

CANADIAN GOVERNMENT PROPOSES CHANGE TO SECTION 116 REPORTING OBLIGATION FOR NON-RESIDENT VENDORS

The Canadian government introduced its 2010 Budget on March 4. The budget includes a measure to address an issue that some Canadian companies and US venture capitalists say has had a negative impact on the flow of US investment money into Canada.

Section 116 of the *Income Tax Act* imposes a tax reporting and filing requirement on non-resident vendors who dispose of "taxable Canadian property" (TCP), including shares of private Canadian companies and, in limited circumstances, public companies. To put these requirements into context, upon a share sale involving a Canadian company that has US or other foreign shareholders, each non-resident vendor must apply for a clearance certificate from Canada Revenue Agency (CRA) either before or within 10 days after the transaction closing date. It can take up to 6 weeks to obtain the necessary certificate and, in many cases, the transaction will close before the certificate can be obtained. If a non-resident vendor does not obtain the necessary certificate before the closing date, then the purchaser must withhold 25% of the purchase price payable to that vendor and, if a clearance certificate is not provided, remit it to CRA as tax payable by the vendor.

The process to obtain a Section 116 clearance certificate is often long and complicated, particularly where the transaction involves multiple vendors in different jurisdictions. Although many countries have a tax treaty with Canada that may apply to exempt a non-Canadian vendor from the Section 116 reporting obligation, the vendor must still file a Canadian tax return to claim that exemption. This requirement has been a burden for non-Canadian vendors because the need to seek recovery of the withheld monies and to file a Canadian tax return adds unnecessary time and expense to the transaction. Moreover, certain foreign investment structures have historically not qualified for benefits under a tax treaty with Canada, and that has reduced their ability or desire to participate in Canadian investments. This has been a particular concern for the US private equity market where the preferred investment structure for a venture capital fund is often a partnership, a limited liability company or other similar entity. Those funds either don't qualify for the benefits under the US-Canada tax treaty or they are forced to comply with the Section 116 requirements involving the identification of each of their ultimate investors.

The budget measure proposes to amend the definition of TCP to exclude shares of any corporation (resident or non-resident) where at no time in the previous 60 months has more than 50% of the fair market value of those shares been derived directly or indirectly from (i) real or immovable property situated in Canada; (ii) Canadian resource properties; (iii) timber resource properties; or (iv) options, interests or rights relating to any of those properties, with the result that the filing requirements for most share investments in private and public companies, regardless of the level of ownership or residence of the vendor, may be eliminated. The amended definition would apply to determinations of taxable Canadian property status after March 4, 2010. With the elimination of these filing requirements, Canadian companies will now be in a better position to attract foreign venture capital investment.

For more information on this pending amendment, please contact [Brock Smith](mailto:bhs@cwilson.com) (bhs@cwilson.com or 604.643.3186) or [Mark Longo](mailto:mjl@cwilson.com) (mjl@cwilson.com or 604.643.3138).

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