Certain Canadian Corporations May Unknowingly be Subject to U.S. Federal Backup Withholding and Reporting Requirements With Respect to Dividend Payments

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Canadian corporations making dividend payments should ensure that they are compliant with U.S. federal backup withholding and reporting requirements to avoid potential U.S. federal income tax issues.

Generally, a Canadian corporation making a payment of dividends aggregating USD$10 or more to another person during the calendar year is subject to the U.S. federal backup withholding and reporting regime. However, a dividend payment by a Canadian corporation is excluded from these rules if it is:

1. from sources outside the United States;
2. by a non-U.S. payor or a non-U.S. middleman; and
3. paid and received outside the United States.

For purposes of this discussion, a reference to a "Canadian corporation" does not otherwise include a Canadian corporation that is treated as a U.S. domestic corporation for U.S. federal income tax purposes under the "anti-inversion rules" in Section 7874(b) of the U.S. Internal Revenue Code of 1986, as amended (the "Code").

Assuming that a payment from a Canadian corporation constitutes a "dividend" for U.S. federal income tax purposes (which analysis often differs from Canadian tax rules), and assuming the payee is not otherwise an exempt employee (which is beyond the scope of this blog article), a dividend payment must satisfy each of the above requirements in order to be exempt from U.S. federal backup withholding and reporting requirements.

In respect of the first requirement above, dividends from a Canadian corporation are generally treated as paid from sources outside the United States unless 25% or more of the corporation's gross income from all sources for the prior three years was, or was treated as, effectively connected with the conduct of a trade or business within the United States.

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In respect of the second requirement above, a Canadian corporation or its non-U.S. middleman (e.g., a non-U.S. financial institution or broker acting as an intermediary) generally should be treated as a non-U.S. payor or non-U.S. middleman. However, certain Canadian corporations or middlemen are not treated as non-U.S. payors or non-U.S. middlemen for these purposes including, without limitation, those that are: (i) “controlled foreign corporations” under Code Section 957(a), (ii) foreign partnerships in which the majority of interests are held by U.S. persons, or (iii) foreign persons for which 50% or more of the gross income for a three-year period has been effectively connected with the conduct of a U.S. trade or business, as applicable.

In respect of the third requirement above, the payment of a dividend by a Canadian corporation (not otherwise treated as a U.S. payor, as discussed above) is generally considered to be made outside of the United States unless (i) such payment is made to an account maintained by a payee in the United States or by mail to a United States address, and (ii) the Canadian corporation’s shares are:

- registered under the Securities Act of 1933;
- listed on an exchange that is registered as a national securities exchange in the United States; or
- included in an inter-dealer quotation system in the United States.

Generally, a Canadian corporation should be aware if its securities are either registered under the Securities Act of 1933 or listed on an exchange that is registered as a national securities exchange in the United States (e.g., the NSYE or Nasdaq), and thus whether its dividends are currently subject to U.S. federal backup withholding and reporting requirements. However, even if the shares of a Canadian corporation are not otherwise registered under the Securities Act of 1933 or listed on a national securities exchange in the United States, it is nonetheless possible that prices for such Canadian corporation’s shares could be quoted on an inter-dealer quotation system in the United States (e.g., certain of the OTC platforms). If a Canadian corporation’s share prices are quoted on an applicable inter-dealer quotation system in the United States, then dividends paid to an account maintained by the payee in the United States or mailed to a U.S. address would generally be subject to the U.S. federal backup withholding and reporting requirements.

In the event a dividend payment is subject to the U.S. federal backup withholding and reporting requirements, the Canadian corporation would be required to withhold backup withholding in respect of such payment at the U.S. federal backup withholding tax rate, currently at a rate of 24%, unless, prior to payment, the payee provides to the Canadian corporation a properly completed and duly executed IRS Form W-9 certifying that such payee is not subject to U.S. federal backup withholding tax. Collecting U.S. tax forms in advance of dividend payments requires advanced planning.

The U.S. federal backup withholding and reporting requirements are complex. Canadian corporations should consult with U.S. counsel and review the potential application of the U.S. federal backup withholding and reporting regime before making a dividend payment.