CRA releases guidance on residency, permanent establishment and other international issues arising during the COVID-19 pandemic

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INTRODUCTION

The global travel restrictions caused by the COVID-19 pandemic have resulted in some individuals involuntarily remaining in one jurisdiction or being unable to enter another jurisdiction. Many taxpayers have expressed concern that unintended tax consequences could arise from these travel restrictions, particularly where tax results depend on the physical location of individuals. For example, the residency of a taxpayer and the existence of a “permanent establishment” both depend in part on the jurisdiction in which certain activities are carried out.

The Canada Revenue Agency (CRA) has released administrative guidance on a number of international income tax issues raised by the COVID-19 crisis that are relevant to both businesses and individuals. In light of the uncertainty regarding the duration of the pandemic and any related travel restrictions, the CRA has stated that its guidance will apply from March 16 until June 29, 2020, and may be extended if necessary. The CRA’s guidance for corporations is generally limited to corporations that are resident in jurisdictions that have a tax treaty with Canada. For corporations that are resident in other jurisdictions, the CRA will consider whether administrative relief is available on a case-by-case basis. The CRA also provided administrative guidance on the residency of individuals, the taxation of cross-border employees and relief for certain processing delays caused by the COVID-19 pandemic.

CORPORATE RESIDENCY IN CANADA

A corporation that is incorporated under Canadian federal or provincial law is generally deemed to be
resident in Canada for purposes of the *Income Tax Act* (Canada) (the Act). Other corporations can also be resident in Canada if the place of their “central management and control” is in Canada. Taxpayers that are resident in Canada are taxed in Canada on their worldwide income.

Canadian courts have generally held that the place of “central management and control” is the location in which the effective decision-making relating to the overall strategic direction and governance of a business is carried out. The location where the board of directors meets and makes its decisions is generally regarded as the most important factor, although courts have also considered other factors when determining the residence of a corporation for tax purposes.

In some cases, a corporation may be resident both in Canada and in a jurisdiction outside of Canada. From a Canadian tax perspective, a company that is considered to have dual residence is liable to pay tax in Canada on its worldwide income unless relief is available under an applicable income tax treaty. In this respect, many of Canada’s tax treaties provide a “tie-breaker” rule that deems a dual-resident corporation to be resident only in one of the two countries based on factors such as the place of incorporation, the place of effective management or any other criterion as agreed to between the competent authorities of the two countries.

In general, a foreign corporation can mitigate the risk of being treated as a resident of Canada by ensuring that its central management and control occurs outside of Canada, such as ensuring that the board of directors meets and makes its decisions outside of Canada. However, travel and mobility restrictions arising out of the COVID-19 pandemic may interfere with a taxpayer’s ability to manage these risks. In particular, while travel restrictions are in place, certain directors may be required to attend board meetings virtually while being physically present in Canada.

The CRA’s guidance provides that cases of dual residency should be appropriately addressed where an applicable tax treaty includes a residency tie-breaker rule based on place of incorporation (such as Article IV of the Canada–U.S. tax treaty). Where a residency tie-breaker rule in an applicable treaty looks to the corporation’s place of effective management, if a director of a corporation must participate in a board meeting from Canada because of pandemic-related travel restrictions, the CRA will not consider the corporation to have become resident in Canada solely for that reason.

The CRA’s guidance is quite helpful for foreign corporations that are resident in countries that have a tax treaty tie-breaker rule based on place of effective management (although the guidance is less clear in circumstances where place of effective management is only one of the factors to be considered under the treaty residence tie-breaker rule). For foreign corporations that are resident in countries without a tax treaty, the CRA has indicated that residency will be determined on a case-by-case basis. In those situations, taxpayers can either seek to rely on a position that a temporary/emergency action located in Canada should not be sufficient to cause its central management and control to be located in Canada, or they can seek administrative relief from the CRA on a case-by-case basis.

The CRA’s guidance on corporate residency is not as clear as the guidance provided by some other countries. The CRA could have provided more clarity and certainty by stating that where a director of a corporation must participate in a board meeting from Canada because of pandemic-related travel restrictions, it will not consider either the corporation’s “central management and control” or its “place of effective management” to be in Canada solely for that reason. Such a position would have eliminated the need to rely on residency tie-breaker rules in many scenarios and would have also provided relief to corporations that may otherwise be a dual resident of Canada and a non-treaty country. The CRA’s reluctance to provide clear administrative relief to corporations located in non-treaty jurisdictions
likely reflects a desire to restrict any potential administrative relief in situations that may be perceived by the CRA to be abusive.

**CARRYING ON BUSINESS IN CANADA/PERMANENT ESTABLISHMENT**

Taxpayers that are not resident in Canada are taxed on income earned from “carrying on business in Canada,” subject to any available relief under an applicable tax treaty. Both a common law test and a statutory deeming rule are applicable in determining whether a non-resident’s activities in Canada exceed the threshold for carrying on business in Canada.

As a general matter, the activity threshold for carrying on business in Canada is low. Under the common law test, whether a taxpayer carries on business in Canada generally depends on whether the essential or profit-making contracts are habitually concluded in Canada and whether the profits of the taxpayer’s business arise in substance from activities performed in Canada. In addition to the common law test, certain activities performed in Canada are deemed by section 253 of the Act to constitute “carrying on business in Canada.” In particular, a non-resident person that “solicits orders or offers anything for sale in Canada through an agent or servant” is deemed to carry on business in Canada in respect of that activity or sale, whether the contract or transaction is to be completed inside or outside of Canada.

If a non-resident taxpayer is eligible for benefits under a tax treaty between Canada and the taxpayer’s jurisdiction of residence, the business profits of that taxpayer will generally only be subject to tax in Canada if the taxpayer carries on business in Canada through a “permanent establishment” (PE) in Canada. Under Canada’s tax treaties, a PE generally exists in Canada if the taxpayer has a fixed place of business (such as an office) or a “place of management” in Canada or if the taxpayer has an agent in Canada (other than an agent of independent status acting in the ordinary course of its business) that habitually exercises an authority to conclude contracts on behalf of the taxpayer (an Agency PE). The Canada-U.S. treaty also includes the concept of a “Services PE,” which provides that a non-resident corporation that does not otherwise have a PE in Canada is deemed to provide services through a PE in Canada if such services are performed in Canada for at least 183 days in a 12-month period and certain other conditions are met. If a non-resident person has a PE in Canada, the profits of the non-resident person will generally be attributed to the Canadian PE based on the arm’s-length standard.

In general, a foreign corporation can mitigate the risk of carrying on business in Canada, or having a PE in Canada, by minimizing the amount of business activities carried on in Canada by its employees or agents, as well as restricting the authority of its employees or agents to conclude contracts on its behalf while in Canada. However, these mitigation strategies may become more difficult, or in some cases impossible, to implement as a result of travel and mobility restrictions arising out of the COVID-19 pandemic.

As mentioned, the PE concept is generally only relevant to non-resident corporations that carry on business in Canada but are entitled to the benefits of one of Canada’s tax treaties. Accordingly, the CRA stated that such corporations will not be considered to have a PE in Canada solely because its employees perform their employment duties in Canada solely as a result of pandemic-related travel restrictions being in force. The CRA also stated that an Agency PE will not be considered to arise solely due to a dependent agent concluding contracts in Canada on behalf of a non-resident entity while travel restrictions are in force, provided that such activities are limited to that period and would not have been performed in Canada but for the travel restrictions. In addition, any days of physical presence in Canada solely due to travel restrictions will be excluded for purposes of applying the “Services PE” test (such as in Article V(9) of the Canada-U.S. tax treaty). The CRA noted that filing obligations for entities that carry on
business in Canada but do not have a PE in Canada continue to apply for the taxation years during which pandemic-related travel restrictions are in place.

For corporations that are resident in non-treaty jurisdictions, the CRA stated that if it can be demonstrated that the non-resident entity has reached the threshold of “carrying on business in Canada” solely because of pandemic-related travel restrictions, the CRA will consider whether administrative relief is appropriate on a case-by-case basis. Unfortunately, the CRA’s position does not provide certainty to taxpayers in this position, and again suggests that the CRA is more open to providing broadly applicable administrative relief to corporations that are resident in treaty jurisdictions, rather than those resident in non-treaty jurisdictions.

APPROACH OF CERTAIN OTHER JURISDICTIONS ON SIMILAR ISSUES

Certain other countries have introduced guidance or relief in respect of residency, PE and carrying on business issues resulting from the dislocation of employees or travel restrictions due to the COVID-19 pandemic. The administrative relief granted in Australia, Ireland and the U.K. appears to be broader than the administrative relief granted by the CRA.

**Australia:** The Australian tax authority has stated that if an employee of a foreign company is present in Australia due to the COVID-19 pandemic, this will not in itself create a permanent establishment in Australia if (i) the foreign-incorporated company did not have a permanent establishment in Australia before the impacts of COVID-19; (ii) there are no other changes in the company’s circumstances; and (iii) the unplanned presence of employees in Australia is the short-term result of them being temporarily relocated or restricted in their travel as a consequence of the COVID-19 pandemic. Regarding corporate residence, Australian guidance provides that if the only reason for holding board meetings in Australia or directors attending board meetings from Australia is because of the effects of COVID-19, then the Australian Taxation Office will not apply compliance resources to determine if a company’s central management and control is in Australia.

**Ireland:** Where an individual is present in Ireland and that presence is shown to result from travel restrictions related to COVID-19, the Irish tax authority has announced that it will be prepared to disregard such presence in Ireland for corporation tax purposes for a non-Irish incorporated company in relation to which the individual is an employee, director, service provider or agent.

**United Kingdom:** The U.K. tax authority has taken a different approach than Ireland or Australia. Unlike those countries, whose COVID-19 guidance suggests that some suspension of the normal application of legal tests will occur as a result of administrative relief, the U.K. has opted instead to stress how its existing administrative guidance is already sufficiently flexible to prevent inadvertent shifts of corporate residence or inadvertent creation of permanent establishments solely due to temporary dislocations of directors or employees. Regarding corporate residence, HMRC notes that its existing guidance already contemplates that occasional U.K. board meetings, or participation in such meetings from the U.K., does not necessarily result in central management and control abiding in the U.K. Similarly, HMRC observes that a permanent establishment requires either that a business is carried on through a fixed place of business in the U.K., or that an agent acting on behalf of the company has and habitually exercises authority to carry out the company’s business in the U.K. The suggestion seems to be that the temporary conduct of business activities by a foreign entity’s employees or agents in the U.K. due solely to the COVID-19 pandemic would not meet those conditions. As Canada’s rules for residency and carrying on business are established on similar common law principles to those in the United Kingdom, it is possible
that the positions stated by the U.K. tax authority could also apply in the Canadian context.

United States: Guidance released by the U.S. Internal Revenue Service and Department of Treasury provides that a foreign corporation may choose an interrupted period of up to 60 calendar days, beginning between February 1, 2020 and April 1, 2020, during which certain activities conducted in the U.S. will not be taken into account in determining whether the foreign corporation is engaged in a “U.S. trade or business” or has a permanent establishment in the U.S. Activities eligible for relief are narrowly defined as those that (i) are performed by an individual temporarily present in the U.S. (i.e., is not normally U.S.-based), and (ii) would not have been performed in the U.S. but for travel disruptions caused by the COVID-19 emergency.

TRAVEL RESTRICTIONS RELATING TO INDIVIDUAL TAXATION

INDIVIDUAL RESIDENCE

At common law, whether an individual is resident in Canada is determined based on an individual’s residential ties to Canada. The CRA stated that where an individual has remained in Canada solely because of travel restrictions relating to COVID-19, that factor alone should not cause the common law factual test of residency to be met.

Ordinarily, an individual who is physically present in Canada for 183 days or more in a tax year will be deemed to be resident in Canada throughout the year. The CRA indicated that it will not consider any days during which an individual is present in Canada and is unable to return to their country of residence solely as a result of travel restrictions to count towards this 183-day limit for deemed residency.

CROSS-BORDER EMPLOYMENT INCOME

Canada’s tax treaties contain rules that allocate taxing rights between the two contracting states over the employment income of a resident of one country earned from employment services performed in the other country. The CRA indicated that, for purposes of applying tax treaty provisions that depend on an individual’s days of presence in Canada (such as Article XV(2)(b) of the Canada-U.S. treaty), the days in which an individual who is resident in a treaty jurisdiction is present in Canada and exercises their employment duties in Canada solely as a result of travel restrictions related to COVID-19 will not be counted and will not cause the non-resident individual to lose entitlement to treaty relief from Canadian tax on employment income.

The CRA also indicated that “letters of authority” issued to Canadian-resident employees of non-resident entities who are forced to perform their employment duties in Canada (rather than outside of Canada) on an exceptional and temporary basis as a result of travel restrictions related to COVID-19 will continue to apply, such that withholding obligations of the relevant non-resident employer will not change as long as there are no changes to the withholding obligations of the non-resident employer in the other jurisdiction.

ADMINISTRATIVE RELIEF FOR PROCESSING DELAYS

WAIVER REQUESTS UNDER REG 102 AND REG 105

Withholding requirements apply in respect of payments to a non-resident individual in respect of duties performed in Canada by the individual as an officer or employee (under section 102 of the Income Tax Act).
CRA's review is complete. No penalty or interest will be assessed as long as funds are remitted when remittance is due, the purchaser’s remittance is due, the purchaser receives a clearance certificate under section 116 of the Act (a Clearance Certificate) or an applicable treaty-based notification is timely filed. A Clearance Certificate is generally issued if the CRA has received from the vendor an amount to cover the tax on any gain realized by the vendor, or appropriate security for such tax. Due to the COVID-19 pandemic, the processing of requests for Clearance Certificates was temporarily interrupted resulting in processing times being longer than usual.

The CRA stated that where a vendor submitted a request for a Clearance Certificate and the certificate has not been issued by the time a purchaser’s remittance is due, the parties may request that the CRA provide a comfort letter, which would advise the parties to retain the funds they have withheld until the CRA’s review is complete. No penalty or interest will be assessed as long as funds are remitted when requested by the CRA, even if this occurs after the date when such remittance would have been due (ordinarily 30 days after the end of the month in which the property is acquired).

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