



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

June 16, 1999

CC:INTL:Br1
WTA-N-100979-99
Number: **199932046**
Release Date: 8/13/1999
UILC: 894.00-00
9114.03-06

INTERNAL REVENUE SERVICE NATIONAL OFFICE
SIGNIFICANT SERVICE CENTER ADVICE

MEMORANDUM FOR

FROM: M. Grace Fleeman
Assistant to the Branch Chief CC:INTL:Br1

SUBJECT: Administering Payment of Refunds of U.S. Tax on Social Security Benefits under the Fourth Protocol to the United States-Canada Income Tax Treaty

This Significant Service Center Advice responds to your memorandum dated January 4, 1999.

ISSUES

1. Does the saving clause of the U.S.–Canada income tax treaty (“Treaty”), as amended by the protocol that entered into force on December 16, 1997 (“Fourth Protocol”), apply to the taxation of social security benefits paid by the United States to U.S. citizens who are resident in Canada?
2. Does the Fourth Protocol require the Service to pay refunds to Revenue Canada on U.S. tax withheld during 1996 and 1997 on social security benefits paid to certain Canadian residents if (a) the taxpayers are in a balance due status; (b) payment of the refunds would put the taxpayers in a balance due status; or (c) the taxpayers previously requested refunds on their own that were granted, but were offset against their balances due for prior years, some of which are years for which the statute of limitations on collection has expired? If the Service must pay refunds that would put taxpayers in a balance due status, how should penalties and interest on the resulting deficiencies be computed?

3. Does the Fourth Protocol require the Service to refund U.S. tax that was remitted directly by certain Canadian residents with respect to U.S. social security benefits that they received during 1996 and 1997?

CONCLUSIONS

1. The saving clause does not apply to the taxation of social security benefits paid by the United States to U.S. citizens who are resident in Canada. Under the Fourth Protocol, such benefits are taxable only by Canada without regard to whether the recipient is a U.S. citizen.

2. The Fourth Protocol does not override domestic law so as to require the Service to pay refunds to Revenue Canada under any of the circumstances specified. The question concerning penalties and interest is moot.

3. Under the Fourth Protocol, if Revenue Canada requests refunds of U.S. tax remitted directly by individual Canadian residents with respect to U.S. social security benefits that they received during 1996 and 1997, the Service generally is required to pay such refunds to Revenue Canada.

FACTS

Paragraph 5 of Article XVIII of the Treaty provides rules that govern the taxation of U.S. social security benefits paid to Canadian residents and Canadian social security benefits paid to U.S. residents. These provisions were revised by a protocol signed on March 17, 1995 (the "Third Protocol") and again by the Fourth Protocol.

Prior to the Third Protocol, each country had the exclusive right to tax social security benefits paid to its residents by the other country. The Third Protocol changed from a residence-based system to a source-based system, effective January 1, 1996. Under the Third Protocol, the country that paid benefits to residents of the other country had the exclusive right to tax the benefits.

The Fourth Protocol, in Article 2, returned to a residence-based system under which social security benefits are taxable exclusively in the country where the recipient resides. The changes made by the Fourth Protocol are generally retroactive to January 1, 1996. However, benefits paid during 1996 and 1997 are not subject to a higher rate of tax than was imposed under the Third Protocol. Individuals who received benefits during 1996 and 1997 that would be subject to a lower rate of tax under the Fourth Protocol are generally entitled to refunds.

Paragraph 3 of Article 3 of the Fourth Protocol addresses the payment of refunds of source-state tax with respect to "source-taxed benefits." In the case of Canadian

residents who are entitled to refunds of U.S. tax withheld on U.S. social security benefits, Article 3(3) provides that the Canadian competent authority will apply for refunds on their behalf and will remit the refunds to them after deducting any additional Canadian tax that may be imposed as a result of the benefits being subject to tax in Canada. The Technical Explanation of the Fourth Protocol issued by the Treasury Department indicates that the Canadian competent authority may base its refund claims on information received from individual Canadians as well as on information provided by the U.S. competent authority.

Pursuant to paragraph 5 of Article 3 of the Fourth Protocol, the U.S. and Canadian competent authorities have established procedures for implementing the refund provision of paragraph 3. In the case of refunds claimed by Revenue Canada on behalf of individual Canadian residents, the competent authority agreement contemplates that the Service will make a separate determination as to whether each particular individual is entitled to a refund. The Philadelphia Service Center is currently processing refund claims submitted by Revenue Canada on behalf of Canadian residents whose U.S. social security benefits appear to be subject to less tax under the Fourth Protocol than under the Third Protocol. Some of these Canadian residents are U.S. citizens.

DISCUSSION

1. Saving Clause

Article XXIX(2) of the Treaty, the “saving clause,” provides that Canada and the United States may tax their residents, and, in the case of the United States, its citizens, as if the Treaty had not taken effect:

Except as provided in paragraph 3, nothing in the Convention shall be construed as preventing a Contracting State from taxing its residents (as determined under Article IV (Residence)) and, in the case of the United States, its citizens (including a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of income tax, but only for a period of ten years following such loss). . . as if there were no convention between the United States and Canada with respect to taxes on income and on capital.

Article XXIX(3)(a) provides that, notwithstanding the saving clause, the United States must respect certain Treaty provisions, including Article XVIII(5), the provision that addresses the taxation of benefits paid under U.S. and Canadian social security legislation. Accordingly, the United States may not tax U.S. social security benefits paid to U.S. citizens who are resident in Canada, and the Service generally is required to make refunds under the Fourth Protocol with respect to U.S. citizens who are Canadian residents.

2. Refunds of Withholding Tax

You asked whether the Service must pay refunds to Revenue Canada with respect to certain Canadian residents who (a) are in a balance due status; (b) would be put in a balance due status if the refunds were paid; or (c) previously requested refunds on their own that were granted, but were offset against their balances due for prior years, some of which are years for which the statute of limitations has expired. We assume, for purposes of this Service Center Advice, that the Service would not be required to pay the refunds in question solely under U.S. domestic law. See Code section 6402(a); Lewis v. Reynolds, 284 U.S. 281 (1932); Treas. Reg. section 301.6402-3(a)(6)(i). Thus, the issue we address is whether the Fourth Protocol overrides domestic law to require a different result.

It is a well-settled principle of treaty interpretation that treaties and federal statutes are of equal status and that, whenever possible, a treaty and a statute relating to the same subject should be construed harmoniously to give effect to both. Whitney v. Robertson, 124 U.S. 190, 194 (1888); Estate of Burghardt v. Commissioner, 80 T.C. 705, 713 (1983), aff'd without published opinion, 734 F.2d 3 (3d Cir. 1985). Only in the event of a clear conflict between a treaty and a statute does the later in time control. Breard v. Greene, 140 L. Ed. 2d 529, 537-38 (1998) (citing Reid v. Covert, 354 U.S. 1, 18 (1957), and Whitney, 124 U.S. at 194). Lindsey v. Commissioner, 98 T.C. 672, 676 (1992), aff'd without published opinion, 15 F.3d 1160 (D.C. Cir. 1994).

Consistent with this principle, section 7852(d)(1) has provided since 1988 that “[f]or purposes of determining the relationship between a provision of a treaty and any law of the United States affecting revenue, neither the treaty nor the law shall have preferential status by reason of its being a treaty or a law.” The legislative history of this provision makes it clear that Congress intends for the Internal Revenue Code to be interpreted harmoniously with treaties when possible and for the later-in-time rule to apply only when there is an actual conflict. S. Rep. No. 445, 100th Cong., 2d Sess. 321-22 (1988).

In the instant case, we believe it is appropriate to apply the Fourth Protocol and the relevant provisions of U.S. domestic law so as to give effect to both. Thus, the Service generally will be required to pay a refund with respect to a particular individual if Revenue Canada has determined that he or she would be required to pay less tax under the Fourth Protocol than under the Third Protocol. However, we do not believe the Service should pay the refund to the extent the individual is in a balance due status or would be put in a balance due status. In such a case, domestic law should control.

Because we conclude that the Service is not required to pay refunds that would put taxpayers in a balance due status, we do not address the imposition of penalties and interest on the resulting deficiencies.

3. Refunds of Tax Remitted Directly by Taxpayer

Your final question concerns potential refunds of U.S. tax that was remitted directly by individual Canadian residents who received U.S. social security benefits during 1996 and 1997.

The changes made by the Fourth Protocol are retroactive to 1996 and 1997 only to the extent refunds are requested from the source states pursuant to the provisions of the Fourth Protocol and the competent authority agreement implementing the Fourth Protocol. Thus, U.S. social security benefits paid to a particular Canadian resident during 1996 and 1997 will continue to be subject to U.S. tax unless Revenue Canada formally requests a refund on behalf of that individual based on information provided by the individual or the U.S. competent authority.

The Service is not required to pay a refund that has not been requested by Revenue Canada. The Service also is not required to pay a refund that is requested by an individual taxpayer instead of by Revenue Canada. In the latter case, the taxpayer should be advised to contact Revenue Canada. The Service is, however, generally required to refund U.S. tax remitted directly by a Canadian resident if a proper refund claim is received from Revenue Canada, as long as the particular individual is not in a balance due status and would not be put in a balance due status if the refund were paid.

If you have any further questions, please call (202) 622-3880.

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