The Joint Committee on Taxation of
The Canadian Bar Association
and
Chartered Professional Accountants of Canada
Chartered Professional Accountants of Canada, 277 Wellington St. W., Toronto ON, Canada M5V3H2
The Canadian Bar Association, 66 Slater St., Suite 1200, Ottawa, ON, Canada K1P 5H1

January 24, 2025

Cathy Hawara
Assistant Commissioner
Compliance Programs Branch
Canada Revenue Agency
344 Slater Street
Ottawa, ON K1A 0L5

Dear Cathy,

Subject: Section 116 of the Income Tax Act

OVERVIEW

Further to our discussion in our meeting on December 2, 2024, this submission sets out the comments and recommendations of the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada (the "**Joint Committee**") in respect of the administration of section 116 of the *Income Tax Act* (Canada) (the "**Act**").[1]

Section 116 is designed to ensure that non-resident taxpayers who dispose of taxable Canadian property ("**TCP**") report the disposition to the Canada Revenue Agency (the "**CRA**") and pay any applicable Canadian income tax. However, there are significant challenges with respect to the administration of section 116 which result in uncertainty, delay and cost for both vendors and purchasers and discourage capital investment into Canada by non-resident investors in favour of other jurisdictions that do not have these complexities. We are reaching out to the CRA in order to ensure that the CRA is aware of the issues and to provide certain recommendations in order to make the system more workable, while at the same time ensuring that section 116 continues to accomplish its intended function. We would be happy to work with the CRA to address any of the issues or recommendations discussed in this letter.

[1] All statutory references are to the provisions of the Act.

STRUCTURE OF SECTION 116

Subsections 116(1) and 116(3) provide that a non-resident vendor that disposes of TCP (other than certain exempt properties) must notify the Minister of National Revenue (the "**Minister**") of the disposition[2]. Where such notification occurs, subsections 116(2) and 116(4) provide that the Minister will issue a certificate of compliance (a "**116 Certificate**") to the non-resident vendor upon payment to the Receiver General of an amount equal to 25%[3] of the amount, if any, by which the non-resident vendor's estimated or actual proceeds of disposition exceed the adjusted cost base of the transferred property, or where sufficient security is provided.

If a 116 Certificate is not obtained prior to the disposition of TCP - which is almost always the case due to the administrative delays described below - subsection 116(5) provides that the purchaser is liable to pay, and **shall remit** within 30 days of the end of the month in which the property was transferred (the "**Remittance Deadline**"), as tax on behalf of the non-resident vendor, an amount equal to 25% of the cost to the purchaser of the transferred property. As a result, and as permitted under subsection 116(5), a purchaser will almost always withhold 25% of the gross purchase price otherwise payable to the vendor in order to protect itself in respect of this liability.

Although the Act requires the purchaser to remit the 25% on or before the Remittance Deadline, where the non-resident vendor has applied for a 116 Certificate, the CRA will typically issue a letter (a "**Comfort Letter**") confirming that the purchaser may continue to hold the withheld funds (without liability for interest or penalties) until the CRA has completed its review of the application and funds are requested by the CRA. The issuance of a Comfort Letter reduces the administrative and financial burdens associated with a remittance of funds by the purchaser, as in virtually all cases, the non-resident vendor's actual Canadian tax liability will be significantly lower than the withheld amount[4]. The purchaser and vendor will typically devote significant resources to the negotiation of an appropriate escrow agreement governing the retention and release (either to the vendor or the Receiver General, as applicable) of the amount withheld.

Only at such time as the 116 Certificate is issued by the CRA – which can often be in excess of a year after the application is made[5] – will the purchaser release the withheld funds. The practical effect of this is that, even after a transaction has been completed, a purchaser and non-resident vendor are unable to go their separate ways until the 116 Certificate is issued. Typically, the purchaser will release a portion of the withheld funds directly to the CRA in order to fund the payment of the amount required to be paid in order for the 116 Certificate to be issued, with the balance released to the vendor upon receipt of the 116 Certificate.

---

[2] Subsections 116(1) and 116(3) are alternative notification mechanisms, the former providing for notice in advance of a disposition of TCP and the latter within 10 days following a disposition of TCP.

[3] Under the recent proposed increase to the capital gains inclusion rate, the 25% rate referenced in section 116 is proposed to be increased, effective January 1, 2025, to 35%. This change, if effective, will exacerbate the issues described in this letter. For simplicity, this letter refers to the currently enacted 25% rate.

[4] The non-resident almost always has a lower actual tax liability than the gross amount withheld due to, for example, a lower effective tax rate, tax cost in the transferred TCP, the realization of a loss on the disposition, or an entitlement to relief from Canadian taxation under the provisions of an applicable tax treaty.

[5] This time period can be particularly lengthy where the vendor is a non-Canadian based private equity fund, due to the complexities of the fund structure and the need to look through partnerships to the ultimate investors. When such investors contemplate investments in TCP, the spectre of having funds tied up in escrow for a potentially long period after a future exit event is a negative factor in their decision-making process for investing in Canada.

ISSUES RELATING TO SECTION 116

The issues we wish to raise related to the administration of section 116, and our recommendations with respect thereto, are set out below.

Issue 1: Practical Difficulty in Obtaining a Comfort Letter

Unless a Comfort Letter is issued before the Remittance Deadline, the purchaser is required to pay an amount equal to 25% of the cost of the transferred property to the Receiver General prior to the Remittance Deadline. A Comfort Letter is an administrative acknowledgement that an application for a 116 Certificate has been submitted and is under review; it does not require any substantive review of that application. However, it is often challenging for a purchaser to obtain a Comfort Letter from the CRA prior to the Remittance Deadline. In particular, it is difficult to make contact with a CRA officer who has the ability to issue the Comfort Letter prior to the Remittance Deadline, and, at least currently, the issuance of Comfort Letters prior to the Remittance Deadline is not something that the CRA undertakes without a specific request in each case. This results in significant commercial uncertainty and can lead to frustration, anxiety and panicked scrambling at month end. Issuing a Comfort Letter prior to the Remittance Deadline, such that the purchaser can continue to hold the withheld funds, is beneficial for the transacting parties as well as the CRA.

Recommendation 1: We recommend that the CRA develop an automated system whereby a Comfort Letter is automatically generated, and forwarded to both the purchaser and vendor, at the time an application for a 116 Certificate is received.

Recommendation 2**:** We recommend that the CRA adopt an administrative position which states that, where the purchaser reasonably believes that the non-resident vendor has applied for a 116 Certificate, the purchaser will not be required to remit the amount withheld by the Remittance Deadline, but rather can continue to hold the funds in trust until the CRA has completed its review of the application, unless otherwise notified by the CRA.

We believe that the foregoing recommendations are entirely consistent with the purpose of the Section 116 regime, since, in all cases, the purchaser would continue to hold the withheld funds in trust until such time as the CRA confirms how much Canadian tax is owing, such that the Minister has certainty regarding the availability of the funds should a remittance to the CRA ultimately be required.

Issue 2: Release of Withheld Funds to Satisfy the Vendor's Part I Tax Liability

Non-resident vendors who have disposed of TCP are required to pay any Canadian tax owing by their balance due-day, even if the application for the 116 Certificate has not yet been processed. However, the 25% amount withheld by the purchaser may not be accessible to the vendor in order to fund this payment.

For example, if a non-resident vendor that has a December 31 taxation year-end disposes of TCP in November, it is unlikely that the 116 Certificate will be issued by the non-resident's balance due day (which would be the last day of February of the following year). It would be reasonable and appropriate for the non-resident vendor to be able to access funds held in trust by the purchaser relating to any section 116 remittance obligation in order to satisfy the non-resident's Part I tax liability. However, the wording of a Comfort Letter typically states that the purchaser should continue to hold the withheld funds in trust for the Receiver General until the CRA has completed its review of the section 116 application. As a result, a purchaser may not agree to release funds, even to the CRA, prior to the issuance of a 116 Certificate. In such a situation, the vendor is then required to fund the Part I tax liability from its own funds despite having 25% of the gross proceeds held in trust on account of Canadian taxes potentially owing. This places an additional unfair burden on the vendor.

Recommendation 1: We recommend that the CRA update the standard language in a Comfort Letter to explicitly provide that, at the request of the non-resident vendor, the purchaser may remit to the CRA all or a portion of the amount withheld as a payment on account of the non-resident vendor's Part I tax liability associated with the disposition to which the withheld funds relate, and that such remittance will reduce any potential liability of the purchaser under subsection 116(5).

Recommendation 2: We recommend that the CRA update its internal systems to ensure that the purchaser can easily remit funds on behalf of the non-resident vendor, and that the funds will be correctly applied on account of the vendor's Part I tax liability.

Issue 3: Payment of Actual Tax Owing to Receive 116 Certificate

The CRA currently requires that an amount equal to 25% of the gain realized on the disposition of TCP be paid by the vendor in order for the CRA to issue a 116 Certificate. In most instances, this will require a payment materially higher than the amount of tax actually owing by the vendor. For example, a non-resident corporation disposing of TCP which is non-depreciable capital property (such as shares) would, based on currently enacted legislation, be subject to an effective Canadian tax rate of 12.5% (25% x ½ capital gains inclusion rate), which is proposed to increase to 16.67% (25% x 2/3 capital gains inclusion rate) if the new capital gains inclusion rate becomes law. Both tax rates are significantly less than the section 116 withholding rate of 25% (or 35% under the proposed amendments). While the vendor should be able to receive a refund of this overpayment when it files its Canadian tax return, this places an unfair cashflow burden on a vendor who is required to overpay on account of its Canadian taxes owing and then wait (many months or possibly longer) for a refund. This also subjects non-resident vendors to foreign exchange risk, as the overpayment and subsequent refund will be in Canadian dollars.

The Act does not actually require the 25% payment to be made in order for the 116 Certificate to be issued. Rather, subsections 116(2) and (4) provide the 116 Certificate will be issued where the taxpayer has either (i) paid to the Receiver General an amount equal to 25% of the (estimated or actual) gain realized, or (ii) furnished security acceptable to the Minister in respect of the disposition of the property. We submit that the payment by the vendor of the actual amount of Canadian tax owing should be considered to be acceptable security in respect of the disposition.

Recommendation: We recommend that the CRA adopt an administrative position confirming that a non-resident vendor can pay the actual amount of tax owing by it to the CRA (rather than an amount equal to 25% of the gain) in order to receive a 116 Certificate. We also reiterate our recommendation above that the CRA update its internal systems to ensure that the purchaser can easily remit funds on behalf of the non-resident vendor, and that the funds will be correctly applied on account of the vendor's Part I tax liability.

Issue 4: Requirement to File a Tax Return

Non-resident vendors who dispose of TCP may be required to file a Canadian tax return, despite having already (i) notified the CRA regarding the disposition through the section 116 clearance certificate process, (ii) paid any taxes owing (or a higher amount, as discussed above); and (iii) received a 116 Certificate. In particular, section 150 generally provides that a non-resident must file a Canadian tax return for a taxation year where, at any time in the year, it has a taxable capital gain or disposes of taxable Canadian property (in both cases, otherwise than from an excluded disposition). This requirement places a burden on non-resident taxpayers to prepare and file a Canadian tax return in addition to navigating the section 116 process. This requirement also places an additional administrative burden on the CRA to process these tax returns, despite having already received the necessary information (and taxes owing) through the

application for the 116 Certificate. These burdens are exacerbated where the vendor is a foreign private equity partnership with many limited partners who are each legally obligated to file a Canadian tax return. The Joint Committee is aware of private equity funds that avoid investing in Canadian real estate or resource property because of this obligation.[6]

Subsection 150(5) sets out what constitutes an excluded disposition by a vendor. The requirements for an excluded disposition in subsection 150(5) are as follows:

(a) the vendor is a non-resident;
(b) no tax is payable under Part I by the vendor for the taxation year;
(c) the vendor is not liable to pay any amount under the Act in respect of any previous taxation year; and
(d) the TCP disposed of by the vendor in the year is excluded property under subsection 116(6), or is property in respect of which the Minister has issued a 116 Certificate.

As a result, where (i) a 116 Certificate is issued, (ii) no Canadian Part I tax is owing by the vendor in respect of other years, and (iii) the disposition resulted in a loss or a gain that was exempt from Canadian tax under any applicable tax treaty (such that no Part I tax is owing for the year for purposes of paragraph 150(5)(b)), the vendor is not required to file a Canadian tax return. However, the CRA has taken the position that paragraph 150(5)(b) is not met where the non-resident vendor realizes a gain on the sale of the TCP which is subject to Canadian tax, even where a 116 Certificate is issued and all amounts of Part I tax payable have been paid as part of that process.[7] We submit that the CRA should interpret paragraph 150(5)(b) as being satisfied where the non-resident vendor realizes a gain on the disposition of the TCP, but has paid the Part I tax owing through the section 116 process; such that no additional Canadian tax is then payable by the vendor for the year. This will help to avoid unnecessary administrative filings and complexity, which can discourage foreign investment into Canada. By requiring that this exception only apply to vendors that have applied for a 116 Certificate, the CRA will ensure that dispositions of TCP are duly reported and the appropriate tax is paid.

While a non-resident vendor may want to file a Canadian tax return in order to receive a refund of taxes which it overpaid in order to receive the 116 Certificate (as discussed above), the adoption of the recommendation in Issue 3 above would eliminate the need for a non-resident vendor to file a tax return in order to receive the refund.

Recommendation: We recommend that the CRA adopt an administrative position confirming that the requirement in paragraph 150(5)(b) will be considered to be satisfied where all Part I tax owing in respect of the disposition of the TCP is paid in connection with the issuance of a 116 Certificate.

Issue 5: Non-TCP Certificate

TCP includes shares which derive, at the time of disposition or at any time in the previous 60 months, more than 50% of their fair market value from Canadian real estate, Canadian resource property and/or certain other properties. However, vendors and purchasers may reasonably disagree about whether the transferred property constitutes TCP, particularly in light of the 60 month look-back period and the uncertainties inherent in valuations. Section 116 does not provide a due diligence defence to the purchaser from the liability under subsection 116(5) even where the purchaser reasonably believes that the property is not TCP. As a result, a conservative purchaser will often withhold under section 116 out of

[6] In many cases the decision not to invest in Canada is not discretionary, as many such funds are contractually bound to avoid investments that could expose their investors to "foreign" tax return filing obligations.
[7] CRA Document 2019-0798861C6 (May 15, 2019).

an abundance of caution where there is any risk of TCP characterization and insist on a 116 Certificate before releasing the funds to the vendor.

In such cases, the CRA's practice is inconsistent. At times, the CRA will assume that the property is TCP and process the 116 Certificate on that basis, without making a determination on the characterization issue, meaning that the amount that must be paid (or security provided) by the vendor to receive the certificate will be computed as if the property were TCP.[8] In such a scenario, the non-resident vendor would then file a tax return on the basis that the property is not TCP, and request a refund. At this time, the CRA would need to analyze the issue of whether the transferred property was TCP. This process would be lengthy and complicated (for both the vendor and the CRA), and would require the vendor to tie up funds for a significant period of time even though, where the transferred property is not TCP, it actually has no Canadian tax liability.

In other circumstances, the CRA may issue the vendor a letter indicating that *"[a] Certificate of Compliance under Section 116 of the Income Tax Act will not be issued in respect of this disposition as the [property(ies)] do not qualify as taxable Canadian property and withholding tax is not applicable*." Such a letter is not, however, a 116 Certificate and it is not clear that it can be relied upon by a purchaser, and therefore a purchaser may not agree to release withheld funds on the strength of such a letter. The CRA's approach of not issuing a 116 Certificate in such circumstances puts the vendor and the purchaser in an irreconcilable position. The purchaser will not release the withheld funds until a 116 Certificate is issued (otherwise it has a potential liability under subsection 116(5)) but the CRA will not issue the 116 Certificate on the basis that the property is not TCP. The Joint Committee is aware of a prior transaction where this circumstance arose; specific arrangements were made with a CRA officer whereby the purchaser remitted the withheld funds to the CRA, and the CRA then arranged for a refund of the same amount to the vendor. However, this process was complex, took several months to complete and required direct contact and arrangements to be made with a CRA officer.

We submit that the CRA should be able to issue a 116 Certificate on the basis that the transferred property is not TCP (assuming it is satisfied that this is the case), such that no amount needs to be paid in order for the 116 Certificate to be issued.

Recommendation 1: We recommend that the CRA adopt an administrative position whereby it can issue a 116 Certificate, after conducting an appropriate review and analysis, on the basis that the transferred property is not TCP. Such a 116 Certificate would be issued on the basis that no Canadian income tax is owing in respect of the disposition.

***Recommendation 2*:** In the event that the CRA cannot agree to Recommendation 1, we recommend that the CRA adopt an administrative position which confirms that a purchaser can rely on a "No-TCP" letter provided by the CRA to release them from any liability under subsection 116(5).

Issue 6: Tax-Deferred Transactions

Section 116 applies to tax-deferred transactions where no tax is payable, such as transactions governed by sections 51[9] and 85.

Sections 51 and 85 include continuity rules which provide that where the transferred property is TCP, the shares acquired by the taxpayer will be deemed to be TCP for a period of 60 months. These continuity rules ensure that there is no risk to the tax base on an exchange or disposition of TCP, as a subsequent

[8] CRA Document 2010-0387141C6 (November 28, 2010).

[9] Although there is no disposition under section 51, there is still considered to be an acquisition by the corporation, such that the section 116 process is still applicable.

disposition will need to be reported and the appropriate taxes paid on such disposition pursuant to section 116.

The CRA has adopted an administrative position that a Section 116 Certificate is not required in respect of an amalgamation under section 87.[10] The CRA states that "*Where the shares of a predecessor corporation were taxable Canadian property of a non-resident shareholder, the postamble to subsection 87(4) deems the shares of the new corporation received by the shareholder on the amalgamation, to be taxable Canadian property of the shareholder at any time within the 60 months immediately following the amalgamation. For this reason, it is the CRA's view that a non-resident holder of shares of a predecessor corporation which constitute taxable Canadian property need not comply with the procedures set out in section 116 in respect of the deemed disposition of the old shares on an amalgamation to which subsection 87(4) is applicable.*"

Recommendation: We recommend that the CRA adopt an administrative position (similar to that respecting amalgamations) confirming that a 116 Certificate is not required where TCP is disposed of on a fully tax deferred basis pursuant to sections 51 or 85.

Issue 7: Time to Receive the 116 Certificate

It generally takes many months to over a year for the CRA to issue a 116 Certificate after the taxpayer has submitted a notification pursuant to subsection 116(1) or 116(3). This length of time can pose significant cash flow burdens and foreign exchange risk on non-resident vendors, who will have a significant portion of their proceeds held in escrow (in Canadian dollars) while waiting for the CRA to issue the 116 Certificate. Many of the issues described above would be partially alleviated if this delay could be reduced.

Recommendation: We recommend that the CRA review the section 116 process and work to improve the service standard for issuing a 116 Certificate.

***

A number of the recommendations above include the adoption of an administrative position. The Joint Committee would be pleased to work with the CRA to discuss and draft this administrative position.

Members of the Joint Committee and the tax community participated in the discussion concerning this submission and contributed to its preparation, including:

- Byron Beswick – KPMG
- Michael Hassar – Goodmans LLP
- Anu Nijhawan – Bennett Jones LLP
- Jeffrey Shafer – Blake, Cassels & Graydon LLP
- Carrie Smit – Goodmans LLP

We would be pleased to discuss this submission with you in further detail at your convenience.

Yours truly,

Byron Beswick
Chair, Taxation Committee
Chartered Professional Accountants of Canada

Carrie Smit
Chair, Taxation Section
Canadian Bar Association

[10] See Folio S4-F7-C1, paragraph 1.82