NATIONAL FOREIGN TRADE COUNCIL, INC.

1625 K STREET, NW, WASHINGTON, DC 20006-1604

TEL: (202) 887-0278 FAX: (202) 452-8160

March 9, 2006

The Honorable John Snow
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: US-Canada Tax Treaty

Dear Secretary Snow,

We have followed with keen interest the on-going discussions between the U.S. Treasury and government officials in Canada with regard to a protocol to the current U.S.-Canada tax treaty. The negotiations are of vital importance, so that the treaty can better serve its purpose of facilitating trade and travel between our two countries.

In the current treaty negotiations, addressing the withholding tax rates is the single most important element for business. The U.S.-Canada treaty is out of step with the U.S. model treaty and with most of our recently negotiated agreements in that there are positive rates of withholding on interest and royalties. Taxpayers expect that the current negotiations will reduce these rates – ideally, to zero for interest, royalties and dividends – to reflect the U.S. model positions on interest and royalties, and the position on dividends the U.S. has adopted in several recent treaties with developed countries.

In this context, we want to focus your attention on one issue in particular: the withholding tax on interest paid by a borrower that is a taxpayer in one jurisdiction to a lender resident in the other jurisdiction. The Canadian negotiators have stated publicly that they are willing to eliminate the withholding tax on interest paid to an unrelated lender, but wish to retain a positive withholding tax on interest paid to a related party lender. We believe it would be wholly inappropriate for the U.S. and Canada to conclude a protocol that treats related party lending differently from unrelated party loans:

i. Distinguishing between related party loans and loans between unrelated parties would seriously distort the lending process. There is no economic justification for making loans between related parties bear a higher rate of tax than loans between unrelated parties.In this connection, we note that even a 5% withholding tax on gross interest is often an exceedingly high tax on net

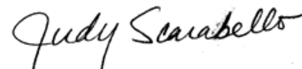
income. (The U.S.-Canada treaty currently imposes a 10% withholding tax on interest.)
A 5% withholding tax on gross interest correlates to an ~15% “profit margin” at the lender; such a large profit margin on lending is not characteristic of the market.

ii. Tax authorities have two potent tools to ensure that related party lending mirrors the results of unrelated party lending: transfer pricing rules enforcing the “arm’s-length” standard and thin capitalization rules to prevent excessive leverage.

The only possible justification we can imagine for distinguishing between related party lending and unrelated party lending is a fear that related party taxpayers will take inappropriate actions to minimize tax. But the transfer pricing rules and thin capitalization limitations provide fully sufficient means by which to prevent abuses.

Eliminating the withholding tax on cross-border payments of interest is a critical element of the current U.S.-Canadian negotiation. We urge you to discuss this matter directly with your counterpart in Canada to ensure the Canadian government understands the importance of this matter. It is vital that the benefits of eliminating the withholding tax on interest apply equally to related party loans as well as to loans between unrelated parties. We very much appreciate your attention to this matter.

Sincerely,



Judy Scarabello

cc: Robert Kimmitt
Eric Solomon
Hal Hicks
Patricia Brown