# The Joint Committee on Taxation of
# The Canadian Bar Association
# and
# The Canadian Institute of Chartered Accountants

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Via email: comments_commentaires@cra-arc.gc.ca

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Canada Revenue Agency
344 Slater Street
Ottawa, Ontario K1A 0L5

Dear Sir/Madam:

**Re: Proposed Declaration Process for Applying Treaty Benefits to Income Paid to Non-Residents**

We are writing in response to your request for public comments on the proposed declaration process for applying treaty benefits to income paid to non-residents. In particular, we are writing to express certain concerns regarding the following draft forms recently released by the Canada Revenue Agency (CRA):

- Form NR301, Declaration of Benefits Under a Tax Treaty for a Non-Resident Taxpayer (Who is Not a Partnership or a Hybrid Entity)
- Form NR302, Declaration of Benefits Under a Tax Treaty for A Partnership with Non-Resident Partners
- Form NR303, Declaration of Benefits Under a Tax Treaty for a Hybrid Entity.

Thank you for the opportunity to submit our views on the proposed declaration process and these draft forms (collectively referred to herein as “Declaration of Benefits forms” or “forms”).

Our general view, described in more detail below, is that the purpose of the forms is unclear. It should also be clarified that the payer will be relieved from penalties if withholding is made at a reduced rate in accordance with the forms and the payer has no reason to believe that the information provided by the non-resident is incorrect. On the other hand, Canadian payers should not be required to withhold tax at

the 25% statutory rate where the payer has information to conclude that a reduced rate applies, but a completed Declaration of Benefits form has not been received.

We hope that our comments will help the CRA modify and improve the proposed declaration process and the draft forms for the benefit of both taxpayers and the CRA.

**Non-resident's Requirement to Complete the Declaration of Benefits forms**

The stated purpose of the forms is to help Canadian payers determine if it is appropriate to apply a reduced rate of withholding for payments made to non-resident recipients. However, there is nothing in the Income Tax Act ("the Act") or Regulations that compels the non-resident taxpayer to submit the completed form.

The instructions to the draft Declaration of Benefits forms are unclear as to whether the Canadian payer is required to have received a completed Declaration of Benefits form before applying a reduced rate of withholding. The instructions provide two examples of situations in which the Canadian payer should not apply a reduced rate of withholding:

- Where the non-resident taxpayer has not provided a completed Declaration of Benefits form or equivalent information and the Canadian payer is unsure whether the reduced rate applies; or
- Where the appropriate Declaration of Benefits form has not been duly completed.

These examples appear to be contradictory. The first example suggests by corollary that the Canadian payer may reduce the withholding if the payer has the information needed to support the payee's entitlement to reduced withholding regardless of whether a completed Declaration of Benefits form has been received. This is consistent with the Request for Public Comment: A payer will not have to receive a form from a non-resident before reducing Part XIII tax withholdings. Moreover, ITAR 10(6) would seem to require the payer to withhold at the lower rate if applicable.

However, the second example suggests that the payer may only reduce withholdings if in receipt of a duly completed Declaration of Benefits form. Examples on the Worksheets also imply that the non-resident is required to complete the appropriate form (e.g., Worksheet A states that "Mr. Smith must provide completed Form NR301 to APAN" and that "USCO…must provide a completed Form NR303 to APAN.")

Where the Canadian payer has sufficient information to support reduced withholdings under a treaty, it is inappropriate to require the Canadian payer to obtain the same information in prescribed form. Payments to non-residents are often subject to gross-up adjustment of withholding tax, so that the Canadian payer bears the cost of the withholding tax. Consequently, even if the non-resident taxpayer were eligible for a lower treaty rate of withholding, the non-resident taxpayer would have no incentive to complete the Declaration of Benefits form to enable the Canadian payer to reduce its withholding tax cost.

We recommend that the instructions for the Declaration of Benefits forms be revised to clarify that the Canadian payer is not required to have received the completed form before applying a reduced rate of

withholding tax where the Canadian payer has other equivalent information available to support the reduced withholding tax rate.

The Canadian payer is also instructed not to apply a reduced rate of withholding tax if the payer is unsure that the reduced rate applies or has any reason to believe that the information provided in the Declaration of Benefits form is incorrect or misleading. Additional guidelines or clarifications are required as listed below:

- To what extent should the Canadian payer rely on the accuracy of information provided by the non-resident taxpayer in the completed form? Should the Canadian payer presume that the information provided in the completed form is complete and accurate unless the Canadian payer becomes aware of other facts that challenge the reliability of the completed form?

- What circumstances or criteria would be regarded as reasonable cause to question the validity or reliability of the information provided in the completed form?

**Canadian payer's due diligence — Waiver of penalties and interest**

Pursuant to subsection 215(6) of the Act, the Canadian payer is required to withhold and remit Part XIII tax at the appropriate rate and is liable to penalty and interest for any deficiency. Pursuant to subsections 212(1) and 227(8.1) of the Act, the non-resident taxpayer is jointly and severally liable to pay the Part XIII withholding tax and any related penalty and interest if the Canadian payer fails to deduct or withhold a required amount.

The recent amendment of the Canada-U.S. Tax Convention (the "U.S. Treaty") increases the complexity and administrative burden for the Canadian payer in verifying the applicable withholding tax rate on payments paid or credited to U.S. resident person. The amended U.S. Treaty denies full treaty benefits to a U.S. resident person if certain limitation of benefits (LOB) provisions are not satisfied. However, the U.S. resident person may still be eligible for treaty benefits on certain types of income under certain other LOB provisions. The amendment also contains a new "look-through" rule which entitles U.S. resident members or owners of a fiscally transparent entity (the "hybrid entity") to claim treaty benefits.

Where the Canadian payer and the U.S. resident person deal with each other at arm's length, the Canadian payer must rely on the representations provided by the U.S. resident person to determine the applicable rate of withholding. The Canadian payer needs more guidance on the extent of the due diligence review required regarding information and representations provided by the non-resident person, recognizing that, in some cases, the non-resident person itself may have to obtain the relevant information from its own investors (for example, in the case of non-resident that is a hybrid entity) and may have difficulty in doing so.

Pursuant to subsection 220(3.1) of the Act, the CRA has the discretion to administer the income tax system fairly and reasonably by waiving penalty and interest in order to help taxpayers to resolve issues that arise through no fault of their own, and to allow for a common-sense approach in dealing with taxpayers who, because of circumstances beyond their control, could not comply with a statutory requirement for income tax purposes.

There may be situations where the Canadian payer withholds and remits tax at a reduced rate based on a completed Declaration of Benefits form submitted by the non-resident to the Canadian payer, but withholdings are later found to be deficient because the non-resident taxpayer has provided incomplete or erroneous information which the Canadian payer had no cause to question. In such cases, the Canadian payer should not be subject to penalties and related interest. In our view, relief from these penalty and interest charges should be available where the Canadian payer has obtained the appropriate Declaration of Benefits form or otherwise conducted due diligence to obtain and review the required information. Such a situation appears to fall within the requirements of subsection 220(3.1) allowing the CRA to extend relief from penalties and interest where taxpayers are unable to comply with a particular provision due to circumstances beyond their control.

**Expiry of Declaration of Benefits forms**

According to the instructions for the draft Declaration of Benefits forms, the forms will expire on the earlier of:

- a change in the taxpayer's eligibility for treaty benefits (Form NR301) or in the effective rate of withholding (Forms NR302 and NR303); or
- two years from the date of signature.

We question the rationale underlying these limitations. On one hand, the Canadian payer may not have access to information about changes in the non-resident's circumstances, if any, that may cause a change in the non-resident's eligibility for treaty benefits or a change in the effective rate of withholding. On the other hand, in many cases, the non-resident's circumstances may not change within the two years. There is no apparent reason why the form should expire two years from the date of signature if the non-resident's circumstances have not changed.

To streamline these requirements, we recommend that the completed forms should remain valid until a change in the non-resident's circumstances invalidates any information on the form and affects its status under a tax treaty.

Since the Canadian payer may not have access to information about changes in the non-resident's circumstances that may cause a change in the non-resident's eligibility for treaty benefits or a change in the effective rate of required withholding, we recommend that the Declaration of Benefits form should include an undertaking by the non-resident that it will notify the Canadian payer within 30 days of any change in its circumstances that may cause any information on the Declaration of Benefits form to be incorrect.

The CRA should also consider providing some examples of the changes in circumstances of the non-resident that may cause a change in the non-resident's eligibility for treaty benefits or a change in the effective rate of withholding and a requirement to complete updated forms. For example, would a nominal change in the allocation percentage of a non-resident partnership or hybrid entity be considered a change in the circumstances of the non-resident partnership or hybrid entity? The CRA should also set out the presumptions that the Canadian payer can apply regarding the changes in the

non-resident's circumstances or the extent and nature of due diligence that the Canadian payer needs to exercise regarding the expiry of the Declaration of Benefits form.

**Tax-exempt organizations**

Under Article XXI of the U.S. Treaty, exempt organizations in the United States are not subject to withholding taxes on dividends. Some exempt organizations are organized in arrangements other than corporations or trusts. As a result, it is currently unclear how U.S. tax-exempt organizations should complete Form NR301 or be entered on Form NR302 or NR303.

**Information required for completing Form NR302**

Worksheet A of Form NR302 sets out the calculation of effective rate of Part XIII withholding tax and Worksheet B sets out the calculation of treaty-exempt income percentage in respect of a non-resident partnership. The percentage allocation and treaty rate of each non-resident partner that is entitled to Canadian tax treaty benefits in respect of the partnership income is to be entered on Part I of Worksheet A, and equivalent information for each non-resident partner that is not entitled to Canadian tax treaty benefits is entered on Part II of the respective worksheet.

The treaty rate for all the non-resident partners not entitled to Canadian tax treaty benefits is 25%. Thus, for Part II disclosure, the aggregate percentage allocation of these non-resident partners should suffice for computing the effective withholding tax rate and treaty-exempt income percentage. This approach is also consistent with the information required for the equivalent Worksheets A and B calculations for Form NR303 in respect of a non-resident hybrid entity.

It is currently unclear how the information for Canadian resident partners should be entered on Worksheets A and B of Form NR302. We recommend that the instructions to Form NR302 be clarified accordingly.

Additionally, it is not clear what form of statement of Canadian residency is required from the Canadian resident partners. Partners are generally required to make a representation to the partnership of their residency. We propose that the Canadian partner’s representation of its Canadian residency to the partnership should suffice for the purposes of completing Form NR302.

**Calculation of percentage allocation**

For purposes of computing the percentage allocation, it would be helpful if the CRA can provide guidance on how to complete the computations in various circumstances, such as where the partnership or hybrid entity structure has multiple classes of partnership/ownership units with different income entitlements. In such cases, the final allocation of the income received by the partnership/hybrid entity from the Canadian payer can only be determined after the fiscal year-end of the partnership or hybrid entity, and so the information necessary to complete this portion of the form will not available until that time.

We recognize that some of the above issues may be dealt with in an updated Information Circular 76-12R6, Non-Resident Income Tax. We would request the opportunity to review and provide comments on this document before it is finalized.

Currently, at the request of a Canadian payer, the CRA provides written confirmation that the Canadian payer's calculations of the effective rate of Part XIII withholding tax on income paid to a partnership or the total treaty exempt portion of business profits or disposition gains realized by a partnership. This confirmation requires the same calculations as in Worksheets A and B of form NR302. The CRA should continue to provide such written confirmation at the Canadian payer's request.

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We thank you for considering these recommendations. This submission is made by the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants which is comprised of senior income tax professionals from both organizations. The Committee's primary role is to provide input to tax authorities with respect to income tax matters. We would welcome the opportunity to elaborate on our concerns and recommendations with you further at your convenience.

Yours truly,

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Elaine Marchand
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