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Tax Traps of US Business Travel

Tax Law

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The next time you travel to the US and a customs official asks whether your purpose is business or pleasure, consider the consequences. Outside the U.S., we are accustomed to rely upon income tax treaties to avoid foreign tax in the absence of a material foreign presence. And, we assume that foreign tax applies only to foreign source income. Certainly, we expect that when Americans come to Canada on business, they avoid personal Canadian income tax so long as they remain for less than 183 days. The corollary, however, does not hold true. The rules do not apply equally. And, if Canadians—individuals as well as the companies that employ them—are to sidestep the U.S. tax traps, we must first know they exist.

Both Canada and the U.S., together with most jurisdictions in this world, tax non-residents on business income, employment income and property income sourced from the particular jurisdiction. That is a matter of domestic law. Such laws are then modified by treaties designed to promote international trade and investment and to allocate the tax base among nations rationally and with some degree of uniformity. Typically, those treaties provide a six-month grace period for employees and, in the absence of a permanent establishment, wholly exempt the business income of their employers. The difficulty for Canadians and other foreigners entering the U.S. is that when the U.S. government signs a treaty, the state governments are not bound.

On the employee side, forty-one out of the fifty states tax out-of-state employees. Of these, twenty-four levy tax from the date on which that employee sets foot in the jurisdiction. The other seventeen have varying *de minimis* thresholds. Fly to Philadelphia for a conference and owe Pennsylvania tax on day one. Visit clients in New York City and enjoy a two-week grace period. It does not matter that your salary is paid by your Canadian employer and that neither you nor your employer have any income sourced in the state. The theory is that if you exercise your employment in that state then you should be taxed in that state: total annual employment income would likely—but not necessarily—be prorated by the number of days (or part days) spent in that state.

The employer then has a corresponding obligation to track the time spent by each employee in each state and apply: (i) a different method of quantifying the time spent in each state; (ii) a different method of quantifying the tax base for each state—that is, for determining the amount of income on which the employee is taxed; and, (iii) a different tax rate for each state. The employer must then file different paperwork for each state. This requires administration, which entails a not-insignificant cost.

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Third, the employer has its own tax liability to consider since, by definition, it carries on business in each state to which it sends its employees. One might object that if the employer has no revenue source in a given State then there is no income to tax. Unfortunately, this is the point at which the U.S. throws something at us called the "Unitary Business Principle". This principle traces its origins back to the 19th century when states won the right to levy property tax based on a railway company's value instead of the value of the tracks which crisscross its territory. Today, this principle enables states to apply income tax to a portion of worldwide profits based on the nebulous notion of "value flow", underpinned by such cryptic concepts as "functional integration", "centralization of management" and "economies of scale".

Accepting that there might be foreign tax payable, one might expect to recover the tax cost through foreign tax credits. This will work for Canadian employees since U.S. personal income tax is generally lower than Canadian personal income tax. Unfortunately for their incorporated employers, however, Canadian corporate tax rates are typically 13% lower than the U.S. equivalent: the effect is to bump up the employer's tax rate from about 26.5% to 40%.

This situation applies not only to non-residents of the U.S. but to Americans themselves. The problem is, in fact, greatest for U.S. businesses and Congress has responded by introducing the *Mobile Workforce State Income Tax Simplification Act* (known as the *Mobile Workforce Act*). The purpose of this Act is to reduce compliance costs by introducing uniformity among the states. Unfortunately, this legislation has been introduced, shot down and re-introduced every year for almost a decade. At present, the 2015 iteration remains alive, having passed committee stage last year. One hopes that this bill will finally become law.

In light of the above, what are Canadians to do?

The answer to that question is to think carefully about whether a Skype or conference call is a suitable substitute for a personal visit. If flying down for a conference, consider the tax laws of the state to which you are headed. And, when next flying south, be sure that you can truthfully answer that your purpose is pleasure.

* * This article is intended only to inform and educate. It is **not legal advice**. Be sure to contact a lawyer to obtain legal advice on any specific matter.

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