



# TaxNewsFlash

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## Announcement 2020-6: References to NAFTA in U.S. income tax treaties, replaced with USMCA

The IRS today released an advance version of Announcement 2020-6 addressing how the U.S. Treasury Department and IRS will interpret references in U.S. income tax treaties to the pending NAFTA-replacement agreement between the United States, Mexico, and Canada (USMCA).

**Announcement 2020-6** [PDF 12 KB] provides that once the USMCA enters into force, Treasury and the IRS will interpret any references to NAFTA in an existing U.S. income tax treaty as a reference to the USMCA.

As explained by today's announcement, most U.S. income tax treaties contain a "Limitation on Benefits" (LOB) article—a measure designed to prevent entities resident in a treaty jurisdiction from inappropriately accessing tax treaty benefits.

Most LOB articles in U.S. income tax treaties provide a series of objective tests by which a resident may qualify for treaty benefits, provided that the resident meets all other requirements specified in the treaty for claiming the benefit. A number of these treaties provide for LOB "derivative benefit" tests that contain explicit references to a "resident of a state that is a party to NAFTA." These provisions are particularly important for multinational corporations with a parent company in Mexico or Canada.

For example, a treaty between the United States and a European trading partner country might permit a resident of that treaty partner to qualify for the benefits of that treaty based on direct or indirect ownership by a company that is resident in a country that is a party to NAFTA (i.e., Canada, Mexico, or the United States) and satisfaction of a base erosion test that can itself be satisfied to the extent payments are to a company that is resident in a country that is a party to NAFTA. Once the USMCA enters into force and replaces NAFTA (expected to be July 1, 2020), it is unclear whether ownership by, or payments to, these NAFTA-resident countries will continue to qualify under these "derivative benefit" tests.

Today's announcement states that Treasury and the IRS believe that any reference to NAFTA should be interpreted as a reference to the USMCA, and that Treasury and the IRS will reach out to countries that have an applicable tax treaty containing references to NAFTA to confirm that they agree with this interpretation.

Notably, Announcement 2020-6 contains no explicit statement describing the extent to which taxpayers may rely on it.

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