



International Fiscal Association (Canadian Branch)
Association Fiscale Internationale (Section Canadienne)



Regulation 102 and Regulation 105: Withholding Considerations and Solutions

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A presentation of the Young IFA Network (YIN)

Goal of Presentation

- To highlight the tax implications of non-residents providing services in Canada, with a particular focus on withholding tax obligations and the impact of tax treaties and permanent establishments in the context of independent service providers and employees.

Section 153 & Regulation 105

Section 153 & Regulation 105

- **Paragraph 153(1)(g) of ITA:** Requires every person paying “fees, commissions or other amounts for services” to withhold at a prescribed rate on account of the recipient’s Part I tax liability.
- **Regulation 105(1):** “Every person paying to a non-resident person a fee, commission or other amount in respect of services rendered in Canada, of any nature whatever, shall deduct or withhold 15 per cent of such payment.”
 - Subsection 105(2) provides an exception for payments that are “remuneration” (these are dealt with under regulation 102), and for payments to “registered non-resident insurers” and “authorized foreign banks”.
 - Note that there are other specific rules to deal with payments to non-resident actors not discussed herein.
 - Additional provincial withholding applies for services provided in Quebec.

Purpose of Regulation 105

- Reg. 105 is a collection mechanism and does not create a primary tax obligation for the non-resident.
 - The purpose of Reg. 105 “is simply to provide security for tax that may later be assessed...” (*Weyerhaeuser Co. v. R.* (2007 TCC 65)).
- The ability to obtain a waiver from Reg. 105 withholding or for the non-resident payee to obtain a refund is based on whether non-resident would otherwise be required to pay Part I tax.
- Absent a waiver, withholding obligations apply even if a non-resident will have no Part I tax liability.

Liability of non-residents for Canadian tax

- Non-residents are subject to subject to Canadian income tax if they carry on business in Canada.
 - **Common law test:** No single test, but relevant factors include: the place where contracts are made; the place where sales are solicited; the site at which operations producing profit take place; and the presence of a representative in Canada.
 - **Section 253:** Deems a non-resident to carry on business in Canada where the non-resident:
 - produces, grows, mines, creates, manufactures, fabricates, improves, packs, preserves or constructs, in whole or in part, anything in Canada whether or not the person exports that thing without selling it before exportation, or
 - solicits orders or offers anything for sale in Canada through an agent or servant, whether the contract or transaction is to be completed inside or outside Canada or partly in and partly outside Canada.

Liability of non-residents for Canadian tax

- Canadian Tax treaties generally require that a non-resident carries on business through a permanent establishment in Canada to be subject to Canadian income tax.
- Permanent establishment means “means a fixed place of business through which the business of an enterprise is wholly or partly carried on” (OECD Model Convention).
 - Includes: a place of management, a branch, an office, a factory, a workshop, and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

Liability of non-residents for Canadian tax

- Some tax treaties create deemed PEs:
 - **Dependent agent (Article V(4) of the Canada-US Treaty):** A person acting on behalf of a resident of the US who has, and habitually exercises the ability to conclude contracts, in Canada on behalf of the US resident may cause the US resident to have a PE in Canada.
 - Exceptions for certain independent agents acting in the ordinary course of their business (covered by article V(7) and for certain activities listed in article V(6)).

Liability of non-residents for Canadian tax

- **Services PE (Article V(9) of Canada-US Tax Treaty):** A US enterprise may be deemed to have a PE in Canada if it provides services and:
 - those services are performed in Canada by an individual who is present in Canada for a period or periods aggregating 183 days or more in any twelve-month period, and, during that period or periods, more than 50 percent of the gross active business revenues of the enterprise consists of income derived from the services performed in Canada by that individual; or
 - the services are provided in Canada for an aggregate of 183 days or more in any twelve-month period with respect to the same or connected project for customers who are either residents of Canada or who maintain a permanent establishment in Canada and the services are provided in respect of that permanent establishment.
 - Exception for a building site or construction or installation project, which must last more than 12 months to be a PE.

Regulation 105

- Applies to a fee, commission or other amount in respect of services rendered in Canada
 - Applies to a fee paid to a non-resident even if the non-resident will not be the person providing the services (see *Ogden Palladium Services (Canada) Inc. v. R.*, 2001 CarswellNat 396, upheld by the FCA in 2002 FCA 336 and *FMC Technologies Co. v. MNR*, 2008 FC 871, upheld in 2009 FCA 217)
- Applies even if payor is a non-resident
- If contract is partly for services rendered in Canada and partly for something else (ex. services rendered outside of Canada or a payment for goods or use of property) contract should provide an allocation of fees to avoid having to withhold on full amount

Fees versus cost reimbursement

- Historically CRA's view has been that Reg. 105 required withholding on expenses, subject to specific administrative exceptions.
- *Weyerhaeuser Co. v. R.* (2007 TCC 65): Reg. 105 withholding “does not extend beyond requiring the payor to deduct and withhold from payments of amounts that are in the nature of fees or commissions that, in the hands of the recipient, have the character of income earned in Canada [emphasis added].”
- CRA accepts this, provided the reimbursement is properly documented, the reimbursement is reasonable and there is no suspected avoidance of Canadian tax : 2008-0297161E5.
- Reimbursed must be for actual out-of-pocket expenses, and should not just be a percentage-based surcharge added to invoice (*Stora Enso Beteiligungen GmbH v. R.*, 2009 TCC 282).

Subcontracting and cascading obligations

- Absent proper structuring, may have multiple levels of withholding
- Properly documented reimbursements of subcontractors fees are not subject to withholding (2008-0297161E5, based on *Weyerhaeuser*)
 - **Example 1:**
 - Customer pays NR1 \$100 flat fee inclusive of all expenses
 - NR1 subcontracts part of work to NR2 and pays NR2 \$40
 - Both payments to NR1 and NR2 are subject to 15% withholding
 - Total withholding = \$21
 - **Example 2:**
 - Customer pays NR1 a \$60 fee and reimburses NR1 \$40 for its subcontracting expense
 - NR1 subcontracts part of work to NR2 and pays NR2 \$40
 - Only the \$60 payment to NR1 and the payment to NR2 are subject to withholding
 - Total withholding = \$15
 - **Example 3:**
 - Same as example 2, but NR1 subcontracts work to a Canadian resident instead of NR2
 - No withholding on payment by NR1 to Canadian resident
 - Total withholding = \$9

Employee Secondments

- **Secondment arrangements:** An employee is lent by a non-resident employer (lending employer) on a temporary basis to an entity carrying on business in Canada (receiving employer)
- If seconded employee remains on lending employer's payroll and lending employer charges a fee to receiving employer there is a risk that lending employer will be carrying on business in Canada
- CRA's position is that Reg. 105 withholding will not apply to reasonable reimbursements made by the receiving employer to the lending employer provided there is a true secondment arrangement (IC 75-6R2)
 - Factors indicating a secondment arrangement: Signed agreements in writing, specified legal terms, receiving employer is responsible for salary and benefit-related costs and travel and relocation costs and there is no profit included in the charge-back.
 - Reasonable reimbursement includes remuneration, travel, accommodation, and per diem costs as well as an administrative overhead charge of \$250 per month per employee

Gross-ups

- Non-residents providing services may require that the customer make them whole for any Canadian tax
- Withholding must be calculated on the “grossed-up amount”
 - Formula: $(\text{withholding rate} \times \text{payment}) / (100\% - \text{withholding rate})$
 - On a 100 dollar payment: $(15\% \times \$100) / (100\% - 15\%) = \17.65
 - Total cost to payor is \$117.65
- If the customer expects to be entitled to any refund for withholding tax this should be dealt with in contract
- Consider the following contract terms:
 - Requirement for non-resident to repay customer any refund
 - Covenant by non-resident to file Canadian tax return and apply for refund
 - Representations as to treaty-entitlement
 - Require non-resident to calculate benefit of foreign tax credits
 - Procedure for dealing with CRA

Regulation 105: Waiver

- Subsection 153(1.1) of the ITA allows the Minister to reduce the amount of withholding where the withholding would result in “undue hardship”.
- In practice, the CRA will grant a waiver in circumstances where it can be shown that the non-resident would be entitled to a refund, notwithstanding that there may be no other “hardship”.
- Two types of waivers:
 - Treaty-based waiver
 - Income and expenses waiver
- Waiver will only be prospective. CRA recommends applying at least 30 days before services begin or initial payment is made.
- Payee applies for waiver using form R105E.

Treaty-based waiver

- Full waiver from Reg. 105 withholding
- Available in the following circumstances:
 1. Individuals (including from non-treaty countries) with income of less than \$5000 for the calendar year.
 2. Entities providing services under a single contract where term of engagement is less than 180 days.
 3. Entities providing services under a recurring contract where term of the current engagement is less than 180 days and the non-resident's total time in Canada is less than 240 days during the three immediately preceding and three immediately proceeding calendar years.
- 2 & 3 are subject to various exceptions, including where the non-resident has a deemed PE under a tax treaty.
 - For detailed list of exceptions see IC 75-6R2, Appendix A.

Income and expense waiver

- Allows for a reduction in the withholding rate.
- Non-resident must provide CRA with list of estimated income and expenses.
- If the non-resident's estimated Canadian tax liability is less than 15% the CRA may grant a waiver for the difference.
- CRA may require security for the amount that is waived.
- See IC 75-6R2, Appendix B for a list of expenses that the CRA will generally accept in calculating non-resident's estimated tax liability.

Regulation 105 - Compliance

- Payor must remit all amounts that have been withheld by the 15th of the month following the month in which the payment was made.
 - Failure to withhold may result in the payor being liable for the full amount required to have been withheld, interest calculated up until the day payment is made and a penalty of 10% (or 20% if the failure to withhold is made knowingly or in circumstances amounting to gross negligence) (ITA, 227(8),(8.1) and (8.3)).
 - Best practice is to include residency representation in any services contract.
- Payor must file T4A-NR Information Return by the last day of February in each year showing all amounts paid to non-residents, and must provide non-residents with a T4A-NR slip.

Regulation 105- Compliance and Refunds

- Non-residents who carry on business in Canada are required to file Canadian income tax returns (regardless of whether Reg. 105 waiver was obtained).
- If the non-resident is liable for Part I tax any amounts that are withheld under Reg. 105 will count towards the non-resident's Part I tax liability.
 - If non-resident is required to pay installments the CRA will administratively allow the non-resident to reduce the amount of the installments by amounts that have been withheld (IC 75-6R2).
- If the non-resident has no liability for Part I tax it will need to file a tax return to get a refund.
 - There is a three year limitation period to apply for a refund (ITA, 164(1)).
 - If the payor is assessed for failure to withhold the limitation period is extended until two years after the assessment (ITA, 164(1.5)(c)(i)).

Section 153 & Regulation 102

Section 153 & Regulation 102: Past, Present & Future

Past

- Increased audit activity in the area of Regulation 102
- Inadvertent non compliance
- Working panel reviewing the issues for 9 years
- Onerous waiver process, REG 102-J and REG 102-R
- T4 reporting required in all cases

Present

- April 2015 budget generally welcomed by business community
- July 31st introduced even further changes. Finance took into account prior comments of business community

Future

- Certification process effective January 1, 2016 for all eligible employers
- No w/h and reporting obligations for all Qualifying non resident employees under \$10K and under & under 45 work days
- CRA administrative process will be rolled out in fall 2015

Proposed Legislative Changes

Current legislation

1. Paragraph 153(1)(a) of the Act is replaced by the following:
 - (a) salary, wages or other remuneration, other than amounts described in subsection 115(2.3) or 212(5.1), and

Budget - April 2015

- (1) Paragraph 153(1)(a) of the Act is replaced by the following:
 - (a) salary, wages or other remuneration, other than
 - (i) amounts described in subsection 212(5.1), and
 - (ii) amounts paid at any time by an employer to an employee if, at that time, the employer is a qualifying non-resident employer and the employee is a qualifying non-resident employee,

Budget – July 31 2015

- (1) Paragraph 153(1)(a) of the Act is replaced by the following:
 - (a) salary, wages or other remuneration, other than
 - (i) amounts described in subsection 212(5.1), and
 - (ii) amounts paid at any time by an employer to an employee if, at that time, the employer is a qualifying non-resident employer and the employee is a qualifying non-resident employee,

Proposed Legislative Changes: Qualifying Non Resident Employer

Budget - April 2015

A **qualifying non-resident employer**, an employer (other than a partnership) is required to:

- be resident in a country with which Canada has a tax treaty; and
- not carry on business in Canada through a permanent establishment (PE) in its fiscal period that includes the time of the payment, and
- be certified by the CRA at the time of the payment.

For an employer that is a partnership to qualify, besides the second and third conditions noted above, at least 90% of the partnership's income for the fiscal period that includes the time of the payment must be allocated to persons that are resident in a treaty country.

Budget - July 2015

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- be certified by the CRA at the time of the payment.

For an employer that is a partnership to qualify, besides the second and third conditions noted above, at least 90% of the partnership's income for the fiscal period that includes the time of the payment must be allocated to persons that are resident in a treaty country.

Proposed Legislative changes: Qualifying Non Resident Employee

Budget - April 2015

Qualifying non-resident employee in respect of a payment if the employee is exempt from Canadian income tax on the payment because:

- (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 I in respect of the payment because of that treaty; and
- (c) is not present in Canada for 90 days or more in any 12-month period that includes that time.

Budget -July 2015

Qualifying non-resident employee in respect of a payment if the employee is exempt from Canadian income tax on the payment because:

- (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 a calendar year that includes that time or is present in Canada for less than 90 days (work & non work days) in any 12-month period that includes the time of the payment.

200.(1.1) No w/h and reporting obligations for all Qualifying non resident employees under \$10K and under & under 45 work days

Treaty Exemption – Employment Income

Article XV of Canada-US Tax Convention:

Remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first mentioned State if:

- a) Such remuneration does not exceed \$10,000 in the currency of that other State; OR
- b) The recipient is present in that other State for a period or periods not exceeding 183 days in any 12 month period commencing or ending in the fiscal year concerned, and the remuneration is not paid by, or on behalf of, a person who is a resident of that other State and is not borne by a permanent establishment in that other State.

Treaty exemption – Employment Income

- Meaning of “borne by” in the context of Article XV
- Difference between direct cost reimbursement and service fee (i.e. cost of services vs. cost for services)
 - CRA Views 2011-0403551E5 dated July 15, 2011
 - CRA Views 2011-0418281E5 dated January 23, 2012

Compliance Obligations – Personal Tax

- Necessary for individual to file Canadian non-resident personal tax return when:
 - Not eligible for a treaty exemption (i.e. they are subject to Canadian tax)
 - Intend to claim a refund of Regulation 102 withholding
- Where taxable in Canada, claim foreign tax credit on personal tax return in the home country

Presenters



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