

Canada reduces tax reporting for non-residents

Todd Miller and Michael Friedman of McMillan Binch Mendelsohn explain how non-residents will benefit from new measures announced in the 2008 federal budget

On February 26 2008, the Canadian government tabled its annual Budget, which proved to be much more modest and cautious in its orientation than the government's Economic and Fiscal Update, released in the autumn of 2007, that set out the government's intention to significantly reduce personal and corporate tax rates over the next five years. Although the 2008 Budget introduced several positive tax changes, including the creation of new tax-free savings accounts for individual taxpayers and the extension of certain preferential capital cost allowances for businesses, the 2008 Budget contained few bold tax announcements.

Nevertheless, hidden within the text of the 2008 Budget were several proposed amendments to the federal Income Tax Act which, when enacted, will enhance opportunities for cross-border investment in Canada by streamlining the tax withholding and filing obligations that have historically burdened non-residents that wish to dispose of property with a substantive link to Canada. These proposed amendments ostensibly respond to ongoing calls made by non-resident investors to lessen the tax reporting burden currently placed on non-residents that dispose of so-called taxable Canadian property. (Taxable Canadian property includes property that has a direct connection to Canada, such as shares of private Canadian corporations that are not listed on a designated stock exchange).

Non-residents disposing of most types of taxable Canadian property, are currently obligated to notify the Canada Revenue Agency (CRA) of the disposition and obtain a clearance certificate (commonly known as a section 116 certificate) from the CRA. The obligation to obtain a section 116 certificate is designed to ensure Canadian income taxes in respect of the gains from such property (if any) are paid or otherwise secured.

In order to obtain a section 116 certificate, a non-resident is generally required to:

- demonstrate that no Canadian income tax will be payable as a result of the relevant disposition;
- remit to the CRA 25% of the amount, if

any, by which the proceeds of disposition of the property exceed the taxpayer's adjusted cost base of the property; or

- post sufficient security with the CRA to cover the tax that will be payable as a result of the disposition.

If a non-resident vendor of taxable Canadian property does not provide a purchaser with a section 116 certificate, the purchaser must generally withhold 25% of the purchase price and remit the amount to the CRA within 30 days after the end of the month in which the property is transferred. A failure to satisfy these withholding and remittance obligations can result in a direct liability to the purchaser.

Non-residents have long complained about the costs and delays associated with requesting and obtaining a section 116 certificate. In recent years, the CRA has been faced with a growing backlog of requests for section 116 certificates, resulting in many applicants having to wait up to a year to obtain a certificate. While the CRA has generally been willing to address these delays through the issuance of section 116 comfort letters, which have the effect of permitting purchasers to refrain from remitting the required withholdings for an extended period, such administrative concessions still generally require the relevant transaction parties to enter into costly and complicated escrow arrangements to ensure that their rights are protected.

The obligation to obtain a section 116 certificate has been particularly bothersome to non-residents that are not subject to Canadian tax by virtue of an applicable income tax convention. Under such circumstances, it has been argued that the need to obtain a section 116 certificate serves no meaningful purpose.

New relieving measures

As a result of the changes proposed in the 2008 Budget, non-residents that dispose of taxable Canadian property in 2009 or later years will generally not be required to obtain a section 116 certificate, provided that any thereto gains arising from the disposition are not subject to Canadian tax by virtue of a treaty. In addition, such vendors will no longer be required to file a Canadian income tax return in respect of the year in

which the disposition occurs solely as a result of the disposition.

To be relieved of the obligation to withhold and remit a portion of the purchase price of taxable Canadian property, a purchaser will generally be required to obtain an acceptable section 116 certificate or either (i) make reasonable inquiries to confirm the Canadian residence status of the vendor; or (ii) take the following steps: (a) make reasonable inquiries to confirm that the vendor is resident in a particular foreign country under the terms of an applicable Treaty; (b) confirm that the vendor would not be subject to Canadian tax on gains arising from the disposition of the subject property by virtue of the applicable treaty; and (c) provide the Minister of National Revenue with notice of the disposition and certain information with respect thereto, within 30 days of the disposition.

Although the relief for non-resident dispositions proposed in the 2008 Budget may appear, on its face, to be broad, purchasers may encounter difficulty in confirming treaty entitlement, particularly where the vendor is a partnership with a number of different non-resident partners, or the relevant Treaty contains a limitation on benefits provision. It is hoped that, over the coming months, the CRA will provide guidance to taxpayers regarding the information/documentary support that a purchaser will be expected to obtain from a non-resident vendor of taxable Canadian property in order to be able to safely conclude that it will not be required to withhold and remit a portion of the purchase price of the property as a result of the new measures.

Despite these potential concerns, the section 116 measures introduced by the Canadian finance minister in the 2008 Budget should be welcome news to non-residents who hold Canadian business interests. Ultimately, the elimination of the burden of obtaining a section 116 certificate in circumstances where gains arising from a disposition will not be subject to tax by virtue of a treaty should reduce the costs associated with completing many cross-border transactions.

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