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Section 119: Flawed Relief from Departure Tax

Section 119 is designed to provide relief from double taxation when an individual emigrates from Canada. Absent such a provision, an individual might be subject to tax under both part I and part XIII of the Act. Because relief does not exist in all situations, care should be taken when one is analyzing a departure situation.

When an individual emigrates from Canada, subsection 128.1(4) deems him or her to have disposed of certain property for proceeds equal to its FMV at the time; any accrued gains are therefore subject to tax under part I on departure. The taxpayer is then deemed to have reacquired the property at this FMV.

Dividends paid to a non-resident are subject to withholding tax under part XIII. Thus, any accrued gain on shares that is taxed at departure may be taxed again when the inherent gain is distributed in the form of dividends. This situation gives rise to the double taxation problem.

The dividend could cause a decline in the value of the shares, and thus a loss might be realized on sale. If the loss were to be recognized for tax purposes and allowed to be carried back to the year of departure, part I tax would be eliminated and the double taxation problem would be solved. (Pursuant to subsection 128.1(8), the carryback period for non-resident individuals disposing of taxable Canadian property [TCP] is not limited to the usual three years.) However, subsection 40(3.7) reduces a non-resident's loss from the disposition of property if taxable dividends are received. Thus, double taxation relief is still needed.

Such relief is provided by section 119, which applies to the withholding tax on dividends subject to the stop-loss rules in subsection 40(3.7) and provides a credit against tax payable in the year of departure. In order to claim this credit, the taxpayer must file an amended departure return to reflect the reduced tax payable. To understand how this process works, assume that Ms. A owns shares of Canco with a nominal ACB and an FMV of $100. Upon emigration, she recognizes the gain of $100 and pays tax of $25 under part I. The ACB of the shares is increased to $100. Post-departure, Ms. A receives $50 of dividends and pays withholding tax of $10. If she subsequently disposes of the shares for $50, she will recognize a loss of $50, which will be reduced to nil pursuant to subsection 40(3.7). In this situation, Ms. A has an economic gain of $50 that is taxed under both part I and part XIII. By applying section 119, she will receive a deduction, in computing tax payable, equal to the lesser of the part I departure tax of $25 and the part XIII withholding tax of $10. In other words, section 119 allows a deduction equal to the relevant part XIII tax paid, up to the amount of part I tax paid at departure.

Section 119 is a federal credit and has no counterpart at the provincial level. Because no withholding tax is levied by the province, there is no need for a credit to provide relief.

There are two flaws in the section 119 double taxation relief:

- For section 119 to apply, the property deemed disposed of under subsection 128.1(4) must be TCP. Historically, the definition of TCP included most private corporation shares, partnership units, and trust units. However, the definition was amended in 2010 to include only those properties that derive 50 percent or more of their value from real property situated in Canada (and certain other Canadian property). Although this amendment was intended to lighten section 116 compliance obligations, the narrower definition restricts the taxpayer's ability to claim a section 119 deduction if the property disposed of is not TCP. Accordingly, double taxation may still occur.
- The section 119 deduction becomes available only when the property is ultimately disposed of, so the double taxation relief is delayed. One solution is to elect under subsection 220(4.5) to post security to the CRA and defer payment of departure tax until disposition.

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