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by Steve Suarez

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PRACTITIONERS' CORNER

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Canada imposes various forms of withholding obligations on persons making payments to nonresidents of Canada, including:

- obligating payers of dividends, rents, management fees, pension benefits, and some forms of royalties, trust income, and interest to nonresidents to withhold 25 percent of the amount of the payment (''Part XIII withholding'');
- requiring a purchaser of ''taxable Canadian property'' from a nonresident to withhold part of the purchase price for the property unless the vendor has obtained a certificate of compliance from the Canada Revenue Agency[1]; and
- imposing a 15 percent withholding obligation on payments to nonresidents in respect of services rendered in Canada.[2]

The payer is generally liable for any deficiency in the amount withheld (plus interest and penalties) and the CRA has no time limitation on reassessing taxpayers for such noncompliance.

In many cases, a recipient who is resident in a country with which Canada has a bilateral tax treaty may be entitled under the terms of such tax treaty to claim a reduction or elimination of tax on amounts subject to such withholding. Historically, in a Part XIII withholding context, the CRA has allowed payers to generally rely on the recipient's name and address to determine whether the recipient was a resident of a treaty country and thereby entitled to a reduced rate of withholding. Unless aware of some reason to believe that this basic information may not reflect the fiscal residence of the beneficial owner of the payment,[3] Canadian payers were not obligated to look beyond this basic information when deciding whether to withhold on a treaty-reduced basis.

Due in part to the limitation on benefits article added to the Canada-U.S. income tax treaty a few years ago, Canadian revenue authorities want a higher degree of due diligence from persons making payments to nonresidents to which Canadian withholding tax applies, when the amount withheld is reduced in reliance on a tax treaty. As a result, on April 19, 2011, the CRA introduced final versions of new information forms (forms NR301, NR302, and NR303) for use for treaty-based withholding, along with explanatory information relating to their use.[4] At that time it was stated

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[1]See Steve Suarez and David Gaskell, ''Canada's Revised Section 116 Regime for Nonresident Vendors,'' *Tax Notes Int'l*, Jan. 26, 2009, p. 321, *Doc 2008-27299*, or *2009 WTD 16-10*.

[2]Referred to as Regulation 105 withholding; discussed in Suarez and Gaskell, ''Withholding Decision Creates Windfall for Revenue Agency,'' *Tax Notes Int'l*, Aug. 24, 2009, p. 600, *Doc 2009-18302*, or *2009 WTD 155-4*.

[3]For example, a payment made to someone identified as an agent or nominee, or possession of contrary information, or a discrepancy between the mailing address and the recipient's registered address.

[4]*See* http://www.cra-arc.gc.ca/formspubs/frms/nr301-2-3-eng.html. Form NR301 is for use by recipients that are corporations or individuals. Form NR302 is for use by a recipient that is

(Footnote continued on next page.)

that these forms would be applicable after December 31, 2011, and that until the end of 2011 the previous policy of generally accepting reduced withholding based only on the payee's name and address would continue to apply (unless the payer had reason to believe this not to reflect the beneficial recipient's fiscal residence).[5]

On December 22, 2011, the CRA announced that it would be extending this transition period for another year until December 31, 2012, during which period the previous administrative policy will continue to govern (subject to the comments below).[6] The CRA release of December 22, 2011, also included pending related amendments to the text of Information Circular IC76-12, "Applicable rate of part XIII tax on amounts paid or credited to persons in countries with which Canada has a tax convention."[7] These revisions include the following comments:

> During the transition period, you can accept the name and address of the payee as the beneficial owner and withhold at the applicable tax treaty rate unless there is reasonable cause to question if this is appropriate. Although it is not a complete list, the presence of any of the following criteria is regarded as reasonable cause. If you have not already been considering these criteria, you should start doing so.
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> 1. The payee is known to act, even occasionally, as an agent or nominee (other than a Swiss agent or nominee).
>
> 2. The payee is reported as "in care of" another person, or "in trust," or the address is a post office box.
>
> 3. The mailing address provided for payment of interest or dividends is different from the registered address of the "owner."
>
> 4. The payee is a flow through entity such as a partnership or limited liability company (that is not taxed on its worldwide income under the laws of another country).
>
> 5. There is reason to believe that a reduced rate will not apply due to limitation of benefits provisions in the Canada-United States tax treaty.

The apparent per se exclusion of payments to flow-through entities from the extended transition period is particularly noteworthy.

Even after 2012, strictly speaking there is no legal obligation on the part of payers to use the new forms. In fact, for payers of amounts subject to Part XIII withholding, the intention is that these forms (when used) are not even sent to the CRA; rather, the intention is that the payer will demand the recipient to complete and provide the applicable form in order to satisfy the payer that the recipient is entitled to a treaty-reduced withholding rate.[8]

The introduction of the new forms has been a matter of some concern. In principle it is understandable why the CRA feels it necessary to go beyond the level of diligence under the existing practice. In particular, the fact that two of the new forms are directed at situations when the level of withholding may depend on the identity of the members or participants in the recipient entity demonstrates that determining entitlement to treaty benefits is often a challenging exercise.

While the use of the new forms is not mandatory (at least in a Part XIII context), they represent the level of due diligence that the CRA believes is appropriate for persons making payments to nonresidents when treaty reductions may be applicable. What is troubling, however, is that even when the payer obtains the relevant form from the nonresident and relies on it in good faith to withhold at a treaty-reduced rate, the CRA will not relieve the payer from potential liability if it turns out for any reason that a higher amount should have been withheld. While it appears that the CRA may be prepared to waive interest and penalties in such circumstances, that appears to be the limit of any substantive legal protection that a payer who obtains and relies on the new forms can expect.[9]

As such, the new forms serve primarily as an information-gathering tool for payers of amounts subject to Part XIII withholding, and as what is likely a necessary (although not necessarily sufficient) demonstration of diligence to support an application for the waiver of interest and penalties should the amount

a partnership, while Form NR303 is for use by a recipient that is a hybrid entity (that is, a foreign entity other than a partnership whose income is taxed at the member or beneficiary level, such as a limited liability company that is fiscally transparent under U.S. tax law).

[5]*See* http://www.cra-arc.gc.ca/tx/nnrsdnts/pyr/prtxiii/wthhldng/bnfclwnrshp-eng.html.

[6]*See* http://www.cra-arc.gc.ca/formspubs/frms/ic76-12r6-eng.html.

[7]Included in these pending revisions is the statement that:

> Payments made to CDS Clearing and Depository Services Inc. (CDS) on securities registered in the name of Cede & Co. are made without withholding tax. Tax will be withheld by CDS based on information received from the Depository Trust Company (DTC) and collected by DTC's participants.

[8]In the case of nonresident vendors seeking a certificate of compliance from the CRA for section 116 withholding purposes in reliance on a treaty exemption, the relevant NR form would be sent to the CRA along with Form T2062 or T2062A.

[9]This was the essence of the CRA's reply to this question at the CRA Round Table at the International Fiscal Association (Canadian Branch) meeting in Toronto, May 20, 2011. The CRA representative did comment that the CRA could, on a case-by-case basis, decide whether to assess the payer, the recipient, or both for any deficiency in withholding.

withheld turn out to be insufficient. The new forms (and the pending amendments to IC76-12) also represent a useful expression of CRA administrative and interpretive policy in what can be a confusing area of the law, and in this regard are helpful to review even before the extended transition period expires (indeed, the stated purpose of the extension is to give payers more time to make their information-gathering systems and withholding procedures compliant with the new policy). In particular, when payments are being made to a partnership or hybrid entity, the examples contained in the relevant new forms usefully illustrate the CRA's interpretation of the entitlement to treaty benefits.[10]

It would be desirable for the CRA to publicly state that a payer who obtains and relies on the relevant new form will not generally be subject to liability for underwithholding, although perhaps the CRA may not be willing to make such a general statement. The potential remains for the CRA to provide relief on a case-by-case basis, and so as a practical matter a payer of amounts subject to treaty-reduced withholding who does not come within the extended transitional relief should generally use the new forms (or simply withhold without regard to any potential treaty reductions, and let the nonresident recipient file a refund claim with the CRA). ◆

[10]For example, Form NR302 illustrates that when a payment is made to a partnership that has both Canadian resident and non-Canadian resident members, no Part XIII withholding need be made to the extent of the Canadian resident partners' interests in the partnership. This represents a change from the CRA's previous practice.

(Footnote continued in next column.)