The Joint Committee on Taxation of
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March 10, 2025

Cathy Hawara
Assistant Commissioner
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344 Slater Street
Ottawa, ON K1A 0L5

Dear Cathy,

Subject: Section 105 of the Regulations to the Income Tax Act

Overview

Further to our discussion in our meeting on December 2, 2024, this submission sets out certain comments and recommendations of the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada (the "**Joint Committee**") in respect of the administration of section 105 ("**Reg. 105**") of the Regulations to the *Income Tax Act* (Canada) (the "**Act**").[1]

Reg. 105 particularizes the withholding obligation in paragraph 153(1)(g) of the Act and imposes a 15% withholding obligation on service fees paid to a non-resident of Canada for services rendered in Canada. This is a mechanism for ensuring that the CRA collects income taxes that may (or may not) be owed by non-residents of Canada in respect of a business carried on by them in Canada. Unfortunately, the broad drafting of Reg. 105 is potentially open to interpretations that could require withholding in situations where (i) there is no practical likelihood that any Canadian taxes will ultimately be owed; (ii) there are multiple layers of withholding, resulting in significant cash flow constraints; and (iii) the withholding obligation is very disruptive to the underlying business transactions. Services rendered by non-residents in Canada are critical to our economy and it is imperative that the interpretation of Reg 105 not provide material disincentives to such activities.

[1] All statutory references are to the provisions of the Act.

We are reaching out to the CRA in order to ensure that the CRA is aware of these issues and to provide certain recommendations for clarification of the interpretation and application of Reg. 105 that would make this regime more workable in the modern commercial environment, without sacrificing the intended role of Reg. 105 of securing taxes that may actually be owed. We would be happy to work with the CRA to address any of the issues or recommendations discussed in this letter.

Structure of the Withholding Obligations

Paragraph 153(1)(g) of the Act requires withholding, in accordance with prescribed rules, from the payment of any "fees, commissions, or other amounts for services". The prescribed rules are set out in Reg. 105, which provides in subsection 105(1) for a 15% withholding obligation on the payment to a non-resident of Canada of "a fee, commission, or other amount in respect of services rendered in Canada".[2]

The words "in respect of" in Reg. 105 are potentially capable of a very broad interpretation, which may not be appropriate in all cases. Bowie J. held, in *Weyerhaeuser Company Limited* v. *The Queen*, 2007 TCC 65 ("*Weyerhaeuser*"), that regulations cannot expand the scope of required withholding beyond the charging provision in the Act (here, paragraph 153(1)(g)). Bowie J. focused on the words in paragraph 153(1)(g) referring to any amount "for" services and concluded that Reg. 105 only applied to "all payments having the character of remuneration for services rendered in Canada, and thus potentially taxable by Canada in the non-resident's hands."[3] This is the legal conclusion of the *Weyerhaeuser* case. Bowie J. then went on to apply that principle to the facts of the case, dealing with the reimbursement of travel and meal expenses, but the case itself establishes principles that are universal, and not restricted to the narrow case of travel and meal expenses.

Issues Relating to Reg. 105

The issues we wish to raise related to the administration of Reg. 105, and our recommendations with respect thereto, are set out below.

Issue 1: Reimbursement for Sub-Contractor Fees – CRA Document 2022-0943241E5

A common circumstance in which Reg. 105 withholding can be very disruptive is in the context of subcontracted services. Consider the case of a non-resident of Canada ("**NRCo**") that contracts to provide services in Canada, but sub-contracts the provision of services in Canada to another corporation ("**SubCo**"). SubCo may be a Canadian resident or a non-resident of Canada.

There is no need for withholding on any fees ultimately payable to SubCo if SubCo is a resident of Canada; payments to Canadians are not the target of Reg. 105. Requiring such withholding negatively (and inappropriately) impacts the cash flow and financial position of Canadian residents providing subcontracted services.

If SubCo is a non-resident of Canada, an overly strict and mechanical application of Reg. 105 could suggest that double withholding is required, once on the payment to NRCo and then again on the payment to SubCo. Such double withholding is not necessary to accomplish the legitimate goal of ensuring payment of taxes ultimately owing by non-residents for the provision of services in Canada and is a material

[2] Subsection 105(2) of the Regulations contains various exceptions not specifically relevant here.
[3] *Weyerhaeuser*, at para. 13.

disincentive to non-residents being willing to provide services in Canada. In the context of specialized services available only from certain entities, this has a negative impact on Canadian businesses, making it more difficult for them to obtain commercially necessary services.

Proper interpretation of Reg. 105 cannot necessarily address these issues in all cases. One such example is the *FMC Technologies Co. v. M.N.R.* (F.C.), 2008 FC 871 ("*FMC*") case. FMC was a judicial review of a denied claim for a refund of Reg. 105 withholding made from the payment of service fees paid to a non-resident that subcontracted the services at issue to a resident of Canada. In that case, the legal contract provided for only the payment of fees, not a reimbursement of expenses (including subcontractor fees), and the contract did not allow for the assignment of the obligation to render services in Canada. The Court found that the payment at issue was legally made to the non-resident, and there was no claim made by the taxpayers that the payment was for anything other than fees. Accordingly, the Court held that Reg. 105 withholding was appropriate.

However, a properly drafted contract providing for the payment to a non-resident of separate amounts for fees and reimbursements of expenses incurred to pay subcontractors would be materially different than the facts in *FMC*. In such a case it is, in our view, clear that an amount that is, and that is clearly identified on an invoice as, a reimbursement of subcontractor fees, should not have the character of income that would bring it within the scope of Reg. 105 withholding as defined by *Weyerhaeuser*.

This position was effectively taken by the CRA in CRA document 2008-0297161E5. However, the CRA recently announced a reversal of this position in CRA document 2022-0943241E5, which reversal the CRA confirmed in its response to roundtable questions at the 2024 CTF Annual Conference. The CRA response focuses in part on the idea that Reg. 105 applies to gross payments (even if the withholding is on account of net income tax).

The *Weyerhaeuser* case clearly establishes that some payments in the nature of a reimbursement may not have sufficient character of income so as to be caught by Reg. 105. With respect, we submit that the view set out in the roundtable response that "*Weyerhaeuser* stands for the proposition that the reimbursement of travel and meal expenses is not subject to withholding pursuant to Regulation 105 in situations that are similar to the situations in that decision" is overly restrictive and does not give fair scope to the legal conclusion in that case. As stated above, the true legal conclusion of the case is that Reg. 105 only applies to payments having the character of income. A reimbursement of clearly delineated subcontractor fees is not dissimilar to the reimbursement of meal and travel expenses – neither amount constitutes income subject to Canadian tax.

In light of the above, we respectfully submit that Reg. 105 should not apply to circumstances where (i) the contract governing the provision of services permits sub-contracting, and (ii) the contract clearly identifies the reimbursement of fees as a separate form of payment that is distinct from the payment of fees to the service provider. This would reconcile with the reasoning in both the *Weyerhaeuser* and *FMC* cases and would also maintain the role of Reg. 105 to ensure the collection of amounts that may ultimately be owed as tax. We also note that interpreting Reg. 105 more broadly to require withholding in such circumstances can cause inappropriate results that are detrimental to Canadian economic activity.

For non-resident sub-contractors, the broad interpretation can result in double (or even more) withholding on the same underlying amount. This almost certainly results in amounts being withheld well in excess of the amount of tax ultimately owed. The excess may be recoverable, but the cash flow

implications can be significant for businesses and can be a material disincentive to non-residents entering into services agreements where services need to be rendered in Canada. The double withholding also runs contrary to the general policy of the Act to avoid double tax, as evidenced by subsection 248(28), even if that provision does not directly apply to prevent the double withholding here.

For Canadian-resident sub-contractors, the broad interpretation results in inappropriate withholding. No withholding should be required where the services are provided by a Canadian resident.

Recommendation 1: We recommend that the CRA confirm that Reg. 105, properly interpreted, does not require withholding on the payment to a non-resident of amounts that are a reimbursement for sub-contractor fees paid by the non-resident in circumstances where (i) the contract governing the provision of services permits sub-contracting, and (ii) the contract clearly identifies the reimbursement of fees as a separate form of payment that is distinct from the payment of fees to the service provider.

Recommendation 2: In the event that the CRA cannot agree to Recommendation 1, we recommend that the CRA confirm that Reg. 105, properly interpreted, does not require withholding on the payment to a non-resident of amounts that are a reimbursement for sub-contractor fees paid by the non-resident to a sub-contractor that has certified its Canadian residence for purposes of the Act, in circumstances where (i) the contract governing the provision of services permits sub-contracting, and (ii) the contract clearly identifies the reimbursement of fees as a separate form of payment that is distinct from the payment of fees to the principal service provider.

Issue 2: Assignment of Service Fee Receivables

Securitization and the factoring of receivables are common approaches to the financing of businesses that generate receivables in the ordinary course. In each case, a "Originator" generates a receivable in the course of its business and sells that receivable to another party ("SPV").[4] The Originator often acts as the "servicer" of the receivables, making it unnecessary to even notify the obligors (the buyers of goods or services to which the receivables relate) in respect of these receivables that any assignment has taken place. If the receivables in question are for service fees owed to the Originator, and if the SPV is a non-resident of Canada, there is some uncertainty as to the potential application of Reg. 105 to the payment by obligors to the SPV on the receivables. Specifically: should these payments be considered to be payments to a non-resident of Canada "in respect of" services rendered in Canada for purposes of Reg. 105?

One solution is certainly to use a Canadian resident SPV. However, this approach can potentially limit access by Canadians to financing provided through these mechanisms, as sponsors of these financing arrangements may be familiar with the legal structure and certainty provided to them using SPVs in other jurisdictions (e.g., a Delaware LLC) and may be unwilling commercially to depart from that legal structure. The application of Reg. 105, which can potentially raise liability for obligors making payments, is particularly problematic here because obligors may not be aware of the assignment.

[4] We do not go into detail on these structures in this submission. These are complex transactions, but the complexity is not relevant to the issues raised here. In general, factoring involves the sale of the receivables for a discount intended to compensate the buyer for the time value of money cost that it incurs by paying up front for receivables to be collected in the future, and for the risk of default by the obligors. In general, securitization involves the sale of the receivables to a special purpose entity that uses the receivables as collateral to support the issuance by it of debt.

As noted above, the *Weyerhaeuser* case makes it clear that while the words "in respect of" in Reg. 105 are potentially very broad, a proper interpretation is limited by the context of this provision (including paragraph 153(1)(g)). In the context of a factoring or securitization transaction, the payment for services (within the meaning of paragraph 153(1)(g)) occurs when the SPV pays the Originator for the receivable. The payment by the obligors to the SPV, while in respect of services rendered in Canada, does not have the character of service fees from the perspective of the SPV. The character of the payment to the recipient is important, as it is the perspective of the non-resident recipient that defines whether the amount is potentially taxable in Canada as income from a business carried on in Canada; protecting the collection of such amounts is the sole purpose of Reg. 105. The payment by obligors in these circumstances thus should not be considered to be a payment to a non-resident of an amount in respect of services rendered in Canada and should not be subject to Reg. 105 withholding.

Recommendation 1: We recommend that the CRA acknowledge that Reg. 105, properly interpreted, does not require withholding on the payment to a non-resident purchaser of receivables that are receivables for service fees originally owed by obligors to a service provider that is a resident of Canada for purposes of the Act.

Issue 3: New Waiver Provisions

The 2024 Federal Budget proposed amendments to the Act to allow the CRA (on behalf of the Minister of National Revenue) specifically broader scope to grant waivers of Reg. 105 withholding in certain circumstances. These proposals specifically contemplate that the CRA (Minister) may set conditions that must be met for waivers to be granted under the proposed new provisions. These are important proposals in facilitating services needed in Canada.

No details are yet available regarding the specific process or conditions for obtaining a waiver under the new expanded wavier provisions, if ultimately passed. However, the CRA's current Reg. 105 waiver guidelines already contain several conditions,[5] and we wanted to raise with the CRA the possibility of re-considering some of these conditions, both for purposes of the existing waiver provisions and the proposed ones. In many cases, the criteria in question exclude non-residents from accessing the waiver program in circumstances when they can demonstrate the availability of a treaty exemption. This is inefficient for the taxpayers involved, and can provide a disincentive for non-residents to provide services to Canadians; in some cases, this can make it difficult for Canadians to access certain services that are highly specialized or available only from limited sources.

(a) Length of Presence Thresholds - The CRA guidelines indicate that waivers will not be available in circumstances when the service provider's presence in Canada exceeds 180 days in the current 12-month period or, for recurring services, 240 days. We understand that length of time spent in Canada may be relevant to the determination of whether a permanent establishment ("**PE**") exists or not, which can be the key factor in the availability of a treaty exemption from taxation of business profits. However, since the relevant test is not a duration test but rather the existence of a PE, these guidelines prevent some taxpayers who may be able to clearly evidence that they will not have a PE (and are thus entitled to a treaty exemption from taxation) from accessing waivers.

[5] https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/information-been-moved/rendering-services-canada/guidelines-treaty-based-waivers-involving-regulation-105-withholding.html

Recommendation 1: We recommend that the CRA revise the waiver guidelines to allow more flexibility in granting waivers to non-residents with a demonstrable entitlement to a treaty exemption even if they exceed the 180- and 240-day thresholds. Because a determination in such cases may be more difficult and may require review by additional or more senior personnel, allowance could be made for longer service standards or other conditions to allow the necessary flexibility. This recommendation is intended to apply equally to the conditions to be set under the proposed new waiver powers, if ultimately enacted.

(b) Measurement of Duration of Presence – The current CRA guidelines provide that, in measuring a non-resident service provider's presence in Canada, time spent by a subcontractor in Canada will be counted towards the non-resident's presence in Canada. There may be circumstances where presence of a subcontractor could potentially contribute towards a non-resident having a PE in Canada, especially where space is made available to the non-resident in Canada and/or its subcontractors, and the duration of time spent may be relevant to establishing sufficient "permanence". However, there are certainly other circumstances where a subcontractor's presence in Canada cannot reasonably be relevant to the determination of the existence of a PE of the non-resident services provider. Non-residents in the latter category are currently excluded from access to the waiver program, and yet they should be able to demonstrate a lack of PE with a high degree of certainty.

Recommendation 2: We recommend that the CRA allow for increased flexibility in the waiver process to allow non-residents to demonstrate, on a case-by-case basis, whether time spent in Canada by sub-contractors should be counted as time spent by the non-resident itself in Canada for this purpose. Again, allowance could be made for longer service standards or other conditions to allow the necessary flexibility in cases where non-residents seek to exclude time spent by sub-contractors. This recommendation is intended to apply equally to the conditions to be set under the proposed new waiver powers, if ultimately enacted.

(c) Multi-Year Contracts and Repetitive Presence – The current CRA guidelines indicate that waivers should not be granted to non-residents that provide services of a repetitive nature where services are performed in the same or "similar" locations and there is a history of presence in Canada or providing those services in two or more previous calendar years (consecutive or not). As with the above examples, we understand how repetitive presence, in some cases, will be relevant to the determination of whether or not a non-resident has a PE in Canada. However, there will be cases when taxpayers with repetitive presence should be able to demonstrate conclusively that no PE exists. Granting of waivers in such cases is entirely appropriate.

Recommendation 3: We recommend that the CRA allow for increased flexibility in the waiver process to allow non-residents to demonstrate, on a case-by-case basis, that no PE exists despite repetitive presence in Canada. Again, allowance could be made for longer service standards or other conditions to allow the necessary flexibility in cases where non-residents with a repetitive presence in Canada seek waivers. This recommendation is intended to apply equally to the conditions to be set under the proposed new waiver powers, if ultimately enacted.

(d) Guidelines for Sub-Contractors Activities – The current CRA guidelines require that activities of sub-contractors, whether Canadian resident or not, must fall within these guidelines. This

requirement potentially excludes a large class of non-residents who have clear treaty exemptions from accessing the waiver program. Specifically, non-residents who have no direct presence in Canada and who sub-contract 100% of the services rendered in Canada to Canadian residents should, generally, be able to demonstrate entitlement to a treaty exemption in respect of the services rendered in Canada and thus eligibility for a wavier. Granting waivers in such cases promotes the use of Canadian resident sub-contractors in these circumstances, which is a net benefit for Canada.

Recommendation 4: We recommend that the CRA revise the waiver guidelines to permit a non-resident with no direct presence in Canada and who sub-contracts 100% of the services rendered in Canada to Canadian residents to access the waiver program, regardless of the activities in Canada of its Canadian-resident sub-contractors. Such non-residents would still be required to demonstrate that they do not have a PE in Canada, although in most cases this should be straightforward. This recommendation is intended to apply equally to the conditions to be set under the proposed new waiver powers, if ultimately enacted.

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A number of the recommendations above include the adoption of an administrative position. The Joint Committee would be pleased to work with the CRA to discuss and draft this administrative position. Members of the Joint Committee and the tax community participated in the discussion concerning this submission and contributed to its preparation, including:

- Anu Nijhawan
- Jeffrey Shafer
- Carrie Smit

We would be pleased to discuss this submission with you in further detail at your convenience.

Yours truly,

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