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FREE GUIDE · Withholding

Before It Moves

How a treaty actually reduces withholding tax, what the payer needs from you, and why recovering over-withheld tax afterwards is the expensive route.

Treaty relief and withholding: the rate before the money moves

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Treaty relief and withholding: the rate before the money moves

Withholding tax is collected by the payer at the moment of payment. A treaty can reduce the rate, but only if the payer holds the right documents before it pays. Every day of delay converts a rate reduction into a refund claim, and refund claims are slow.

Who this is for

- Non-residents receiving dividends, interest, royalties, pensions or service fees from another country.
- Payers who have to decide what rate to withhold and carry the liability if they get it wrong.
- Anyone who has received a payment net of tax at a higher rate than the treaty allows.

What withholding is doing

A country that cannot assess a person outside its borders collects tax at source instead: the payer deducts a percentage and remits it, and reports the payment on an annual information return. The rate is set by domestic law, and a treaty between the two countries may reduce it for specific categories of income.

The payer, not the recipient, is liable for getting it right. That asymmetry explains a great deal of payer behaviour: faced with uncertainty, a payer will withhold at the full domestic rate, because over-withholding is the recipient's problem and under-withholding is the payer's. Making the payer comfortable is therefore the recipient's job.

Relief is documentary

Each system has its own paperwork for claiming a treaty rate, and in every case the documents go to the payer before payment. In the United States the recipient certifies its status and treaty claim on the relevant withholding certificate. In Canada a treaty benefit declaration is provided to the payer, with different versions for individuals, partnerships and hybrid entities. In India a treaty information declaration is provided together with a tax residency certificate from the recipient's own authority.

Two practical points decide whether this works. Documents expire, so a certificate obtained once is not a permanent solution and a lapsed one puts the payer back to the full rate. And the entity type matters: partnerships, trusts and entities treated as transparent in one country and opaque in the other need the version of the declaration written for them, because the payer cannot apply a treaty rate to a recipient it cannot characterise.

Waivers and certificates: relief below the treaty rate

Sometimes the treaty rate itself over-collects, because the payment is gross and the recipient's actual profit is small. Several systems allow an advance application for a reduced or nil deduction in those circumstances rather than making you wait for a return.

Canada has waiver applications for withholding on services rendered in Canada and on payments to non-resident employees working there temporarily, and a separate route for reduced withholding on certain periodic payments. India has an application for a lower or nil deduction certificate. All of these take time to obtain and none is retroactive, so they are part of planning a contract rather than a remedy after invoicing. Our pages on theservices waiverand thelower or nil deduction certificatecover the applications.

Recovering what was over-withheld

If the money has already been withheld at too high a rate, there are usually two routes: a refund claim in the source country, or a credit on your home country return for the tax actually paid. The credit route is easier but it only helps if you have enough home country tax on the same income to absorb it, and excess foreign tax credits can strand.

The refund route works but is measured in months and sometimes longer, and it generally requires the payer's information return, evidence of the tax remitted, and proof of residence for the period. Where two authorities disagree about which of them may tax the income, the treaty's mutual agreement procedure exists — a genuine remedy, and a slow one.

A payer's view, which recipients should understand

The payer has to identify the recipient, characterise the payment, decide the rate, remit on time, and report annually. It is exposed to the tax it failed to withhold plus penalties and interest, and it will not take a commercial risk on a treaty position it cannot document.

Recipients who understand this get paid faster. Sending the declaration with the first invoice, keeping certificates current, and describing the payment consistently in contract and invoice removes the payer's reason to default to the highest rate.

Getting the rate right, in order

Everything useful happens before the invoice is paid.

1. **Characterise the payment** Interest, dividend, royalty, service fee, pension or something else, because the treaty rate is set by category and the categories are not always intuitive.
2. **Read the applicable treaty article** Rates differ by category and by treaty, and some articles have conditions such as a minimum shareholding or a specific type of payer. The treaty that applies is the one between the two countries actually involved.
3. **Obtain the residency evidence** A residency certificate from your own tax authority where required, and a tax identification number in the paying country where the rate depends on it. Both take time.
4. **Lodge the declaration with the payer** The correct version for your entity type, signed and current, in the payer's hands before payment rather than with the first query.
5. **Apply for a waiver where the rate over-collects** Where withholding on a gross amount exceeds the eventual liability, apply in advance. These applications are not retroactive.

6. **Reconcile at year end** Match the payer's information return to what you received, claim the credit or the refund, and diarise the certificate renewals for next year.

Papers to gather

What a withholding review needs:

- The contract or agreement governing the payment, and the invoices issued.
- Details of the payer, its country and the character of what it is paying for.
- Your tax residency certificate, and its date of issue and expiry.
- Any treaty declaration or withholding certificate already lodged with the payer.
- Tax identification numbers held in the paying country.
- Information returns received from the payer, and remittance evidence.
- Your home country return showing how the income and any credit were treated.
- For a transparent entity, the ownership chain and the residence of the ultimate owners.

Where it goes wrong

- **Lodging the declaration after the first payment** The reduced rate applies to payments made after the payer holds the documents. One late declaration converts a rate question into a refund claim measured in months.
- **Letting a residency certificate lapse** Certificates expire. A payer with a stale certificate on file reverts to the full domestic rate, usually without telling you until the payment arrives light.
- **Using the wrong declaration for the entity** Partnerships, trusts and hybrid entities need the version written for them. A payer that cannot characterise the recipient will withhold at the highest rate available to it.

Questions this raises

Can I claim the treaty rate after the tax has been withheld?

You can recover the excess, but not by re-rating the payment. The routes are a refund claim in the source country or a foreign tax credit at home, and the credit only helps if you have enough home country tax on the same income to absorb it.

Why is my payer withholding at the full domestic rate?

Almost always because it does not hold documents that let it justify a lower one. The payer carries the liability for under-withholding, so uncertainty defaults to the highest rate. Sending the correct current declaration usually resolves it.

What is a tax residency certificate for?

It is your own tax authority confirming that you are resident there for treaty purposes, which is what entitles you to the treaty rate. Several systems require it before a payer may apply a reduced rate, and it has a limited validity period.

Can withholding be reduced below the treaty rate?

Sometimes, where withholding applies to a gross amount that greatly exceeds the eventual liability. Advance applications for a reduced or nil deduction exist in several systems. They take time and are not retroactive, so they belong in the contracting stage.

What to do next

If payments are already running, reconcile one year: what was withheld, what the treaty allowed, and whether the difference is recoverable by refund or absorbed by credit. If a contract is being negotiated, the documents can be a condition of the first payment.

We handle treaty positions, declarations, waiver applications and refund claims as fixed-fee engagements agreed before work starts. See the Canadian withholding review, withholding refund recovery and the treaty rate lookup.

Legal Quotient Consultants

Cross-border and international tax. Fixed fees agreed in writing before work starts, quoted from your own documents.

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