The Joint Committee on Taxation of
The Canadian Bar Association
and
Chartered Professional Accountants of Canada

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May 26, 2015

Brian Ernewein
General Director, Tax Policy Branch
Finance Canada
140 O'Connor Street, 17th Floor, East Tower
Ottawa, ON K1A 0G5

Dear Mr. Ernewein:

Subject: Federal Budget 2015 - Proposed Amendments to Non-resident Employee Withholding Obligations

We are enclosing a submission which considers the proposed changes to the Income Tax Act (the "Act") as it relates to the withholding of source deductions from non-resident employees working for non-resident employers, commonly referred to as Regulation 102 withholding. Such changes were proposed in the budget announced by the Honourable Joe Oliver, Minister of Finance on April 21, 2015. Overall we welcome the proposed changes as well as the Department's understanding of the concerns previously raised by the relevant stakeholders and its efforts to address the administrative burden impacting them. In that context, and in reviewing the draft legislation, significant points have been raised by our members which require additional clarity and we would welcome your review of such issues which have been described attached submission.

We would like to thank you for your consideration of this matter. A number of members of the Joint Committee and others in the tax community have participated in the discussions concerning our submission and have contributed to its preparation, in particular:

Fatima Laher (Deloitte)
Anne Kestenbaum (PwC)
Angelo Nikolakakis (Couzin Taylor LLP)
Dan Fontaine (PwC)
Jacob Freedman
Jeffrey Trossman (Blake, Cassels & Graydon LLP)

We trust that you will find our comments helpful and would be pleased to discuss them further at your convenience.

Yours very truly,

Janice Russell
Chair, Taxation Committee
Chartered Professional Accountants of Canada

Mitchell Sherman
Chair, Taxation Section
Canadian Bar Association

Cc: Gabe Hayos, Vice President, Taxation, CPA Canada

Proposed Amendments to Non-resident Employee Withholding Obligations
Submission by the Joint Committee on Taxation
May 26, 2015

Proposed Amendments to Non-resident Employee Withholding Obligations

This submission addresses the proposed changes to the *Income Tax Act* (the "Act") as it relates to the withholding of source deductions from non-resident employees working for non-resident employers, commonly referred to as Regulation 102 withholding. Such changes were proposed in the budget announced by the Honourable Joe Oliver, Minister of Finance on April 21, 2015. Overall we welcome the proposed changes as well as the Department's understanding of the concerns previously raised by the relevant stakeholders and its efforts to address the administrative burden impacting them. In that context, and in reviewing the draft legislation, significant points have been raised by our members which require additional clarity and we would welcome your review of such issues which have been described below.

Definition of "Permanent Establishment" for purposes of "Qualified Non-resident Employer"

The proposed definition of "Qualified Non-resident Employer" as indicated in subsection 37(2) of the Notice of Ways and Means motion requires that the entity "*does not, in its taxation year or fiscal period that includes that time, carry on business through a permanent establishment (as defined by regulation) in Canada"*. The text refers to the definition of a Permanent Establishment ("PE") as defined by regulation. This presumably refers to the definition of PE as prescribed in Regulation 400(2) of the *Income Tax Regulations* (the "Regulations") which is used for the purposes of allocating income between the various provinces where the entity conducts operations in more than one Canadian province.

In the context of the Canadian taxation of non-resident entities, generally speaking Canada's network of tax treaties requires that the non-resident entity carry on business in Canada through a PE in order to be subject to Canadian tax on its Canadian source profits. The definition of PE is specifically defined in the relevant tax treaty. The definition of a PE in the relevant treaty and in Regulation 400(2) may differ with such difference potentially being significant. As a result an entity may not have a PE as defined in the Regulations but may have a PE as defined by the relevant tax treaty. As such the employer may not be required to withhold source deductions from the non-resident employees under the proposed legislation even though the employee may be subject to Canadian tax with no eligibility for an exemption under the relevant treaty. This would appear to be an unintended result.

The most significant example of this unintended result occurs with respect to Canada's treaties that contain a deemed PE definition as it relates to service contracts ("Services PE"), the most significant of which was introduced in the Fifth Protocol to the *Canada-United States Income Tax Convention* (the "Canada-US Treaty") which was signed on September 21, 2007. Under Article V, paragraph 9 of the Canada-US Treaty an enterprise shall be deemed to have a permanent establishment, when one would otherwise not exist under the Canada-US Treaty, should the enterprise perform services in Canada for a period exceeding 183 days in a twelve month period and other conditions are satisfied. Given the existence of a deemed PE for purposes of the Canada-US Treaty, such US resident employees who are performing the Canadian based services would also not be eligible for a treaty exemption under Article XV of the Canada-US Treaty unless their Canadian source remuneration was less than $10,000 CAD.

In such circumstances, further guidance is requested as to whether or not non-resident employers who do not have a fixed place of business in Canada but are deemed to have a Services PE as a result of the definition of PE in the relevant treaty would meet the definition of Qualified Non-resident Employer under the proposed legislation.

The same unintended consequences may also apply in cases where a non-resident entity is determined to have a PE as defined under Regulation 400(2) but not under the relevant tax treaty. In such cases the employer may not be relieved of its obligations to withhold source deductions even though the employees will not ultimately be subject to Canadian income tax on his/her Canadian source remuneration. This would appear to be unintended result and thus further guidance in such circumstances is required.

The existence of the Services PE provisions in the Canada-US Treaty as well as others also raises additional questions in relation to the proposed amendment. In the context of the Canada-US Treaty, a non-resident entity may have multiple contracts which are not related in any way to each other, some of which give rise to a Services PE and others which do not. Further guidance as to whether the employer is able to bifurcate the employee population into those who do and do not work on the contracts that give rise to a Services PE should be considered. Such bifurcation would appear reasonable given that those employees not associated with a Services PE are able to enjoy the intended relief.

Implications of Employee Surpassing 90 days in Canada

The proposed legislation only applies where the non-resident employee is present in Canada for any reason less than 90 days in any 12 month period that includes the time of receiving the Canadian source remuneration. This is despite the fact that most of Canada's tax treaties indicate that an individual is exempt from Canadian taxation on Canadian source remuneration provided he or she is present in Canada for less than 183 days in a period (the definition of a period is dependent on the specific treaty) and the compensation costs are not borne by a Canadian resident or PE in Canada.

The above requires clarification in two specific areas. The first is the definition of a 12 month period. A 12 month period may indicate the calendar year (i.e. the employee's tax year), the employer's fiscal year or alternatively a rolling 12 month period. All three of these 12 month periods are utilized throughout Canada's network of tax treaties. Therefore additional clarity is required as to which would apply and does the definition change depending on which country the employee is a resident as to match the exemptions from withholding and taxability. Non-resident employers would prefer monitoring its non-resident employees using the 12 months calendar year "presence test"

It is foreseeable that a non-resident employee working for a Qualified Non-resident Employer may at some point in the 12 month period exceed 90 days in Canada even though this may not have been originally anticipated. Presumably if such individual remains exempt from Canadian taxation under the relevant treaty (i.e. he/she is present for less than 183 days in the period) then the current waiver program will continue to be available and the individual can make such application. However amendments to the current waiver program would appear to be necessary in order to allow for the waiver of the withholding obligation on a retroactive basis for the first 90 days in which the individual was present in Canada and thus was expected to be subject to the proposed legislation. We would welcome the opportunity to work with the Canada Revenue Agency in order to determine what specific adjustments may be required to the current waiver program so that it easily can transition employees working in Canada in excess of 90 days during the period from the proposed program and into the existing program.

Attestation that Employer does not have a Permanent Establishment in Canada

The draft legislation indicates that a non-resident employer who wishes to take advantage of the proposed relief must be "certified" by the Minister of National Revenue in order to be considered a Qualified Non-resident Employer. Although the specific requirements in order to be certified are forthcoming, based on proposed

subparagraph 153(7)(a)(ii) we presume the employer will be required to demonstrate in some fashion that it does not have a PE (as defined by regulation) in Canada. This may include the employer having to sign an attestation to this fact.

Further guidance as to what type of attestation, or similar requirements, is required. Such guidance would include commentary as to the expected level of assurance that the employer must attest to and the potential penalties that the employer may face should it later be determined that the employer did in fact have a PE in Canada during the relevant period.

For example, assume that a US resident employer in the services industry ("USCo") obtains a service contract with a Canadian client which requires the employees of USCo to perform at least a portion of the services in Canada. This is the only Canadian contact USCo possess and USCo does not have a fixed place of business in Canada. The contract is for a relatively short duration and thus USCo does not anticipate that it will be deemed to have a Services PE under the provisions of Article V paragraph 9 of the Canada-US Treaty nor a fixed base PE as also described in the Article V. As such it seeks the relief available under the proposed legislation, including attesting to its belief that it does not have a PE in Canada, and is certified by the Minister of National Revenue accordingly. However for unforeseen reasons, the contract is extended and as such is now sufficient in length as to create a Services PE.

As we are sure it can be appreciated, non-resident employers may be reluctant to sign an attestation or similar requirement under the certification process even though they have made a good faith analysis of the facts known to them, or reasonably expected to be known to them, at the time of certification if they could be subject to significant penalties in the event that the facts change at some point in the future. As such the success of the proposed legislation in achieving its objectives of reducing administration and increasing efficiency may be reduced. As a result, additional guidance as to what PE attestation requirements will exist and what potential penalties employers may face in the event that they made a reasonable and good faith analysis at the time of attestation only for facts to subsequently change, thus rendering their initial conclusion incorrect, is necessary.

***De minimus* thresholds**

The proposed legislation takes into account only non-resident employees whose compensation costs are not borne by a resident of Canada or a PE located in Canada. This is in order to align with the general provisions of Canada's network of tax treaties which requires an individual to be present in Canada for less than 183 days over a certain period of time and not have their compensation costs paid by a resident of Canada or borne by a Canadian PE. However, in addition to this general exemption, many of Canada's treaties also have a *de minimus* exemption whereby provided the individual's compensation is less than a stated amount, the individual is eligible for a treaty exemption on such remuneration regardless of how the costs are accounted for by the employer. The most significant of such *de minimus* exemption is Article XV, paragraph 2(a) of the Canada-US Treaty which imposes a $10,000 CAD *de minimus* exemption per calendar year. It would be welcomed if the proposed legislation took such *de minimus* thresholds into account when offering withholding relief for treaty exempt employees

In addition the $10,000 CAD *de minimus* threshold provided for in the Canada-US Treaty was implemented in the original treaty of 1980 which has subsequently been amended by five protocols. The *de minimus* amount has not been adjusted for inflation over this 35 year period and we would welcome the representatives of both countries to revisit this amount during the next renegotiation with the view to allowing it to increase for inflation each year.

Relief for US Limited Liability Companies ("LLCs") or other Non-treaty eligible entities

It is possible that some employers are organized from a corporate perspective as entities which are not "residents of a Contracting State" under the relevant Canadian tax treaties. For example, a US based employer may be

organized as a Limited Liability Company under US corporate law. The employees that work for these entities may still be eligible for treaty relief under Article XV of the Canada-US Treaty either because their Canadian source remuneration for the year is less than $10,000 or they were present in Canada for less than 183 days in a 12 month period and their compensation was not borne by a PE in Canada regardless of the corporate structure. Additional guidance as to whether LLCs or other non-treaty eligible entities are able to take advantage of the proposed changes is appreciated.

Reporting Requirements

The proposed legislative changes are a welcome action and for those entities who qualify should relieve many of the cash flow concerns which have existed to date. However the proposals do not modify the current reporting requirements which also create significant administrative burdens on non-resident organizations conducting operations in Canada. Such reporting requirements would include the need for the employer to register as a Canadian payroll remitter, having each employee obtain an Individual Tax Number ("ITN") and having the employer issue a T4 slip to each treaty exempt employee. In addition to the relief provided with respect to the need to withhold and remit source deductions we would also welcome changes to the reporting obligations in order to also streamline such requirements. The streamlining of such administrative reporting may also provide efficiencies from the perspective of the Canada Revenue Agency as it will require less information to be processed and also reduce the probability that the Minister of National Revenue issue demands to file personal tax returns for individuals who are otherwise not required to file.

Summary

Overall we welcome the Department of Finance's proposed amendments and believe they will be beneficial over the long run for many non-resident employers with non-resident employees working in Canada. We believe that with some additional guidance and clarity around the areas mentioned above, as well as some additional clarifications which are more minor in nature, the proposed amendments will achieve their objectives of reducing administration and making it easier for foreign companies to conduct activities in Canada.