



Canadian Taxation of Non-Resident Employees

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

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

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

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

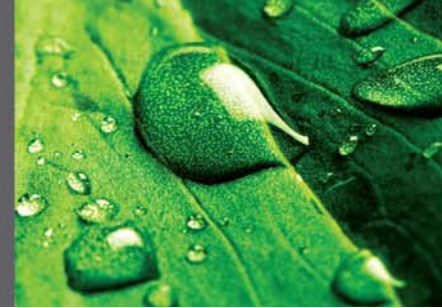
➤ **183 days**

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

This concept of a rolling 12-month period was introduced by the Organisation for Economic Co-operation and Development (OECD) in their Model Tax Convention with Respect to Taxes on Income and on Capital ("OECD Model Convention"). According to the OECD's technical notes, the phrase "12-month period beginning or ending in the fiscal year concerned" is intended to catch situations in which the employee's time is allocated between taxation years. Canada's treaties that include language similar to that introduced by the OECD Model Convention include those with the U.S., France and Germany. Under Canada's treaty with the U.K., the criterion refers to "183 days in the calendar year concerned". A U.K. resident could therefore be exempt from Canadian income tax despite being present in Canada for 364 consecutive days if the 182nd day were December 31st.

➤ **"Employer"**

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



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

Canada's laws in this regard apply a substance over form approach. If a Canadian resident is the employer in fact then the employee will be taxable in Canada notwithstanding formal documentation to the contrary.

➤ **"Borne by"**

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

➤ ***De minimus* exemption**

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

What are the employer's withholding and remittance obligations?

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

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

Premiums are not payable into Canada's mandatory employment insurance program if premiums in respect of the employment exercised in Canada are payable under the unemployment insurance laws of the non-resident employee's home jurisdiction.



What are the employee's filing obligations?

The non-resident employee would only be required to file a Canadian income tax return if Canadian tax were payable. If, therefore, a waiver were obtained then the employee would not file a return. If, on the other hand, the employer withholds and remits income tax then the employee must file a return in order to claim the rebate.

If an employer pays the tax on behalf of the employee, the employee will then have a taxable benefit in the amount of such payment. This results in a greater tax liability, a greater tax payment by the employer and, therefore, a still greater tax liability. This circularity can be addressed by "grossing up" the tax payment made by the employer by an appropriate percentage. The tax cost to the employer would therefore be greater than would otherwise have applied to the employee.

Immigration Matters

When addressing taxation issues facing non-resident employees, the topic of immigration must inevitably be considered as well. Our firm's Immigration Practice Group was created in order to provide our international business clients with a comprehensive service offering in order to facilitate the entry of foreign workers to Canada and advise on all matters pertaining to Canadian Immigration Law.

Patrick Westaway is a Partner at Dale & Lessmann LLP, a Toronto, Ontario, Canada-based full service law firm specializing in Canadian taxation law. Patrick advises on a broad range of Canadian taxation issues such as corporate tax planning, structuring inbound investments, corporate reorganizations, cross-border financings, tax opinions for public disclosure documents, tax assessments, personal tax matters, wealth preservation, and on federal and provincial sales tax matters (HST/GST/PST). Patrick also practices corporate and commercial law with an emphasis on the implementation of matters related to his tax planning practice.