

Question 11 – Non-Resident Seller (s.116 Certificate)

1. When is a certificate under s.116 of the Income Tax Act required in a real estate transaction?

Results:

- 100% of respondents indicated correctly that a certificate is required when the seller is a non-resident of Canada.

Working Group (WG) comment:

This was the only correct response. Citizenship is not the test and landed resident status in Canada has no bearing on the requirement. The determination of residency of the seller is critical to how a transaction is to be handled and it is always the first fact that you need to determine. It is not always patently obvious from the circumstances of your client or the other side's client and you should always dig further if you get the sense that something is not right. If you encounter a situation where there is any question, go to Canada Revenue Agency's website at: www.cra-arc.gc.ca/tax/nonresidents/common/residency-e.html, and to the CRA circular IT-221R3. Residency is usually confirmed by way of statutory declaration: "The seller 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 within the meaning of s.116 of the Income Tax Act (Canada)." The Residency paragraph of the OREA Agreement of Purchase and Sale provides that "Buyer shall not claim such credit if Seller 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.

2. Is the need to obtain a certificate under s.116 of the Income Tax Act tied to the type of property (i.e. residential, commercial, recreational)?

Results:

- 94% of respondents indicated that the type of property does not go into the consideration of whether a s.116 certificate is required from a non-resident seller.

WG comment:

The only test to determine if a s.116 certificate is required is residency. It does not matter if a non-resident is selling a residential, commercial, recreational, industrial or other type of property. (See Question 1 for more information)

3. When is the s.116 certificate required to be delivered?

Results:

- 68% of respondents indicated that a certificate is required to be delivered at the time of closing.

WG comment:

If the certificate is not available on closing, the buyer must retain a holdback from the closing proceeds pending receipt of a certificate or payment to CRA. Confirmation of the seller's residency status should be requisitioned early and if the seller is not going to provide the regular statutory declaration of residency (see Question 1) the lawyers should keep each other informed of the status of the availability of the s.116 certificate as closing approaches.

4. What is the correct amount of the holdback to be retained if a s.116 certificate is required but not available?

Results:

- 97% of respondents indicated that the amount of holdback if no s.116 certificate is available on closing is 25%.
- 45% of respondents indicated that the amount of holdback if no s.116 certificate is available on closing is 50%.

WG comment:

This was a multiple-choice question and the correct answer may be either 25% or 50%. The amount depends on the type of property – see question 5 for more information.

5. What is the criterion to determine the holdback requirement (% of purchase price) in lieu of the certificate?

Results:

- Only 36% of respondents indicated that the use of the property from a tax perspective was the criterion to determine if the holdback should be 25% or 50%.

WG comment:

The location, the sale price or the anticipated capital gains from the sale of the property are not material to determine if the holdback should be 25% or 50%. This is

however not necessarily a simple determination. The legislation requires a 50% holdback for property referred to in subsection 116(5.2). Many default to 25% as that is typically used for residential properties. The legislation does not use labels such as residential and commercial but rather raises issues of how the property was used or treated for tax purposes. How does one qualify a residential property from which the seller runs their business or operates an Airbnb? See <https://www.practicepro.ca/practice-aids/checklists/non-resident-sale-holdback-flowchart/> for a flow chart and other resources to assist you if you have any questions or retain an accountant or tax lawyer to determine the issue.

6. Concerning the funds withheld in lieu of a certificate, who has the obligation to withhold the funds, according to the ITA?

Results:

- 48% of respondents indicated correctly that the buyer had the obligation to withhold funds from the proceeds of sale if no s.116 certificate was available on closing.
- 19% of respondents indicated that the buyer's lawyer was obligated.
- 19% of respondents indicated wrongly that the seller's lawyer was obligated.
- 13% of respondents indicated wrongly that the seller was obligated.

WG comment:

The CRA rules obligate the seller to deliver a certificate on closing. If no certificate is provided, the buyer is then obligated to keep a holdback out of the closing proceeds. The buyer is provided with a right to withhold. Although the buyer is the specified person, typically their lawyer would undertake this responsibility. Seller's are comforted by the fact that the holdback is held in trust by a lawyer. In view of the payment obligations, either on receipt of a certificate after closing or otherwise (see question 8), it is prudent that a lawyer hold the funds (see question No. 7). It would not be prudent to have the seller hold the holdback.

7. Concerning the funds withheld in lieu of a certificate, who typically withholds the funds according your practice?

Results:

- 74% of respondents indicated that the seller's lawyer retains the holdback.
- 22% of respondents indicated that the buyer's lawyer retains the holdback.

WG comment:

The CRA rules obligate the seller to deliver a certificate on closing. If no certificate is provided, the buyer is then obligated to keep a holdback out of the closing proceeds

and provided with the right to do so. As the consequences of closing without a certificate all fall upon the buyer, it would seem logical that the buyer, via their lawyer, would be in control of the holdback to ensure compliance and avoid any penalties and interest. The precedent undertaking posted by the Working Group (<https://www.lawyersworkinggroup.com/ontario-standard-closing-document>) does provide that the buyer's lawyer is the holder of the holdback. However, there is no problem if the seller's lawyer holds the funds, provided they follow the CRA requirements, which have been incorporated in the Working Group's undertaking. Provided the correct amount of the holdback is held and paid in accordance with the CRA rules (see Question No 8), either lawyer may hold the funds.

8. There is an obligation to remit the funds withheld from the purchase price to CRA after closing even if you have not received the certificate. When are the funds required to be remitted to CRA?

Results:

- 55% of respondents indicated that the holdback needs to be paid to CRA within 30 days of closing.
- 38% of respondents indicated that the holdback needs to be paid to CRA within 30 days of the end of the month within which the closing occurred.

WG comment:

CRA requires payment of the holdback within 30 days of the end of the month within which the closing occurred. For example, if a transaction closes on the 12th of March, payment would be required on or before the 30th day of April. The seller's or buyer's year-end are of no consideration in the payment deadline. Payment within 30 days of closing would be within the time required and a good practice to follow to ensure payment is delivered on time without any risk of incurring any penalties or interest charges against the buyer.

9. Did you know that the Working Group on Lawyers and Real Estate has posted a precedent undertaking for when a s.116 ITA certificate is not available?

Results:

- 64% of respondents indicated they did not know of the Working Group's precedent non-resident undertaking.
- 36% of respondents indicated that they were aware of the undertaking.

WG comment:

Please go to (<https://www.lawyersworkinggroup.com/ontario-standard-closing-document>) to see the Non-Resident Undertaking. This is a suggested format and

lawyers are free to modify it to fit the terms of their particular transaction, while being mindful of the traps in dealing with holdbacks – the amount and the timing of the payment to CRA.

10. Did you know that LAWPRO's practicePRO has a s.116 ITA Flowchart for when a non-resident sells?

Results:

- 70% of respondents indicated they did not know of the flowchart available on practicePRO.ca.
- 30% of respondents indicated that they were aware of the flowchart.

WG comment:

The flowchart sets out the questions to be determined and course of action to follow. In addition, it does provide information and other resources for any lawyer who wishes to learn more or confirm any detail. (see <https://www.practicepro.ca/practice-aids/checklists/non-resident-sale-holdback-flowchart/>)

11. Which undertaking do you use if you require one?

Results:

- 60% of respondents indicated that they have their own undertaking.
- 16% of respondents indicated that the undertaking is typically negotiated by the two lawyers.
- 10% indicated they have used the Working Group's undertaking.
- 7% of respondents indicated they have used the undertaking provided by their real estate software.
- 7% of respondents indicated they have used the undertaking provided by the other side.

WG comment:

There is no required undertaking that must be used. It is a good idea that the undertaking used provide for all the necessary requirements. Particularly, it should confirm the amount of the holdback, who retains it and when it will be paid out. The Working Group recommends that each lawyer compare the undertaking they typically use or the last one they used to the Working Group's undertaking to ensure all requirements and eventualities have been provided for. The Working Group welcomes any feedback you might have on its precedent undertaking.

12. If you are the payer of the funds to CRA, do you provide the other side with a copy of proof of payment?

Results:

- 84% of respondents indicated that they provide the other lawyer with a copy of the proof of payment to CRA.
- 16% of respondents indicated that they do not.

WG comment:

Although there is no requirement to provide the other side with proof of payment, the Working Group finds it a good practice to do so. It is a more friendly way to practice and can be helpful for the seller to have the information in order to claim back any amount if they in fact owed less. The initial payment triggered by filing of the Form T2062 is merely a withholding tax, which is held by CRA as security against non-resident vendors who may have been tempted to leave the country after closing and never pay their tax. The income tax return that they file by April 30th the next year is what actually counts to calculate the amount of the capital gains tax payable, if any. Note that it will very often be in the client's best interests to file this tax return in Canada since certain expenses that were not applicable in calculating the withholding tax, such as legal fees, real estate commissions and appraisal costs etc. will be deductible as against the capital gains tax. They will most likely get a refund.

13. When is the latest a party can apply for the s.116 certificate?

Results:

- 53% of respondents indicated that a seller must apply no later than 10 days after the closing date for a s.116 certificate.
- 20% of respondents indicated that a seller must apply no later than 30 days after the closing date for a s.116 certificate.
- 10% of respondents indicated either within 10 or 30 days prior to the closing date.
- 7% of respondents indicated one may file up to the closing date.

WG comment:

CRA permits a seller to file up to 10 days after the closing date. The penalty, under subsection 162(7), for failing to file or submit a notice on time is \$25 a day. There is a minimum penalty of \$100 and a maximum penalty of \$2,500.

14. Who should apply for the s.116 certificate?

Results:

- 35% of respondents indicated that the seller should apply for the s.116 certificate.

- 32% of respondents indicated that the accountant should apply.
- 26% of respondents indicated that the lawyer should apply.
- 6% of respondents indicated that the buyer should apply.
- None of the respondents thought the real estate agent should apply.

WG comment:

The seller is definitely the party who is responsible to apply as they are the ones that get the most benefit for doing so. Typically, the seller would require assistance to do so. Although lawyers can do so, they may not have the information or resources available to the accountant. Notwithstanding who applies, the important consideration is to apply early enough to have the certificate from CRA in time to deliver to the buyer on closing. The Working Group understands that this is becoming more and more rare and therefore recommends that lawyers faced with a closing without a certificate, ensure that they have a solid undertaking to ensure compliance with CRA rules and avoid any liability to the buyer.