



Federal Budget Proposal Benefits Foreign Investment into Canada

[Kevin Fritz](#)
[Andrea Shreeram](#)

On March 5th, the federal government tabled its 2010 budget, which included a number of tax related proposals. One proposal of particular note to the business and investment communities is a fundamental change to the way that Canada imposes income tax on foreigners who invest in Canadian private companies. The government hopes that this change will increase foreign investment in Canada, particularly foreign venture capital.

Currently, non-residents of Canada are subject to Canadian tax on capital gains arising from the disposition of "taxable Canadian property" ("TCP"), which includes shares of a Canadian corporation that are not listed on a "designated stock exchange". However, in many instances relief is available from Canadian capital gains tax if the foreign investor resides in a country with which Canada has a tax treaty.

A significant problem with Canada's tax laws in this area has been that, even when a capital gain was exempt from Canadian tax pursuant to a tax treaty, the non-resident investor has been required to obtain a tax clearance certificate from the Canada Revenue Agency ("CRA") and file a Canadian income tax return with respect to the capital gain in order to access the treaty tax exemption. Purchasers of Canadian private company shares from a non-resident have been required to withhold 25% of the purchase price pending receipt of this tax clearance certificate (known as a section 116 certificate).

The tax clearance certificate process has been much maligned by foreign investors, as the CRA has required voluminous documentation to substantiate treaty exemptions and has been very slow to process requests for tax clearance certificates. Complying with the CRA's information requests has been particularly difficult in the case of investment funds structured as partnerships, as the CRA requires tax information for each partner, which could number in the hundreds or more. In the authors' experience it could take from 2 months to over a year to obtain a tax clearance certificate from the CRA. During this time, 25% of the foreign investor's sale proceeds

were being held in escrow by the purchaser. It is generally accepted that this administrative process has discouraged foreigners from investing in Canadian business.

The budget proposes to amend the definition of TCP to exclude shares of Canadian corporations, and certain other interests, unless they derive their value principally from real or immovable property situated in Canada, Canadian resource property, or timber resource property. This is a welcome development and is consistent with the Canadian tax treatment of such property under most of its bilateral tax treaties. This simple legislative change will eliminate the compliance burdens that have frustrated foreign investors in Canada for many years.

This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.

If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.

Wildeboer Dellelce LLP

Wildeboer Dellelce Place
365 Bay Street, Suite 800
Toronto, ON M5H 2V1
Phone: (416) 361-3121
Fax: (416) 361-1790

187 King Street S, Suite 205
Waterloo, Ontario N2J 1R1
Phone: (519) 741-8708
Fax: (519) 741-9576



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