

Withholding Tax - The Impact of Investing in Foreign Countries

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As more investors diversify their portfolio and invest outside their country of residence, the more important the issue of withholding tax become for them.

The purpose of this article is to discuss some of the basic concepts of withholding tax and how withholding tax affects investors. As is always the case when clients are investing and there are tax consequences, they should consult their own tax advisors to ensure the tax implications of their decisions have been fully assessed.

Determining Residency

In most cases, an individual pays tax on their worldwide income to the country that they are resident of (as opposed to citizens of) . Whether or not an individual is a resident of a particular country is a question of fact but can be largely determined for most people by the amount of time that is spent in a particular jurisdiction.

Residency is important because if you are not a resident of a country, you will be subject to withholding tax on any income sent from that country.

The Issue of Double Tax

As noted above, a person pays income tax to the country that they are resident of and are subject to a withholding tax if they invest in a foreign investment. This means that there is the potential for double taxation (withholding tax in the foreign country and income tax in the country of residence) on income earned in a foreign country.

To avoid double taxation on foreign source income, many countries have entered into reciprocal tax agreements that provide relief for withholding taxes. This relief comes by recognizing that there have been taxes paid to a foreign jurisdiction and those taxes reduce the taxes otherwise payable in the investor's country of residence.

Withholding Tax for Canadians Investing Outside Canada

Withholding tax rates for Canadians investing in foreign countries will depend upon the tax laws of the foreign country invested in as well as whether or not there is a reciprocal tax agreement.

Investing in the United States

The United States is the most popular foreign destination for direct investment dollars for Canadians. Generally speaking, the withholding tax rate on income is 25% but because we have a treaty with the US, this rate is reduced.

The withholding tax rate for US investments by Canadians is 15% for interest and dividends. However, this withholding tax can be claimed as a foreign tax credit on their tax return to reduce the effect of double taxation.

Exceptions to the 15% rate are noted below:

US Source Interest Income:

The withholding tax rate is 15% **except** on the following:

- US Federal, State and Municipal Bonds
- Certain US corporate bonds-each situation is different and should be assessed by the client's tax advisor
- Interest earned on bank or S&L deposits

US Dividend Income

The 15% rate on dividends is not reduced any further under the treaty for individuals.

US Capital Gains

In most cases, there is not withholding tax on capital gains with the exception of US real property to which a 10% rate on the proceeds of disposition applies.

Non-Residents Investing in Canada

The standard withholding tax rate for foreign investors investing in Canadian property is 25% for interest and dividend income. This rate can be reduced if there is a treaty between Canada and the country of residency of the foreign investor.

There are also certain Canadian investments that are not subject to withholding tax for foreign investors.

No Withholding Tax.....

The 25% withholding tax is reduced to zero for the following investments:

- Government Debt Obligations issued after April 15, 1966:
 - issued by the federal, provincial or any municipal government
 - guaranteed by the Government of Canada
- Other debt obligations issued:
by a corporation that is at least 90% owned by a province or municipality and issued after April 15, 1966

- by a Canadian corporation after June 25, 1975 provided not more than 25% of the principal is payable within the first 5 years of the term of the bond (ie from date of issue)
- Capital Gains derived from investments in Canada with the exception of real estate

Withholding Tax Rates

The chart below outlines the withholding tax rates for non-residents of Canada receiving interest or dividend income as noted and also for Canadians investing in the noted countries. There are exceptions which are shown in parenthesis—these numbers relate to Canadian Investors.

Country Interest % Dividend %

Argentina 12.5 10.15
 Australia 15 15
 Austria 15 15
 Bangladesh 15 15
 Barbados 15 15
 Belgium 15 15
 Brazil 15 15
 Cameroon 15 15
 China (a) 10 10/15
 Cyprus 15 15
 Czech Republic (a) 10 10/15
 Denmark 15 15
 Dominican Rep 18 18
 Egypt 15 20
 Estonia (b) 10 5/15
 Finland 10 15
 France 10 15
 Germany 15 15

Country Interest Dividends

Guyana 15 15
 Hungary (c) 10 5/10/15
 India 15 15
 Indonesia 15 15
 Ireland 15 15
 Israel (d) 15/25 15
 Italy 15 15
 Ivory Coast 15 15
 Jamaica (e) 15 15/22.5
 Japan 10 15

Kenya (a) 15 15/20
Korea 15 15
Latvia (b) 10 5/15
Luxembourg 15 15
Malaysia 15 15
Malta 15 15
Mexico 15 15
Morocco 15 15
Netherlands 10 15
New Zealand 15 15
Norway 15 15
Pakistan 15 20
New Guinea (b) 10 15/25
Philippines 25 15
Poland 15 15
Romania 15 15
Russia 15 15
Singapore 15 15
Slovakia (b) 10 10/15
Spain 15 15

Country Interest Dividends

Sri Lanka 15 15
Sweden 15 15
Switzerland 15 15
Thailand 15 15
Trinidad 10 15
Tunisia 15 15
United Kingdom 10 15
United States 10 15
Zambia 15 15
Zimbabwe(a) 15 10/15

Notes:

- a) The lower rate applies where the recipient company owns 10% or more of the payer stock
- b) The lower rate applies where the recipient company owns 25% or more of the payer's voting stock
- c) A protocol modifies the convention to reduce the withholding on dividends as follows:

1. 5% if beneficial owner is a company that controls at least 25% of the voting power
 2. 10% if paid by a company that is resident of Canada and a non-resident owned investment corporation to a company resident in Hungary that controls at least 25% of voting power
 3. 15% in any other case
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- d) The lower rates apply where royalties, interest and dividends are taxable in the country of residence of the beneficial owner. Otherwise the rate is 25%.
 - e) The higher rate applies where a Canadian recipient owns 10% or more of the voting stock or payer is considered a foreign affiliate of the Canadian recipient.