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Foreign Employers Sending Non-Canadian-Resident Employees to Canada to Work On Short-Term Projects May Benefit from Proposed Changes Introduced in the 2015 Federal Budget and Clarified on July 31, 2015

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Changes introduced in the 2015 Federal Budget (the ''2015 Budget'') would exempt certain employers from payroll withholding obligations associated with their employees travelling back and forth to Canada on a periodic basis. On July 31, 2015, the Department of Finance released draft legislation and explanatory notes (the ''July 31 Draft Legislation'') related to these proposals.

BACKGROUND — ITA REGULATIONS §102

Section 102 of the Regulations to the Income Tax Act (Canada) (the ''Regulations'') imposes a withholding obligation on every person paying salary, wages, or other remuneration to employees working in Canada. This withholding obligation applies to both Canadian resident and nonresident employers and is imposed at marginal rates. The amount withheld is considered by the Canada Revenue Agency (CRA) to be an installment of the nonresident's potential Canadian income tax liability. What comes as a surprise to many employers is that the obligation to withhold applies even if the employee is ultimately exempt from Canadian tax under an income tax treaty between Canada and the employee's country of residence.

Prior to the proposals introduced in the 2015 Budget, the only exception from the requirement to withhold was where the nonresident employee could establish he or she was eligible for an exemption from Canadian income tax under a relevant income tax treaty and the employer obtained from the CRA a waiver of the withholding obligation in advance of the payment. No exemption for a *de minimis* dollar amount or number of days was available.[1]

For employers with a highly mobile workforce, complying with this system often required a sophisti-

[1] While it is beyond the scope of this article to detail the requirements for nonresidents providing employment services in Canada to be considered exempt from tax in Canada under the country's income tax treaties, very generally a U.S. employee providing employment services in Canada will be exempt from tax in Canada under the provisions of art. XV of the Canada-U.S. Income Tax Treaty (the ''Canada-U.S. Treaty'') if: (1) the remuneration does not exceed CDN$10,000; or (2) the employee is present in Canada for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing in or ending in the relevant fiscal year, and the remuneration is not paid by or on behalf of a person who is a Canadian resident and is not borne by a permanent establishment in Canada.

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cated employee tracking program to ensure that waiver applications (where possible) were filed in advance of the particular employee's travel to Canada. Even where the waiver was granted in advance of the payment and the employer was relieved from the withholding obligation, the non-Canadian-resident employer was still obligated to report the payments to the employee on a Canadian T4 slip, thereby requiring some understanding and familiarity with Canada's reporting obligations.

In recent years, the CRA has acknowledged the administrative burden that complying with the requirements of Regulation 102 has imposed on both resident and nonresident taxpayers. As a direct response to these concerns, the CRA proposed a new certification measure in the 2015 Budget intended to streamline and reduce that burden. While the proposals in the 2015 Budget were generally considered to be relieving in nature, a number of concerns were identified by the tax community, several of which were presented to the Department of Finance by the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada (the ''Joint Committee''). Some of these concerns were addressed in the July 31 Draft Legislation. However, as this article points out, further modifications and some additional clarification would still be welcome.

THE 2015 BUDGET

In an attempt to address the issue of an exemption from the withholding obligation being available only in the presence of a waiver (often cited as the most onerous provision of the Regulation 102 withholding regime), the 2015 Budget introduced an exemption to the Regulation 102 withholding requirement in respect of payments made by ''qualifying non-resident employers'' to ''qualifying non-resident employees.''

Under the new proposal, where a qualifying nonresident employer pays salary, wages, or other remuneration to a qualifying nonresident employee, no withholding is required and more importantly, a waiver is not necessary. However, upon further review of the criteria needed to satisfy the definitions of ''qualifying non-resident employer'' and ''qualifying non-resident employee,'' it is apparent that some additional compliance burdens have been introduced into the system.

Qualifying Nonresident Employer

In order to be a qualifying nonresident employer under the 2015 Budget, an employer must be:

(1) resident in a country with which Canada has an income tax treaty (the United States or the United Kingdom, for example);[2]

(2) not carrying on business in Canada through a permanent establishment in its fiscal period that includes the time of the payment; and

(3) certified by the Minister at the time of payment (as discussed below).

Qualifying Nonresident Employee

To be a qualifying nonresident employee under the 2015 Budget, the employee must be:

(1) a resident of a country with which Canada has an income tax treaty;

(2) exempt from Canadian tax in respect of the payment because of an income tax treaty between Canada and the employee's country of residence; and

(3) not present in Canada for 90 days or more in any 12-month period that includes the time of payment.

THE JULY 31 DRAFT LEGISLATION — WHAT CHANGED?

One of the amendments made to the definition of ''qualifying non-resident employee'' in the July 31 Draft Legislation broadened the circumstances in which an employee could be a qualifying nonresident employee. The proposed amended definition reads as follows:

> ''qualifying non-resident employee'' at any time in respect of a payment referred to in paragraph (1)(a) means an employee who
>
> (a) is at that time, resident in a country with which Canada has a tax treaty;
>
> (b) is not liable to tax under this Part in respect of the payment because of that Treaty; and
>
> (c) works in Canada for less than 45 days in the calendar year that includes that time or is present in Canada for less than 90 days in any 12 month period.

The requirement that the employee not be present in Canada for 90 or more days in any 12-month pe-

[2] If the employer is a partnership, then 90% or more of the income or loss of the partnership for the fiscal period that includes the time of the payment must be allocable to partners of the partnership who are resident in a country with which Canada has an income tax treaty.

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riod in order to be a qualifying nonresident employee was amended to provide that either the employee works in Canada for less than 45 days in the calendar year that includes the time of payment, or the employee is present in Canada for less than 90 days in any 12-month period that includes the time of payment. For purposes of this ''45 days working in Canada'' test, days worked in Canada will include only days during which the employee is physically present in Canada and paid by his or her employer for the time spent in Canada, which generally excludes weekends, days off, and holidays.[3] This ''45 days working in Canada'' test may, however, impose additional and more detailed tracking requirements than needed to satisfy the ''90 days present in Canada'' test.

Many employers may be better able to monitor ''work days'' than simple presence in Canada. As the 90-day test to be a qualified nonresident employee is based on days present in Canada and not simply days working in Canada, employers may be required to introduce new methods to more closely track their employees' travels to and from Canada, thereby imposing even further administrative burdens on nonresident employers.

The notes accompanying the July 31 Draft Legislation point out that because all of the conditions listed in the definition of ''qualifying non-resident employee'' must be satisfied, it is possible that an employee may be either working in Canada for less than 45 days in the calendar year or present in Canada for less than 90 days in any 12-month period, but still not meet the criteria for a qualifying nonresident employee. For example, the employee may be in Canada for more than 183 days in a rolling 12-month period that overlaps two consecutive calendar years (but still be working in Canada for less than 45 days in the calendar year), and would therefore not satisfy paragraph (b) of the definition by virtue of being potentially liable for tax in Canada under a treaty.

QUALIFYING NONRESIDENT EMPLOYER

One of the primary concerns identified by the Canadian tax community with the definition of ''qualifying non-resident employer'' as defined in the 2015 Budget was the requirement that the employer not ''. . .carry on business through a permanent establishment (as defined by regulation) in Canada.''

Subsection 400(2) of the Regulations defines ''permanent establishment,'' which is generally relevant for purposes of allocating income among various provinces. Canada currently has approximately 90 income tax treaties in force with other countries and it is generally these treaties that are relevant for the purposes of determining Canadian tax liability for non-Canadian entities operating in Canada.

There are often significant discrepancies between the definition of ''permanent establishment'' in the Regulations and the definition of ''permanent establishment'' in Canada's tax treaties. One such example cited by the Joint Committee is where a nonresident employer does not have any fixed place of business in Canada (and does not have a permanent establishment in Canada for purposes of the Regulations) but may be deemed to have a permanent establishment in Canada for purposes of a particular tax treaty. A common example of this occurs where the treaty deems an entity resident in one country to be providing services through a permanent establishment in the other country (commonly referred to as the ''services PE rule'').[4]

The July 31 Draft Legislation eliminated in its entirety the requirement that the employer not carry on business through a permanent establishment. Accordingly, this will not be a requirement to be a qualifying nonresident employer.

CERTIFICATION BY THE MINISTER

While one of the objectives of the 2015 Budget and the July 31 Draft Legislation relating to the Regulation 102 withholding obligation was to streamline the process and simplify the administrative burden imposed on non-Canadian-resident employers sending their employees to Canada, introducing the requirement that an employer must be ''certified by the Minister at the time of payment'' in order to be a qualifying nonresident employer may undermine this objective.

The Ministerial certification process introduced in the 2015 Budget remains unchanged — and unclarified — in the July 31 Draft Legislation. In addition to the authority to certify an employer (coupled with the ability to revoke such certification), the Minister also has the authority to provide such certification for a specified period of time if the Minister is satisfied that the employer, having applied in a prescribed form containing prescribed information, meets the conditions in paragraph (a) of the definition of a ''qualify-

[3] When an employee is physically present in Canada for only a portion of a day, the employee will be considered to have been physically present in Canada for the whole day for purposes of applying this test.

[4] For example, art. V(9)(a) of the Canada-U.S. Treaty deems an entity to have a permanent establishment in Canada if it provides services in Canada for an aggregate of 183 days or more in any 12-month period with respect to the same or connected project for customers who are Canadian residents or have Canadian permanent establishments and the services are provided in respect of those permanent establishments.

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ing non-resident employer'' (as set out above) and meets the conditions established by the Minister. However, to date, no ''prescribed'' form, information, or conditions have been established for these purposes.

Concerns raised by the Joint Committee with respect to the form of attestation that may be required from an employer to receive certification have also not yet been addressed. It remains to be seen whether the certification process will be so onerous that it deters employers from attempting to comply with this certification process.

GENERAL COMPLIANCE ISSUES

Historically, employers have used the CRA's voluntary disclosure program to address past Regulation 102 non-compliance exposure and to enable future use of the Regulation 102 waiver process. While the material released to date does not make any reference to being in compliance or in good standing, it remains to be seen whether compliance for all prior years will be a pre-condition to the proposed certification process and, if so, whether the voluntary disclosure program will be able to cope with a possibly significant influx of new applications. It is also unclear whether an application for certification pursuant to the 2015 Budget may result in exposure of an applicant's past deficiencies.

PENALTY RELIEF

The July 31 Draft Legislation also introduced relief from penalties that otherwise would have applied in cases of failure to withhold tax. If, after making reasonable inquiry, a qualifying nonresident employer had no reason to believe at the time the payment was made to the employee that he or she was not a qualifying nonresident employee, then no penalty will arise.

REPORTING REQUIREMENTS

Another area of concern that was identified in the Joint Committee report as causing significant administrative burdens for nonresident employers sending employees to Canada, but not addressed in the 2015 Budget or the July 31 Draft Legislation, was the requirements to report payments of salary, wages, or other remuneration. Under the new proposals, even where the exemption from the withholding obligation is available, the employer will continue to be subject to the reporting requirements under the Income Tax Act (Canada) with respect to such payments and will have to complete and file the necessary T4 slips and T4 Summary.

SUMMARY

The Supplementary Information released with the 2015 Budget specifically acknowledged that ''. . .the existing employee waiver system has been criticized as inefficient'' and that these new provisions are intended ''. . .to reduce the administrative burden of businesses engaged in cross-border trade and commerce. . . .''

These rules represent a significant step forward in alleviating many of the concerns identified by employers and the tax community. However, once released in more detail, the rules and procedures relating to the proposed certification process will need to be more carefully considered as to whether they will achieve their intended results and ultimately benefit non-Canadian-resident employers that have significant cross-border employee presence. It is hoped that the Department of Finance will continue to monitor these proposals and amend them as necessary to deal with practical compliance issues as they arise.

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