termination of your right of appeal under Canadian income tax law.

Corporate reorganizations. Article XIII(8) permits requests to be made to the competent authority to defer the recognition of profit, gain, or income on property alienated in a corporate or other organization, reorganization, or similar transaction. These requests should follow the procedures outlined in Revenue Procedures 96-13 and 98-21.

How To Get More Information



You can get help from the IRS in several ways.

Free publications and forms. To order free publications and forms, call 1-800-TAX-FORM (1-800-829-3676). You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address. Your local library or post office also may have the items you need.

For a list of free tax publications, order Publication 910, *Guide to Free Tax Services*. It also contains an index of tax topics and related publications and describes other free tax information services available from IRS, including tax education and assistance programs.

If you have access to a personal computer and modem, you also can get many forms and publications electronically. See *Quick*

and Easy Access To Tax Help and Forms in your income tax package for details.

Tax questions. You can call the IRS with your tax questions. Check your income tax package or telephone book for the local number, or you can call 1-800-829-1040.

You can write to the IRS with your tax questions. The address for assistance is:

Internal Revenue Service
Assistant Commissioner (International)
Attn: CP:IN:D:CS
950 L'Enfant Plaza South, S.W.
Washington, DC 20024

TTY/TDD equipment. If you have access to TTY/TDD equipment, you can call 1-800-829-4059 to ask tax questions or to

order forms and publications. See your income tax package for the hours of operation.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our "800 number" telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistors objectively. We hold these recordings no longer than one week and use them to measure the quality of assistance.

- We value our customers' opinions. Throughout the year, we will be surveying our customers for their opinions on our service.

Text of Treaty

You can get the text of the U.S.—Canada income tax treaty from:

Superintendent of Documents
U.S. Government Printing Office
P.O. Box 371954
Pittsburgh, PA 15250-7954

The treaty can also be found on various sites on the Internet.