

Tax Law

March 4, 2010

Federal Budget Significantly Reduces Section 116 Requirements

In the 2010 Federal Budget released this afternoon, the Department of Finance announced a significant, and very welcome, amendment to the *Income Tax Act* (Canada) (the “Tax Act”), which should greatly facilitate non-resident investment into Canada. **In general, this amendment will eliminate the need to obtain clearance certificates under section 116 of the Tax Act on the disposition of shares of most Canadian corporations.**

Under the current provisions of the Tax Act, all shares of Canadian private corporations, and shares of Canadian public corporations where the holder and non-arm’s length persons own 25% or more of a class of shares, are considered to be “taxable Canadian property”. As a result, on the disposition of such shares the vendor must comply with the notification requirements of section 116 of the Tax Act, and will be liable for Canadian tax on any capital gain, unless such capital gain is exempted by virtue of an applicable income tax convention. In addition, in certain situations, a Canadian tax return must be filed in respect of the disposition.

These requirements posed significant administrative obstacles and costs for non-resident investors, particularly private equity funds. Private equity funds, often formed as partnerships with numerous partners, were required to provide information respecting each partner in order to obtain the necessary section 116 certificate and, in certain cases, those partners were also required to file Canadian tax returns.

Under the proposed amendments, the definition of “taxable Canadian property” is narrowed to include shares of corporations only where those shares derived 50% or more of their value from real estate or resource property situated in Canada at any time in the 5-year period preceding the disposition. As a result, shares of many Canadian corporations which were previously taxable Canadian property will now be exempted from the Canadian tax system. More specifically, a disposition of shares which are not taxable Canadian property under the amended definition will not give rise to section 116 notification requirements, a Canadian tax liability or Canadian filing obligations. (In certain circumstances where a share was acquired on a tax-deferred basis or pursuant to a merger where the initial investment was taxable Canadian property, the share may be deemed to be taxable Canadian property regardless of the corporation’s asset base.)

The announced amendment is a fundamental change to the rules of Canadian taxation and will significantly enhance the ability of non-residents to invest into Canada. The measure will apply in determining, after March 4, 2010, whether property is taxable Canadian property.

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