



Part XIII – Tax & Traps

2018

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Agenda

1. Scope of Part XIII
2. Income subject to Part XIII
3. Back-to-back loans, royalties and dividends
4. Compliance



Part XIII Tax

- 212(1) – Every non-resident person shall pay an income tax of 25% of every amount that a person resident in Canada pays or credits, or is deemed by Part I to pay or credit, to the non-resident person as, on account of or in lieu of payment of, or in satisfaction of,
 - Dividends – 212(2));
 - Management fees – 212(1)(a);
 - Interest – 212(1)(b);
 - Rents and Royalties – 212(1)(d);
 - Restrictive covenants – 212(1)(i);
 - [...]



1. Scope of Part XIII – 212(1)

- a. Payor: “a person resident in Canada”
- b. Taxpayer: “a non-resident person”
- c. Meaning of “pays or credits”



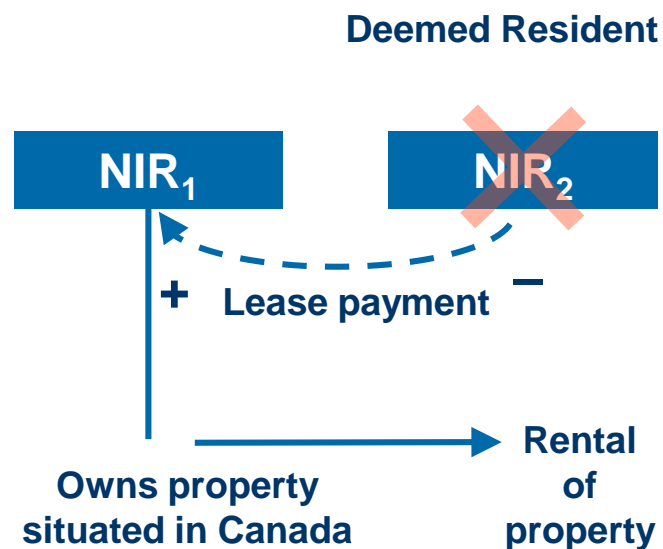
1.(a) Payor: A person resident in Canada

- Individual:
 - A person ordinarily resident in Canada – 253, or
 - Deemed resident (sojourn >183 days/ calendar year) – 250(1)(a)
- Partnership deemed a person resident in Canada – 212(13.1)(a):
 - Re. amount deductible in computing income or loss of the partnership from sources in Canada – 96(1)(f) & (g)
- Corporation:
 - Incorporated in or continued into Canada – 250(4)(a) and (5.1)
 - Central management and control – Garron, Saint Michael Trust Corp., Fundy Settlement



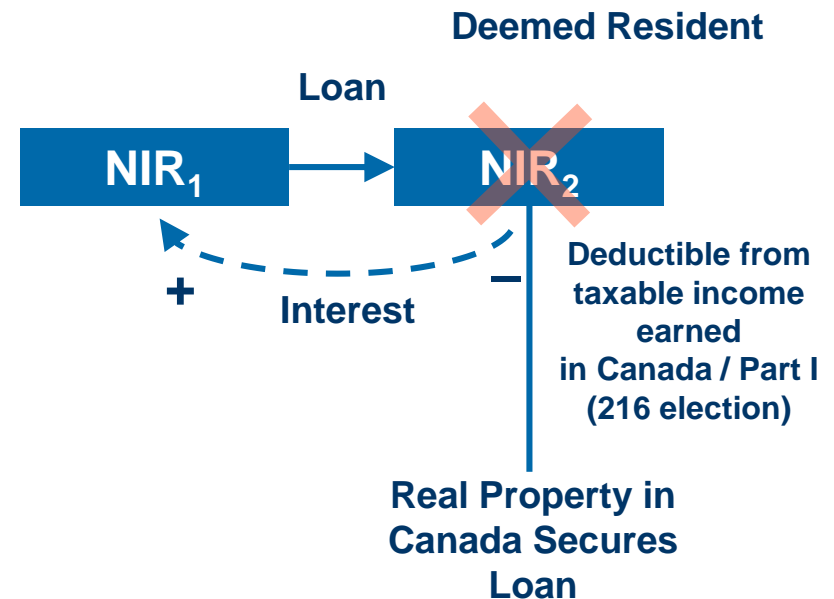
1.(a) Payor: Deemed resident in Canada

- N/R makes payments re. property in Canada:
 - Rent for the use in Canada of property (but not vehicles – Canada -US VIII:6) – 212(13)(a)



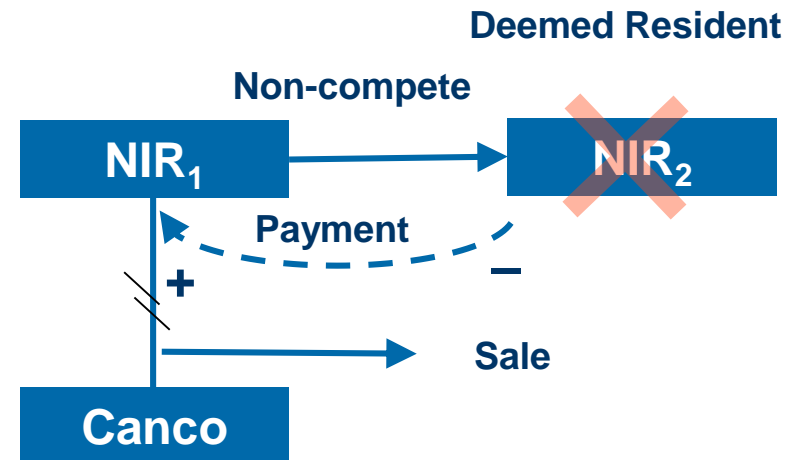
1.(a) Payor: Deemed resident in Canada

- N/R makes payments re. property in Canada:
 - Interest on a loan that is secured by a mortgage on real property situated in Canada if the interest is deductible in computing taxable income earned in Canada or Part I liability (216 election) – 212(13)(f)



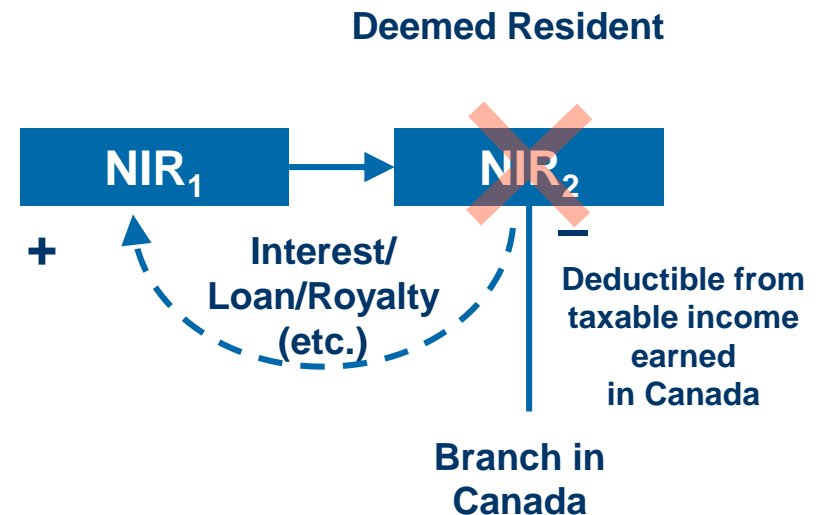
1.(a) Payor: Deemed resident in Canada

- N/R makes payments re. property in Canada:
 - Income re restricted covenants (56.4(2)) that affects acquisition/provision of property or services in Canada, or by a Canadian resident outside Canada, or acquisition/provision of TCP outside Canada – 212(13)(g)



1.(a) Payor: Deemed resident in Canada

- Branch of N/R corporation – 212(13.2):
 - Canadian branch of N/R re. amount that is deductible from taxable income earned in Canada
 - Interest, rents, royalties but not dividends
 - Exception for source of income that is a treaty-protected business (e.g., branch is not a PE) or a treaty-protected property (116(5.01))



1.(b) Taxpayer: A non-resident person

- Every non-resident person shall pay an income tax of 25% on [...]
 - Individual
 - Corporation
 - Partnership is deemed a “N/R person”, except if it is a “Canadian partnership” – 212(13.1)(b)
 - “Canadian partnership”: all of the members are resident in Canada – 102
 - Therefore, a N/R with a 1% interest in a partnership taints the partnership
 - CRA practice is to look through a partnership to consider the partners to be the “beneficial owners” of the partnership’s income and eligible to claim treaty benefits on their share of any amount paid to the partnership



1.(b) Taxpayer: A non-resident person

- No Part XIII tax on amounts that may reasonably be attributed to the business carried on by the person through a PE in Canada – Reg. 805
 - If the N/R earns income from a business and not from property, it will be subject to Part I tax
 - Exception only applies if there is a PE
 - PE defined as per treaty, or if no treaty applies, per the Act (see Reg. 8201)
 - Payor must receive a Regulation 805.1 certificate to be released from liability



1.(c) Meaning of “pays or credits”

- “Setting aside and making the amount unconditionally available to the N/R.” (IC 77-16R4 para. 5)
 - E.g., amount due is applied by the resident against an amount owing by the N/R
- Recording of the payable by way of journal entry does not constitute “credited” (Income Tax Technical News, No. 14, Cartier)
- Accrued interest is not deemed “paid or credited”
 - Accrued interest on excess loan under thin capitalization rules that is re-characterized as a dividend under 214(16) is deemed paid in the year – 214(17)



Income subject to Part XIII

- a) Management fees
- b) Interest
- c) Dividends
- d) Rents and Royalties
 - Royalties
 - Restrictive Covenants
 - Rental of Immovables



2.(a) Management Fee – 212(1)(a)

- Amount in connection with the direction or supervision of business activities
- Management fee does not include 212(4):
 - 212(4)(a) Fees paid to arm's length persons for services performed in the ordinary course of their business – but Reg. 105 may apply if service provided in Canada; and
 - 212(4)(b) Reimbursement of expenses – but NR4 must be issued
 - 212(4) Exception applies “to the extent that the amount so paid or credited was reasonable in the circumstances”.
- Under treaty, exempt from WHT unless attributed to a PE (business profits Art. VII)



2.(b) Interest – 212(1)(b)

- No withholding on arm's length interest except for “participating debt interest”
 - 212(3) - “Participating debt interest” interest that is:
 - Contingent/dependent on use of or production from a property in Canada; or
 - Computed by reference to revenue, profit, cash flow, commodity price, dividend paid, etc.



2.(b) Interest – 212(1)(b)

- Withholding on non-arm's length interest unless it is “fully exempt interest” (debt guaranteed by a government/province)
- WHT rate reduced by treaty (Art. XI(1)):
 - Canada-US reduced to 0% even when non-arm's length
 - Others – 10%



2.(b) Deemed Interest

- Standby charges and guarantee fees are deemed payment of interest
 - Guarantee fees: N/R receives an amount for the guarantee of the repayment of principal amount of a bond, note, mortgage etc. of a person resident in Canada (e.g., N/R parent receives a fee for guaranteeing the loan of a Canadian subsidiary) – 214(15)(a)
 - Standby charges: N/R receives an amount for making an amount of money available to be drawn on in the future by a person resident in Canada (e.g. line of credit)



2.(b) Deemed Interest

- B2B Loans – results in deemed payment of interest :
 - where a N/R lends to its CanSub through an intermediary in order to access a lower WHT than would have applied had it made the loan directly, CanSub is deemed to pay the interest directly to the N/R – 212(3.1) and 212(3.2)



2.(c) Dividends – 212(2)

- Amount paid by a CRIC on account of:
 - Taxable dividends (includes stock dividends)
 - Capital dividends (83(2) election to distributed $\frac{1}{2}$ untaxed CG) therefore no election should be made in favour of a N/R shareholder
- No WHT on a return of capital
 - But excess above PUC is a deemed dividend 84(1) that is subject to WHT
- WHT rate reduced by treaty (Art. X(2)):
 - (a) If beneficial owner is a company which owns at least 10% of votes 5% (but Canada-US Treaty allows look-through for ownership through N/R fiscally-transparent entity)
 - (b) Otherwise 15%



2.(c) Dividends –Fiscally-Transparent Entity

- Canada-US Treaty – considers a N/R corporate partner to hold the voting stock of the CRIC owned by the FTE in proportion to its ownership interest in the FTE
 - Thus if a partnership wholly-owns a CRIC, a N/R corporate partner holding at least a 10% interest in the partnership could benefit from the 5% reduced WHT on dividends
- Under other treaties, only a corporate shareholder can benefit from the 5% reduced rate and all other shareholders can only access the 15% WHT

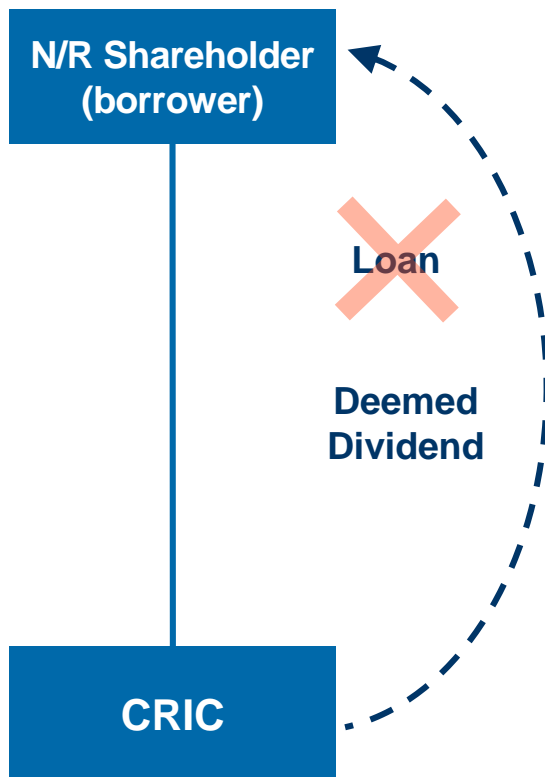


2.(c) Deemed “Dividends”

- Deemed dividends under Part I are included under 212(2)
 - At 84(1), (2), (3) & (4) – on increases or reduction in PUC; distribution of funds or property on the wind-up of a business; and redemption, acquisition or cancellation of shares;
- Deemed dividends under Part XIII
 - Shareholder loans – 15(2) and 214(3)(a)
 - Shareholder interest benefit – 80.4(4), 15(9), 214(3)(a) and 214(3.1)
 - Thin capitalization – 18(4) and 214(16)
 - Foreign affiliate dumping (FAD) – 212.3(2)(a)



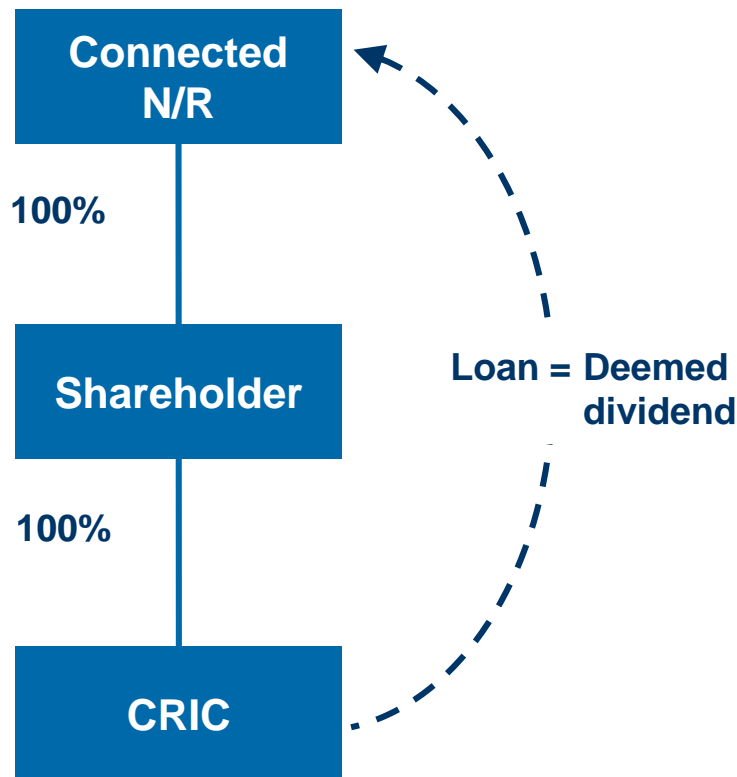
2.(c) Deemed “Dividend” – Shareholder Loan – 15(2)



- N/R Shareholder of a CRIC, receives a loan from CRIC that is outstanding for more 2 years after years end
- N/R Shareholder must include the amount of the loan in its income in the year it was made **under 15(2)**
- The amount of the loan is deemed paid as a dividend to the N/R Shareholder - 214(3)(a)
- Part XIII - dividend WHT - 212(2)



2.(c) Deemed “Dividend” – Shareholder Loan – 15(2)

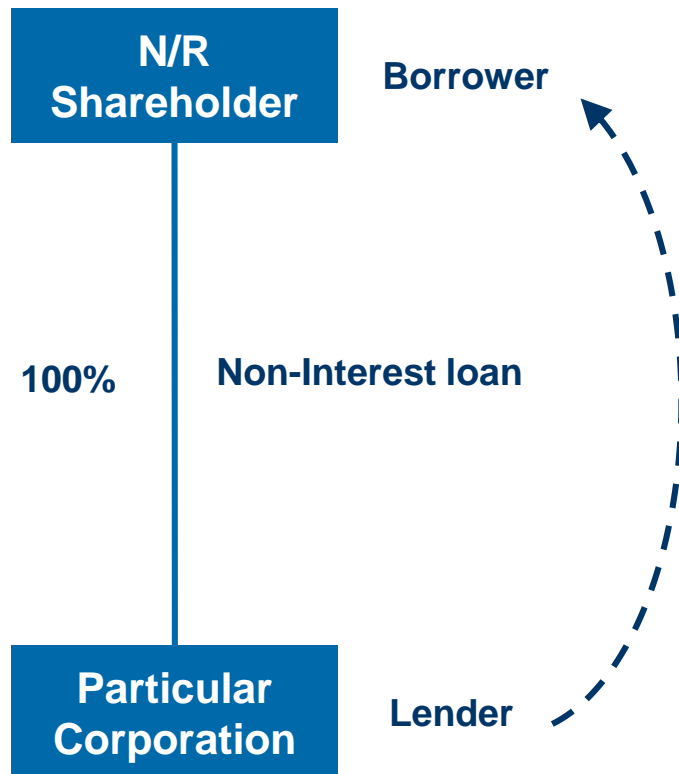


Applicable WHT Rate

- Deemed dividend can benefit from reduced treaty WHT rate
- The dividend is deemed paid to the recipient of the loan (the “Connected N/R”) and not to the immediate Shareholder.
- Depending on the applicable treaty, the lower WHT rate (5%) may not be available because there is no direct share ownership.
 - e.g. Canada-US Treaty = 15%
 - e.g. Canada-UK Treaty = 5% (due to indirect shareholding rule)



2.(c) Deemed “Dividend” – IFL Shareholder Benefit – 80.4(2)



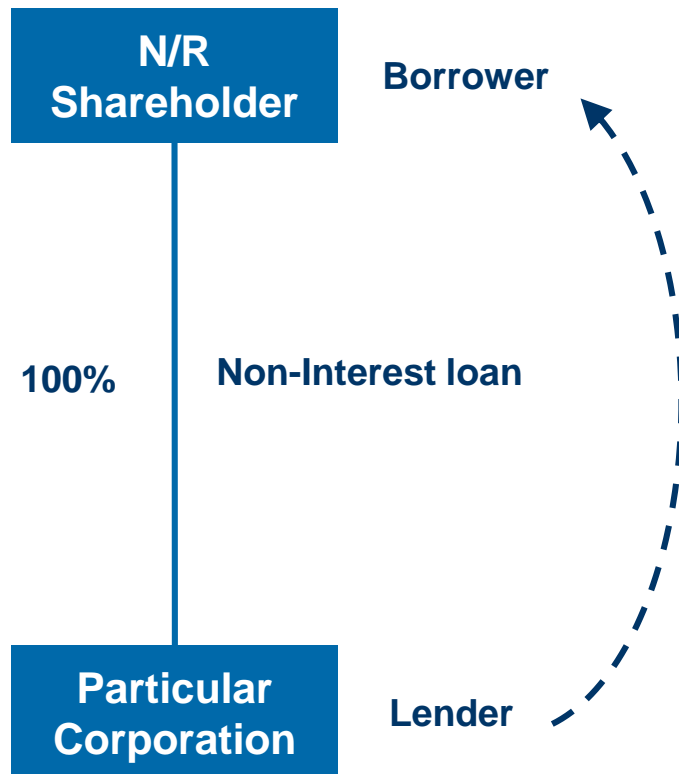
Conditions

- Applies where a **N/R Shareholder** (or a N/R person *connected* to the shareholder) receives a loan from a **particular corporation** or from a corporation related to the particular corporation.
- The loan bears no interest or interest less than prescribed rate (2% in 2018 Reg. 4301(c)).

Exception

- When 15(2) applies – 80.4(3)(b) (i.e. 80.4(2) only applies up to the end of the first taxation-year of the Particular Corporation following the year the loan was issued)

2.(c) Deemed “Dividend” – IFL Shareholder Benefit – 80.4(2)



Consequences

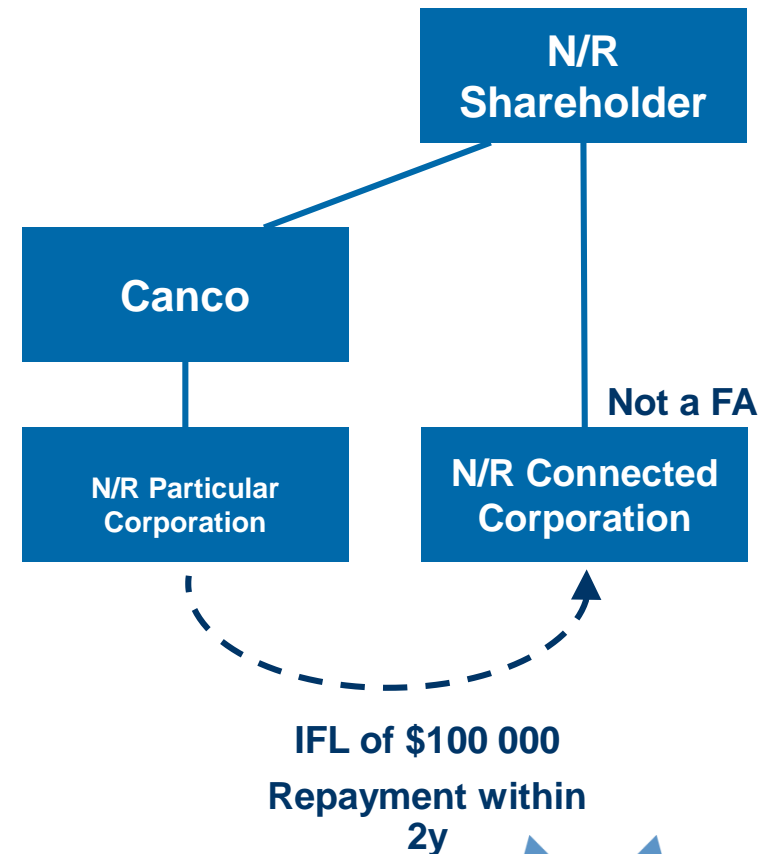
- Excess of the interest on the loan at the prescribed rate over the actual interest paid is deemed to be a **shareholder benefit** for N/R Shareholder for each taxation year that the loan is outstanding (2006-0187061E5)
- The benefit is **deemed to be a dividend** to the N/R Shareholder –15(9), 15(1), 214(3)(a) & (3.1).



2.(c) Deemed “Dividend” – IFL Shareholder Benefit – 80.4(2) Example

2015-0622751I7

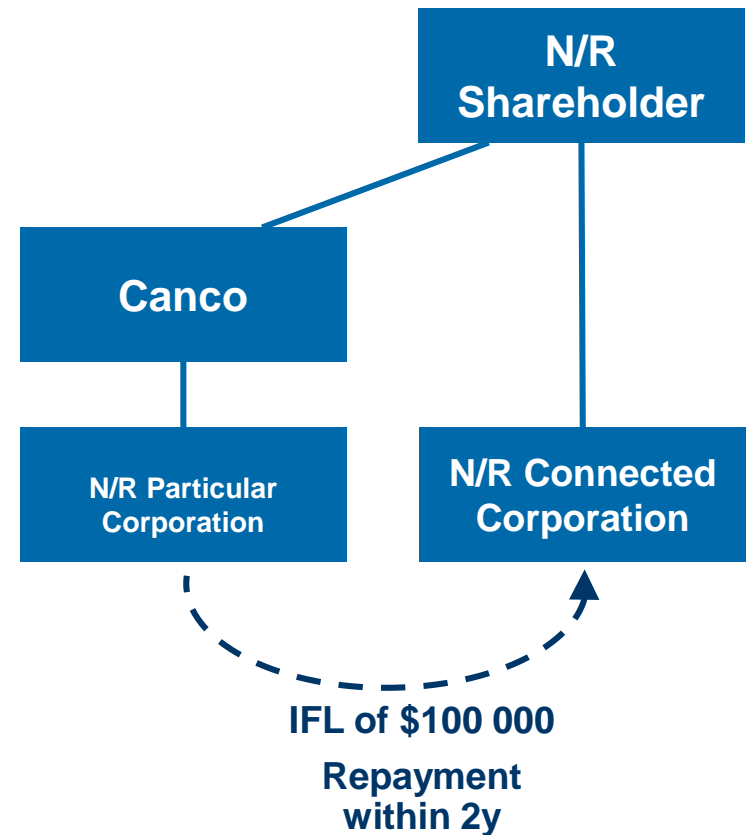
- IFL to N/R Connected Corporation
- Not exempt under 80.4(8) as it is not a FA of Canco
- Deemed interest-free benefit to N/R Connected Corporation under 80.4(2) of \$2,000 (at 2%)
- 15(9) deems \$2,000 to be a benefit conferred on a shareholder for purposes of 15(1)
- 214(3)(a) deems the benefit to have been **paid as a dividend** to the taxpayer (i.e. the N/R Connected Corporation) from a deemed CRIC (i.e. the N/R Particular Corporation)



2.(c) Deemed “Dividend” – IFL Shareholder Benefit – 80.4(2) Example

2015-062275117 – continued

- N/R Particular Corporation is liable to withhold and remit under 215(1)
- CRA considers that the WHT liability of N/R Particular Corporation could also attach under 160(1) to any dividends that flowed up the chain to Canco to the extent of the unremitted WHT
- CRA also considers that directors of N/R Particular Corporation could potential be liability under 227.1 for the failure to withhold and remit (but consider the due diligence defense)



2.(c) Deemed “Dividend” – Thin Cap

- Interest paid on portion of “**outstanding debts to specified non-residents**” (“ODSNR”) that exceeds the permitted debt-to-equity ratio of 1.5:1 is not deductible under Part I – 18(4) under Part I
- ODSNR : debts owing to “specified N/R shareholder” or N/R NAL vis-à-vis a “specified shareholder”
- “Specified shareholder” is a person who (alone or with NAL) owns 25% or more of the votes/value of CRIC

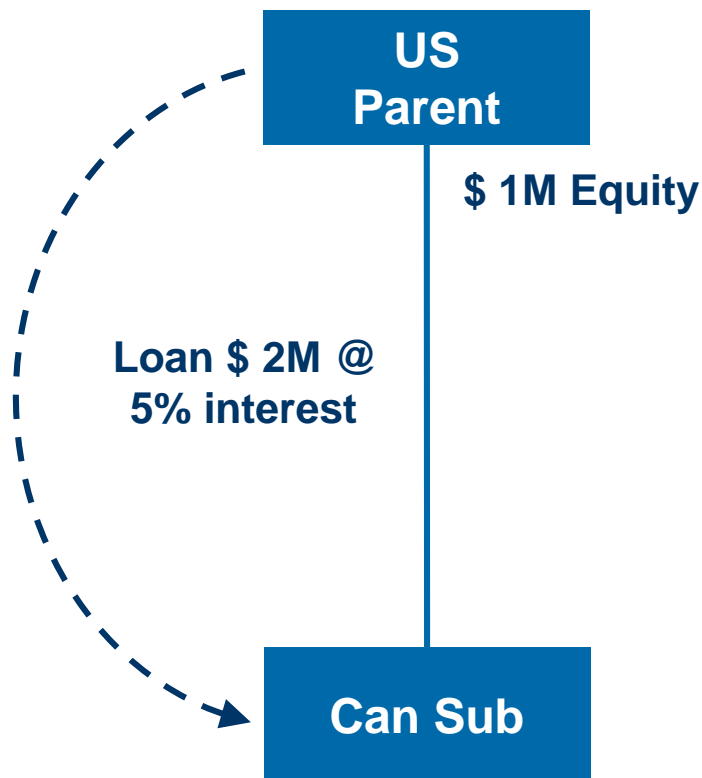


2.(c) Deemed “Dividend” – Thin Cap

- For Part XIII, non-deductible interest is re-characterized as a dividend paid by the Canadian corporation – 214(16)(a)
- Interest “payable” by a CRIC at the end of the year is deemed to have been paid immediately before the year-end – 214(17)(a)
 - Deeming rule does not apply to compound interest



2.(c) Deemed “Dividend” – Thin Cap

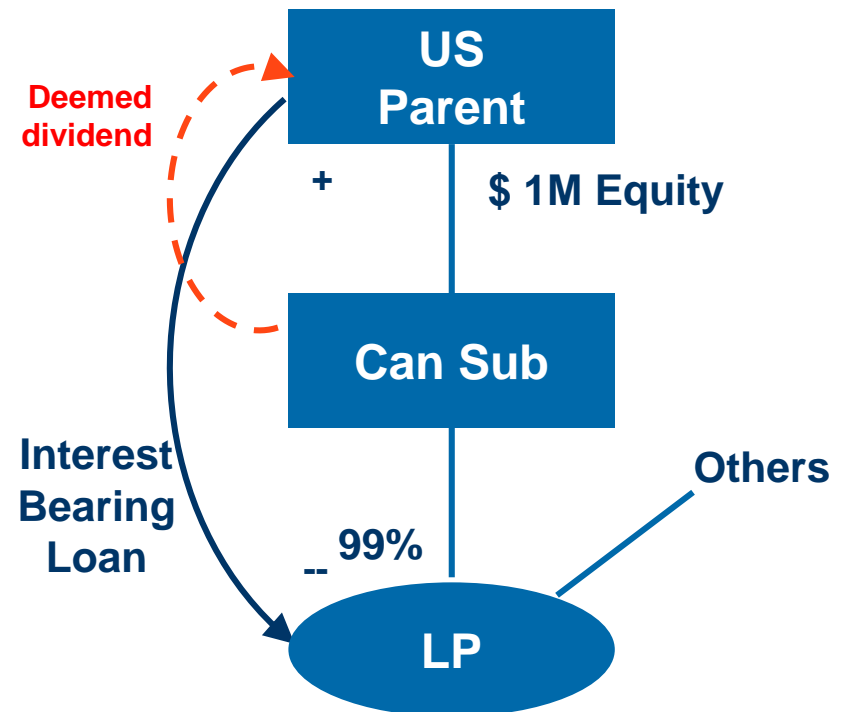


Example:

- US Parent capitalized with \$1M Equity and Loan of \$2M at 5%
- Excess debt is \$0.5M = $\$2M - 1.5 * (\$1M \text{ Equity})$
- Denied interest deduction is $\$25,000 = \$0.5M * 5\%$
- Deemed dividend = \$25,000
- WHT is $\$25,000 * 25\%$ (or treaty rate) = \$6,250

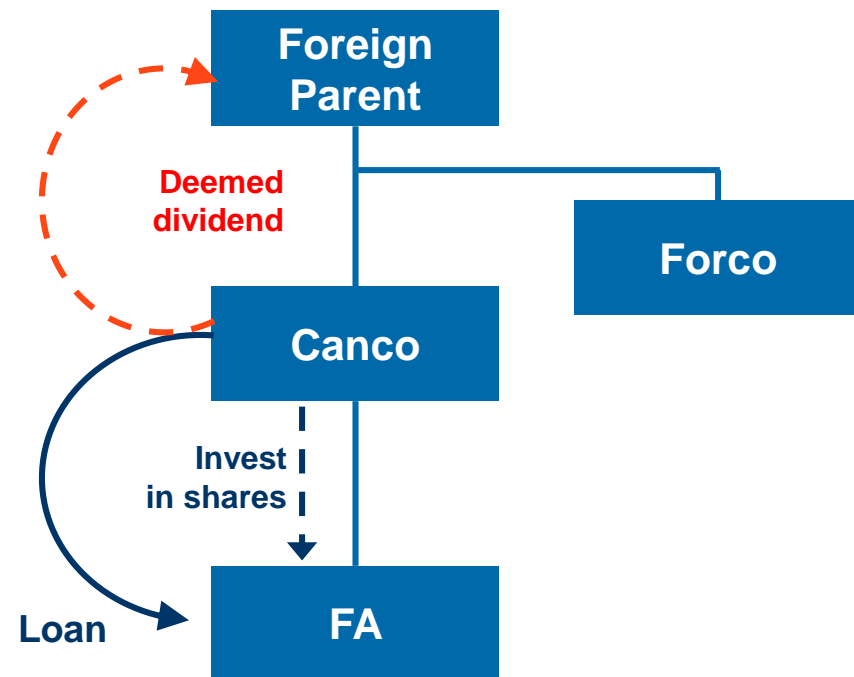
2.(c) Deemed “Dividend” – Thin Cap

- Issue when the ODSNR is held through a partnership
- The dividend is deemed paid to the N/R Parent with respect to CanSub portion of the partnership income
- Partnership may not know the CanSub’s thin cap position and may not have withheld WHT with respect to the interest paid on the Loan
- If partnership does not distribute income in the year, Cansub may not have the funds with which to remit WHT

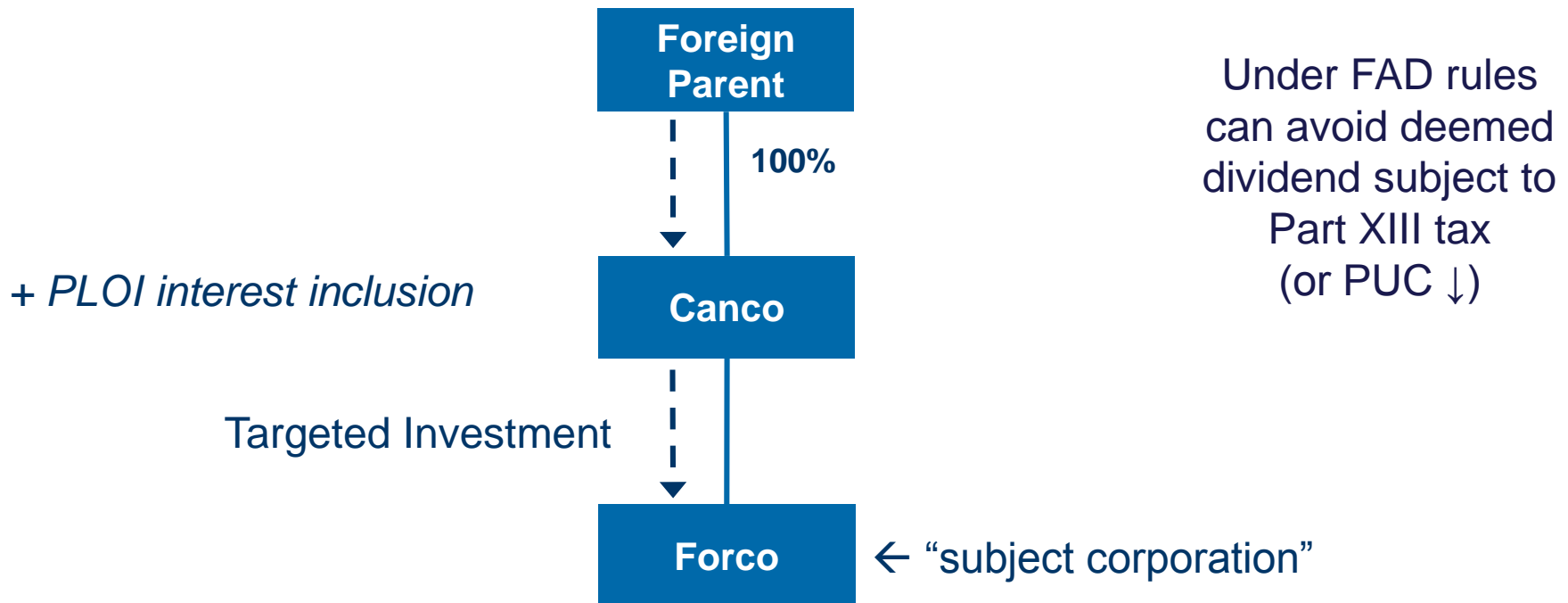


2.(c) Deemed “Dividend” – FAD

- Foreign affiliate dumping (FAD) rules apply to foreign-controlled CRIC that invests in a FA
- Investment treated as distributions out of Canada. CRIC is deemed to have paid a dividend to foreign parent at the investment time – 212.3(2)
- Deemed dividend is reduced by cross-border PUC of Foreign Parent in CRIC (filing requirements)
- WHT applies on deemed dividend



2.(c) Deemed “Dividend” – PLOI Election



- To avoid the deemed FAD dividend, can make a PLOI election (212.3(11)(c)) re. the “targeted investment”
- Canco will have imputed interest at least equal to interest on the “funding obligation”



2.(d) Rents & Royalties – 212(1)(d)

- “Rent, royalties or similar payments” – 212(1)(d)
- Are not defined terms in the Act, but see list of enumerated inclusions in that paragraph
 - A “royalty” is:
 - Calculated by reference to the payee’s use of the property, rights or information (e.g., number of copies sold or articles rented)
 - The payments for such use are contingent upon the extent or duration of use, profits or sales of the user
 - see *Grand Toys Ltd. v. Minister of National Revenue*, 90 D.T.C. 1059 (T.C.C.); *Hasbro Canada Inc. v. The Queen*, 98 D.T.C. 2129 at para. 22 (T.C.C.) and *Vauban Productions v The Queen*, [1975] C.T.C. 511 (FCTD) ; 75 D.T.C. 5371)



2.(d) Rents & Royalties – Inclusions

- Payments for the use (or right to use) in Canada of property of any kind whatsoever including:
 - an invention, a trade-name, a patent, a trade-mark, a design, a model, a plan, a secret formula, or a process – 212(1)(d)(i);
- Payments for information (“know-how”) or services concerning industrial, commercial or scientific experience (but not services in connection with the sale of property or negotiation of a contract) if computed by reference to :
 - the use to be made of it or the benefit to be derived from it,
 - production or sales of goods or services, or
 - profits
 - – 212(1)(d)(ii) and (iii)



2.(d) Rents & Royalties – Inclusions

- Payments dependent on the use of or production from property in Canada – 212(1)(d)(v),
 - including instalments of its sale price (see 12(1)(g))



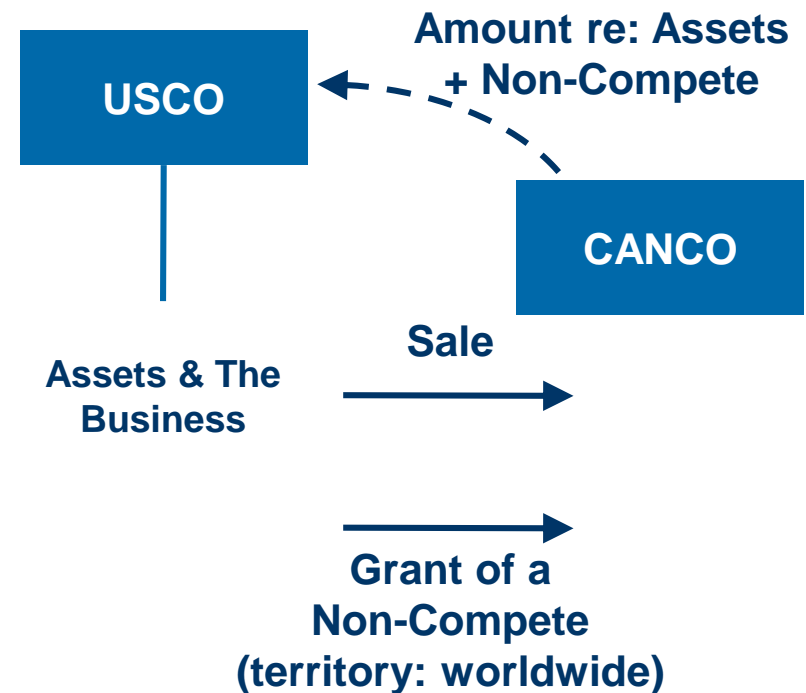
2.(d) Rents & Royalties - Some Exclusions

- Royalties re copyright in respect of the production/reproduction of a literary, dramatic, musical or artistic work – 212(1)(vi) (but see 212(5) for film)
- Payments for R&D under a cost-sharing arrangement under which the payer is entitled to an interest in any rights arising therefrom – 212(1)(d)(viii)
- Rent for the use outside Canada of any corporeal property – 212(1)(d)(ix)
- Amounts deductible in computing the income of the Canadian payer from a business carried on outside Canada, provided the parties are dealing at arm's length – 212(1)(d)(x)



2.(d) Restrictive Covenants

- Amount in respect of a RC, which would be included in the N/R's income under 56.4(2), if it were resident in Canada – s. 212(1)(i)
 - i.e., an amount in respect of an agreement, or undertaking, or the waiver of an advantage or right, that affects the acquisition or provision of property or services by the NR grantor – note s. 68(c) can re-allocate consideration to RC
 - applies irrespective of whether or not the undertaking (e.g. not to compete) is with respect to Canada or outside Canada
 - Per 212(13)(g), can also apply to a RC granted by a NR to a NR if the amount affects the acquisition or provision of property or services in Canada.
 - No treaty WHT relief, unless otherwise exempt under Article VII (PE)



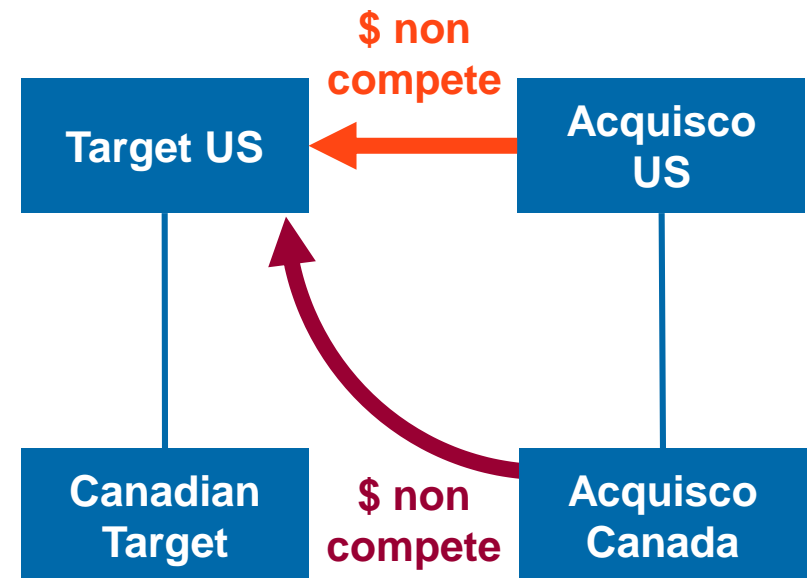
2.(d) Restrictive Covenants

- If not captured by 56.4(2), may be subject to WHT as a “royalty” under 212(1)(d)(iv)
 - Payments for the agreement by the NR to not use property in Canada or “know-how” (in Canada or elsewhere), or for the grant to the Canadian payor of an exclusive right to use such property or “know-how”
 - Benefits from treaty WHT for royalties



2.(d) Restrictive Covenants - Example

- Structure sale of shares or assets so as to avoid having a NR grant any form of RC to a resident of Canada or in relation to a Canadian business
 - 212(1)(i) If Target US was Canadian 56.4(2) would include amount in income
 - 212(3)(g) If Acquisco US deemed to be resident if amounts affect in any way the acquisition 6/S in Canada or outside Canada by a Canadian resident or outside Canada by TCP



2.(d) Example Interaction of Royalties & RC

2017-070129117

- Facts:
 - In consideration for a lump sum payment, a N/R in a treaty country granted Canco the exclusive right to distribute its property in Canada.
 - Canco agrees not to sell competitive products.



2.(d) Example Interaction of Royalties & RC

2017-070129117 - continued

- Ruling – Canadian Tax Consequences:
 - Not a “royalty” per 212(1)(d) – as a lump sum payment not dependant on Canco’s profit or degree of exercise of its exclusive distributorship right
 - Not the payment for the use of any property in Canada per 212(1)(d)(i) – an exclusive right to buy/sell does not constitute the right to use the product
 - Not a payment pursuant to an agreement by NR to not use or permit any other person to use any property per 212(1)(d)(iv) –because there is no property listed in 212(1)(d)(i)
 - Is a RC subject to 212(1)(i) because the grant by the NR of exclusive distribution rights is an undertaking or waiver that affects the acquisition/provision of property so that 56.4(2) would have applied to include the amount in the NR’s income, if the NR were resident of Canada



2.(d) Example Interaction of Royalties & RC

2017-070129117 – continued

- Ruling – Treaty relief:
 - Treaty royalty provisions do not apply. Not a “royalty” under Art XII(4)– OECD commentary “payments for obtaining the exclusive distribution rights of a product in a given territory do not constitute royalties as they are not made in consideration for the use of, or the right to use, property”
 - Payment represents a purchase price for the product. Exempt under Article VII, as a business profit from a business that is not carried on through a PE in Canada.



2.(d) Rents & Royalty – Treaty Relief

- Art. XII(3) Canada-US Treaty: exempts the following payments that are beneficially owned by a resident of a treaty country from WHT:
 - Copyright payments for literary, dramatic, musical or artistic work (but not motion pictures)
 - Payments for the right to use computer software;
 - Payments for the right to use patents, or information (“know-how”) concerning industrial, commercial or scientific experience (but not information in connection to a rental or franchise agreement)



2.(d) Rents & Royalty – Treaty Relief

- Art. XII(2) and XII(4) Canada-US Treaty: 10% WHT on “royalties” for the right to use :
 - any copyright of motion pictures,
 - trade mark, design or model, plan, secret formula or process,
 - tangible personal property,
 - Gains from alienation of any rights described in the definition of “royalties” at Art. XII(4)



2.(d) Real-Estate Rental Income Earned in Canada

- If it is active business income, it is subject to Part I;
- Combined federal/provincial Part I tax on net rental income (revenue minus expenses), and
- If profits are not re-invested, branch tax of 25%; reduced by treaty to 5%, [and first \$500K exempt (Art. X(6)) of Canada-US Treaty]
- Part XIII does not apply, since the rental payments to the NR are attributable to a PE in Canada (as defined at Reg. 8201) - Reg. 805
- No further relief under the treaty because have a PE (Art. VII)
- Must file an income tax return in Canada & Quebec



2.(d) Real-Estate Rental Income Earned in Canada

- If it is passive rental income, Part XIII at 25% on gross rental income;
- Part XIII WHT is not reduced by treaty (Art. VI allows full domestic taxation)
- Possibility of electing under 216(1) to be taxed under Part I on net rental income
 - Election made within 2 years of the end of the tax year
 - CRA policy to allow one late filed return without penalties
 - Must file an income tax return in Canada (T1159) & Quebec as if the income from the property were the NR's only income



2.(d) Real-Estate Rental Income Earned in Canada

Passive rental income (cont'd)

- Possibility of electing under 216(1) – continued
 - May deduct CCA and other expenses incurred for purpose of earning that income
 - Cannot claim deductions under Division C of Part I in calculating taxable income (e.g. use the loss carry forward provisions and corporate deduction for charitable donations)
 - If claim CCA, may be subject to recapture when sell the property – 216(5)



2.(d) Real-Estate Rental Income Earned in Canada

Passive rental income (cont'd)

- Possibility of undertaking under 216(4)(a) to file a Part I return within 6 months of the year-end (Form NR6)
- Allows the Canadian payer or the NR's agent (e.g. property manager) to not remit Part XIII WHT on gross rents but instead to remit 25% of "any amount available" to be paid to the NR
 - excess of rental income over the deductible expenses incurred to earn it except capital outlays and non-cash items such as CCA
- If the N/R fails to file the return or pay the tax within the required time, the payer/agent is liable to pay the full amount of the WHT on gross rents minus any amount already withheld, plus penalties and interest – 216(4)(b)



2.(d) Real-Estate Rental Income Earned in QC

- Québec anomaly if NR corporation earns passive rental income in QC
 - Under QTA a corporation is subject to QC tax if it has “establishment” in QC
 - 12(2) QTA deems a corporation to have an establishment in a province in which an immovable owned by the corporation and used principally for the purpose of earning or producing gross revenue that is rent is situated
 - This same rule does not exist in the definition of PE at 400(2) ITA
- Section 124(1) provides for a 10% provincial abatement on “taxable income earned in a province” – see Reg. 402, which deem that income is earned in a province where there is a PE in that province
- Therefore, could have Quebec corporate tax apply to passive rental income without the Federal abatement



3. Back-to-back Rules

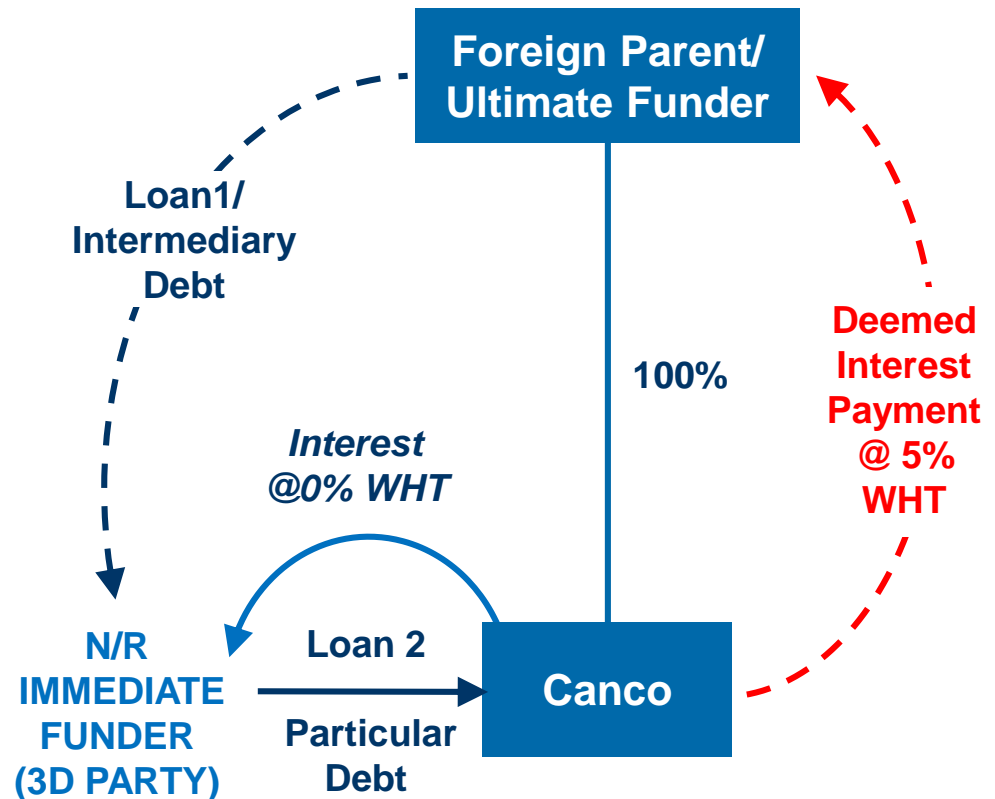
- Address “conduit” arrangements in which certain amounts are paid by a CRIC through an intermediary where certain conditions are met, and these amounts are subject to less WHT than would have been the case if they would have been paid directly to the NR
- Rules for:
 - Loans
 - Rents and Royalties
 - Shareholder Loans – 15(2) * 80.4



3.(a) B2B Loans - 212(3.1) - 212(3.3)

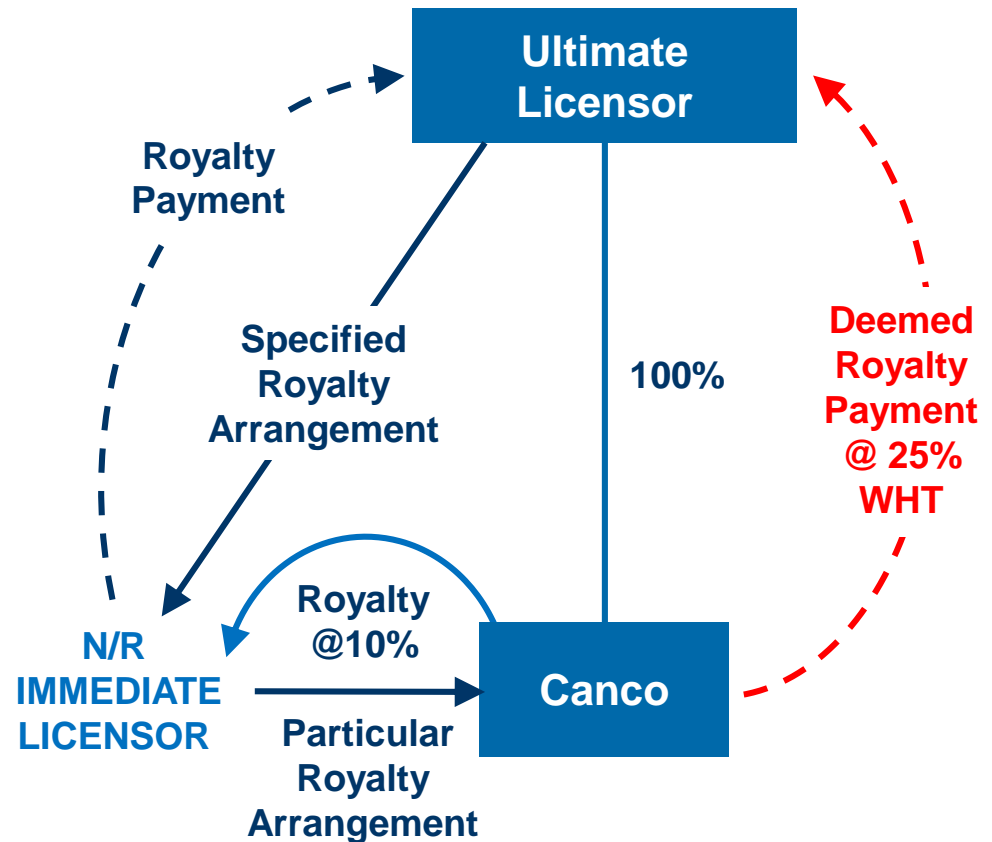
- 212(3.1)(a)&(b) Canco makes interest payment to a NR Immediate Funder
 - Immediate Funder is not a NAL person resident in Canada
- 212(3.1)(c) Loan1 meets the connection test to Loan2 – intermediary debt rule/specified right
- 212(3.1)(d) if the interest payment was paid to the Ultimate Funder, the amount of WHT would be higher
- 212(3.1)(e) *de minimum* rule does not apply (at least 25% of the Loan2 was funded by Loan1)

Deemed interest payment from Canco to Ultimate Funder



3.(b) B2B Rents & Royalties - 212(3.9) - 212(3.91)

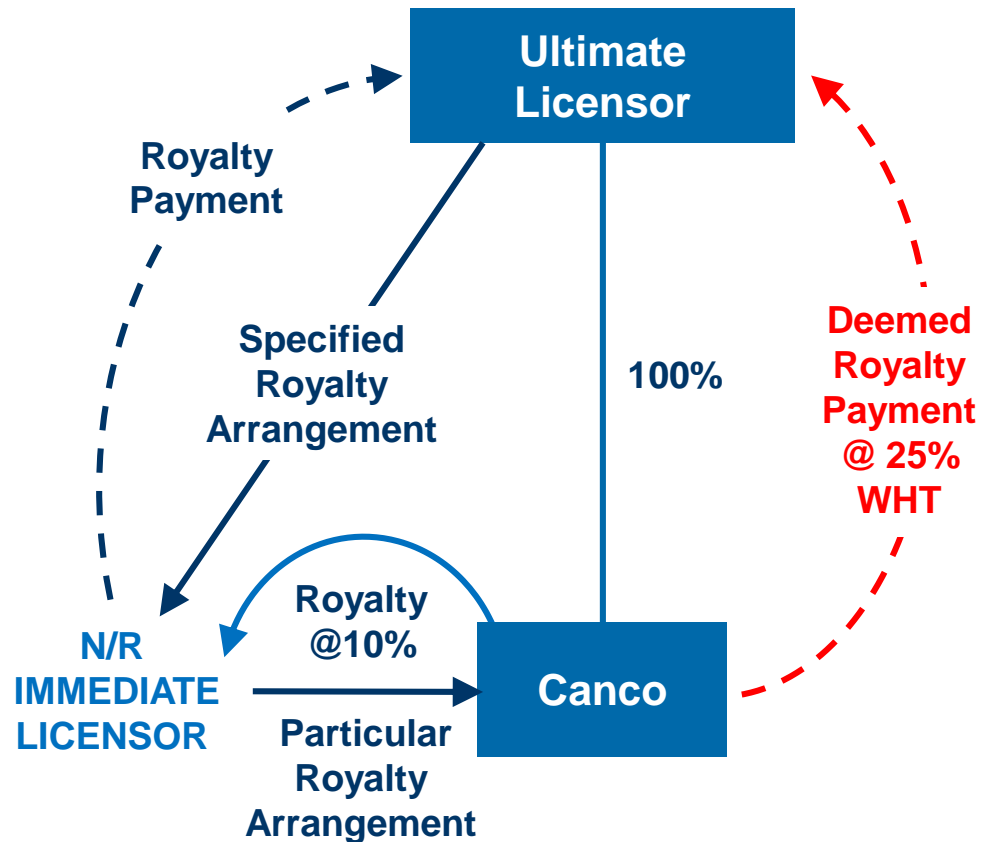
- Canco pays a rent, royalty, or similar payment to NR Immediate Licensor
- Immediate Licensor must pay a royalty to the Ultimate Licensor and the amount is determined by reference to:
 - an amount paid in respect of the Particular Royalty Arrangement, or
 - the FMV, revenue, profits, income, cash flow, etc. of a particular property if a right in respect of the property is granted under the Specified Royalty Arrangement.



3.(b) B2B Rents & Royalties - 212(3.9) - 212(3.91)

- Either:
 - the Ultimate Licensor & Canco are NAL, or
 - it is reasonable to conclude that one of the main purposes of the Specified Royalty Arrangement was to reduce or avoid WHT in respect of the Particular Royalty Arrangement
- If the royalty payment was paid to the Foreign Parent, the amount of WHT would be higher

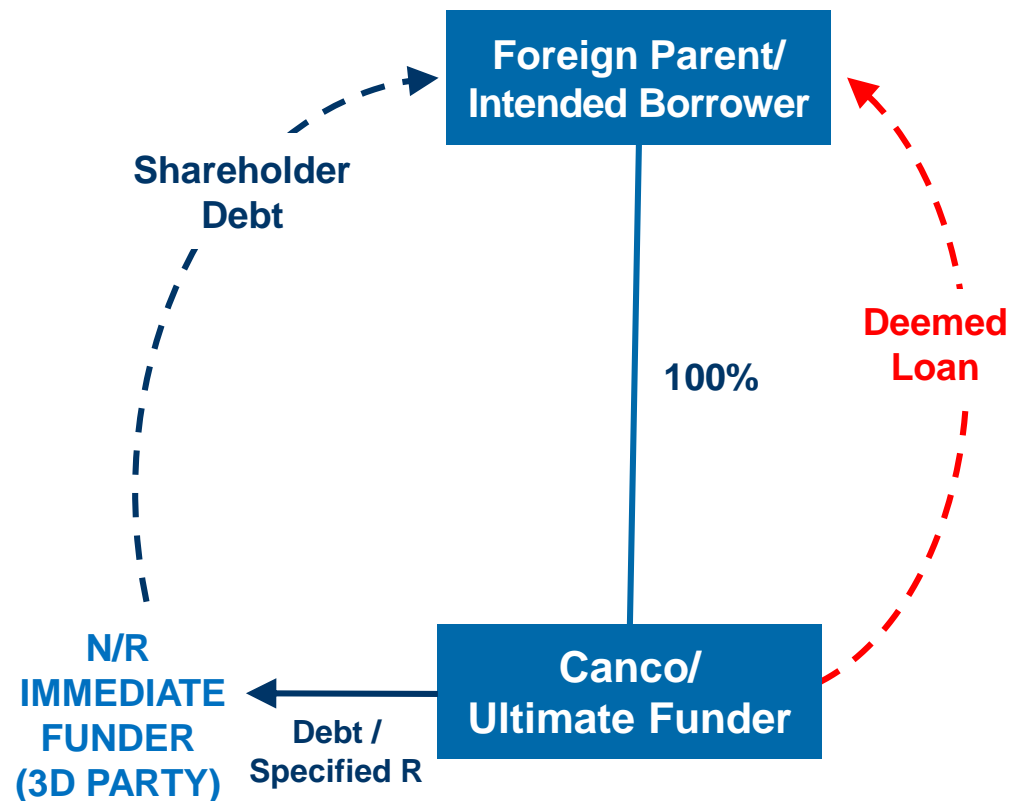
Deemed royalty payment from Canco to Ultimate Licensor



3.(c) B2B Shareholder Loans - 15(2.16) - (2.192)

- 15(2.16)(a)&(b) Intended Borrower owes Shareholder Debt to Immediate Funder
 - 15(2) does not apply to the Shareholder Debt b/c Immediate Funder is dealing at arm's length
- 15(2.16)(c) Immediate Funder has an intermediary debt (not subject to 15(2)) owing to Ultimate Funder or holds a specified right
- 15(3.1)(d) a direct loan from the Ultimate Funder to the Intended Borrower would be subject to 15(2)

For 15(2) and 80.4, Intended Borrower is Deemed to receive a loan from Ultimate Funder = portion of Shareholder Debt indirectly funded by Ultimate Funder



5. Compliance

- a) Overview liability of NR and Canadian Payor
- b) Liability of the Canadian Payor
- c) Compliance by the Canadian Payor
- d) Gross-up Clause
- e) Compliance by the NR
- f) Reduced Treaty WHT Rates
- g) Refund of Part XIII



5. (a) Compliance - Overview

- NR is :
 - Liable to pay 25% income tax on every amount listed at 212 that a person resident in Canada pays or credits or is deemed by Part I to pay or credit
 - Joint and severally liable for interest accrued on amounts not withheld
- Canadian payor:
 - Must withhold and remit to the Receiver General of Canada the tax on behalf of NR within the period ending 15 days after the last day of the month where amount was paid – 215(1)
 - If he fails to withhold and remit:
 - personally liable to pay the amounts that should have been withheld – 215(6)
 - subject to penalties and interest



5. (b) Liability of Canadian Payor

Amounts that should have been withheld under 215:

- Penalty of 10% (20% if gross negligent) – 227(8) & interest on penalty at prescribed rate of 6% – 161(11)
 - Exception no penalty for failing to WHT on deemed dividend due to thin-cap rules or transfer pricing adjustment 227(8.5)
- Interest at prescribed rate of 6%, from the 15 day of the month following the month in which the amount should have been withheld – 227(8.3)
 - NR jointly liable with the Canadian to pay interest – 227(8.1)

Amounts that were withheld under 215 but were not remitted :

- Graduated penalty up to 10% (20% if gross negligent) – 227(9) & interest at prescribed rate of 6% – 161(11)
- Interest at prescribed rate of 6%, from the 15 day of the month following the month in which the amount should have been withheld – 227(8.3)



5.(b) Liability of Canadian Payor

- No statute of limitation for assessment if Canadian payor fails to withhold amount under Part XIII – 227(10)(d)
- No actions lies against Canadian payor for withholding in intended compliance with Part XIII;
- All amounts must be remitted even if the amount was withheld in error – 227(1)
 - Refund of Part XIII only available for the NR – 227(6)
 - Canadian resident can only claim if it has an assignment or other legal arrangement with the NR that allows it to assert the NR's rights – *Sentinel Hill No. 29 Limited Partnership* (2008 ONCA 132)



5.(c) Compliance by Canadian Payor

- Canadian payor must file NR-4 Segments and a NR-4 Summary, by March 31 of the following year – Reg. 202
- The NR4 are considered to be “information returns” and are subject to the penalty for failure to file in the same way as T4s
 - the penalty is dependent on the number of days the returns are late and the number of outstanding returns
 - see also CRA administrative policy, which reduces the penalty rates



5.(d) Gross-up clause

- A gross-up clause provides that an amount due under the contract should be grossed-up so that the net amount received by the NR would not be less than the amount that would have been received if no withholding applied
- Effectively, the Canadian payor will “pay the WHT”
- As withholding is also required on any additional payments, those amounts must also be grossed-up
- Gross-up formula:
 - Required withholding = [(applicable withholding rate) × payment] ÷ (100% – applicable withholding rate)



5. (e) Compliance for NR

- Part XIII tax is not refundable (contrast to Reg.105 withholding where NR may have to file a tax return)
- Provided Part XIII tax is appropriately deducted by the Canadian payor, the NR will have no further Canadian tax obligations in respect of this income.
- Thus NR does not have to file a Canadian tax return to report their income unless they elected under section 216 of the Act



5. (f) Refund of Part XIII Tax

- NR must make the request using Form NR-7 within 2 years from the year in which the excess tax was paid – 227(6)
 - even if the Canadian payor bore the cost of the tax due to a gross-up agreement, only the NR may claim a refund
- The 2 years delay can be extended by treaty provisions
 - Article XXVI Canada-U.S. Treaty provides that the competent authorities may grant relief so long as they are notified within the six-year treaty limitation
 - Article XXI Canada-Singapore Treaty



5. (f) Reduced Treaty WHT Rates

- NR can provide the Canadian payor with a declaration of eligibility for benefits (reduced tax rate) under a tax treaty (NR301 – for a NR, NR302 for a partnership with NR partners or NR303 for a hybrid entity)



5.(f) Reduced Treaty WHT – Partnership

- WHT applies on the full amount of any payment to a partnership with NR partners, even if some of the partners are Canadian residents – IT-81R1
- Income allocated to the Canadian partners
 - WHT at 25% applies
 - Canadian partners must claim a credit against their tax otherwise payable under Part I (2012-0450491E5)
 - Form NR302 provides that WHT of 0% could apply, but there is no basis for this in the legislation
- Income allocated to the NR partners
 - WHT at reduced treaty rates applies
 - Form NR302 must be obtained to calculate the effective WHT rate



5. (f) Refund of Part XIII Tax

- Repayment of NR shareholder loan – 227(6.1)
 - WHT can be refunded if loan is repaid (if not part of a “series”)
 - Repayments of loans are considered made on a “first-in first-out” basis
 - The refund is equal to the lesser of :
 - the amount of Part XIII tax paid; and
 - the amount of Part XIII tax that would be payable on the deemed dividend at the repayment time
 - Part XIII refund may be less than WHT originally paid (e.g., a change of shareholding or of country of residence)



Thank you

For further information or assistance, please contact:



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