

2010 Federal Budget - significant tax changes announced concerning Canadian-company stock sales by non-residents

client advisory

With the stated intention of facilitating foreign investment and bringing Canada's domestic tax rules more in line with the tax laws of its major trading partners, yesterday's 2010 federal budget announced changes that will effectively exempt non-resident investors (regardless of tax treaty status) from Canadian federal income taxes in respect of any capital gains realized from the disposition of most Canadian-company stock, provided the stock has not, at any time during the 60 months preceding the relevant disposition, derived its value principally (read as 50% plus) from real or immovable property situated in Canada (such shares being referred to as "qualifying shares" for the purposes of this advisory). The changes, which are to apply to dispositions occurring after March 4, 2010, will be effected through an amendment removing qualifying shares from the definition of "taxable Canadian property" contained in section 248(1) of the *Income Tax Act* (Canada).

While qualifying share dispositions are already excluded from Canadian income taxation under many of Canada's existing international tax treaties, reliance on such treaties by foreign investor groups, such as private equity funds operating as limited partnerships, has proven to be difficult or impractical in the absence of relatively sophisticated structuring measures, including the use of intermediary holding entities in treaty jurisdictions such as Luxembourg, the Netherlands and Barbados. The new proposed measures would, in many situations, eliminate the need to adopt such planning techniques.

In addition to potentially reducing non-resident tax obligations (Budget 2010 projects that the new measures will cost the government C\$130 million in forgone revenues over the coming five fiscal years), there will be a consequential easing of non-resident compliance-related obligations. Most importantly, qualifying share dispositions will no longer be subject to the compliance certificate and notification regime contained in section 116 of the *Income Tax Act* (Canada), which, in certain cases, can require non-resident share vendors to obtain compliance certificates from the Canada Revenue Agency in order to avoid withholdings being applied on a portion of the sale proceeds. In addition, the removal of qualifying shares from the definition of "taxable Canadian property" should eliminate the need for a non-resident corporation disposing of such shares to file a Canadian income tax return (to the extent the non-resident corporation is not otherwise required to do so).

The announced changes, assuming they are enacted, could have a profound effect on the structuring of inbound investment. While the creation or maintenance of certain intermediary holding structures may continue to be warranted, the new budget announcements should serve as a strong motivation to review all existing arrangements and traditional planning approaches.

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