REMOTE WORKING ARRANGEMENTS: TAX PLANNING & PITFALLS

Posted on February 8, 2022

Categories: COVID-19 Resource Centre, COVID-19 Publications, Insights, Publications

The COVID-19 pandemic has caused many employers in Canada to re-examine the extent to which they need to maintain a physical presence. As a result, many employers have closed or downsized their offices, or otherwise introduced temporary or permanent remote work arrangements in order to provide employees with increased flexibility to work from alternate locations such as the employee's home. These new arrangements raise questions as to the impact on an employer's payroll withholding obligations and, in some cases, the appropriate provincial payroll tax rates to apply on remuneration paid to employees. Remote working arrangements can also create issues for employers as they could find themselves inadvertently becoming subject to tax in jurisdictions where they no longer or never have had a physical presence.

This article will consider the following scenarios:

(1) where an employer retains a physical presence in Canada, but no physical presence in the particular province where its employee works, and .

(2) where an employer has no physical presence in Canada but has employees working remotely from locations in Canada.

Interprovincial Considerations

Payroll Withholding Obligations

Regulation 102 of the federal Income Tax Regulations (the "**Regulations**") provides that an employer must withhold on remuneration paid to an employee where the employee reports to work at an establishment of the employer in a province.[1] Regulation 100(4)(a) further provides that where an employee is not required to report to work at any establishment of the employer, the employee will be deemed to report to work at the establishment from which the remuneration is paid.[2]

In the case of an employee working remotely, the withholding rate that should be applied to remuneration paid to the employee is the applicable rate in the province where the payroll department is located, as opposed to the province where the employee is located. However, the individual's taxation rates which they would be required to pay would nonetheless be based on the province in which they reside. This could result in a mismatch where, for example, an employee works remotely in British Columbia but is paid from the company's office located in Ontario. The consequence of such a mismatch could be that there could be inadequate withholdings made from payroll, leaving the employee with a balance due when filing their tax return for the year. In order to address such discrepancies and to smooth out the impact of the balance, the employee may choose to voluntarily request an increase in the amount of regular payroll withholdings otherwise due by completing federal Form TD-1 and providing it to their employer. It is recommended that the employee obtain the assistance of an accountant in filing their tax return, especially with respect to the first year of working remotely, in order to ensure that all claims in respect of interprovincial amounts are properly reported.

The CRA recently confirmed this approach in a statement at the 2021 Canadian Tax Foundation Conference.[3] Despite concerns raised by employers about the administrative burden of an employee having to prepare the TD-1 form and the payroll department then processing it, the CRA did not offer any alternatives but advised that it would continue to monitor trends in the remote working environment.

For employers which have employees that work remotely in Québec, they should note that there may be additional considerations. The employees will need to complete and file the TD-1 form to request additional withholdings, but will also need to request on their provincial tax return to have the federal source deductions transferred to Revenu Québec. While it might have been a simpler alternative for a non-Québec employer to directly make Québec payroll withholdings for employees located in Québec, that is not possible as an employer cannot generally maintain a payroll number in Québec unless they also have an establishment there.

Permanent Establishment Considerations

For income tax purposes, a "permanent establishment" of a taxpayer gives rise to certain tax consequences, such as the requirement to pay income tax and file tax returns. The Regulations set out the definition for "permanent establishment" which is "a fixed place of business of the corporation, including an office, a branch, a mine, an oil well, a farm, a timberland, a factory, a workshop or a warehouse".[4] The Regulations also provide other ways by which a taxpayer can have a permanent establishment such as "where a corporation carries on business through an employee or agent, established in a particular place, who has general authority to contract for his employer or principal…".[5]

Where a taxpayer has a permanent establishment in a province, the employer will be subject to taxation in that province. Where a taxpayer has multiple permanent establishments, the employer will pay taxes proportionate to the gross revenue that is attributable to the permanent establishment in each province.[6]

Ordinarily, an employee working remotely from their home office would generally not be considered to constitute a fixed place of business of the employer. The Canadian Courts have generally found that as the employer does not have control over the employee's home office (i.e. they do not own or lease the space) that this is not considered a fixed place of business of their employer. Specifically, in *Knights of Columbus v. R.*, the Tax Court of Canada emphasized that to be a place of business, the place must have some degree of permanence, and the business of the non-resident must be carried on through that place, to the point where the non-resident has that place of business "at its disposal."[7] Generally, a Court will consider how the premises are used, controlled, paid for, and managed in determining whether or not an employee's home office would constitute a fixed place of business of the employer.

In addition, it may be possible for an employee working remotely to inadvertently create a permanent establishment for their employer in that location in instances where they have "general authority to contract" on behalf of their employer. The CRA has stated that a home office will generally not constitute a permanent establishment, except for when an employee has the general authority to contract and utilizes such authority from a home office.[8] General authority to contract exists when the employee, in the ordinary course of business, is able to bind the corporation on behalf of their employer. Canadian jurisprudence is generally limited to situations with sales representatives, and as such, cases where an employee can approve orders without prior permission have been found to constitute a general authority to contract.[9] In contrast, sales representatives who require approval, or have limited ability to open new accounts for customers have not generally been found by Canadian courts to possess the general authority to contract.[10]

Accordingly, employers should be mindful as to whether, in moving to a remote working arrangement for their employees they may be inadvertently creating a permanent establishment, and thus become subject to tax and tax filing obligations, in provinces where they do not maintain a physical presence.

International Employers

Remote working arrangements may also have tax implications for international companies with Canadian operations. In particular, companies that decide to remove their physical presence from Canada while continuing to retain employees working in Canada, may still have ongoing Canadian tax obligations.

From a payroll withholding perspective, should the employer not have any establishment in Canada, they will need to withhold based on the tax rates of the province where the employee resides.[11]

Companies will also need to consider if they have any Canadian tax obligations or filing obligations should their sole Canadian presence be limited to employees working remotely. These filing and tax obligations would exist where a Company is determined to be "carrying on business in Canada". The concept of "carrying on business in Canada" is defined both by the *Income Tax Act* (Canada) (the "**Tax Act**") as well as the applicable jurisprudence.[12] Generally, only a limited degree of activity taking place in Canada would suffice in order for a company to be considered carrying on business in Canada.

Section 253 of the Tax Act expands the common law definition of carrying on business to include a company that “solicits orders or offers anything for sale in Canada through an agent or servant, whether the contract or transaction is to be completed inside or outside Canada or partly in and partly outside Canada”.[13]

The CRA has outlined a number of general factors to be considered in determining whether a person is carrying on a business in a particular place for the purposes of the Act.[14] These factors include, the place where a contract is made, the place where goods are delivered, the locations where decisions to purchase and sell are made, the location of the business assets, and more factors related to location and proximity of other elements of the business.

Depending on the company’s country of residence, there may be relief available under a tax treaty that the company's home jurisdiction might have with Canada. Generally, many of Canada’s bilateral tax treaties would exempt business profits from taxation in Canada where the company does not have a permanent establishment in Canada. The test for a permanent establishment under Canada’s bilateral tax treaties generally follows that of the test of the Regulations as discussed above. A company could have a permanent establishment in Canada either by having a fixed place of business or if it otherwise has an employee that has the general authority to contract on behalf of the company.[15]

Conclusion

Where an employee is working remotely, the applicable withholding rates will be determined based on the province the employee is paid from. Employers should advise that their employees may complete a TD-1 form where the withholding rate in the province where the employee is located varies from that of the province the employee is paid from. Employers should also be prepared to take on the administrative burden of processing such forms.

While employees working from their home office would generally not be considered to be a fixed place of business of the employer, employees who do have general authority to contract on behalf of their employer could constitute a permanent establishment. Accordingly, employers should review the scope of authority granted to their employees working remotely to ensure that they do not unintentionally have any permanent establishments in those locations.

International employers will need to withhold on remuneration paid to Canadian employees. International employers will also need to determine the scope of their activities in Canada as the mere presence of employees working remotely in Canada could create tax and filing obligations for the employer in Canada.

In sum, while it is likely that remote work arrangements will increase in popularity, employers should consider the tax implications as an important element of such arrangements.

[1] *Income Tax Regulations*, CRC, c 945 (2021) (the "**Regulations**").
[2] See Regulations, *supra* note 1.
[3] Yves Moreno and Stephane Prud'Homme, "CRA Round Table - Consolidated Questions and Answers" (delivered at the Canadian Tax Foundation 73rd Annual Tax Conference, 25 November 2021).
[4] Regulations, *supra* note 1, s 400(2).
[5] Regulations, *supra* note 1, s 400(2).
[6] The Regulations, *supra* note 1, s 402.
[7] *Knights of Columbus v R.*, 2008 TCC 307.
[8] See CRA, Views Doc 2010-0378421I7 (October 13, 2010).
[9] *Enterprise Foundry (NB) Ltd v Minister of National Revenue*, 64 DTC 660.
[10] See *Sunbeam Corporation (Canada) Ltd v MNR*, [1963] SCR 45.
[11] See Regulations, *supra* note 1, s. 100(4)(b).
[12] *Income Tax Act*, RSC 1985, c 1 (5th Supp.), s 253 ("***Tax Act***").
[13] *Ibid* .
[14] See CRA, Views Doc 2012-0438691E5 (October 17, 2012).
[15] See for example the *Convention Between Canada and France for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital* , Canada and France , 2 May 1975, Can TS 1953 No 8 at article 5, paras 1 and 5.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.