SPECIAL REPORT

Canadian Tax Considerations of Nonresidents Providing Services in Canada

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The author looks at the applicability of Canadian income tax legislation to business income earned in Canada by nonresident entities and nonresident individuals, and to employment income earned by nonresident individuals. The author also discusses the Canadian withholding and remittance requirements that may apply to payments made to nonresidents. Finally, the author outlines the Canadian tax reporting requirements regarding these obligations.

A nonresident of Canada is liable for Canadian income tax for a tax year under the Income Tax Act (Canada) only if the nonresident was employed in Canada, disposed of taxable Canadian property,[1] or carried on a business in Canada.[2]

When a nonresident who would be liable for tax under the ITA for a tax year as a result of carrying on business or being employed in Canada qualifies for benefits[3] under a tax treaty between Canada and the nonresident's country of residence, the treaty may exempt the nonresident from Canadian tax if certain conditions are met. For example, if a nonresident who carries on business in Canada in a tax year qualifies for benefits under an applicable tax treaty with Canada, the nonresident will not be taxed in Canada on its profits from that business unless the nonresident carries on that business through a permanent establishment situated in Canada. Canadian tax liability and potential treaty relief applicable to a nonresident who carries on business in Canada or who is employed in Canada are discussed below in sections I.B and I.C.

[1]The disposition of taxable Canadian property (TCP) by a nonresident is a separate topic that is beyond the scope of this article; accordingly, this article will not address dispositions of TCP by a nonresident. For a discussion of the Canadian tax treatment of TCP dispositions by nonresidents, see Steve Suarez and Marie-Eve Gosselin, ''Canada's Section 116 System for Nonresident Vendors of Taxable Canadian Property,'' *Tax Notes Int'l*, Apr. 9, 2012, p. 175.

(Footnote continued in next column.)

[2]In contrast, a Canadian resident person (whether a corporation, an individual, or a trust) is liable to pay Canadian income tax under the ITA on worldwide income and net taxable capital gains (50 percent of net capital gains) from any source.

[3]To qualify for benefits under a tax treaty with Canada, the nonresident must be resident in the foreign treaty country under the terms of the treaty (generally, this means that the nonresident must be comprehensively liable to tax on the nonresident's worldwide income in the foreign treaty country). Under the Canada-U.S. income tax treaty, the nonresident must also ensure that the limitation on benefits provision in Article XXIXA of the treaty does not restrict or deny treaty benefits. Depending on the type of income received, the antiavoidance provisions in a particular tax treaty with Canada may restrict treaty benefits on payments between non-arm's-length persons in some circumstances (see, for example, Article XII(7) of the Canada-U.S. treaty).

Regardless of whether a nonresident is exempt from liability for Canadian income tax under an applicable tax treaty, payments received by the nonresident may be subject to Canadian withholding tax. The two types of payments that can be subject to Canadian withholding tax are fee income (or similar types of income) and employment income.

If a nonresident is paid a fee, commission, or other amount for services rendered in Canada, the payer (whether Canadian resident or nonresident) is generally required to withhold and remit 15 percent of the gross amount of the payment to the Canada Revenue Agency on account of the nonresident's future Canadian tax liability. Withholding in this case is required even if the nonresident is exempt from Canadian tax under an applicable tax treaty, unless a waiver of the withholding requirement is obtained from the CRA before making the payment. This services withholding requirement is discussed in Section II.A.

If a nonresident employee receives remuneration for employment performed in Canada, the employer (whether Canadian resident or nonresident) is generally required to withhold and remit normal employee payroll deductions regarding that remuneration to the CRA. Withholding is required even if the nonresident employee is exempt from Canadian tax under an applicable tax treaty between Canada and the nonresident employee's country of residence, unless a waiver of the withholding requirement is obtained from the CRA before making the payment. This employee payroll withholding requirement is discussed in Section II.B. Employee transfers and secondments to Canada raise specific issues, which are discussed in Section II.C.

A nonresident may be subject to a 25 percent Canadian nonresident withholding tax under Part XIII of the ITA on the receipt of service type payments from Canadian residents, such as management or administration fees or certain royalties, unless the withholding tax is reduced or eliminated under an applicable tax treaty between Canada and the nonresident's country of residence. Part XIII nonresident withholding tax on service-type payments is discussed in Section III.

I. Nonresident Services in Canada

This section discusses:

- who is considered to be a nonresident of Canada;
- when is business income of a nonresident subject to Canadian tax;
- what constitutes a business carried on through a PE in Canada;
- employment in Canada;
- whether the person is an employee or an independent contractor;
- Canadian tax liability and treaty relief; and
- Canadian tax reporting.

A. Nonresident or Canadian Resident?

Generally, a corporation incorporated outside Canada (and that has not been continued into Canada under Canadian federal or provincial laws)[4] is considered to be nonresident for Canadian tax purposes, except if the corporation's central management and control is exercised in Canada. Central management and control of a corporation is considered to be exercised in Canada if the directors of the corporation (or other persons who have the legal power to manage and control the corporation) meet and exercise the management and control in Canada. If the corporation's central management and control is situated in Canada, the corporation is considered to be resident in Canada for Canadian tax purposes unless the corporation qualifies as a resident of another country under the terms of an income tax treaty with Canada; in that case the corporation would be deemed under the ITA not to be resident in Canada for Canadian tax purposes.[5]

A corporation incorporated in Canada is generally considered to be resident in Canada for Canadian tax purposes unless it was continued under the laws of a jurisdiction outside Canada or determined to be resident in another country under the terms of a tax treaty with Canada.

A trust established under the laws of a foreign country is generally considered to be nonresident as long as its central management and control is situated outside Canada.[6]

An individual is generally a nonresident of Canada if he does not ordinarily reside in Canada,[7] is not physically present in Canada for a total of 183 days or more in any year, and does not have significant residential ties in Canada.[8]

A partnership, whether created under provincial/territorial or foreign law, is fiscally transparent for purposes of the ITA and therefore is not liable for Canadian income tax. A partner of the partnership who is

[4]*See* the rule in subsection 250(5.1) of the ITA.

[5]Subsection 250(5) of the ITA.

[6]The Supreme Court of Canada upheld the use of a central management and control test to determine the residence of a trust for Canadian tax purposes in *Garron Family Trust (Trustee of) v. The Queen*, 2012 DTC 5063 (SCC), *aff'g* 2010 DTC 5189 (FCA), *aff'g* 2009 DTC 1568 (TCC).

[7]The courts have held that ordinary residence is ''a matter of the degree to which a person in mind and fact settles into or maintains or centralizes his ordinary mode of living with its accessories in social relations, interests and conveniences at or in the place in question''; *see Gaudreau v. The Queen*, 2005 DTC 66 (TCC), *aff'd*, 2005 DTC 5702 (FCA); and Interpretation Bulletin IT-221R3 (Consolidated), ''Determination of an Individual's Residence Status,'' at paras. 2 and 10.

[8]According to the CRA, significant residential ties to Canada include a home, a spouse, a common law partner, or dependents in Canada; *see* Interpretation Bulletin IT-221R3 (Consolidated), *supra* note 7, at para. 49.

resident in a non-treaty country is taxable in Canada on its share of the partnership's income for a tax year if the nonresident is considered to carry on business in Canada in that year, while a partner who is resident in a country that has a tax treaty with Canada is taxable in Canada on its share of the partnership's income for a tax year only if the nonresident carried on business in Canada in that year through a PE situated in Canada. If a partner of a partnership is considered to carry on the business of the partnership,[9] in Canada, the partner will be liable for Canadian tax on the partner's share of the partnership's income unless treaty relief is available. As discussed in Section III, a partnership may in some circumstances be deemed to be a Canadian resident person or a nonresident person for purposes of Part XIII nonresident withholding tax.

B. Nonresident Business Income

1. Is There a Business?

The first question to be asked is whether the nonresident is carrying on business at all. If, for example, the nonresident provides services in Canada but does not charge a fee for those services (or charges only its cost), is the nonresident really carrying on business?

A business is defined broadly but non-exhaustively in the ITA to include a profession, calling, trade, manufacture, or undertaking of any kind whatsoever and, except for specific purposes of the ITA, an adventure or concern in the nature of trade. However, a business does not include an office or employment.[10]

The Supreme Court of Canada confirmed that the term ''business'' does not require a reasonable expectation of profit, and cited the traditional common law definition of business as ''anything which occupies the time and attention and labour of a man for the purpose of profit.''[11] The Court also established a two-step test for determining the existence of a business.[12] First, is the activity undertaken solely for profit, or is it a personal endeavor? When the activity has no personal element and is clearly commercial, no further inquiry is required: The activity necessarily involves the pursuit of profit. Second, if the activity contains a personal element, is it carried on in a commercial manner so as to constitute a potential source of income?

If it is determined that the nonresident is carrying on a business, the next step is to determine where that business is carried on.

2. Is the Business Carried On in Canada?

Business income of a nonresident is subject to Canadian tax only if it is attributable to a business of the nonresident that is carried on in Canada. The question of where a business is carried on for Canadian tax purposes is generally determined under common law principles, although the ITA also has a deeming rule that extends its meaning.

a. The Common Law. Canadian courts have employed numerous tests to determine whether a corporation is carrying on business in Canada. The two most common tests are the ''place of contract'' and the ''place of operations/place where profits are earned,'' which are discussed below.

i. Place of contract: Initially, the jurisprudence suggested that the place where the contracts were made was the most important factor in determining the situs of a business.[13] For the purposes of this test, the courts generally focus on the profit-making contracts and do not consider preliminary or ancillary contracts.[14] The place where a contract is made depends on where the offer and acceptance were made and the means by which they were communicated.

ii. Place of operations/place where profits are earned: Although the place of contract is generally recognized as the principal factor in determining the situs of a business, the courts have also considered other factors that, in some cases, have overridden the place of contract test.[15] Generally, the place of operations and the place where the profits are earned will also be considered. The CRA maintains that regarding a provision of services, the place where the services are performed is an important consideration.[16]

The courts consider all the relevant facts and circumstances of the business to determine the place of operation from which the business profits in substance arise.

b. ITA — Extended Meaning of Carrying On Business in Canada. The ITA extends the meaning of carrying on business in Canada for Canadian tax purposes to include, among other activities,[17] producing, growing, or manufacturing anything in Canada and soliciting orders or offering anything for sale in Canada.

If a nonresident carries on a business in Canada, the next question to be answered is whether the business is carried on through a PE in Canada.

3. Is the Business Carried On Through a PE in Canada?

The general principle that a nonresident who carries on business in Canada is liable for Canadian income tax on Canadian business profits is modified when the

[9]Except for specific purposes of the ITA; *see* section 253.1 of the ITA.

[10]Subsection 248(1) of the ITA.

[11]*Stewart v. The Queen*, 2002 DTC 6969 (SCC), at para. 38.

[12]*Id.* at para. 50.

[13]*Werle v. Colquhoun*, 1888, 2 TC 402, at 408 (CA).

[14]*Cutlers Guild Ltd. v. Her Majesty The Queen*, 81 DTC 5093 (FCTD).

[15]*See, e.g.*, *The Queen v. London Life Insurance Co.*, 90 DTC 6001 (FCA).

[16]Interpretation Bulletin IT-270R3, ''Foreign Tax Credit,'' Nov. 25, 2004, at para. 23.

[17]Section 253 of the ITA.

nonresident qualifies for benefits[18] under a tax treaty between Canada and the nonresident's country of residence. In that case, the nonresident's business profits are taxable in Canada only if the nonresident carries on business in Canada through a PE situated in Canada, and only to the extent of the income attributable to the PE.[19]

a. Fixed Place of Business. The definition of a PE in Canada's income tax treaties is generally based on article 5 of the OECD model income tax convention.

Article V(1) of the Canada-U.S. treaty, for example, defines a PE to be a fixed place of business through which the business of the nonresident is wholly or partly carried on. Article V(2) provides a nonexhaustive list of what constitutes a PE, including 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 mineral resources.

Under Article V(3), a building site or construction or installation project constitutes a PE if it lasts more than 12 months.

b. Use of Space. In one of the leading Canadian cases on the question of what constitutes a PE, the Federal Court of Appeal held that a nonresident's use of a Canadian entity's facilities did not constitute a PE for the nonresident when the facilities could be used by the nonresident only during the Canadian entity's normal office hours and only for the purpose of performing services for the Canadian entity that were required under a contract.[20]

Nevertheless, the commentary to article 5 of the OECD model treaty acknowledges that a nonresident may have a place of business where it does not have its own premises but it has a certain amount of space at its disposal (regardless of whether the space is owned, rented, or merely at its disposal at a third party's premises such as a client's premises). The nonresident's place of business may be situated in the business facilities of another enterprise where, for example, the nonresident has at its constant disposal certain premises owned by the other enterprise.

c. Exclusion for Preparatory or Auxiliary Activities. Article V(6) of the Canada-U.S. treaty provides that a PE in Canada does not include a fixed place of business in Canada used solely for, or an agent referred to in Article V(5) (discussed below) engaged in Canada solely in, certain activities such as the use of storage facilities, purchase of goods, advertising, or scientific research.

d. Deemed PE in Canada.

i. Dependent agent in Canada habitually exercising authority to contract: Article V(5) of the Canada-U.S. treaty provides that an agent in Canada who has the power to bind a U.S. resident to contractual arrangements is deemed to be a Canadian PE of the U.S. resident, subject to an exclusion for an agent of an independent status to whom Article V(7) applies. Article V(7) states that a U.S. resident will not be deemed to have a PE in Canada merely because the U.S. resident carries on business in Canada through a broker, general commission agent, or any other agent of an independent status, provided that those persons are acting in the ordinary course of their business.

ii. Providing substantial services in Canada: The Canada-U.S. treaty contains an additional deemed PE rule, introduced by the treaty's fifth protocol.[21] As of January 2015, it is the only Canadian tax treaty to have such a provision. Subject to two other PE rules, when a U.S. resident who provides services in Canada is not found to have a PE in Canada by virtue of any other rule in Article V, Article V(9) generally deems the U.S. resident to provide those services through a PE in Canada if either:

- those services are performed in Canada by an individual who is present in Canada for an aggregate of 183 days or more in any 12-month period, and during that period more than 50 percent of the gross business income of the enterprise consists of income derived from the services performed in Canada by that individual; or
- those services are provided in Canada for an aggregate of 183 days or more in any 12-month period[22] regarding the same or a connected project for customers who are either residents of Canada or who maintain a PE in Canada, and the services are provided regarding that PE.

4. Canadian Tax Liability and Treaty Relief

If a nonresident corporation carries on business in Canada through a PE situated in Canada, it will be subject to two levels of Canadian tax. First, corporate income tax based on the combined federal and applicable provincial tax rates will be levied on profits derived from the Canadian PE. Second, branch tax at 25 percent under the ITA will be levied on all profits earned by the PE that are not reinvested in the Canadian operations.[23] The branch tax is intended to be a

[18] *See supra* note 3.

[19] *See, e.g.*, Article VII of the Canada-U.S. treaty.

[20] *Dudney v. The Queen*, 2000 DTC 6169 (FCA).

[21] The fifth protocol was signed on September 21, 2007, and came into force upon completion of the ratification procedures on December 15, 2008. The amendment adding Article V(9) to the Canada-U.S. treaty applies to services rendered or business revenues that occur or arise on or after January 1, 2010. Article V(9) was added to overrule the decision in *Dudney*, *supra* note 20.

[22] Note that for purposes of this test, a particular calendar day counts as only one day no matter how many persons are present in Canada on that day. For example, if a U.S. employer has 12 employees in Canada on July 15, that counts as only one day for purposes of the 183-day test.

[23] Section 219 of the ITA.

proxy for Part XIII Canadian nonresident withholding tax on dividends paid by a Canadian subsidiary to its nonresident parent corporation. Canada's tax treaties generally reduce the branch tax rate to the treaty rate applicable for dividends (5 to 15 percent) and may provide some relief from the tax. For example, under the Canada-U.S. treaty, the rate is reduced to 5 percent, and the first C $500,000 of after-tax profit is exempt from the branch tax.[24]

If a nonresident individual carries on business in Canada through a PE situated in Canada, he will be subject to federal income tax at marginal rates that increase with the amount of taxable income, as well as the relevant provincial/territorial taxes, which are usually calculated as a percentage of federal income tax payable. The combined federal-provincial income tax rates for individuals vary by province/territory.

5. Canadian Tax Reporting

A nonresident corporation that carries on business in Canada in a tax year is required to file a corporate income tax return regardless of whether any tax is payable for the year, or whether any business profits it realizes may be exempt from Canadian tax because of a treaty. The corporate income tax return must be filed no later than six months after the end of the corporation's fiscal year.[25]

A nonresident individual who carries on business in Canada in a tax year is required to file an income tax return for the year only if he has Canadian tax payable for the year.[26]

A nonresident will be subject to late-filing penalties and interest if a tax return required to be filed for a tax year is not filed by the filing due date.[27]

A nonresident carrying on business or providing services in Canada is generally also required to register for the purposes of collecting and remitting Canadian goods and services tax/harmonized sales tax. The GST/HST considerations associated with a nonresident's activities in Canada are beyond the scope of this discussion.[28]

C. Nonresident Employment Income

1. Employee or Independent Contractor?

Canadian courts and the CRA have provided guidance on distinguishing between an employee and an independent contractor for Canadian tax purposes when an individual rather than a corporation is providing services. The distinction is important for tax purposes for a number of reasons. If a service provider is an employee (whether Canadian resident or nonresident), the employee is subject to Canadian tax on Canadian employment income, unless a treaty exemption applies as discussed below. Also, the employer (whether Canadian resident or nonresident) is required to withhold and remit to the CRA normal employee payroll deductions from any remuneration paid to an employee who performs any services in Canada, as discussed in Section II.B of this article. On the other hand, if a nonresident that provides services in Canada is an independent contractor, the individual is subject to Canadian tax on the income earned from the contractor's business carried on in Canada, as outlined in Section I.B. Further, payments to the nonresident for those services are subject to services withholding as discussed in Section II.A.

a. Jurisprudence. The Supreme Court of Canada[29] has noted that there is no universal test for determining whether a person is an employee or an independent contractor. Rather, the central question is whether the person has been engaged as a person in business on his own account. Nevertheless, the courts have established several guidelines for determining whether an individual is an independent contractor or employee.

b. CRA Administrative Views. The CRA has published its own detailed guidelines for determining whether a relationship is one of independent contractor or employee based on the factors developed by the courts and the intentions of the parties. Although not law, these guidelines are useful indicators of how the CRA would likely assess a particular relationship.[30]

2. Canadian Tax Liability and Treaty Relief

A nonresident individual is subject to income tax under the ITA for a tax year if he was employed in Canada in that year.[31]

However, the provisions of an applicable tax treaty between Canada and a nonresident employee's country of residence may exempt a nonresident employee from Canadian income tax on remuneration received for employment duties performed in Canada. For example, Article XV of the Canada-U.S. treaty *exempts* a U.S. resident's remuneration from tax in Canada where either:

- the remuneration does not exceed C $10,000; or
- the recipient of the remuneration is present in Canada for less than 184 days in any 12-month period beginning or ending in the tax year and the remuneration is not paid by, or on behalf of, a

[24]Article X(6)(d) of the Canada-U.S. treaty.

[25]Para. 150(1)(a) of the ITA.

[26]Para. 150(1)(d) of the ITA.

[27]*See* sections 161 and 162 of the ITA. The maximum penalty under subsection 162(2.1) for a nonresident corporation's failure to file a tax return by the filing due date is C $2,500 for each year that the return is not filed.

[28]For a general discussion of the application of GST/HST to nonresidents, see Camille Kam, ''Nonresidents and Canada's VAT System,'' *Tax Notes Int'l*, Aug. 20, 2012, p. 771.

[29]*671122 v. Sagaz Industries Canada Inc.*, [2001] SCR 983 (SCC).

[30]*See* CRA Guide RC4110, ''Employee or Self Employed?''

[31]Subsection 2(3) and subpara. 115(1)(a)(i) of the ITA.

Canadian resident person and is not borne by a PE in Canada (that is, it is not deductible as an expense of a PE in Canada).

3. Canadian Tax Reporting

A nonresident individual who is employed in Canada in a tax year is required to file an income tax return for the year if he has Canadian tax payable for the year.

II. Canadian Withholding

A. Payments to Nonresident Contractors

This section discusses:

- when the withholding requirement applies;
- what services are caught;
- what payments are excluded;
- how bundled contracts are treated;
- when a waiver from withholding can be requested and obtained;
- what the remittance and reporting requirements are; and
- when a refund of amounts withheld can be obtained.

1. When Does the Withholding Requirement Apply?

The ITA imposes a broad withholding and remittance obligation (known generally as Regulation 105 withholding),[32] which requires every person (whether resident or nonresident) paying to a nonresident person a fee, commission, or other amount (other than employment income[33] or certain other specified amounts) for services rendered in Canada, of any nature whatever, to withhold and remit 15 percent of the payment to the CRA.[34] The Regulation 105 withholding obligation may be waived in some circumstances as discussed in Section II.A.5. If the services for which the nonresident receives payment are rendered in the province of Québec, the payment is subject to an additional 9 percent withholding tax[35] unless a separate waiver is obtained directly from the Québec taxing authorities.

2. What Services Are Caught?

Canadian courts have held that Regulation 105 withholding applies to an amount paid to a nonresident for services rendered in Canada to the payer, even when the services are performed by another person (for example, a subcontractor of the nonresident).[36] For example, one court concluded that Regulation 105 withholding applied to amounts paid by a Canadian resident for services rendered in Canada by another Canadian resident who had subcontracted with its nonresident parent company to provide the services, because the payer was contractually obligated to pay the nonresident contractor (and not the Canadian subcontractor) for the services.[37]

Subcontracting arrangements can also generate cascading Regulation 105 withholding obligations when the subcontractor is nonresident, since any payment made by a nonresident contractor to the nonresident subcontractor for services performed by the subcontractor in Canada would also be subject to Regulation 105 withholding. (See figure.)

However, with appropriate structuring of contractual arrangements (such as through reimbursement arrangements as described below), cascading Regulation 105 withholding obligations arising from the engagement of multiple service providers regarding services rendered in Canada may be avoided.

3. Reimbursement of Costs and Expenses Excluded

The Tax Court of Canada has held that the fees, commissions, or other amounts for services rendered in Canada subject to Regulation 105 withholding must be limited to amounts having the character of income earned in Canada by nonresident recipients, since only those amounts are potentially subject to tax under the ITA.[38] Accordingly, Regulation 105 may not apply to some reimbursements.

4. Bundled Contracts

Contracts often bundle services with the provision of goods, or may provide for services to be partly performed in Canada and partly performed outside

[32]Para. 153(1)(g) of the ITA and section 105 of the Income Tax Regulations (Regulation 105).

[33]Payments described in the definition of remuneration in subsection 100(1) of the Income Tax Regulations are excluded from Regulation 105 withholding, because those payments are subject to the employee payroll deduction withholding requirements discussed in Section II.B. Remuneration is defined in subsection 100(1) of the Income Tax Regulations to include all income and taxable benefits from an office or employment, for example, salary and wages, commissions and other similar amounts, bonuses, stock options, superannuation and pension benefits, and retiring allowances. Also explicitly excluded from withholding under Regulation 105 are payments made to a registered nonresident insurer and payments made to an authorized foreign bank regarding its Canadian banking business.

[34]Excluding any GST/HST charged regarding services rendered in Canada by a nonresident.

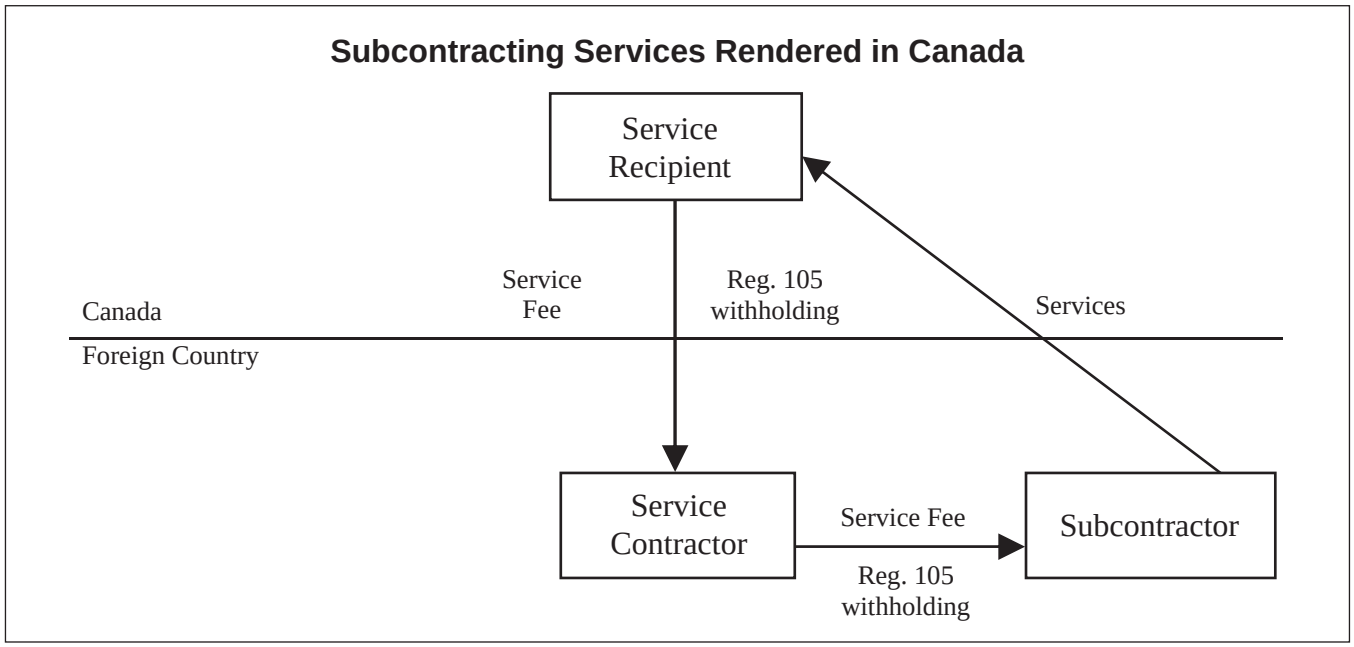
[35]*See* section 1015R18 of the Regulation Respecting the Taxation Act (Québec). Withholding is not required if the payment is made:

- in the course of regular and continuous employment;
- to a registered nonresident insurer within the meaning of section 804 of the Income Tax Regulations; or
- to an authorized foreign bank regarding its Canadian banking business.

[36]*Ogden Palladium Services (Canada) Inc. et al. v. The Queen*, 2001 DTC 345 (TCC), *aff'd*, 2002 DTC 7378 (FCA).

[37]*FMC Technologies Co. v. The Queen*, 2008 DTC 6560 (FC), *aff'd*, 2009 DTC 6064 (FCA), leave to appeal to Supreme Court of Canada refused, 2010 Carswell Nat 33 (SCC).

[38]*Weyerhaeuser Company Ltd. v. The Queen*, 2007 DTC 392 (TCC).



Canada (or some services to be performed in Canada and other services to be performed outside Canada). These contracts need to be carefully drafted to minimize the applicable Regulation 105 withholding. Any fees for services that are provided in Canada by a non-arm's-length nonresident are also subject to Canadian transfer pricing rules.

5. Waiver From Regulation 105 Withholding

Regulation 105 withholding does not represent a final tax; rather, it is a payment on account of the nonresident's Canadian tax liability under Part I of the ITA for the year. If the nonresident is resident in a treaty country and does not carry on business in Canada through a PE situated in Canada, the nonresident may apply to the CRA for a treaty-based Regulation 105 waiver. If granted, this waiver will relieve the payer from the Regulation 105 withholding obligation on payments made to the nonresident (but not from the reporting obligations noted in Section II.A.6).

To apply for a treaty-based Regulation 105 waiver, the nonresident must be able to establish both residence in a treaty country and entitlement to treaty benefits. The CRA will evaluate complete applications according to its published administrative guidelines for granting treaty-based waivers.[39] The receipt of a Regulation 105 waiver relieves the payer from withholding only regarding specified payments made to the nonresident. However, the nonresident is still required to make any secondary-level withholdings that may be required under Regulation 105 (for example, on payments made by the nonresident to nonresident subcontractors for services rendered in Canada) or under Regulation 102 (for example, on payments made by the nonresident to employees employed in Canada) unless a waiver is obtained regarding such secondary withholding requirements.

A payee that does not qualify for a treaty-based Regulation 105 waiver may instead apply for an income and expense waiver to reduce the required Regulation 105 withholding if the withholding would otherwise exceed the payee's ultimate tax liability based on estimated income and expenses relating to the services to be provided in Canada.[40]

Regardless of whether a Regulation 105 waiver is obtained, the payer generally must comply with the reporting requirements described in Section II.A.6. Also, the receipt of a Regulation 105 waiver does not affect the requirement of a nonresident payee to file a Canadian income tax return for a tax year as described in Section I.B.5.

6. Remittance and Reporting

Payers are generally required to remit the amount withheld to the CRA by the 15th day of the month following the month in which the amount was paid to the nonresident,[41] and to comply with specified reporting requirements, including issuing a T4A-NR slip to

[39] *See* the CRA's Guidelines for Treaty-Based Waivers Involving Regulation 105 Withholding, *available at* http://www.cra-arc.gc.ca/tx/nnrsdnts/cmmn/rndr/trty_gdlns-eng.html.

[40] *See* Information Circular 75-6R2, ''Required Withholding From Amounts Paid to Non-Residents Providing Services in Canada,'' Feb. 23, 2005, Appendix B.

[41] Section 108 of the Income Tax Regulations.

each nonresident.[42] Regardless of whether a waiver from the Regulation 105 withholding obligation is obtained as described in Section II.A.5, the payer must comply with these reporting requirements if the total of all payments in the calendar year exceeds C $500.[43]

Payers are responsible for determining whether payments are being made to a nonresident for services rendered in Canada, and are liable for amounts not withheld or remitted as required, along with interest and penalties.[44] Note that a payment made to a Canadian branch of a nonresident corporation for services rendered in Canada is subject to Regulation 105 withholding. Similarly, payments for services rendered in Canada by a joint venture or partnership with a nonresident participant or member would be subject to Regulation 105 withholding based on the nonresident's participation or membership.[45]

When the payer is contractually obligated to make a payment to the CRA on behalf of a nonresident that is equivalent to the Regulation 105 withholding amount otherwise required to be deducted from a payment to the nonresident, the payer is required to calculate the withholding on a grossed-up amount.

7. Refund of Amounts Withheld

If a Regulation 105 waiver is not obtained before the first payment for services is made, the payer must make the required Regulation 105 withholding, remit it to the CRA, and comply with the reporting requirements described in Section II.A.6. The CRA will apply this withholding against the nonresident's Canadian tax liability for the year. If the amount withheld under Regulation 105 exceeds the amount of Canadian tax owing by the nonresident (or no tax is owing), the excess will be refunded to the nonresident.

B. Withholding on Remuneration to Employees

This section discusses:

- when the withholding requirement applies;
- what remuneration is caught;
- how directors' fees are treated;
- when a waiver from withholding can be requested and obtained;
- what the remittance and reporting requirements are; and
- when a refund of amounts withheld can be obtained.

1. When Does the Withholding Requirement Apply?

The ITA imposes a withholding and remittance obligation regarding payroll deductions[46] (generally known as Regulation 102 withholding) on any person (whether Canadian resident or nonresident) paying salary, wages, or other remuneration in a tax year to:

- any Canadian resident employee regardless of whether the employment duties are performed inside or outside Canada;[47] and
- any nonresident employee that performs employment duties in Canada.[48]

The Regulation 102 withholding obligation may be waived in some circumstances as discussed in Section II.B.4.

2. What Remuneration Is Caught?

Regulation 102 withholding applies to all types of employee remuneration, including noncash taxable employee benefits such as stock options.[49] For a nonresident employee, if the services are performed partly in Canada and partly outside Canada, the payer is responsible for allocating the remuneration paid to the services performed in Canada on a reasonable basis. When an employment contract provides that the employer will pay for some or all of the potential Canadian tax liability of the nonresident employee regarding the employment services rendered in Canada, according to

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[42]Sections 200 and 205 of the Income Tax Regulations. A nonresident who has inadvertently failed to remit or report past payments should consider speaking to a tax adviser about the possibility of filing a voluntary disclosure with the CRA to avoid penalties for noncompliance.

[43]*See* CRA Guide RC4157, ''Deducting Income Tax on Pension and Other Income, and Filing the T4A Slip and Summary.''

[44]Subsections 227(8), (8.3), and (8.4) of the ITA. Under section 227.1 of the ITA, when a corporation fails to withhold or remit as required, the corporation's directors at the time of the failure may be held jointly and severally, or solidarily, liable along with the corporation to pay the amount due, including penalties and interest (subject to a due diligence defense). A payer who has failed to withhold, remit, or report past payments should discuss with a tax adviser the possibility of filing a voluntary disclosure with the CRA, which may allow the payer to avoid penalties for noncompliance.

[45]Information Circular 75-6R2, *supra* note 40, at paras. 21 and 22.

[46]For Canadian income tax, employment insurance premiums when applicable, and contributions to the Canada Pension Plan (or Québec Pension Plan if the employee is pensionable in Québec) when applicable.

[47]However, when the Canadian resident employee renders services for the payer outside Canada, the employee may be able to request a letter of authority from the CRA authorizing the employer to reduce Canadian payroll deductions to take into account any foreign tax credit the employee would be entitled to claim regarding foreign taxes payable on the employment income; *see* CRA document 2010-038356I7, ''Payroll Withholdings by Non-Resident Employer,'' Nov. 3, 2010; and Guide T4001, ''Employers' Guide — Payroll Deductions and Remittances,'' chapter 5.

[48]Para. 153(1)(a) of the ITA, and sections 102 and 103 and subsection 104(2) of the Income Tax Regulations. The withholding and remittance obligation even extends to salary continuation payments paid to a nonresident former employee regarding employment performed in Canada while the employee was a resident of Canada; *see* CRA document 2007-0228561E5, ''Withholding,'' May 10, 2007.

[49]*See supra* note 34.

the CRA, this payment is additional remuneration and is therefore subject to Regulation 102 withholding.[50]

3. Directors' Fees

A director is an employee for purposes of the ITA, and therefore directors' fees paid to nonresident directors of a corporation for duties performed in Canada are subject to Regulation 102 withholding (rather than Regulation 105 withholding). However, if a nonresident director does not attend any meetings or perform any duties in Canada, fees paid to the director for carrying out directorial duties are generally not subject to Regulation 102 withholding. The CRA has cautioned that the fee paid to a nonresident director should be proportionate to the fees paid to other arm's-length directors of the corporation; if the fee is found to be disproportionate, the CRA may consider it to be a management fee subject to Canadian nonresident withholding tax under Part XIII of the ITA (see Section III.B).[51]

4. Waiver From Regulation 102 Withholding

Regulation 102 withholding does not represent a final tax; rather, it is a payment on account of the nonresident's Canadian income tax liability under the ITA for the year.

A waiver from Regulation 102 withholding regarding a nonresident employee's remuneration for employment duties performed in Canada may be requested when the employee qualifies for a treaty exemption from Canadian tax on the remuneration. One of two possible waiver application procedures may be used to apply for a Regulation 102 waiver, depending on the circumstances.

a. R102-J Waiver Request. The employer and the employee may file a joint Form R102-J waiver application form to request a waiver from Regulation 102 withholding regarding the employee's remuneration from employment in Canada in the following circumstances:

- the employee performing services in Canada is a U.S. resident and will earn no more than C $10,000 (or is a resident of another treaty country with a similar exemption and will earn no more than C $5,000); and
- it is not practical to apply for an R102-R waiver (or for the required individual tax number or social insurance number for the employee for that waiver) before the start of services, because of the nature of the services being performed (for example, servicing of equipment as needed, consulting, or services for which the dates and names of employees coming to Canada cannot be determined until the last minute).[52]

b. R102-R Waiver Request. When the employer and the employee are not eligible to apply for a R102-J waiver but the employee qualifies for a treaty exemption from Canadian tax on the remuneration he will receive from employment in Canada, the employee may file a Form R102-R waiver application with the CRA to request a waiver from Regulation 102 withholding regarding the employee's remuneration from employment duties performed in Canada.

The effective date of an R102-R waiver can be significantly different from the effective date of an R102-J waiver. If timing is an issue, this should be carefully considered.

If the waiver is granted, the employer will be issued an authorization from the CRA not to withhold payroll deductions under Regulation 102 from the remuneration paid to the employee regarding employment duties performed by the employee in Canada. However, the employer will still be required to comply with the reporting requirements described in Section II.B.5, and the nonresident employee will still be required to file a Canadian income tax return if he has Canadian tax payable for the year (see Section I.C.3). Relief from withholding in respect of Canada Pension Plan contributions and employment insurance premiums may also be available.

5. Remittance and Reporting

Employee payroll withholding must be calculated on the employee's remuneration in accordance with prescribed rules,[53] and remitted to the CRA generally by the 15th day of the month following the month in which the remuneration was paid. Payers are liable for amounts not withheld or remitted as required, along with interest and penalties.[54]

Payers must also comply with specified reporting requirements,[55] which apply regardless of whether a waiver from the withholding obligation is obtained as described in Section II.B.4.

6. Refund of Amounts Withheld

If a waiver is not obtained and employee withholding, remittance, and reporting are required, a nonresident employee who is entitled to a treaty exemption may obtain a refund of the withheld amount once his

[50]Information Circular 75-6R2, *supra* note 40, at para. 72.

[51]*See, e.g.*, CRA document 2009-0345151E5, ''Directors' Fees Paid to Non-Residents, Part XIII,'' Jan. 25, 2010.

[52]*See* Treaty-Based Waivers Involving Regulation 102 Withholding, *available at* http://www.cra-arc.gc.ca/tx/nnrsdnts/cmmn/rndr/wthhldng-eng.html.

[53]Sections 102 and 103 of the Income Tax Regulations.

[54]*See supra* note 44.

[55]Section 200 of the Income Tax Regulations.

Table 1. Summary of Potential Canadian Withholding Obligations on Nonresident Employee Transfers and Secondments to Canada

Nonresident Employee Arrangement	Withholding Obligations
Employee is transferred to, and remunerated directly by, receiving employer.	Regulation 102 withholding obligation on receiving employer on remuneration to employee.
Employee is seconded to receiving employer, remains on lending employer's payroll, and lending employer receives no compensation from receiving employer for seconded employee.	Regulation 102 withholding obligation on lending employer on remuneration to employee for services performed in Canada.
Employee is seconded to receiving employer, remains on lending employer's payroll, and lending employer receives compensation from receiving employer for seconded employee.	Regulation 102 withholding obligation on lending employer on remuneration to employee for services performed in Canada. Regulation 105 withholding obligation on receiving employer on compensation to lending employer unless no profit element and secondment meets other CRA administrative requirements.

Canadian tax return for the year in which employment duties were performed in Canada has been processed.[56]

C. Nonresident Employee Transfers

Particularly in multinational group situations, it is not uncommon for employees resident in one country to be sent abroad for a period to assist foreign subsidiaries with various operations and activities. When, for example, employees of a nonresident company (the lending employer) are sent to Canada to perform employment duties for the nonresident's Canadian subsidiary or other affiliate (the receiving employer), the arrangement may, depending on how it is structured, trigger withholding obligations not only under Regulation 102 but also under Regulation 105 (as well as raising the issue of whether the lending employer is carrying on business in Canada). The Regulation 102 withholding obligation will be either on the lending employer if the loaned employee remains on the lending employer's payroll or on the receiving employer if the employee is seconded[57] to and remunerated directly by the receiving employer, unless the CRA grants a waiver from the obligation as described in Section II.B.4.

Whether a Regulation 105 withholding obligation is also triggered will depend on the particular terms of the arrangement between the lending employer and the receiving employer. No waiver is possible in this situation because the Regulation 102-J and 102-R waivers are available only to nonresident employers (see Table 1).

If the employee is transferred to the receiving employer, the receiving employer pays all the employee's salary, wages, and other employment benefits, and the receiving employer does not pay the lending employer any fee for the transfer of the employee, only a Regulation 102 withholding obligation should arise for the receiving employer. No waiver is possible in this situation because the Regulation 102-J and 102-R waivers are available only to nonresident employers.[58]

However, if the employee remains on the payroll of the lending employer and the receiving employer pays the lending employer a fee for providing the services of the employee, that arrangement on its face raises a potential Regulation 105 withholding obligation for the receiving employer (subject to obtaining a waiver), as well as a Regulation 102 obligation for the lending employer as noted above. Fortunately, the CRA provides an administrative exception from Regulation 105 withholding when specific requirements are met.[59] When specific facts supporting a secondment are met and the lending employer retains the nonresident employee on its payroll, the CRA will not require Regulation 105 withholding on any payments made for ''reasonable'' reimbursements of the lending employer's expenses, provided that the receiving employer retains supporting documentation to substantiate the payments made to

[56]An interesting taxable benefit issue arises when an employer remits the required Regulation 102 withholding on behalf of a nonresident employee in Canada who is eligible for treaty relief. If the employee does not file a Canadian tax return and recover the taxes remitted (and then turn over the refund to the employer), the employer should impute a taxable benefit to the employee for the Regulation 102 tax remitted plus the applicable gross-up.

[57]For the CRA to accept that the employee has been seconded, the employer must meet specific requirements.

[58]Note that since the Regulation 102 withholding obligation generally includes withholding for Canadian pension plan contributions and employment insurance premiums, this transfer arrangement may raise an issue for nonresident employees working temporarily in Canada who wish to continue making social security and employment insurance payments in their country of residence. Those employees will need to determine whether they qualify for relief from withholding.

[59]Information Circular 75-6R2, *supra* note 40, at para. 37.

the lending employer.[60] The payer of the seconded employee's remuneration will still be responsible for making the required Regulation 102 withholding (subject to obtaining a waiver) and related reporting regarding that remuneration (see Section II.B).

The CRA has cautioned that it may view the payment of a profit element or an unreasonable charge for overhead costs by the receiving employer as evidence that the lending employer is carrying on business in Canada, and would require the entire payment to be subject to Regulation 105 withholding (unless a waiver is obtained).[61]

III. Part XIII Withholding

This section discusses:

- what amounts are subject to Part XIII withholding;
- when Part XIII withholding applies to management and administration fees or charges;
- when Part XIII withholding applies to royalties; and
- what the remittance and reporting requirements are.

A. Amounts Subject to Withholding

Under Part XIII of the ITA, some types of passive income, such as dividends, rents, royalties, and some service-type income, such as management or administration fees paid or credited by a Canadian resident to a nonresident, are subject to Canadian nonresident withholding tax at the rate of 25 percent (subject to potential reduction or elimination under an applicable tax treaty).[62] Payers (or paying agents) are generally obligated to withhold and remit Part XIII tax from the gross amount paid or credited to a nonresident.[63]

For the purposes of Part XIII withholding tax, a partnership — other than a partnership whose partners are all Canadian residents — that receives an amount from a Canadian resident is deemed to be a nonresident person.[64] In contrast, other rules in the ITA deem persons who might otherwise not be considered to be residents of Canada to be resident for purposes of imposing on them the obligation to withhold Part XIII tax on payments they make to other nonresidents.[65]

Part XIII withholding tax does not apply to amounts paid or credited to a nonresident to the extent that the amounts are attributable to a business carried on by the nonresident through a qualifying PE in Canada; the amounts are instead taxable under the normal income tax rules in the ITA.[66] However, note that a qualifying PE for this purpose is narrower than it is for treaty purposes: It does not include a deemed PE as described in Section I.B.3.d. Accordingly, a nonresident that is subject to income tax under the ITA regarding income derived from carrying on a business through a deemed PE in Canada should consider whether the income could also be subject to tax under Part XIII (for example, nonexempt management fees or royalties) and, if so, whether it would be advantageous to establish an actual PE in Canada to avoid Part XIII tax.

If a nonresident does not carry on business in Canada through a PE, some service-type payments such as ''management or administration fees or charges'' or royalties received from (or credited by) a Canadian resident may be subject to the 25 percent Canadian nonresident withholding tax under Part XIII, subject to reduction or elimination under an applicable tax treaty. In contrast to the waiver application procedures described above to obtain relief from Regulation 105 or 102 withholding, the CRA does not provide a formal procedure by which payers can obtain approval for withholding from a payment to a nonresident at a treaty-reduced Part XIII withholding rate. However, to prompt payers to carefully determine whether a nonresident recipient of a payment is entitled to a treaty-reduced rate of Part XIII tax, the CRA requires payers to obtain (and retain on file) a detailed information form supporting the nonresident's entitlement to the treaty-reduced rate before withholding from a payment to the nonresident at the treaty-reduced rate.[67]

Note that any payments made to a nonresident that are for services rendered in Canada would also be subject to Regulation 105 withholding (subject to obtaining a waiver), as discussed in Section II.A (see Table 2).

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[60] *Id.* at para. 38.

[61] *See*, *e.g.*, ''Services Provided by a U.S. Employee to a Canadian Subsidiary,'' *Income Tax Technical News* 44, Apr. 14, 2011.

[62] Sections 212-216 of the ITA.

[63] Section 215 of the ITA.

[64] Para. 212(13.1)(b) of the ITA.

[65] Subsections 212(13), (13.2), and (13.3) and para. 212(13.1)(a) of the ITA.

[66] Section 805 of the Income Tax Regulations. To obtain a certificate stating that an amount is exempt from Part XIII nonresident withholding tax under section 805, the payee may file an application with the CRA under section 805.1 of the Income Tax Regulations.

[67] *See* Form NR301 (for use by corporations and individuals), Form NR302 (for use by partnerships), Form NR303 (for use by hybrid entities), and pending amendments to Information Circular IC76-12, ''Applicable Rate of Part XIII Tax on Amounts Paid or Credited to Persons in Countries with which Canada has a Tax Convention,'' Nov. 2, 2007. For a more detailed discussion of the recent changes in the CRA's administrative policy regarding treaty-based Part XIII withholding, see Steve Suarez, ''Canada Extends Transition Period for Treaty-Reduced Nonresident Withholding,'' *Tax Notes Int'l*, Feb. 27, 2012, p. 687.

Table 2. Summary of Canadian Withholding Requirements on Service Type Payments to Nonresidents

Payment to Nonresident (NR)	Withholding Requirement	Possibility of Waiver or Exemption?
Fees for services rendered in Canada (other than employment income)	Regulation 105	Withholding applies unless waiver obtained (even if income treaty exempt). Formal CRA waiver application process. Waiver application alternatives: • Treaty-based waiver request (must qualify for treaty benefits and meet one of three tests). • Income/expense waiver request (if withholding would exceed Canadian tax liability). Reporting required even if waiver obtained.
Remuneration for employment duties performed in Canada (including directors' fees)	Regulation 102 (also Regulation 105 if receiving employer pays fee to lending employer; see above)	Withholding applies unless waiver obtained (even if income treaty exempt). Formal CRA waiver application process. Waiver application alternatives: • R102-J waiver request (must qualify for treaty benefits and meet other specified conditions). • R102-R waiver request (must qualify for treaty benefits and apply for/provide social insurance number/individual tax number). Reporting required even if waiver obtained.
Management or administration fees or charges	Part XIII (also Regulation 105 if management or administration performed in Canada; see above)	Withholding applies unless ITA or treaty exemption applies. No formal waiver/exemption process. Payer must satisfy self that NR qualifies for treaty-reduced rate or exemption. Reporting required even if treaty applies.
Royalties for the provision of services, information. or expertise	Part XIII (also Regulation 105 if part of royalty is for services rendered in Canada; see above)	Withholding applies unless ITA or treaty exemption applies. No formal waiver/exemption process. Payer must satisfy self that NR qualifies for treaty-reduced rate or exemption. Reporting required even if treaty applies.

B. Management or Administration Fees or Charges

The term ''management or administration fee or charge''[68] is not defined in the ITA. However, a rule in the ITA provides that a management or administration fee or charge does not include some arm's-length payments or reimbursement of some expenses. The Federal Court has stated that ''generally speaking, a management or administration fee is an amount paid in respect of managerial services in connection with the direction or supervision of business activities.''[69] The CRA considers the term ''management and administration'' to generally include the functions of planning, direction, control, coordination, and systems, as well as other managerial functions and various activities performed by accounting, financial, legal, electronic data processing, employee relations, management consulting, labor relations, and taxation personnel.[70]

If a management or administration fee or charge is not exempted from Part XIII nonresident withholding tax under the ITA, Part XIII withholding will often be eliminated under an applicable tax treaty between Canada and the payee's country of residence. Most of Canada's tax treaties treat management and administration fees as business profits, and therefore they would generally be exempt from Canadian tax as long as the business is not carried on through a PE in Canada. Management or administration fees or charges

[68]Para. 212(1)(a) of the ITA.

[69]*Peter Cundill & Associates Ltd. v. The Queen*, 91 DTC 5085 (FCTD), at para. 21.

[70]Interpretation Bulletin IT-468R, ''Management or Administration Fees Paid to Non-Residents,'' Dec. 29, 1989, at para. 5.

paid to non-arm's-length nonresidents are also subject to Canadian (and applicable foreign) transfer pricing rules.

C. Royalties

Fees for the provision of services or information or expertise of a commercial, scientific, or industrial nature may be considered to be royalties or business profits, depending on the circumstances and the terms of an applicable tax treaty. If the fees are royalties, an exemption from Part XIII nonresident withholding tax may be available under the ITA or an applicable tax treaty between Canada and the nonresident's country of residence.[71] If the fees are business profits and the nonresident is entitled to benefits under an applicable tax treaty, the profits will be exempt from Canadian tax unless they are attributable to a PE of the nonresident in Canada.

The ITA provides a number of exemptions from Part XIII nonresident withholding tax on royalty-type payments. For example, an exemption is available for payments under a bona fide cost-sharing arrangement under which the payer shares on a reasonable basis with one or more nonresident persons research and development expenses in exchange for an interest in any or all property or other things of value that may result therefrom.[72] Also exempted are payments made to an arm's-length person if the payments are deductible in computing the payer's income for Canadian tax purposes from a business carried on by the payer in a country other than Canada.[73]

Additional royalty withholding tax exemptions may be available under an applicable tax treaty between Canada and the nonresident's country of residence. For example, some Canadian tax treaties (such as the Canada-U.S. treaty) provide for exemptions from withholding taxes for payments for the use of, or the right to use, any patent or any information concerning industrial, commercial, or scientific experience.[74]

D. Remittance and Reporting

Payers are generally required to remit Part XIII tax withheld (including the amount of any gross-up for Part XIII tax withheld) to the CRA by the 15th day of the month following the month in which the amount was paid to the nonresident. Also, payers must comply with specified reporting requirements.[75]

Payers and nonresident recipients can be liable for amounts not withheld or remitted as required, along with interest and penalties.[76] If Part XIII tax was withheld from a payment to a nonresident that was entitled to treaty relief, the nonresident may apply to the CRA for a refund of the tax withheld.[77]

In contrast to Regulation 102 and Regulation 105 withholding, nonresidents do not file a Canadian tax return regarding amounts withheld under Part XIII, because Part XIII tax is a final tax. However, the nonresident may be able to claim a foreign tax credit for Part XIII tax paid under the tax laws of the nonresident's country of residence.

IV. Conclusion

Nonresidents providing (or arranging for the provision of) services in Canada or to Canadian residents should be aware of the Canadian tax, withholding, and reporting requirements that may apply to their activities. Consulting a Canadian tax professional before entering into such arrangements may enable nonresidents in some cases to minimize the Canadian tax consequences resulting from their activities. ◆

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[71] Para. 212(1)(d) of the ITA.

[72] *See* subpara. 212(1)(d)(viii) of the ITA.

[73] *See* subpara. 212(1)(d)(x) of the ITA.

[74] *See* Article XII(3) of the Canada-U.S. treaty.

[75] Section 202 of the Income Tax Regulations.

[76] *See* subsections 215(6), 227(8), and 227(8.3) of the ITA.

[77] *See* Form NR7-R, ''Application for Refund of Part XIII Tax Withheld,'' and Information Circular 77-16R4, ''Non-Resident Income Tax,'' May 11, 1992.