

Non-Residents Performing Services in Canada Policy – Waivers from Withholding Obligations Under Regulations 105 and 102

Issue

Many Canadian companies routinely, or as required, work with non-resident consultants, engineers and other service providers from the United States and elsewhere. Onerous tax withholding and reporting requirements exist in relation to these services and serves to discourage growth, act as a barrier to international trade, and create unnecessary reporting and withholding requirements for Canadian businesses.

The Chamber community appreciates the Government's Budget 2015 announcement of an exemption of the Regulation 102 withholding requirement for qualifying non-resident employers who are exempt from Canadian income tax because of a tax treaty. However the application and reporting requirements remain very onerous, particularly compared with best practices in other jurisdictions, such as the US or the UK. In fact, the process requires a complex application followed by a lengthy waiting period for CRA approval, and payments made before receiving the approval are not exempt from the withholding.

Background

Sections 105 and 102 of the Income Tax Regulations impose withholding requirements on payments for services rendered in Canada by non-residents. Regulation 105 covers situations where a fee is paid to a non-resident for services rendered in Canada while regulation 102 addresses compensation paid to a non-resident employee who is working in Canada. These requirements exist in isolation from Canada's tax treaties, which can exempt a corporation or an employee from any tax liability in Canada (leading to exempt corporations and employees still being subject to withholding taxes).

Section 105 of the Canadian Income Tax Regulations ("Regulation 105") stipulates that "every person paying to a non-resident person a fee, commission or other amount in respect of services rendered in Canada, of any nature whatsoever, shall deduct or withhold 15 per cent of such payment" and remit it to the Canada Revenue Agency (CRA). The non-resident corporation can apply to the CRA for a treaty based waiver to exempt them from the withholding tax if they apply 30 days in advance of carrying out the work performed in Canada, and have no outstanding tax filings or balances with the CRA.

The Regulation 105 withholding program isn't working as intended. The withholdings are intended to be an instalment on potential Canadian taxes, to be refunded when the non-resident files a Canadian tax return. Many non-resident companies do not file treaty based returns, even for a refund that is legally due to them. As a result of stiff penalties in other jurisdictions, many non-resident companies do not seek refunds of Regulation 105 withholdings simply to minimize exposure to scrutiny from Canadian tax authorities. Instead, these businesses shift the economic burden of Regulation 105 onto their Canadian customers by insisting on tax gross-up clauses in their contracts and intentionally never file a Canadian return. The result of this is:

- The non-resident corporation is left with the cash they wanted (net of withholdings) and stay below the CRA's radar.
- Canadian companies are overpaying for non-resident services, increasing the cost of projects in Canada and ultimately reducing their profitability.
- The CRA is unduly enriched by the taxes withheld that will never be refunded (at the cost of Canadian taxpayers).

Under section 102 of the Income Tax Regulations, non-resident employers have an obligation to withhold and remit Canadian payroll withholdings for their employees who cross the border and work in Canada. CPP and EI premiums along with personal taxes must be properly calculated, withheld and remitted to the CRA for each day of employment in Canada. Similar to Regulation 105, a non-resident employer can apply for a treaty based waiver, but it must also be filed 30 days in advance of the start of the employment in Canada, and the employee must have a Social

Insurance Number or Individual Tax Number. However the waiver is applicable only for a specific employee for a specific period of time.

The Regulation 102 withholding program is also not working as intended. The CRA is not issuing waivers to non-resident employers, without previously being approved for a Regulation 105 waiver and without being fully compliant in previous years. These CRA requirements dramatically increase a non-resident's Canadian compliance burden.

The 2015 Federal Budget proposal provides some welcome relief to the issue. The proposal provides an exemption for "qualifying non-resident employers" (requiring certification by the CRA) from the Regulation 102 requirements for payments to "qualifying non-resident employees." This can significantly reduce the current withholding administrative burden depending on how it's implemented. However, the certification required by the CRA can continue to cause delays, there are certain terms that are defined differently under the Income Tax Act versus Canada's tax treaties which can create unintended results. As well, non-resident companies will still be required to maintain a Canadian payroll account and issue annual T4 slips to qualifying non-resident employees (who will also have to apply for Canadian tax identification numbers) even though these employees are exempt from Canadian tax under the Treaty.

As Regulations 102 and 105 of the *Income Tax Act* apply equally to all non-residents (including foreign entities affiliated with Canadian corporations) and the compliance burden, or processes for voluntary disclosure, represent a significant barrier to trade, and reduce the profitability of businesses in Canada. The unexpected outcomes of the CRA's administration of the regulations add considerable cost to doing business in Canada to both resident and non-resident corporations and runs counter to the spirit of the articles of the income tax treaty.

Recommendations

That the federal government:

1. Adopt a Regulation 105 procedure similar to the United States, where a resident of a tax treaty country can be exempted from the withholding tax on services without advance approval from a tax authority if they provide a signed information form confirming tax treaty benefits.
2. Improve the Regulation 102 proposals by replacing the CRA advanced approval (certification) of qualified non-resident employers with a signed information form confirming tax treaty benefits, while also eliminating the T4 reporting requirement for qualified non-resident employees.