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Canadian Taxation of Non-Resident Employees

Multinational business requires multinational tax planning, for employees as well as employers. When sending employees abroad, it is generally up to the employer to minimize the employeesôforeign taxes and to ensure that all foreign taxes are paid and filings made. The following briefly describes the tax issues to be addressed when transferring or seconding employees to Canada.

What are the thresholds below which non-resident employees are not taxable in Canada?

The general rule under Canadaôs typical tax treaty is that a non-resident employee is exempt from Canadian income tax if three conditions are met:

(i) the employee is present in Canada for no more than 183 days in any 12-month period beginning or ending in the fiscal year concerned;
(ii) the employeeôs remuneration is paid by or on behalf of an employer who is not a resident of Canada; and
(iii) the employeeôs remuneration is not borne by a Canadian permanent establishment of the non-resident employer.

- *183 days*

On a strict reading, a non-resident employee could be subject to Canadian income tax for two taxation years because of time spent in Canada during a single 12-month period. This situation arises because a single 12-month period would frequently begin in one taxation year and end in another. It is, however, understood that the Canada Revenue Agency (ñ**CRA**ò) would only tax a non-resident for a single taxation year notwithstanding that the particular 12-month period touches upon two.

This concept of a rolling 12-month period was introduced by the Organisation for Economic Co-operation and Development (**OECD**) in their *Model Tax Convention with Respect to Taxes on Income and on Capital* (ñ**OECD Model Convention**ò). According to the OECDôs technical notes, the phrase ñ12-month period beginning or ending in the fiscal year concernedò is intended to catch situations in which the employeeôs time is allocated between taxation years. Canadaôs treaties that include language similar to that introduced by the OECD Model Convention include those with the U.S., France and Germany. Under Canadaôs treaty with the U.K., the criterion refers to ñ183 days in the calendar year concernedò. A U.K. resident could therefore be exempt from Canadian income tax despite being present in Canada for 364 consecutive days if the 182nd day were December 31st.

- *"Employer"*

Canadaôs treaty with the U.S. differs from its treaties with other countries, including the U.K., France and Germany, by substituting ñpersonò for ñemployerò in the second criterion. Under the U.S. treaty, then, it is irrelevant whether the Canadian-resident payor is the employer. If a non-resident employee exercises its employment in Canada and is paid by or on behalf of a person resident in Canada then that employee will be subject to Canadian income tax.

Under Canadaôs other treaties, such as those with the U.K., France and Germany, the employee is taxed in Canada if the Canadian-resident payor is the employer. Whether a person is an ñemployerò is determined under the domestic laws of the source country.

Canadaôs laws in this regard apply a substance over form approach. If a Canadian resident is the employer in fact then the

employee will be taxable in Canada notwithstanding formal documentation to the contrary.

- *"Borne by"*

The third criterion applies to situations in which the non-resident employer allocates the cost of the employeeõs remuneration to a Canadian branch. If the branch deducts the amount of that remuneration from its taxable Canadian income then the branch is considered to have ñborneò that cost and the exemption will not be available.

- *De minimus exemption*

Canadaõs treaty with the U.S. also differs from its treaties with other countries by providing a *de minimus* exemption: if a non-resident employeeõs remuneration in respect of employment exercised in Canada is CDN$10,000.00 or less in a given calendar year then that employee is not subject to Canadian income tax. Unfortunately, this exemption is not available to residents of Germany, the U.K. or France.

What are the employer's withholding and remittance obligations?

Employers are required to withhold and remit Canadian income tax regardless of whether a treaty exemption applies. If, however, a treaty exemption is available, the employee or the employer (with the employeeõs authorization) may apply for a waiver. The waiver application should be made 30 days before employment in Canada begins and must provide information as to the applicability of the treaty exemption relied upon, a copy of the employment contract and sufficient information or documentation to satisfy the CRA that the employee is resident in the treaty jurisdiction. If a waiver is made after remuneration is paid to the employee then the waiver will only apply to subsequent payments.

This waiver applies only to the employerõs withholding and remittance obligations. The employer is still legally required to open a Canadian payroll account with the CRA, to issue a T4 slip to each employee who comes to Canada and to file copies, together with a T4 Summary, with the CRA. The T4 slip is the document on which an employer reports to each employee the amount of their Canadian taxable income and the amount of Canadian income tax withheld and remitted. The argument for maintaining these obligations in the face of a waiver is that employees must have their T4 Slips to file with their Canadian income tax returnsõ which, the CRA submits must be filed notwithstanding that no Canadian income tax is payable and the penalty for failing to file would be nil.

Regarding social security payments, Canadaõs social security agreements with other countries exempt non-resident employers from the obligation to withhold and remit contributions to the Canada Pension Plan. In order to qualify for these exemptions, the period of the non-resident employeeõs employment in Canada cannot exceed specified time limits. In respect of employees resident in the U.S., the U.K. or Germany, the period of employment is not to exceed 5 years. Under the agreement with France, the period is 3 years.

Finally, premiums are not payable into Canadaõs mandatory employment insurance program if premiums in respect of the employment exercised in Canada are payable under the unemployment insurance laws of the non-resident employeeõs home jurisdiction.

What are the employee's filing obligations?

As stated above, non-resident employees are legally required to file Canadian income tax returns regardless of whether the above waiver has been obtained. However, since the penalty for failing to file is calculated as a percentage of the tax owing, the penalty applicable to an individual for failing to file would be zero.

In the absence of a waiver, the issue for non-resident employees is the potential for double taxation until a foreign tax credit can be obtained the following year in the employeeõs home jurisdiction. A typical solution is for an employer to pay the Canadian income tax

on behalf of the employee. This creates a taxable benefit which in turn increases the tax liability, the tax paid by the employer and so, again, the taxable benefit. This circularity is addressed by ñgrossing upò the tax payment made by the employer by an appropriate percentage. The tax cost to the employer would therefore be greater than would otherwise have applied to the employee. A more cost effective alternative is for the employer to lend the amount of the tax to the employee. The loan would be repaid upon the employeeôs receipt of the foreign tax credit in their home jurisdiction.

About the Author
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Patrick Westaway is Tax Counsel to Sorbara, Schumacher, McCann LLP, one of the largest and most respected regional law firms in Ontario. Patrick advises on a broad range of Canadian taxation issues such as corporate tax planning, structuring inbound investments, corporate reorganizations, cross-border financings, tax opinions for public disclosure documents, tax assessments, personal tax matters, wealth preservation, and on federal and provincial sales tax matters (HST/GST/PST). Patrick also practices corporate and commercial law with an emphasis on the implementation of matters related to his tax planning practice.

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