



## Amendments to Canadian Withholding Tax Rules on the Sale of “Taxable Canadian Property”

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A common complaint of non-residents who invest in Canada is the withholding tax and tax clearance certificate process that they must deal with when disposing of a Canadian investment. Under the *Income Tax Act*, Canada imposes tax on non-residents who dispose of “taxable Canadian property” (“TCP”), which includes shares of private Canadian corporations and Canadian real estate. However, non-residents may be exempt from this Canadian tax if they reside in a country with which Canada has entered into a bilateral tax treaty.

Regardless of whether a treaty exemption applies, non-residents have been required to provide notice to the Canada Revenue Agency (the “CRA”) of any disposition of TCP and request a tax clearance certificate (typically referred to as a “**Section 116 Certificate**”). Depending on the type of TCP, purchasers would withhold either 25% or 50% of the purchase price pending receipt of the Section 116 Certificate. In addition to the compliance burden, this process has resulted in significant delays in non-residents receiving full payment of their sale price due to backlogs in processing time at the CRA of up to a year in some instances.

As of January 1<sup>st</sup> of this year, the Section 116 Certificate rules have been amended to provide some relief from this cumbersome process. Unfortunately, the Canadian government did not adopt the recommendations of many commentators to eliminate the requirements entirely.

Much of the process remains the same. Non-residents will still be required to (1) pay income tax on any gain (subject to treaty exemption), (2) provide a detailed notice to the CRA within 10 days of the disposition of TCP, and (3) file a Canadian income tax return with respect to the disposition.

The key amendments relate to the purchaser’s obligation to withhold tax pending receipt of a Section 116 Certificate where a treaty exemption applies to the transaction. Under the prior rules, unless a Section 116 Certificate was received, a purchaser of TCP from a non-resident was personally liable to

remit an amount equal to either 25% or 50% of the purchase price to the CRA within 30 days after the end of the month in which the transaction took place. Accordingly, purchasers would withhold an appropriate amount from the purchase price in order to ensure that sufficient funds were available to satisfy this remittance obligation.

The amendments provide for an exemption from this liability to the purchaser where the TCP is “treaty-protected property”. In order for this exemption to apply, the following requirements must be met:

1. the purchaser must conclude after “reasonable inquiry” that the vendor is resident in a country with which Canada has a tax treaty;
2. the disposition of TCP must be exempt from Canadian income tax as a result of the application of that tax treaty; and
3. the purchaser must file a notice reporting the transaction with the CRA within 30 days of closing.

The burden will be on the purchaser to determine whether these requirements are met. Oftentimes, significant information gathering and legal analysis will be required in order to determine the vendor’s residency and whether a treaty exemption applies. If the purchaser is not satisfied that these conditions are met then it will insist that the vendor provide a Section 116 Certificate, as has been done in the past.

*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.*

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