

TAX LAW BULLETIN

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BUDGET 2008: LESSENING THE TAX REPORTING BURDEN ON NON-RESIDENTS

On February 26, 2008, Canadian Finance Minister Jim Flaherty tabled the federal government's 2008 Budget. While the Budget contained little in the way of substantive income tax reductions, the Government finally heeded calls to lessen the historical tax reporting burden 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).

BACKGROUND

If a non-resident disposes of certain types of taxable Canadian property, they must notify the Canada Revenue Agency (the "CRA") of the disposition and must generally obtain a clearance certificate (commonly known as a "Section 116 Certificate") from the CRA. The obligation to obtain a Section 116 Certificate is aimed at ensuring that non-residents duly pay Canadian tax in respect of gains that arise on the disposition of taxable Canadian property.

In order to obtain a Section 116 Certificate, a non-resident is generally required to:

- (i) demonstrate that no Canadian income tax will be payable as a result of the relevant disposition;
- (ii) 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;¹ or
- (iii) 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. 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 is generally willing to issue 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 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 (a "Treaty"). Under such circumstances, it has been argued that the need to obtain a Section 116 Certificate serves no meaningful purpose.

¹ Greater remittances may be required in respect of certain types of taxable Canadian property, such as depreciable property.

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 gains arising from the disposition are not subject to Canadian tax by virtue of a Treaty. In addition, such vendors will generally 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 of a vendor; or (ii) both make reasonable inquiries to confirm that the vendor will not be subject to Canadian income tax on gains arising from the disposition by virtue of a Treaty and notify the Minister of National Revenue of the disposition within 30 days of the transaction. Although the relief proposed in the Budget may appear to be broad, purchasers may encounter difficulty in confirming the entitlement of a particular vendor to claim the benefits of a Treaty, particularly where the vendor is a partnership with a number of different non-resident members, or the Treaty contains a limitation on benefits provision.

* * *

The relieving measures introduced by the Finance Minister are welcome news to non-residents who hold Canadian business interests. 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.

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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