

September 29, 2009

Sent via email to [comments\\_commentaires@cra-arc.gc.ca](mailto:comments_commentaires@cra-arc.gc.ca)

Canada Revenue Agency  
c/o Ms. Janet Schermann  
Non-resident Policy Advisor  
Small and Medium Enterprises Directorate  
Compliance Programs Branch  
112 Kent Street  
Ottawa, ON K1A 0L5

Dear Sirs/Mesdames:

**Comments regarding draft Forms NR301, NR302 and NR303**

On behalf of PricewaterhouseCoopers LLP and its associate law firm Wilson & Partners LLP, I am pleased to submit comments regarding draft Forms NR301, NR302 and NR303 (collectively, "Forms") which were released by the Canada Revenue Agency ("CRA") for public comment in June 2009.

Our comments are organized into a general section which relates broadly to all the forms and the tax policy relating to the initiative and into sections which focus on the specific forms.

In this letter, all legislative references are to the Income Tax Act ("ITA") unless otherwise specified.

**A. General comments**

1. A key issue for a payer of an amount to a non-resident of Canada will be whether the payer would be protected from being assessed penalties, interest and deficiencies associated with insufficient withholding under Part XIII if the completed and signed applicable Forms are received from the non-resident recipient prior to making the applicable payment but at

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Canada Revenue Agency  
c/o Ms. Janet Schermann  
September 29, 2009

some later date the CRA were to determine that the non-resident in question was not eligible for the treaty benefits on which the Forms were based.

Each of the Forms should clearly state in their instructions, or the CRA should otherwise publicly state, that receipt of completed and signed Forms prior to making the payment in question will provide assessment protection to the payer (assuming of course that any withholding that was determined to be owing based on the completed Forms is properly withheld and remitted in a timely manner).

We understand that the CRA may be reluctant to administratively give up an avenue of assessment. However, if use of the Forms does not provide some assessment protection to the Canadian payer then wide spread use of the Forms will likely not take place. The assessment provisions of the ITA provide the CRA with the ability to assess tax and interest directly against the non-resident so there should be an opportunity for the CRA to collect the proper amount of tax.

Of course, if a payer does not receive completed Forms and instead determines the rate of withholding through its own research and due diligence, then the payer should bear the risk of assessment if it is determined that the rate of withholding was actually higher (as is the case now).

2. The “Instructions for payers” on each Form advise a payer to not apply a reduced rate of withholding if the “form has not been provided ... and [the payer is] unsure that the reduced withholding rate applies”, if the “form has not been duly completed” or if the payer has “any reason to believe that the information provided in this declaration is incorrect or misleading”. These comments imply there is a level of due diligence that the CRA would expect a payer to perform on the Forms but there is no further guidance provided.

We can understand the comment relating to duly completed forms – the due diligence involved should be limited to ensuring that the applicable sections of the Form are completed and that it is signed and dated. However, we suggest that the other comment be deleted – a payer should be able to accept a duly completed form as being valid without being expected to perform additional due diligence. Otherwise, we would expect that the use of the Forms will not become widespread.

Canada Revenue Agency  
c/o Ms. Janet Schermann  
September 29, 2009

We noted that the payer's level of certainty did not seem to apply where the Form had been provided but not duly completed or where the payer had reason to believe the information was incorrect or misleading. As noted in Point 1 above, if the Forms cannot be relied upon to alleviate the payer's risk of assessment, then the reason for such a qualifier is not obvious to us.

3. The Forms are designed for non-residents that are aware of the "type" of entity they are ("partnerships" are to use Form NR302 while "hybrid entities" are to use Form NR303). Except for individuals, there are often situations when the classification of an entity is subject to debate or at least unclear. For example, the status for Canadian income tax purposes of certain foreign partnerships, trusts and even corporations is not obvious to many taxpayers.

We strongly suggest that the CRA update and re-issue IT-343R to reflect the CRA's position regarding the classification of all foreign entities that it has had occasion to review and opine on (as well as to consolidate its views regarding the appropriate method to use in classifying an entity that is summarized in Income Tax Technical News No. 38 (containing the CRA's responses to the 2007 Canadian Tax Foundation Round-Table). Non-resident taxpayers and payers should be able to rely on that re-issued bulletin in order to determine which Form should be used.

We note that entity classification issues could have a significant effect on the rate of withholding tax that is applicable. If the CRA determines that a particular non-resident entity is not what it purported to be when the Forms were completed (and relied on by the payer) then the payer should not be assessed for any additional Part XIII tax or related interest and penalties; rather, the non-resident entity should be assessed directly by the CRA.

4. We are concerned that the "any reason to believe..." requirement, uncertainty with respect to entity classification and the possibility of penalties and interest on under remitted withholding taxes subsequent to a CRA audit will cause payers to withhold at 25% instead of what should have been the applicable treaty rate. This will result in the filing of more refund claims by non residents which will increase the already, in our experience, very long processing time for such requests. We suggest that the CRA make a clear statement that reliance on the Forms as completed and submitted to the payer by the non resident will not result in any liability for interest and penalties should the Forms at a later time prove to be incorrectly completed.

Canada Revenue Agency  
c/o Ms. Janet Schermann  
September 29, 2009

5. In situations where interest is paid to a non-resident that deals at arm's length with the payer, ITA 212(1)(b) should not apply to such interest except where it is "participating debt interest". The Forms should clearly state that they are not applicable with respect to interest paid to such an arm's length person to avoid a situation where a payer who was not aware of ITA 212(1)(b) might believe that withholding is required.
6. Forms NR302 and NR303 specifically refer to their potential use in Regulation 105 waiver and Section 116 notification (in addition to Part XIII) situations. However, Form NR301 is restricted to Part XIII situations. We suggest that Form NR301 could also be completed for Regulation 105 waiver and Section 116 notification purposes (to establish residency and access to treaty benefits). In addition, the Forms might be used for non-resident persons, trusts, partnerships and hybrid entities that are filing partnership information returns or income tax returns in respect of income that would otherwise be taxable income (such as income from carrying on a business) but for the application of a treaty.
7. Each of the Forms includes space for the non-resident to include its CRA Business Number, social insurance number or other identification number. Many non-residents would not have such numbers issued to them. The "Instructions for the non-resident" on each Form should be clear that such numbers are to be provided if they had previously been issued to the non-residents but that no application for an identification number is required in order for the Form to be valid.
8. Each of the Forms should clearly state that the Forms are to be given to the payer and not submitted to the CRA with respect to Part XIII withholding situations.
9. Page 2 of Form NR301 indicates that the Form is not to be used by agents. Rather, the certification process described in IC 76-12R6 is to continue to be used by the agent certifying whether the investors for which it holds the securities are treaty eligible. Is the CRA intending that such an agent can rely on this Form as prepared by its clients when it makes the certification to the Canadian payer? If so, this should be made clear in the instructions.

In addition, since agents can act for both partnerships and hybrid entities, we suggest that a similar clarification be added to the instructions for Form NR302 and Form NR303.

10. The "Instructions for payers" on each Form advise a payer to consult the general CRA website if more information is needed. We suggest that the CRA direct payers to a more

Canada Revenue Agency  
c/o Ms. Janet Schermann  
September 29, 2009

topical section of the website, such as possibly the International and Non-resident Taxes section.

11. The CRA issued the Forms in draft in June 2009 and requested comments by September 30, 2009. We suggest that it would be reasonable for payers, non-residents and their advisors to expect the Forms and related guidance to be issued in final by the end of November 2009. In the meantime, we suggest that the CRA issue a formal notice that the draft versions of the Forms can be relied upon by payers and non-residents until the final Forms are issued and that, unless there are substantive changes to a particular Form, a duly completed and signed draft Form should be valid for the full time frame that is noted on the Forms under “Expiry Date”.
12. The CRA should update Information Circular 77-16R4 (last updated in 1992) to reflect the changes to the basic requirements for withholding and remitting non-resident tax under Part XIII, including the introduction of the Forms and how the Forms can be relied upon by payers to avoid penalty and other Part XIII assessments.
13. The instructions to Forms NR302 and NR303 indicate that such Forms are to be submitted with any NR7-R (withholding tax refund), R105 (Reg. 105 waiver), or T2062 (s.116) requests. We suggest that such other forms be updated to include a reference to the Forms.

#### **B. Comments relating to Form NR301**

Form NR301 is to be used by non-residents that are persons rather than being partnerships or hybrid entities. This would presumably include individuals, corporations and many trusts.

1. The reference to the limitation on benefits (“LOB”) rules in section 5 appears to be directed only at non-residents that are relying on the “derivative benefits” rules in Article XXIX-A(4) of the Canada-U.S. Income Tax Convention, as amended by the 5<sup>th</sup> Protocol (the “US Treaty”). That is also the paragraph noted in the “Instructions for the non-resident taxpayer”. There are other provisions in the LOB rules that could apply to persons that are not “qualifying persons” [such as the “active trade or business test” in Article XXIX-A(3) and the “competent authority approval” in Article XXIX-A(6)].

We suggest that the Form be redesigned so that a non-resident to which the LOB rules potentially applies only needs to certify that they believe they are eligible for benefits under the US Treaty rather than having to make a determination as to whether or not

Canada Revenue Agency  
c/o Ms. Janet Schermann  
September 29, 2009

Section 5 is applicable. A payer should not be required to do any due diligence with respect to the LOB rules if the Form certifies that the non-resident is eligible for benefits after considering such rules.

2. The Form directs payers to Information Circular 76-12R6 for the current rates of withholding on particular types of income paid to residents of particular countries. We suggest that IC 76-12R6 be updated for all pertinent developments in Canada's treaty network. We specifically suggest that IC 76-12R6 be revised to clarify that Income Tax Application Rule ("ITAR") 10(6) not only applies to "automatically" reduce the rate of withholding from 25% under ITA 212 to a lower amount that is provided in a treaty but also that it applies in situations where the payment in question is entirely exempt from Canadian tax. Our specific concerns in this regard are the comments in CRA Document # 9805075 which was issued in French and dated July 31, 1998.

### **C. Comments relating to Form NR302**

Form NR302 is to be used by non-residents that are partnerships.

1. As noted in the General Comments, whether an entity is a "partnership" is not always clear. For example, the issue of whether a U.K. limited liability partnership is a "partnership" or a "corporation" does not appear to have been the subject of a review by the CRA (at least according to publicly available documents/information). We suggest that the CRA provide specific examples of entities that would be viewed as "partnerships" either in the instructions or by directing the non-resident to the updated IT-343R.
2. The Note on Page 1 indicates that "if the partnership is subject to tax as a corporation on its worldwide income in a treaty country, complete and submit Form NR301 or Form NR302, whichever is more beneficial for the purposes of Part XIII". Such ability to make a choice of the most beneficial characterization is consistent with comments of the Department of Finance at the 2008 International Fiscal Association conference. However, this could also lead to confusion for partnerships that meet such criteria. Would the CRA consider such a "hybrid partnership" to be a corporation for Canadian income tax purposes? If so, what would be the need for including each partners' information on Form NR302? If not, why would using Form NR301 even be an option?

We suggest that Form NR302 would be the appropriate Form to use for any partnership regardless of whether the partnership is itself eligible to claim treaty benefits but that the

Canada Revenue Agency  
c/o Ms. Janet Schermann  
September 29, 2009

Form be amended to provide for such a partnership to indicate that it is a taxable resident of a Contracting State and therefore that it is eligible for treaty benefits on its own.

3. Under "Requesting a Refund of Part XIII Tax" on Page 1, Form NR302 states that a completed Form NR302 must be submitted with the NR7-R together with the applicable Form NR301, NR302 or NR303 for each partner. This would be administratively challenging in situations where a partnership is multi-tiered or has a significant number of partners. In cases where information is available for only certain partners to support that treaty benefits are available, would the CRA still process the request on the basis that partners with no Forms (or other supporting proof) would not be eligible for treaty benefits and issue the resulting refund to the partnership (as the deemed non-resident person under ITA 212(13.1)? In other words, if a partner is a hybrid entity or a partnership, and no Form NR303 or Form NR302 is provided in respect of such partner, would the CRA expect that the partner should be reflected on Part II of Worksheet A?
4. Would the CRA expect this form to be filed along with Form T5013 for any partnership that "carries on business in Canada"? This should be clarified in the instructions.
5. Under the certification, we suggest the second bullet be revised to say "...the partnership is in receipt of a duly completed Form NR301, NR302 or NR303 (or equivalent information)...". This would allow for the potential that the same information requested on such forms could be provided in a different manner and would be consistent with Form NR303.
6. In Worksheet A, column C of Parts I and II should be clarified - is it to reflect the partner's tax identification number in the partner's country of residence or the partner's CRA identification number. If it is truly the latter, then many partners will need to file T1261 and RC1 application forms. That appears to be an unnecessary step.

Also, column E of Parts I and II should be clarified – is it the allocation used by the partnership to allocate income (or loss) to that partner for foreign tax purposes or it is the ownership percentage (which might be different).

What about partners who are residents of Canada? Part I and Part II appear to be for non-resident partners only. Is it expected that residents of Canada will have no tax withheld in respect of their share of the income or will the withholding need to be 25%? This should be clarified.

Canada Revenue Agency  
c/o Ms. Janet Schermann  
September 29, 2009

Lastly, Worksheet A is too small to use except for very small partnerships. Will the CRA allow taxpayer's to design and attach their own "version" of Worksheet A (using a spreadsheet program, for example) as long as it contains the same information? This should be clarified.

7. In Worksheet B, is the caption in the top right corner "Total income – disposition gains" intended to be "Total income" less "disposition gains" or is it intended to be the portion of total income represented by disposition gains? This should be clarified.
8. Example 1 should be made more complex to illustrate the issues. Specifically, why are there two Spanish resident individuals as sample partners? We suggest that one of the partners be a corporation resident in a non-Treaty country and that one of the partners be an individual resident in Canada. Also, Canada recently signed a treaty with Greece so perhaps the non-Treaty resident individual should be from a different country.

#### **D. Comments relating to Form NR303**

Form NR303 is to be used by non-residents that are "hybrid entities".

1. As noted in the General Comments, whether an entity is a "hybrid entity" is not always clear. We suggest that the CRA provide specific examples of entities that would be viewed as "hybrid entities" (besides the LLC example) either in the instructions or by directing the non-resident to the updated IT-343R. The CRA might specifically address entities that are formed outside the U.S. but that are treated as "flow-through" entities for U.S. tax purposes (such that the income of such entity is currently taxable to U.S. members/shareholders). An example of this was addressed by the Department of Finance at the 2007 Canadian Tax Foundation Conference.
2. The instructions indicate that a hybrid entity "is a foreign entity (other than a partnership) that is not entitled to Canadian tax treaty benefits in its own right, but its members/owners are entitled to treaty benefits by virtue of a "look through" rule contained in a Canadian tax treaty." Presumably, a foreign entity that has "elected" to be treated as a taxable person under the laws of the foreign country would not be a "hybrid entity". Form NR303 should clearly state whether such an entity should file Form NR301 instead of Form NR303.
3. Under "Requesting a Refund of Part XIII Tax" on Page 1, Form NR303 states that a completed Form NR303 must be submitted with the NR7-R together with the applicable

Canada Revenue Agency  
c/o Ms. Janet Schermann  
September 29, 2009

Form NR301, NR302 or NR303 for each member/owner. This would be administratively challenging in situations where a hybrid entity is multi-tiered or has a significant number of members. In cases where information is available for only certain members to support that treaty benefits are available, would the CRA still process the request on the basis that members with no Forms (or other supporting proof) would not be eligible for treaty benefits and issue the resulting refund to the hybrid entity (as the non-resident person for purposes of the ITA)? In other words, if a member is a hybrid entity or a partnership, and no Form NR303 or Form NR302 is provided in respect of such member, would the CRA expect that the member should be reflected on Part II of Worksheet A?

4. In the “Instructions for the hybrid entity declaring benefits”, it states that “treaty benefits are not applicable to any person that is not a resident of the U.S.”. Please refer to the comments relating to Form NR301 with respect to how the LOB rules should be addressed in the Forms.
5. The “Instructions for the hybrid entity declaring benefits” refer to the use of a “partnership statement”, which is in essence a modified Form NR302 that would be prepared on the basis that any partner who is not a resident of the U.S. would not be entitled to treaty benefits. This will likely create confusion – we suggest that the Form NR302 instructions be clarified to cross reference to this requirement.
6. In Worksheet B, is the caption in the top right corner “Total income – disposition gains” intended to be “Total income” less “disposition gains” or is it intended to be the portion of total income represented by disposition gains? This should be clarified.

We would welcome the opportunity to meet with representatives of the CRA to discuss these comments. If you have any questions or would like to schedule a meeting, please contact either myself at 416-365-2701 or Dan Fontaine at 905-949-7313.

Yours truly,



Nick Pantaleo, FCA  
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