Tax Notes

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UPDATE ON THE EXEMPTION FOR NON-RESIDENTS FROM PAYROLL WITHHOLDING

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In the 2015 Canadian Federal Budget ("Budget 2015"), the Minister of Finance announced a program to ease the administrative burden associated with Canadian withholding on the salary, wages, or other remuneration paid to non-resident employees performing their duties in Canada for a short period of time. These measures aim to remove certain 'qualifying non-resident employers' and 'qualifying non-resident employees' from the withholding requirements imposed under subsection 153(1) of the *Income Tax Act* (Canada) (the "Tax Act"). Furthermore, these measures will alleviate the need for qualifying non-resident employees to apply for waivers from withholding (commonly known as regulation 102 waivers).

The Canada Revenue Agency ("CRA") recently released form RC473 which should be used by non-resident employers who wish to get certified by the CRA in order to participate in the program. This article outlines the existing withholding regime imposed on non-resident employees, the new exemption contained in the Legislative Proposals Relating to the *Income Tax Act* and Regulations released July 31, 2015 (the "Proposed Amendments"), and the certification process employers will need to complete in order to participate in the program.

This program is a step forward in modernizing Canada's employee withholding regime as it applies to non-residents of Canada carrying out their employment duties in Canada for short periods of time.

The Existing Employee Withholding Regime and Non-Residents of Canada

Pursuant to subsection 153(1) of the Tax Act, every person (including non-resident employers) paying salary, wages, or other remuneration is required to withhold and remit the amount determined in accordance with the *Income Tax Regulations* (the "Regulations"). Subsection 104(2) of the Regulations limits the withholding requirement applicable to remuneration paid to non-resident employees to the remuneration reasonably attributable to the duties performed or to be performed in Canada by the non-resident person.

As such, the Tax Act aims to impose employee withholding on non-residents to the extent they perform any employment duties in Canada regardless of whether these non-resident employees will ever have an ultimate tax liability under the Tax Act. The Tax Act also imposes penalties for failure to withhold amounts required even where no tax would ultimately be payable. Amounts which are withheld and remitted can only be recovered by the employee if they file a Canadian income tax return.

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Businesses that have employees coming to Canada from other countries are subject to these withholding rules even though many of the employees will not ultimately be subject to tax in Canada as a result of protection under one of Canada's tax treaties. For instance, where a business traveler is resident in the United States, the *Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital* (the "Treaty") provides at Article XV that where such a person exercises employment in Canada, they are only taxable in the United States if such remuneration does not exceed $10,000 or the employee is only present in Canada for a period or periods not exceeding 183 days in a twelve-month period and not borne by a permanent establishment in Canada.

To deal with such situations, the CRA allows for employees resident in a country with which Canada has a tax treaty to apply for a regulation 102 waiver which can be presented to the employer in order to waive the withholding requirements. These waivers are essentially an opportunity for the CRA to verify that a particular income tax treaty will apply to protect the employee from Canadian tax in the circumstances.

However, unlike the equivalent process in many other countries, the process for obtaining a regulation 102 waiver requires at least thirty days of lead time and is time consuming to complete, making application impractical in many situations. This is especially true in situations where the employee does not know ahead of time if or when they may be traveling to Canada. Moreover, the CRA has imposed its own administrative policies over and above the requirements set out in most treaties, such as requiring the employee to apply for a tax number and provide a copy of the employment contract, making regulation 102 waivers costly and burdensome to obtain.

The New Exemption

Recognizing that the existing system was impractical for many business travelers, Budget 2015 proposed to streamline the regulation 102 withholding compliance requirements for non-resident employers in relation to non-resident employees working in Canada. As set out in the Proposed Amendments, "qualifying non-resident employers" are not required to withhold tax pursuant to subsection 153(1) of the Tax Act on amounts paid to "qualifying non-resident employees".

A 'qualifying non-resident employee' is defined in the Proposed Amendments to mean an employee who:

(a) is, at that time, resident in a country with which Canada has a tax treaty;

(b) is not liable to tax under Part I of the Tax Act in respect of the payment because of that treaty; and

(c) works in Canada for less than 45 days in the calendar year that includes that time or is present in Canada for less than 90 days in any 12–month period that includes that time.

A 'qualifying non-resident employer' is defined in the Proposed Amendments to mean an employer who:

(a) is either resident in a country with which Canada has a tax treaty, or in the case of an employer that is a partnership, the entitlement to 90% or more of the income or loss of the partnership is to a resident of a country with which Canada has a tax treaty;

(b) does not, in the relevant year, carry on business through a permanent establishment in Canada; and

(c) is certified by the CRA.

Pursuant to the definition of 'qualifying non-resident employee', the new exemption is only available where the non-resident employee is eligible for benefits under one of Canada's tax treaties and works in Canada for less than 45 days in the calendar year or is present in Canada for less than 90 days in any twelve-month period. These time restrictions came as a surprise since most if not all of Canada's tax treaties exempt employees from Canadian tax so long as they are not present in Canada for a period or periods exceeding 183 days in any 12-month period. Because of this arbitrary restriction set out in the Proposed Amendments, there could still be a large number of business travelers who will either be required to apply for a regulation 102 waiver, or be subject to withholding tax and be required to file a return to obtain a refund of the tax pursuant to protections under one of Canada's tax treaties.

Pursuant to the definition of 'qualifying non-resident employer', the new exemption is only available where the non-resident employer is resident in a country with which Canada has a treaty, the employer does not have a permanent establishment in Canada during the relevant year, and certification is obtained.

Qualifying Non-Resident Employer Certification

Certification is obtained by completing and submitting form RC473, which was released by the CRA in January 2016. Form RC473 requires identification of the employer, the industry in which it operates, the types of services the employees in Canada will provide, a residency declaration, and a requirement that the employer obtain a CRA business number.

The CRA requests that the form be sent at least 30 days prior to the date a qualifying non-resident employee begins providing services in Canada. Once an employer is certified, it will be considered a qualifying non-resident employer and will not be required to withhold tax on remuneration paid to qualifying non-resident employees. Certification will be valid for a period of two years, subject to renewal.

The CRA can revoke the certification at any time if the employer ceases to satisfy one of the required conditions, at which time the employer may become liable to withhold and remit tax and be subject to any related penalties.

Record Keeping and Reporting for Qualifying Non-Resident Employers

It should be noted that even though this process removes the employer from the withholding and remitting requirements for qualifying non-resident employees, certain reporting obligations remain. Qualifying non-resident employers will be required to:

(a) determine whether the employees are resident in a country with which Canada has a tax treaty,

(b) track and record the number of days each employee is either working in Canada or is present in Canada and the income attributable to these days,

(c) complete and file the applicable Canadian income tax returns for the calendar years under certification, and

(d) prepare and file a T4 Summary and Information Return for the employees that are not excluded by proposed subsection 200(1.1) of the Regulations.

Proposed subsection 200(1.1) of the Regulations exempts T4 reporting for amounts that qualify under these new exemptions if the employer, after reasonable inquiry, has no reason to believe that the employee's total amount of taxable income earned in Canada under Part I of the Tax Act during the calendar year is more than $10,000.

What This Means for Non-Canadian Businesses

While these new exemptions do not cover every type of business traveler to Canada, they are very helpful for employers that periodically send employees to Canada for short periods of time. This is especially true in circumstances where business trips are unplanned or occur in a manner that does not allow sufficient time to obtain a regulation 102 waiver. For these non-resident employers, it will certainly be easier to comply with this new program, rather than rushing employees to obtain a regulation 102 waiver or withholding and remitting tax on the employees' behalf. Once in the program, qualifying non-resident employers should continue to monitor employee travel and require employees that will be working in Canada for more than 45 days or present in Canada for more than 90 days to apply for regulation 102 waivers to ensure no withholding will be required.

A number of tax lawyers from Dentons Canada LLP write commentary for Wolters Kluwer's Canadian Tax Reporter *and sit on its Editorial Board as well as on the Editorial Board for Wolters Kluwer's* Income Tax Act with Regulations, Annotated. *Dentons Canada lawyers also write the commentary for Wolters Kluwer's* Federal Tax Practice *reporter and the summaries for Wolters Kluwer's* Window on Canadian Tax. *Dentons Canada lawyers wrote the commentary for* Canada–U.S. Tax Treaty: A Practical Interpretation *and have authored other books published by Wolters Kluwer:*

Canadian Transfer Pricing *(2nd Edition, 2011);* Federal Tax Practice*;* Charities, Non-Profits, and Philanthropy under the Income Tax Act*; and* Corporation Capital Tax in Canada. *Tony Schweitzer, a Tax Partner with the Toronto office of Dentons Canada LLP and a member of the Editorial Board of Wolters Kluwer's* Canadian Tax Reporter*, is the editor of the firm's regular monthly feature articles appearing in* Tax Topics.

CURRENT ITEMS OF INTEREST

Department of Finance Releases Legislative Proposals on the Tax Rules for Certain Trusts and Their Beneficiaries

On January 15, 2016, the government released draft legislation for consultation that would change some of the provisions related to the taxation of estates and trusts previously announced in the spring budget of 2014. The proposals contained in this announcement include:

- Clarifying what types of investment funds are excluded from the loss restriction event rules that otherwise limit a trust's use of certain tax attributes (including losses);
- Allowing greater flexibility in the income tax rules for recognizing charitable donations made by an individual's former graduated rate estate; and
- Ensuring that income arising in certain trusts on the death of the trust's primary beneficiary is taxed in the trust and not in the hands of that beneficiary, subject to a joint election for certain testamentary trusts to report the income in that beneficiary's final tax return.

Interested parties wishing to provide comments on the draft legislative proposals are requested to do so by February 15, 2016. Comments can be sent by email to fin.trusts-fiducies.fin@canada.ca or by mail to:

Tax Policy Branch
Department of Finance
90 Elgin Street
Ottawa, Ontario
K1A 0G5

CRA Revises Form 5000-S1A – T1 General 2015 – Family Tax Cut

Budget 2015 introduced a change to the calculation of the Family Tax Cut for 2014 and subsequent years that allows unused tuition, textbook, and education credits to be transferred from a spouse or common-law partner.

This change will ensure that families receive the appropriate value of the Family Tax Cut.

The change may provide affected taxpayers between $2 and $750 more for this credit. The credit claimed by affected taxpayers will be automatically adjusted by the CRA for 2014.

The Minister of National Revenue Waives Reporting Requirements Under Bill C-377

On December 21, 2015 , Diane Lebouthillier, the Minister of National Revenue, announced that she was waiving the reporting requirements for labour organizations and labour trusts arising from Bill C-377, *An Act to amend the Income Tax Act (requirements for labour organizations)*, for fiscal periods starting on December 31, 2015, and through 2016.

These requirements were to have been effective for year ends beginning on or after December 31, 2015. The government plans to repeal Bill C-377. In the meantime this announcement removes the obligation from labour organizations and labour trusts of having to file the reports as indicated therein.

Auto-Fill My Return

On December 23, 2015, the CRA announced that it had renamed the *Tax Data Delivery* ("TDD") program, first introduced in February 2015, to *Auto-fill my return*. The service is also being extended to individuals using *Netfile* to file their returns in addition to those using the *Efile* service.

Auto-fill my return will operate on some certified software and will offer an expanded list of slips, including T3 and T5 slips, for the 2016 tax filing season. In addition, for authorized representatives, *Auto-fill my return* will include the ability to download information available from the Client Data Enquiry ("CDE") webpage in the Represent a Client online portal, without having to complete form T1153, *Consent and Request*. As a result, the System for the Electronic Notification of Debt (SEND) web service, which previously provided this information, will be permanently discontinued effective February 12, 2016.

2016 Automobile Deduction Limits and Expense Benefit Rates for Business

On December 24, 2015, Finance Minister Bill Morneau announced that, subject to two changes, the income tax deduction limits and expense benefit rates that applied in 2015 when using an automobile for business purposes will also apply in 2016.

The two changes for 2016 are:

- the limit on the deduction of tax-exempt allowances paid by employers to employees who use their personal vehicle for business purposes will be reduced by 1 cent to 54 cents per kilometre for the first 5,000 kilometres driven, and to 48 cents per kilometre for each additional kilometre. For the Northwest Territories, Nunavut, and Yukon, the tax-exempt allowance is 4 cents higher, and will be reduced by 1 cent to 58 cents per kilometre for the first 5,000 kilometres driven, and to 52 cents per kilometre for each additional kilometre; and
- the general prescribed rate used to determine the taxable benefit of employees relating to the personal portion of automobile operating expenses paid by their employers will be reduced by 1 cent to 26 cents per kilometre. For taxpayers employed principally in selling or leasing automobiles, the prescribed rate used to determine the employee's taxable benefit will be reduced by 1 cent to 23 cents per kilometre.

FOCUS ON CURRENT CASES

This is a regular feature examining recent cases of special interest, coordinated by *John C. Yuan* and *Christopher L.T. Falk* of McCarthy Tétrault LLP. The contributors to this feature are from McCarthy Tétrault LLP, Montreal, Toronto, Calgary, and Vancouver.

Liberal Interpretation of Appeal Restrictions on Large Corporations

***Devon Canada Corporation v. The Queen*, 2015 DTC 5108 (Federal Court of Appeal)**

The *Devon* case may be helpful for large corporations engaged in complex tax appeals. The case contemplates the circumstances in which a large corporation may raise issues in its notice of appeal to the Tax Court which were not addressed in the corporation's notice of objection.

The taxpayer in this case sought to deduct payments that had been made by predecessor corporations to employees as consideration for the surrender of stock options. The Minister held that because the payments were on account of capital, they were not deductible pursuant to paragraph 18(1)(*b*) of the *Income Tax Act* (the "Act"). Notices of reassessment were issued and the taxpayer filed notices of objection. The notices of objection, as originally filed, raised only the issue of whether the payments were deductible as current expenses in computing the profit or loss of the predecessor companies for purposes of section 9 of the Act.

The taxpayer agreed to hold the notices of objection in abeyance until the release of the decision in the factually similar case *Imperial Tobacco* (2012 DTC 5003). In *Imperial Tobacco*, the Federal Court of Appeal decided that the payments made to the corporation's employees in exchange for surrendering options were on account of capital, and therefore not deductible pursuant to paragraph 18(1)(*b*) of the Act. The taxpayer in the *Devon* case subsequently filed

a memorandum that raised, for the first time, the argument that a deduction should be allowed pursuant to either paragraph 20(1)(*b*) or 20(1)(*e*) of the Act. Explanations and notices of confirmation were issued by the Minister to address the taxpayer's arguments relating to paragraphs 20(1)(*b*) and 20(1)(*e*) (which pertain to eligible capital expenditures and expenses relating to the issuance of shares, respectively). The Minister asserted that the payments were not deductible pursuant to these paragraphs of the Act.

The taxpayer's notice of appeal relied on section 9 and, in the alternative, paragraphs 20(1)(*b*) and 20(1)(*e*). At the Tax Court, the Minister argued that neither paragraph 20(1)(*b*) nor 20(1)(*e*) related to issues raised in the taxpayer's notice of objection. Consequently, the Minister brought a motion to strike the paragraphs of the notice of appeal relating to those paragraphs on the basis of subsection 169(2.1) which, generally, precludes a large corporation from raising issues on appeal to the Tax Court that were not raised in the corporation's notice of objection.

The Tax Court decided that paragraph 20(1)(*b*) raised new issues that were not otherwise addressed in the notice of objection and would have provided the taxpayer with deductions that were unrelated to the payments to cancel the stock options. Paragraph 20(1)(*e*) was held not to raise new issues. The Tax Court of Canada therefore struck the reference to paragraph 20(1)(*b*) but left the reference to paragraph 20(1)(*e*). The taxpayer appealed and the Minister cross-appealed.

At the Federal Court of Appeal, Webb JA (Trudel and Rennie JJA concurring) allowed the taxpayer's appeals and dismissed the Minister's cross-appeals. The Court began by concluding that neither paragraph 20(1)(*b*) nor 20(1)(*e*) was covered by the original notices of objection:

> When Devon was seeking [. . .] to claim a deduction under either paragraph 20(1)(b) or 20(1)(e) of the Act it was raising new issues [. . .] the nature of the claims is different because the new deductions claimed are based on a different premise (payments on account of capital versus a current expense) and on different statutory provisions each with its own set of conditions.

It was nevertheless held that, because paragraphs 20(1)(*b*) and 20(1)(*e*) were specifically referred to in a memorandum filed by the taxpayer during the course of the objection process, and because the Minister considered these submissions (treating them as part of the objection), these submissions should be considered to be part of the notice of objection for the purposes of subsection 169(2.1). The Court noted that the Large Corporation Rules set out in subsection 169(2.1) were introduced to provide the Minister with notice, at the objection stage, regarding the nature and quantum of the dispute. Webb JA noted that:

> If the Minister allows a large corporation to raise additional issues before the objection stage is completed, it is difficult to accept that the Minister would be prejudiced if the large corporation is allowed to continue to pursue those issues before the Tax Court of Canada.

By specifically addressing paragraph 20(1)(*b*) in confirming the assessments under appeal, the Minister was held to have explicitly accepted that the issue related to paragraph 20(1)(*b*) was part of the objection. Although paragraph 20(1)(*e*) was not specifically referenced by the Minister in the notices of confirmation, the arguments raised by the taxpayer in respect of paragraph 20(1)(*e*) were included in the same memorandum in which it raised the arguments with respect to paragraph 20(1)(*b*). The inclusion of paragraph 20(1)(*b*) as part of the objection was thus deemed to imply inclusion of paragraph 20(1)(*e*).

By adopting a flexible approach in surveying the arguments made by the taxpayer and considered by the Minister *throughout* the course of the objection process, the *Devon* case may expand the scope of what has traditionally been considered to be part of a notice of objection. The decision may bode well for large corporations engaged in complex disputes in which the position of the parties evolves as the dispute continues.

— *Krupa Kotecha, Law Student*

RECENT CASES

Implied undertaking rule not applicable where information disclosed prior to commencement of proceedings

The taxpayer had claimed scientific research and experimental development tax credits for the 2007 and 2008 tax years. Following an audit of those claims in 2009, the Canada Revenue Agency issued a reassessment. The taxpayer appealed from that reassessment and, at the time it filed the appeal in 2012, provided a number of documents to the Crown. Those documents were forwarded to the Minister of National Revenue who, based on the information in the documents, issued additional reassessments of the taxpayer. The taxpayer then brought a motion before the Tax Court seeking an order vacating those reassessments on the basis that the making of the reassessments was a violation of the implied undertaking rule. The Tax Court held that the implied undertaking ruled applied and it issued an order providing that the Crown could not use any of the documents in any court proceeding. The Crown appealed from that decision.

The appeal was allowed. The only issue for determination in the appeal was whether the implied undertaking rule applied to the documents provided to the Crown by the taxpayer. The appellate Court noted that the implied undertaking rule applies to evidence that a party to civil litigation is compelled to disclose in the course of that litigation. Consequently, in the Court's view, in relation to appeals before the Tax Court of Canada, the implied undertaking rule does not apply to any evidence that was disclosed prior to the commencement of the proceedings in the Tax Court, or any evidence that a party produced in the course of such proceedings but which it was not compelled to produce. The Court then reviewed the circumstances in which the documents in question had been produced by the taxpayer. The appellate Court concluded that the Tax Court Judge had made a palpable and overriding error in finding that those documents were first disclosed in April of 2012. Rather, the transcript of the hearing showed that those documents had been provided to the Minister in the course of the audit of the taxpayer undertaken in 2009. There was no basis for the finding of the Tax Court Judge that the documents were first disclosed in 2012. Since the evidence showed that the documents were disclosed in 2009, prior to the commencement of the proceedings before the Tax Court, the implied undertaking rule did not apply. An order was issued allowing the appeal, setting aside the order of the Tax Court and dismissing the taxpayer's motion for an order vacating the reassessments.

The Queen v. Fio Corp., 2015 DTC 5126

Court having plenary power to require submissions from parties on issue of mootness of appeal

An order was issued by the Federal Court requiring the Minister of National Revenue to examine the tax return filed by the taxpayer for the 2012 taxation year and to issue a Notice of Assessment with respect to that return. The minister complied with that order, but also sought to continue the appeal to the Federal Court of Appeal, in order to resolve an important point of jurisprudence. The taxpayer advised the minister that as, in his view, the appeal had become moot, he would not be filing an appearance or participating in the appeal. The minister sought direction from the Court on the conduct on the appeal.

An order was issued requiring the parties to make submissions on the mootness of the appeal. The Court noted at the outset that as matters currently stood, a hearing of the appeal could be held at which submissions on the issue of mootness would be heard from only one party, which was clearly unsatisfactory. The Court held, however, that it possessed a plenary power to regulate the procedure of matters before it. That plenary power and the discretion granted under it were to be governed by the objective set out in the Federal Courts Rules of achieving the "just, most expeditious and least expensive determination of every proceeding on its merits." Using those powers, the Court could raise the issue of mootness at any time on its own motion and could call for submissions as to whether an appeal should continue. The Court determined that obtaining such submissions from both parties was the appropriate action. The letter sent by the respondent to the minister, and already filed with the Court, provided clear and complete arguments as to why the appeal should be dismissed on account of mootness. The Court therefore ordered that the minister should respond to those submissions by filing a letter with the Court setting out the arguments as to why the appeal should still be heard. The respondent would then have an opportunity to file reply submissions by letter, following which the matter would be returned to the Court for determination.

MNR v. McNally, 2015 DTC 5122

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