TaxNewsFlash

United States

No. 2017-448
October 16, 2017

Do not overlook possible tax implications of NAFTA re-negotiations

Representatives of the governments of the United States, Canada, and Mexico during 2017 have been involved in re-negotiations of the North American Free Trade Agreement (NAFTA). The fourth round of the re-negotiations began in October 2017.

Much attention has been focused on the trade implications of the NAFTA re-negotiations. Read, for instance, a **KPMG report** following the third round of the re-negotiations.

Still, taxpayers need to consider what could be the possible tax implications of the NAFTA re-negotiations.

Derivative benefits rule

Under the network of U.S. bilateral income tax treaties, a signatory country generally grants treaty benefits (e.g., reduction of that country's tax) only to the income of a company that is a resident of the other country, if that company is owned by defined residents of one of the two signatory countries. U.S. income tax treaties with many EU countries contain so-called "derivative benefits" provisions that generally expand this rule also to allow treaty benefits to a company that is a resident of the other country if that company is owned by a resident of a country that is a signatory of NAFTA (under the derivative benefits rule).

Thus, for example, if NAFTA were to be terminated, payments by Canadian-owned companies to their EU affiliates generally could no longer benefit for U.S. tax purposes from the derivative benefits rule as currently available under the network of U.S. income tax treaties.

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