

S. 116 ITA Flowchart for sale by a non-resident

Follow this flowchart when dealing with the sale of a property by a non-resident vendor where there is no s.116 certificate of compliance on closing. LAWPRO sees claims from the vendors and purchasers lawyers who have missed or misinterpreted the obligations and liabilities which arise when a non-resident sells a property without delivering a s.116 certificate of compliance as part of the closing process.

CAUTION: If you are not comfortable with the issues described below, have your client seek appropriate professional advice from a tax lawyer or accountant. Refer to ITA and supporting material for full details.



1. Taxable Canadian Property (TCP) for purposes of s.116 will typically be:

- (a) real property situated in Canada, whether capital property or inventory;
- (b) shares, partnership interests or interests in trusts where more than 50% of the fair market value of such shares, partnership interests or interests in trusts is (or was at any time within the prior 60 months) derived from any combination of Canadian real property, Canadian resource property, timber resource property or options of or interests in such property; or
- (c) options in respect of or interest in such properties

2. Residency Test - Is your vendor "not a non-resident"? (it's about residency and not citizenship!)

- Determination of residency depends on many factors, including, ties to Canada, ties to another country and special rules;

- Ties to Canada, include: home in Canada, spouse or common-law partner or dependants who stay in Canada, personal property in Canada (car or furniture), social ties, economic ties, Canadian driver's licence, provincial health insurance; etc.

- Special rules:

- Deemed residency if stayed in Canada for 183 days or more;
- Government employee outside Canada or member of Canadian Forces serving outside Canada;

- Rules may apply whether or not any gain is realized or any Canadian tax is owing from the disposition by the vendor;

For more information: click [here](#) (Income Tax Folio S5-F1-C1, Determining an Individual's Residence Status which cancelled Interpretation Bulletin IT-221R3); Form NR74, Determination of Residency Status (entering Canada); or, Form NR73, Determination of Residency Status (leaving Canada)

3. Usually confirmed by way of statutory declaration: "The vendor states that he/she/they is/are not now and will not be at the time of closing of this transaction a non-resident of Canada for the purpose of applying s.116 of the *Income Tax Act* (Canada)." The Residency paragraph of the OREA Agreement of Purchase and Sale provides that "Purchaser shall not claim such credit if Vendor delivers on completion the prescribed certificate". Case law (see *Kau v. The Queen*, 2018 TCC 156) has found that the receipt of a certificate remains subject to reasonable inquiry not revealing any indicators to the contrary

4. CRA Principal Residence Guide available [here](#)

5. Quantum of withholding tax:

- 25% of sale price - non s.116(5.2) taxable Canadian properties;
- 50% of sale price for s.116(5.2) property (see note 7) (typically commercial type properties, depreciable taxable Canadian properties, resource properties, etc.)

- Payment directly to CRA; payment confirmed by letter of acknowledgement (LoA) issued by CRA – no Certificate of Compliance – purchaser no further obligation once has LoA;

- Purchaser: entitled to deduct from the purchase price and remit to CRA, 25% or 50% of property's purchase price on account of the vendor's Canadian tax liability

6. Filing – Form T2062 – Advise clients ASAP of required supporting documents:

- Offer to purchase (for arms length transactions)
- Original deed from the time of acquisition
- Copy of registered transfer from the sale
- Copy of original receipts for any capital improvements claimed
- Letter of opinion or original appraisal (for non-arms length transactions)
- ITN for each vendor
- Notarized copies of non-resident's ID

7. Section 116(5.2) property is typically depreciable property, Canadian resource property and timber resource property, however if unsure consult a tax professional. Caution of the status of mixed (e.g. residential/commercial) use properties, properties which have been used for short term rental (e.g. Airbnb) or homes with home offices, which might be categorized as depreciable property. Although non-s.116(5.2) is typically residential or recreational property, beware of the caution above

8. Purchaser withholds based on purchase price, unless vendor provides certificate of compliance for which vendor paid tax or security based on purchase price less ACB. ITA and OREA agreement provide for a credit to the purchaser for the amount of the holdback if the vendor does not have a s.116 certificate on closing

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9. Penalties

- Vendor's failure to report – s.162(7) ITA – greater of \$100 and \$25/day, max of \$2,500

- S.116(5) ITA-purchaser liable to pay vendor's tax unless obtain Certificate of Compliance or comfort letter from CRA (why critical to get vendor's lawyer's undertaking to obtain, if not available prior to closing, in addition to the holdback)

- Purchaser failure to pay within 30 days of the end of the month in which the property was acquired – 10% of the amount that was to be paid

- s.227(9) interest on tax and penalties, compounded daily, current rate 5%

10. Individual Tax Number – Form T1261 (online also) each owner is required to obtain an ITN for Non-Residents from CRA; required for any filings; CRA accepts one notification filed on behalf of all partners for a partnership disposition. Need notarized copies of non-resident's ID required to obtain ITN

Other useful information:

a) Period of ownership

- No capital gains tax in Canada prior to 1972;

- Under the Canada-U.S. Tax Convention the gains derived in Canada by U.S. Vendors were exempt until Dec 31, 1984, provided the property was owned on September 26, 1980;

b) U.S. dollars structured transactions:

- ACB converted into Canadian dollars at its historical rate;

- proceeds of disposition converted at the exchange rate in effect at the date of disposition (appears may be either the date of the agreement of purchase and sale or the closing date);

c) Canada – United States Tax Convention (1980), Fifth Protocol (September 2007) – U.S. non-resident vendor may qualify for a reduction in tax payable as capital gains in Canada:

- See Period of ownership

- Pro-rata method calculation: # of months between date of acquisition or Jan 1, 1972 (whichever is later) and Dec 31, 1984, divided by # of months between date of acquisition or Jan 1, 1972 (whichever is later) and date of disposition, (see publication IT-173R2SR);

- Transitional Tax Treaty Rule Method or Fresh Start Rule calculation with CRA approval: (if want allocation for significant pre 1984 appreciation)

d) Non-arms length transfers: (spouses, adult children and related parties)

- FMV proceeds deemed at FMV, even if only adding spouse to title – only exception if the result of the death of a spouse;

e) Reporting Requirements

- Non-residents need not file a tax return in Canada however, they may want to – filing T2062 and receiving Certificate of Compliance only establishes withholding tax; filing tax return, establishes actual amount of capital gains tax payable and certain expenses not allowed to calculate withholding tax are deductible and likely to create a refund. Forms are available [here](#)

- Vendor's tax = Fair Market Value (FMV)/proceeds of disposition, less adjusted cost base (ACB) & period of ownership; (for non-arms length disposition for less than FMV, proceeds deemed = FMV) of taxable Canadian property – defined in s.248(1) ITA, which includes any "real property in Canada".

- U.S. tax filing different as U.S. citizens required to report annually on their worldwide income when they file their U.S. tax returns. Capital gains in Canada and U.S. calculated differently and so need to fully re-report and be re-assessed in the U.S. but as a result of the Tax Convention (1980) they will get a credit in the U.S. for tax paid in Canada

f) Timing: CRA requests a minimum of 30 days prior to closing to review, process and issue a Certificate of Compliance, although it should be anticipated to take longer

g) This checklist is based on a paper and presentation by Clare Brunetta, Barrister and Solicitor-Canadian Cottage and Recreational Properties Owned by United States Residents: s.116 *Income Tax Act* Considerations, OBA Institute program February 4, 2016, Quirky Conveyancing – Tools for the Modern Real Estate Lawyer. Click [here](#) to read full paper

h) See Working Group on Lawyers and Real Estate, Forms – Undertaking (Non-Resident) for when no certificate is produced on closing [here](#)