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The Implications of Withholding Requirements on Non-Residents Providing Services in Canada

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A number of tax lawyers from Fraser Milner Casgrain LLP write commentary for CCH's CANADIAN TAX REPORTER *and sit on its Editorial Board. Fraser Milner Casgrain lawyers also sit on the Editorial Board and write the commentary of CCH's* CANADIAN TAX OBJECTION AND APPEALS PROCEDURES *reporter and have authored four books currently available from CCH –* THE ESSENTIAL GAAR MANUAL: POLICIES, PRINCIPLES AND PROCEDURES; CHARITIES, NON-PROFITS AND PHILANTHROPY UNDER THE INCOME TAX ACT; CORPORATION CAPITAL TAX IN CANADA; *and* CANADIAN TRANSFER PRICING. *Tony Schweitzer, a Tax Partner with the Toronto Office of Fraser Milner Casgrain LLP, and a member of the Editorial Board of CCH's* CANADIAN TAX REPORTER, *is the editor of the firm's regular monthly feature articles appearing in* TAX TOPICS.

In order to ensure that non-residents pay tax on Canadian-sourced income, the *Income Tax Act* (the "ITA") imposes on residents of Canada who make payments to non-residents an obligation to withhold tax on the payments. In the event that residents fail to withhold the appropriate amount of tax, the ITA also imposes on residents an obligation to pay tax on behalf of the non-residents, and subjects residents to penalties and interest. Examples of such requirements are seen in the following provisions of the ITA:

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- Part XIII imposes a withholding tax of 25% (subject to any applicable tax treaty between Canada and the country of residence of the payee) on payments of "passive" income made by Canadian residents to non-residents;

- section 116 requires a non-resident to provide a certificate to the purchaser of taxable Canadian property and imposes a withholding tax obligation on the resident if an appropriate certificate is not provided; and

- paragraph 153(1)(*g*) requires a person paying an amount to non-residents for services performed in Canada to withhold and remit tax.

This article comments upon the obligations of residents to withhold tax pursuant to paragraph 153(1)(*g*) and Regulation 105 of the ITA.

Obligation to withhold and remit

Paragraph 2(3)(*b*) of the ITA provides that a non-resident is subject to tax where, *inter alia*, the non-resident "carries on business in Canada". Virtually all tax treaties limit a non-resident's obligation for tax payable on business income to income allocable to a permanent establishment in Canada. A non-resident person who carries on business in Canada is required to file an income tax return,[1] regardless of any exemption the non-resident may have for tax by virtue of a tax treaty.

Paragraph 153(1)(*g*) provides that every person paying fees, commissions, or other amounts for services at any time in a taxation year shall deduct or withhold from the payment the amount determined in accordance with "prescribed rules" and shall remit that amount to the Receiver General on account of the payee's tax for the year. The pertinent "prescribed rule" is Regulation 105, which requires that 15% of the gross payment "to a non-resident person" of a "fee, commission or other amount in respect of services rendered in Canada, of any nature whatever" be withheld.[2]

The meaning of the words "in respect of services" in Regulation 105 is noticeably broader than the words "for services"used in paragraph 153(1)(*g*) of the ITA. In one particular case still before the courts,[3] a taxpayer company that withheld amounts on payments made to non-residents for services rendered in Canada was reassessed for additional amounts that the Minister claims were related to payments "in respect of services" rendered in Canada. These additional payments included retainers and service fees allocated to services rendered outside of Canada, reimbursements for the non-residents' out-of-pocket costs, and charges for the non-residents' travel time. As the Minister's reassessment was based on the broader wording used in Regulation 105 instead of the narrower wording in section 153 of the ITA, the taxpayer is arguing that the Regulation unduly broadens the scope of section 153 and is therefore *ultra vires*.

Regulation 105 waivers

As stated above, Regulation 105 withholding is computed by reference to the gross payment made to the non-resident person and is not intended to determine the final tax liability of the non-resident, which is ultimately computed in accordance with Part I of the ITA. Non-residents are required to file a Canadian income tax return in which they calculate their tax liability. Non-residents will either receive a refund of the excess tax paid where the withholdings exceed their Canadian tax liability, or, alternatively, the amount withheld will be treated as a credit towards their final Part I tax liability.

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It may, however, be possible to obtain a waiver in respect of the obligation to withhold tax pursuant to Regulation 105. The general position of the Canada Revenue Agency (the "CRA") on the issue of waivers is set out in Information Circular 75-6R2.[4] In general, where a non-resident can demonstrate, based on tax treaty protection or estimated income and expenses, that the normally required withholding is in excess of the non-resident's ultimate tax liability, the CRA may waive or reduce the amount of withholding. The guidelines for treaty-based exemptions are contained in Appendix A to IC 75-6R2. The key issue for determining whether a tax treaty waiver may be obtained is generally whether or not the non-resident has a fixed base or permanent establishment in Canada. Appendix B to IC 75-6R2 provides the guidelines for a reduction of the Regulation 105 withholding based on estimated income and expenses relating to the services to be provided in Canada. This waiver allows the non-resident to claim expenses against Canadian-sourced income. The net income is then subject to tax at graduated rates similar to those applicable to residents. The non-resident will benefit from this waiver where the estimated tax payable is lower than the Regulation 105withholdings otherwise required.

Liability for failure to withhold and penalties

Paragraph 153(1)(*g*) and Regulation 105 place the responsibility for withholding on the person who pays the non-resident. Pursuant to the rules in section 227 of the ITA, failure to withhold and remit in accordance with Regulation 105renders the payer liable to pay the amount that should have been withheld, plus interest and penalties.

Subsections 227(8.3) and (8.4) provide that a payer who is obliged to withhold an amount but fails to do so is liable to pay the amount "as tax" on behalf of the non-resident payee, plus interest thereon. However, subsection (8.4) also entitles the payer to recover from the non-resident any amount paid "as tax" by deducting or withholding from any amount paid or credited to the non-resident.

The Minister's power to make assessments for a failure to withhold and remit are contained in subsections 227(10) and (10.1). Subsection 227(10) provides the Minister with authority to assess the payer "at any time" on the amount that should have been withheld plus interest and penalties. The inclusion of the words "at any time"means there is no time limit for the CRA to reassess in respect of a failure to withhold under Regulation 105. The Minister only has authority under section 227 to assess a payee for the amount of interest payable in respect of the failure to withhold.[5]

A payer that fails to withhold tax from amounts paid to non-residents as fees, commissions, or other amounts for services in accordance with subsection 153(1) must (subject to the discussion below) pay a penalty of 10% of the amount that should have been withheld under subsection 227(8) of the ITA. In cases of repeat offences or gross negligence, the penalty is 20%. The failure to remit tax where it has been withheld is also subject to the same penalties described above under subsection 227(9) of the ITA.

Subsection 227.1(1) provides that where a corporation has failed to withhold and remit an amount as required by section 153, the directors of the corporation at the time the corporation was required to withhold and remit the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it. There is, however, a due diligence defence that may be available in appropriate circumstances to directors by virtue of subsection 227.1(3).[6]

Defences for failing to withhold

The question of whether a due diligence defence exists for residents who fail to withhold amounts pursuant to paragraph 153(1)(*g*)and Regulation 105 has two aspects. On the one hand, the courts have not accepted a due diligence defence in respect of the failure of a resident to withhold or remit amounts pursuant to these provisions, even where *bona fide* errors have occurred.[7]However, case law has evolved which may permit a due diligence defence against penalties for failure to withhold and remit amounts in spite of the wording of subsections 227(8)and (9), which appear to impose absolute liability on the payer. As noted above, the liability for directors of a corporation which fails to remit amounts pursuant to paragraph 153(1)(*g*) and Regulation 105 is subject to the due diligence defence indicated in subsection 227.1(3).

In *Pillar Oilfield Projects Ltd. v. Canada*,[8], Bowman, J. (as he then was) held that the test for fiscal penalties, like other offences, should be one of strict liability rather than absolute liability. While *Pillar* was a GST case dealing with errors made in GST returns, Bowman, J. spoke broadly on the issue of administrative penalties stating:

> The penalty under section 280 is one of "strict liability" rather than "absolute liability". If the person assessed can show "due diligence" in attempting to comply with the legislation, the penalty will not apply. It would be abhorrent for a person to be susceptible of being penalized administratively by a public servant without any possibility of exculpating himself by demonstrating due diligence. Penalties are no different from criminal or provincial offences in this respect.

Justice Bowman's approach to the due diligence defence in respect of penalties was adopted in *Ogden Palladium Services (Canada) Inc. et al. v. The Queen*,[9] a case that specifically considered the potential application of the defence for failure to withhold under Regulation 105. In *Ogden*, the taxpayers were owners of entertainment facilities who executed licence agreements with an American entertainment producer to stage figure skating shows at the entertainment facilities. The taxpayers collected ticket money from show patrons and paid the ticket money to the producer of the shows. One of the issues addressed by Lamarre, J. in the decision was whether the penalties charged under subsection 227(8) were exigible from the taxpayers. The Court held that there was an absolute liability in respect of the appellants' obligation to withhold and remit the proper amounts under paragraph 153(1)(*g*), and separately considered whether the appellants were subject to penalties.

In determining whether the defence was available to the taxpayers in the particular circumstances of this case, Lamarre, J. held that the question to be considered in ascertaining whether due diligence was exercised turned on "whether the appellants can positively prove that all reasonable care was exercised to ensure that errors were not made".[10] Citing *Pillar*, the Court held that the taxpayer is expected to comply with the requirements of the ITA with a high degree of diligence using the sources of information, facilities, and resources available to that taxpayer. It is unfortunate that the professional tax advice relied on by the appellants in *Ogden*, advising that no tax would be payable, was not filed as evidence. Consequently, the Tax Court judge could not evaluate the steps taken by the appellants with respect to determining their withholding obligations. The Court concluded as follows:

> The appellants, as payors, had a duty to ensure that they had fulfilled all their obligations under the Act. I see no evidence showing that the appellants took any action in that regard. The fact that [the non-resident] had obtained a waiver in the previous year is not a valid defence, as a non-resident is required to make such a request in advance of the payment to be received. It is the Minister who has the authority, pursuant to subsection 153(1.1) of the Act to reduce the required withholding under section 105of the Regulations.
>
> It is only upon receipt of a waiver that a payor is released from the obligation of withholding an amount from payments made to a non-resident. Without such a waiver, the payor's obligation must stand. The burden remains on the non-resident to show that no tax is payable in Canada and to request a refund, if any is due.
>
> For all these reasons, I am of the opinion that the appellants did not discharge their burden of showing that they exercised due diligence. The penalties shall therefore be maintained.[11]

To date, there is little jurisprudence directly relating to the application of paragraph 153(1)(*g*)and Regulation 105. It is clear, however, that the onus is on Canadian resident payers to exercise a high degree of caution to ensure proper withholding and remittance for services provided by non-residents of Canada.

Hot News Items

2007 Budget Season

Budget season is upon us once again. To date, the following provinces/territories have issued their 2007 Budgets. Highlights of the Budgets relating to payroll are reproduced below. As the other provinces/territories issue their Budgets, they will be added to the list.

British Columbia

The 2007 British Columbia Budget of February 20, 2007, presented by Finance Minister Carole Taylor, contained the following measures related to payroll.

Personal Income Tax Rates and Credits

Personal Tax Rates

Personal tax rates have been cut to help every taxpayer with their housing costs. Effective for the 2007 and subsequent tax years, the province will reduce the four lowest personal income tax bracket rates and reduce the phase-out rate for the B.C. Tax Reduction such that all taxpayers will receive a reduction in personal income taxes payable. The tax rate changes will mean at least a 10% personal income tax cut up to $100,000. The direct benefit to taxpayers will be approximately $515 million on a full-year basis.

The four lowest tax bracket rates are reduced by about 5% for the 2007 tax year and by about 10% for the 2008 and subsequent tax years. The phase-out rate for the BC Tax Reduction is reduced from 3.6% to 3.4% for 2007 and to 3.2% for 2008 and subsequent tax years. The table below shows British Columbia's personal income tax brackets and corresponding rates before and after the changes for 2007 and 2008. The tax rates will be adjusted effective July 1, 2007 for source deduction purposes.

Taxable Income	*2007 British Columbia Tax Rate*	*2008 British Columbia Tax Rate*
up to $34,397	5.70%	5.35%
$34,397.01 – $68,794	8.65%	8.15%
$68,794.01 – $78,984	11.10%	10.50%
$78,984.01 – $95,909	13.00%	12.29%
Over $95,909	14.7%	14.7%

Adoption Expense Tax Credit

Effective for the 2007 and subsequent tax years, the province will provide an Adoption Expense Tax Credit. The credit will be harmonized with the federal adoption expense tax credit and will be calculated using the same expenses used to calculate the federal credit but using the provincial non-refundable tax credit rate. The maximum expenses that can be claimed is $10,445 for 2007 (indexed to national inflation) and will provide parents with a provincial personal income tax reduction of up to $595 for 2007. It is expected that about 600 families will be able to claim the credit each year.

Enhanced Dividend Tax Credit

As announced on October 10, 2006, the province is implementing an enhanced dividend tax credit at the 12% rate effective for 2006 and subsequent tax years. The change parallels the new federal enhanced dividend tax credit mechanism and will reduce the extent to which corporate income is taxed at both the corporate and personal level.

Under the new enhanced dividend tax credit mechanism for personal income tax:

- eligible dividends will be determined under federal income tax rules;
- dividends will be grossed up by 45% and added to taxable income;
- a new enhanced dividend tax credit will apply to the grossed up amount (federal rate is 19% and BC rate is 12%).

The existing B.C. dividend tax credit of 5.1% is unchanged and will continue to apply to dividends that are subject to the existing federal gross up of 125%. This is primarily dividends paid by corporations eligible for the small business deduction.

B.C. Training Tax Credit

As previously announced, a package of training tax credits for employers and employees is introduced to help address the skill shortage in B.C. There are three main elements to the training tax credits:

- basic credits;
- completion credits; and
- enhanced credits for First Nations individuals and persons with disabilities.

British Columbia's basic credits will complement the federal government's incentives for apprenticeship training which are limited to the first two years in Red Seal apprenticeship programs (apprentice programs that are recognized across Canada). British Columbia's basic training tax credits will provide similar incentives to B.C.-recognized (non-Red Seal) apprenticeship programs not currently eligible for the federal incentives.

The basic credit for employers will be 10% of wages paid up to $2,000 per apprentice in the first 24 months of a non-Red Seal apprenticeship program. The basic credit for employees will be $1,000 per year for completing the first year or second year levels of any non-Red Seal apprenticeship program.

British Columbia's completion credits will apply to both Red Seal and non-Red Seal apprenticeship training programs and provide further benefits tied to the completion of higher training levels. The employer credits will be the lesser of $2,500 or 15% of wages paid to an apprentice that completes level 3 of any apprenticeship program, and up to $3,000 or 15% of wages paid to an apprentice that completes level 4 or higher of any apprenticeship program. The employee credits will be $2,000 for an apprentice that completes level 3 of any apprenticeship program, and $2,500 for an apprentice that completes level 4 or higher of any apprenticeship program.

To encourage greater participation in trades training in respect of First Nations individuals or persons with disabilities, individual and employer tax credits will be 50% higher than they would otherwise receive. Eligible First Nations individuals are those persons who hold Status Indian cards, and persons with disabilities are those eligible for the disability amount credit on their income tax return.

The employer credits are effective for wages paid after December 31, 2006 and the employee credits are available for the 2007 and subsequent tax years. The credits will be scheduled to expire effective January 1, 2012.

Quebec

The 2007 Quebec Budget of February 20, 2007, presented by Finance Minister Michel Audet, contained the following measures related to payroll.

Personal Income Tax Rates and Credits

Personal Tax Rates

In order to pursue the government's commitment to reducing the tax burden of Quebecers to the Canadian average, the taxable income thresholds to which the rates of the personal income tax table apply will be raised by 7% on January 1, 2008. This increase represents a tax cut of $250 million for 2.4 million taxpayers in 2008. The table below sets out the new tax rates.

Taxable Income	*Quebec marginal rate*
up to $32,000	16%
$32,000 – $64,000	20%
$64,000 and over	24%

As of January 2009, the thresholds and ceilings establishing the taxable income brackets will be indexed.

Existing Tax Credits

The 2007-2008 Budget Speech also provides for an increase from $1,000 to $1,500 in the tax credit for retirement income.

New Tax Credits

Because education and families are also among the government's priorities, the 2007-2008 Budget Speech announced a number of new initiatives.

Volunteer respite services to informal caregivers:

Because health is a priority, and to recognize the volunteer work of many citizens on behalf of people with a disability, the 2007-2008 Budget Speech announces, as of the 2007 taxation year, a new refundable tax credit of up to $500 for people providing volunteer respite services to informal caregivers.

Quebec RESP:

To encourage Quebec families to save more for their children's post-secondary education, the 2007-2008 Budget Speech announces that contributions to a registered education savings plan (RESP) now give entitlement to a refundable tax credit for education savings paid by the Quebec government.

The tax credit is based on RESP contributions from parents, grandparents or anyone wishing to participate in a child's education. The tax assistance for education savings will equal 10% of the first $2,000 in annual contributions. In the case of low- and middle-income families:

- the rate of the tax credit may increase from 10% to 20% on the first $500 contributed yearly;
- the rate will remain at 10% for contributions over $500, to a maximum of $2 000.

Thus, for an annual contribution of $2,000, the Quebec government will add:

- $200 (10%) for a family income of over $74,357;
- $225 (11.25%) for a family income of over $37,178 to $74,357;
- $250 (12.5%) for a family income of $37,178 or less.

The maximum lifetime tax credit granted for one child is $3,600.The tax credit will be paid into the beneficiary's RESP account, on top of the contribution. The investment income generated by the contributions and tax credit will accumulate sheltered from tax until the child begins post-secondary studies. The accumulated amounts will become taxable for the child once they have been received by the latter in the form of an education assistance payment.

The Quebec tax credit is in addition to the federal education assistance granted on annual RESP savings.

Tax assistance for parents with children engaged in vocational training or post-secondary studies:

Also, to relieve the tax burden of parents who financially support a child engaged in postsecondary studies, the 2007-2008 Budget Speech provides for the enhancement and simplification of the tax assistance for parents with children engaged in vocational training or post-secondary studies.

- Transfer of tuition and examination fees to parents: Tuition and examination fees paid during a year give entitlement to a nonrefundable tax credit in the calculation of income tax payable by students. The portion of tuition and examination fees not used to offset the amount of income tax payable by the student is deferrable to the following years. Since parents often pay all or part of their children's tuition fees, students may, as of the 2007 taxation year, transfer the unused portion of tuition and examination fees for the year to their parents so that they can reduce their income tax.
- Enhancement of the tax credit for parents of a child under 18 who is a student. The tax system grants parents a maximum tax credit of $3,720 for children engaged in vocational training or post-secondary studies. The amount of the tax credit is reduced by the amount of the child's net income. The tax system will be amended as of the 2007 taxation year to reduce the tax credit by an amount equal to 80% of the child's net income, rather than 100%. In addition, scholarships and bursaries will no longer be considered in the calculation of the child's income for the purposes of reducing the tax credit

granted to the parents. These changes will increase the value of the tax credit for parents.

- Transfer to parents of the amount for recognized needs of a child over 18 who is a student. As of the 2007 taxation year, the tax credit claimed by parents for an adult child who is a student ($6,504) will be replaced by a transfer to parents of the unused portion of the amount of recognized essential needs for the child ($6,650). The maximum amount for recognized essential needs that may be transferred by the child will be equal to the amount of the tax credit it replaces. In addition, scholarships and bursaries received by students will no longer reduce the amount of the tax credit that may be transferred to the parents. Consequently, the tax credit claimed by parents for adult children will be higher.

Refundable Tax Credit for child care Expenses:

Lastley, the Finance Minister also announced the enhancement of the refundable tax credit for child care expenses. As of 2007, the refundable tax credit for child care expenses will be granted regardless of earned income. This change will substantially increase the financial assistance granted to families whose child care expenses exceed the household's lowest earned income. It will also greatly simplify calculation of the tax credit.

Thus, spouses who run a family business (e.g.; a farm), where the business makes a profit and only one of the spouses reports earned income, will now be able to claim the tax credit even if the income of the spouse with the lowest earned income is below the incurred child care expenses. For example, the annual gain for a couple whose only earned income is a net business income of $25,000 and whose child care expenses are $7,500 will be $5,250.

A single-parent family whose reported business income is less than its incurred child care expenses and the family has no other earned income will benefit from the full value of the tax credit.

Promoting Phased Retirement

In the wake of the Forum des generations held in October 2004, the government decided on a number of initiatives to meet the challenges posed by Quebec's public finances and demographic changes.

One of those initiatives consisted in developing measures to encourage phased retirement in pension plans so as to keep individuals close to the end of their career working for a longer time. Phased retirement enables individuals to leave the labour market gradually by continuing to work part-time for a defined period rather than taking full retirement right away.

The government set up a committee consisting of representatives of several government departments as well as employer and labour groups to propose solutions to make phased retirement more attractive.

In the 2006-2007 Budget Speech, further to the committee's recommendations, the Quebec government made a commitment to work with the federal government for the purpose of implementing the new provisions to encourage phased retirement. In this respect, the Minister of Finance of Québec presented his federal counterpart with the proposals set forth in this document. The federal government is currently analysing these proposals.

In November 2006, the Quebec government passed a recommendation designed in particular to authorize the ministère des Finances du Québec, jointly with the ministère de l'Emploi et de la Solidarité sociale and the Régie des rentes du Québec, to continue talks with the federal government with a view to applying the new provisions promoting phased retirement. In the 2007-2008 Budget Speech, the Quebec government is presenting the detailed analysis behind the proposals for phased retirement.

Workers retiring early

The average retirement age in Quebec has fallen substantially over the last 30 years. For example, between 1970 and 2000, the average retirement age of men decreased by five years, from 65 to 60. Although the same trend has been observed for Canada as a whole, it is more heightened in Quebec.

As these trends show, the number of years spent in the labour market is dropping while the number of years spent in retirement is rising. In the context of an aging population and the possible labour shortage it may lead to, it will be important to encourage workers to remain in the labour force longer.

Pension plans provide little incentive to continue working

There is little incentive for workers, especially those participating in a private sector supplemental defined benefit plan, to continue working after age 60. According to a statistical portrait of such plans, the average percentage of individuals who are fully retired increases rapidly between the ages of 55 and 60, from 14% to 65%. This proportion increases to 83% at age 63.

This rapid increase in retirement rates between ages 55 and 60, as well as the marked decrease in the average retirement age, is primarily attributable to the financial benefits of early retirement.

The current phased retirement provisions are not attractive to workers:

Even though private sector supplemental defined benefit pension plans currently provide for phased retirement, only marginal use is made of this form of retirement, primarily because of the existing tax legislation and the laws regulating pension plans.

For example, a representative worker aged 60 would receive, after taxes and contributions, an additional net income of just $4.32 for each hour worked during phased retirement, whereas his or her gross hourly salary is $28.85. In this case, only individuals with a marked preference for working opt for phased retirement.

Encouraging individuals to prolong their working life

Based on the work carried out by the Comité sur la retraite progressive,the government is proposing new provisions to encourage the use of this form of retirement and enhance the work incentive for individuals close to the end of their career. These terms and conditions would apply to private sector supplemental defined benefit pension plans.

More specifically, the new terms and conditions should aim to:

- enable payment of a pension and employment income simultaneously with the accumulation of service under a retirement plan;
- enable payment of incidental benefits in the case of phased retirement or fulltime employment.

To ensure that the new terms and conditions of phased retirement are not more advantageous than full-time employment, which would result in a reduced labour supply:

- access to phased retirement would be allowed as of age 60 or 30 years of service. For example:
  - a worker aged 60 with less than 30 years of service would be eligible for the new phased retirement mechanisms,
  - a worker aged 55 with 30 years of service would also be eligible,
- the pension paid during phased retirement would be proportional to the reduction in work time;
- payment of incidental benefits would be permitted as of age 60 or 30 years of service to encourage late retirement.

Access to these new terms and conditions of phased retirement would not be a right for workers and must be covered by an agreement between them and their employer.

The federal tax legislation and the Quebec *Supplemental Pension Plans Act* must be amended in order to apply the new terms and conditions.

Impacts of the proposed changes

The new terms and conditions would make phased retirement more flexible and more attractive. Following an agreement with an employer, a worker could reduce his or her work time and, in return for lower income, receive financial compensation from the pension plan while continuing to contribute to it in order to accumulate service on the basis of the full-time salary.

Impact on income during phased retirement:

The new terms and conditions would enable workers to maintain their standard of living, while working part-time rather than full-time. For example, according to one of the scenarios proposed, during phased retirement, a representative worker would receive a net income of $35,239 at age 60 while working just three days a week, compared with $37,002 working full-time.

Impact of phased retirement on future income:

The new terms and conditions of phased retirement would improve a person's income while working as well as after he retires. .

Thanks to the new terms and conditions of phased retirement, the same person would receive $34 383 more net income during retirement compared with $15 534 under the current system.

This represents net income of $9.55 for each hour worked during phased retirement from ages 60 to 63, compared with $4.32 per hour under the current system.

Positive effects on labour supply:

This enhancement would increase income enough during phased retirement to encourage workers to stay in the labour market. In the example given, the new terms and conditions would push, on average, four out of ten workers aged 55 to 65 to prolong their working life by one year.

In the current demographic context, a strategy to encourage workers close to the end of their career to continue working would have several positive effects:

- employers would be assured of skilled and experienced workers who, by remaining at work, would increase productivity and encourage the transfer of knowledge within the business;
- employees would have a new option offering more flexibility in transitioning from work to full retirement;
- these factors would have a positive effect on the supply of labour and would enhance economic growth.

Northwest Territories

The 2007 Northwest Territories Budget of February 8, 2007, presented by Finance Minister Floyd Roland, contained no new tax increases/decreases affecting payroll. It did, however, indicate that the N.W.T. would be seeking an increase in the Northern Residents Deduction.

Need To Know

Manitoba Employment Standards Amendments Become Law April 30, 2007

The most comprehensive changes to the *Employment Standards Code* in 30 years will come into effect April 30,2007 Labour and Immigration Minister Nancy Allan has announced. "The extensive changes to legislation and regulations being implemented better reflect the realities of today's workplaces", said Allan.

Highlights of the changes include:

- clear criteria governing the exclusion of managers from hours of work and overtime provisions;
- exemptions from hours of work and overtime for employees who earn a minimum annual amount and exercise substantial control over their work schedule;
- three new unpaid days for illness or to attend to family responsibilities and three new unpaid bereavement days;
- improved statutory holiday pay provisions for part-time workers;
- new graduated termination notice rules based on employees' years of service;
- guaranteeing employees who report for work minimum pay of three hours or pay for the regularly scheduled shift, whichever is less;
- new measures to promote compliance with the legislation including fines for repeat offenders;
- streamlining the process for obtaining averaging permits and hours of work variances;
- new protections for children including specific restrictions on hours of work for those under 16 years of age and prohibiting those under 18 from working alone at night;
- limiting the liability of company directors in cases of bankruptcy or closure;
- improving the ability to recover earned wages;
- provisions to prevent deductions from pay where there is no direct benefit to the worker;
- improving overtime pay provisions for incentive-based workers;
- improved coverage for domestic workers and live-in nannies;
- prohibiting employment of those under the age of 18 in higher-risk industries; and
- expanding the definition of a family member to qualify for various statutory leaves. The expanded definition of family leave came into effect January 31, 2007 to ensure individuals can access the compassionate care leave benefits under the Employment Insurance program.

Bill 2 (now S.M. 2006, c. 26), the *Employment Standards Code Amendment Act*, was previously summarized in Report No. 137 dated November 2006 and Report No. 138 dated December 2006.

With this Report, we have begun the process of incorporating the new Manitoba Employment Standards into PaySource.

The new provisions have been incorporated into the "Employment Standards" section of PaySource at the following sections:

- Minimum Age, ¶5116;
- Vacations With Pay, ¶5326;
- Statutory Holidays, ¶5426;
- Payment of Wages, ¶5726; and
- Maternity, Parental and Misc. Leaves, ¶5926.

Saskatchewan Northern Overtime Exemption Report Issued

The Northern Overtime Exemption is a regulation that exempts employees working north of Township 62 from sections 6 and 12 of the *Labour Standards Act*. Most of Saskatchewan's north is affected by the exemption. It applies to the area north of a line beginning approximately at Meadow Lake Provincial Park's southern boundary, eastward to the northern boundary of Prince Albert National Park, and ending at a point five miles north of Sturgeon Landing at the Manitoba–Saskatchewan border. The exemption does not affect the towns of Uranium City, La Ronge, Creighton and the surrounding 10 km areas.

Section 6 of The *Labour Standards Act* establishes the eight-hour workday and 40-hour workweek. This section also obliges payment of an overtime premium of time and a half regular earnings for hours worked in excess of the standard workday or workweek. Section 12 is the right to refuse overtime work. Overtime work may be refused if 44 hours have been worked in a week, except in an emergency circumstance. Employer reprisals for refusing overtime are not permitted under section 12.

A review of the Northern Overtime Exemption was held during the fall of 2006 and was previously summarized in Report No. 134 dated August 2006.

A summary of the recommendations of the review committee is set out below.

1. Eliminate the Northern Overtime Exemption without delay. Northern workers overwhelmingly wish to be treated fairly and enjoy all the labour standards protections that are currently afforded to those working outside the Northern Exemption area. Labour standards in the North must be aligned with the rest of the province. It is socially divisive and no longer acceptable to have a

two-tiered structure that lets a northern worker legally be denied the standard workday of eight hours and a workweek of 40 hours, earn an overtime premium for excess hours worked, or refuse unwanted overtime work. Both workplace parties recognize that the averaging of hours permit system is a flexible *Labour Standards Act* option that will satisfy the North's unique work scheduling needs for most, if not all, employees and employers.

2. Establish a labour standards office in La Ronge with at least two officers. The officers will provide public education on all aspects of labour standards to employers and employees. Expand staff duties to include monitoring and compliance responsibilities upon completion of the initial public education phase. Workplaces in the Northern Overtime Exemption area will benefit from a transition period that allows both employers and employees to adapt to sections 6 and 12 of the *Labour Standards Act*. A comprehensive public education program will help minimize adjustment difficulties and, in addition, raise awareness of other labour standards obligations. Initially, public education will be the main duties of the two officers, including visiting communities to host workshops. Program material should be provided in three languages: English, Cree and Dene.

3. Treat fishers and trappers as primary producers (traditional family farm) under the *Labour Standards Act*. These sectors are mainly small family operations, or individuals. Section 6 (hours of work) and section 12 (right to refuse overtime) are not pertinent to these seasonal activities. Individuals engaged in trapping and fishing should be treated under the *Labour Standards Act* in the same fashion as the traditional family farm.

4. Grant a province-wide regulatory exemption to sections 6 and 12 of the *Labour Standards Act* to outfitters. Outfitting is one of Saskatchewan's most important tourism activities. Outfitters and their employees must maximize earnings within a short season. Camps in remote northern locations would face operational challenges adopting a standard or modified work schedule. The provinces of British Columbia and Ontario exempt – through labour standards regulations – hunting and fishing guides from statutory hours of work and overtime provisions. Regulations in Manitoba and Alberta do not exempt hunting and fishing guides. The Northern Overtime Exemption Review recommends that outfitting receive a general, province-wide exemption from sections 6 and 12 to recognize the sector's seasonal nature and its unique work and remuneration arrangements.

5. Maintain and publicize existing *Labour Standards Act* provisions. Compressed workweeks, averaging of hours permits and other variances, provide sufficient flexibility to accommodate northern Saskatchewan's unique work scheduling needs. No further statutory or regulatory exemptions – occupational or sectoral – are required beyond those recommended above. Options under the Saskatchewan *Labour Standards Act* currently allow modified work schedules. Three are especially suited for the North's unique work scheduling needs. These are the averaging of hours permits under section 7 (compressed workweek) and section 9 (permits) and the weekly Day of Rest exemption set out in section 13. Most averaging of hours applications qualify for approval by Saskatchewan Labour. Annually, about 600 averaging permits are issued. Many northern employers already operate with shift arrangements that meet averaging of hours criteria. Some already have experience with section 7 and 9 permits because they also have operations situated outside of the Northern Overtime Exemption area. Some northern employers will be bound by contractual arrangements that may extend beyond the set date for compliance with sections 6 and 12 of the *Labour Standards Act*. This requires monitoring and may require attention on a case-by-case basis.

Subscribers will be notified when any legislative or regulatory changes are made.

Minimum Wage Increase Reminders

The new minimum wage rates have been incorporated into the "Employment Standards" section of PaySource at ¶5505; ¶5534; ¶5536; ¶5540; and ¶5546.

Saskatchewan

On March 1, 2007, the minimum wage will increase to $7.95 per hour, up from the current level of $7.55 per hour.

Manitoba

On April 1, 2007, the minimum wage will increase to $8.00 per hour, up from the current level of $7.60 per hour.

Prince Edward Island

On April 1, 2007, the minimum wage will increase to $7.50 per hour, up from the current level of $7.15 per hour.

Yukon

On April 1, 2007, the minimum wage will increase to $8.37 per hour, up from the current level of $8.25 per hour.

Nova Scotia

On May 1, 2007, the minimum wage will increase to $7.60 per hour, up from the current level of $7.15 per hour. The minimum wage for inexperienced workers – those with less than three months employed in the type of work they are hired to do – will rise to $7.15 per hour from $6.70.

Recent Cases and Rulings

Penalties imposed on corporate taxpayer for late source deduction remittances upheld

The Minister assessed the corporate taxpayers for penalties for late source deduction remittances for the period ending April 30, 2004 (the "Remittances"). The Tax Court of Canada dismissed the taxpayers' appeals (2005 DTC 1417). The taxpayers appealed to the Federal Court of Appeal.

The taxpayers' appeals were dismissed. The Tax Court judge correctly determined whether: (a) the taxpayers were "prescribed persons"; (b) the source deduction remittance period ended on May 3, 2004; (c) the "average monthly withholding amounts" in Regulation 108(1.2)(*b*) were miscalculated; (d) the Remittances were not received by the Minister until May 7, 2004; and (e) the taxpayers could have avoided the mistake of failing to make the Remittances to a financial institution. There was no reason to interfere with the Tax Court judge's conclusions.

N.A. Johnson Ltd. et al., (Federal Court of Appeal), 2007 DTC 5001.

Minister's decision-makers failed to consider relevant factors in decision not to waive source deductions remittance penalty

The Minister assessed the corporate taxpayer, a "large employer", for a penalty under paragraph 227(9)(*a*) of the Act because the taxpayer remitted source deductions directly to the CRA instead of to a financial institution. In a two-level decision, the Minister refused to waive this penalty, on the ground that the circumstances were not extraordinary. The taxpayer applied to the Federal Court for judicial review.

The taxpayer's application was granted. The applicable standard of review was reasonableness (*Lanno v. CCRA*, 2005 DTC 5245 (F.C.A.)). The Minister's decision-makers ignored a number of relevant factors, including whether, by accepting the taxpayer's large source deductions cheque, the CRA cashier made an "error in processing". An "error in processing" is listed in paragraph 6(*d*) of information circular 92-2 as an "extraordinary circumstance". Therefore, the matter was referred back to the Minister for reconsideration.

McNaught Pontiac Buick Cadillac Ltd., (Federal Court Trial Division), 2007 DTC 5014.

Payment to taxpayer on leaving his employment was retiring allowance

After failing to obtain a promotion, the taxpayer filed a grievance against his employer, the Canada Revenue Agency ("CRA"), alleging discrimination. Following mediation, the taxpayer agreed to retire, and was given 21 weeks' pay, amounting to $20,613, as a "departure premium" under the relevant collective agreement, plus two weeks' salary in place of vacation, amounting to $1,965. In assessing the taxpayer for 2002, the Minister included the $20,613, plus the $1,965, in his income. On his appeal to the Tax Court of Canada, the taxpayer argued that there was no section in the Act under which these amounts could be included in his income, since they represented either a gift or payments resulting from the CRA's tortious conduct.

The taxpayer's appeal was dismissed. The taxpayer produced no evidence to support his argument. The two amounts in dispute fell within the definition of "retiring allowance" in subsection 248(1) of the Act. They were paid to him in recognition of his many years of service when he left the CRA's employ. Both amounts were properly included in his income for 2002.

Alcindor, (Tax Court of Canada), 2007 DTC 89.

Director personally liable for unremitted corporate Part XIII tax

The taxpayer was a director of a corporation (the "Corporation") that engaged the services of non-resident persons to produce a motion picture in Canada. The Minister assessed the taxpayer vicariously for the Corporation's unremitted Part XIII tax on payments made by it to the non-resident persons performing services for it in Canada (the "Payments"). On his appeal to the Tax Court of Canada, the taxpayer put forward a due diligence defence, and also sought to impugn the accuracy of the underlying corporate assessment. His allegation was that only some of the persons who had received the Payments from the Corporation were liable for Part XIII tax on them.

The taxpayer's appeal was dismissed. Without adequate supporting evidence, it was impossible to determine whether the taxpayer's allegations about the accuracy of the corporate assessment were well-founded. Also, hiring a payroll company to process the Payments for the Corporation was not sufficient to establish due diligence on the taxpayer's part. In addition to hiring the payroll company, the taxpayer had a duty to oversee what that payroll com-

pany was doing, particularly since he was the directing mind behind the Corporation.

Hamilton, (Tax Court of Canada), 2007 DTC 121.

Minister did not have discretion to refund employment insurance premiums paid by taxpayer

In a second-level decision, the Minister refused the applicant's request to refund employment insurance ("EI") premiums on the grounds that (a) the fairness provisions of the Act are inapplicable to EI premiums, and (b) the applicant's request was statute-barred. On his application to the Federal Court for judicial review, the applicant sought an order compelling the Minister to grant relief by using his reassessment powers under the fairness provisions of subsection 152(4.2) of the Act, and award $5,000 in damages for stress, duress, and time lost in attempting to achieve fair treatment.

The taxpayer's application was denied. The fairness provisions of the Act apply only to income tax. The *Unemployment Insurance Act* places what is essentially a three-year limitation on a request for refunds of premiums paid. Therefore, the Minister had no discretion to grant the relief being requested, and the Court was without power to assist the taxpayer. Also, the taxpayer's claim for $5,000 in damages could not be made in judicial review proceedings.

McGaw, (Federal Court Trial Division), 2007 DTC 5009.

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