BUDGET 2015: INTERNATIONAL TAX - TACKLING ADMINISTRATIVE CHALLENGES

Posted on April 28, 2015

Categories: Insights, Publications

As compared to past federal Budgets, Budget 2015 contained fewer (and arguably less controversial) international tax measures. Nevertheless, Budget 2015 did announce the Government's intention to address taxpayer concerns relating to (i) the withholding obligations borne by non-resident employers that have non-resident employees that work in Canada, and (ii) the reporting obligations of Canadian taxpayers that do not hold sizable amounts of foreign property. These new administrative proposals should be well received by both individuals and businesses.

Non-Resident Employer Withholding Requirements

Background

Generally, non-residents that earn employment income that is attributable to employment duties performed in Canada are subject to Canadian income tax. However, an employee that is resident in a country that has a tax treaty with Canada will often be exempt from Canadian income tax on income from employment duties performed in Canada if certain conditions are met. For example, an individual that is a resident of the US and that is employed by a non-resident employer will generally be exempt from Canadian income tax on his or her remuneration for employment duties performed in Canada where (i) the individual's remuneration in respect of his or her duties performed in Canada does not exceed CAD $10,000, or (ii) the individual is not present in Canada for more than 183 days in any 12-month period and his or her remuneration is not paid by, or on behalf of, a Canadian resident and is not borne by a permanent establishment in Canada. Yet, even where a non-resident's employment remuneration is exempt from Canadian taxation under an applicable tax treaty, the individual's employer, regardless of whether it is resident in Canada, is generally required to withhold amounts on account of the potential Canadian income tax liability of the employee. The non-resident employee is also required to file a Canadian income tax return in respect of such remuneration.

In certain circumstances, an employer may be able to obtain employee-specific waivers from the Canada Revenue Agency (the "**CRA**") with respect to its withholding and remittance obligations, but the requirements imposed by the waiver application process are often difficult to meet, particularly from a timing perspective,

and, as such, obtaining a withholding waiver has generally been viewed as impractical.

Budget 2015: Withholding Relief on the Horizon

Budget 2015 announced the Government's intention to provide an exception to the statutory withholding and remittance requirements that apply in respect of salaries, wages or other remuneration paid by "qualifying non-resident employers" to "qualifying non-resident employees". Under this proposal, a non-resident employee will generally be considered a "qualifying non-resident employee" in respect of a payment if the employee is exempt from Canadian income tax by virtue of being resident at the time of the payment in a country with which Canada has a tax treaty and the non-resident employee is not present in Canada for 90 days or more in any 12-month period that includes the time of the payment. An employer will be considered a "qualifying non-resident employer" at a particular time, provided the following three conditions are met. First, the employer (other than an employer that is a partnership) must be resident in a country with which Canada has a tax treaty. (In the case of an employer that is a partnership, at least 90% of the partnership's income or loss for the fiscal period that includes the time of the payment must be allocated to persons that are resident in a country with which Canada has a tax treaty.) Second, the employer must not carry on business in Canada through a permanent establishment in its fiscal period that includes the time of the payment. Finally, the employer must be "certified" by the Minister of National Revenue (the "**Minister**") at the time of the payment. In order for an employer to obtain the necessary certification, it must apply to the Minister in prescribed form containing prescribed information, and the Minister must be satisfied that the tests noted above are satisfied, together with such other conditions as the Minister may establish. Certification may be revoked if the employer does not meet the foregoing conditions (which are expected to include a failure to comply with ongoing Canadian tax obligations).

Where the aforementioned conditions are met, a qualifying non-resident employer will not be required to withhold and remit any amounts from remuneration paid to qualifying non-resident employees. However, the employer will continue to be responsible for complying with applicable reporting requirements in connection with the amounts of remuneration paid to such employees (such as filing required T4 information returns), and will continue to be liable for any withholding for employees who do not meet the above-noted conditions. Finally, even if certification is obtained by a non-resident employer, this will not affect the non-resident employer's liability for source withholdings where the conditions that provide relief from source withholding cease to apply, such as where qualifying non-resident employee status is subsequently lost due to the non-resident employee not ultimately being entitled to claim the benefits of a tax treaty or due to changes in circumstances that result in the employee failing to satisfy the less than 90 days in Canada test. In such cases, penalties for failure to withhold will not apply if, after reasonable inquiry, the employer had no reason to believe, at the time of the payment, that the employee did not meet the conditions to be a qualifying non-

resident employee.

This measure will apply, when enacted, in respect of payments made after 2015.

While we applaud the long overdue relief provided by this measure, it will be interesting to see what the third requirement for non-resident employer certification will entail – specifically the requirement to meet the "conditions established by the Minister". Similarly, the content of the prescribed form that will be required to be submitted to obtain certification will likely influence the degree to which non-resident employers seek to take advantage of this new measure.

The stated purpose for this measure is the reduction of the administrative burden borne by businesses engaged in cross-border trade and commerce. Hopefully, the CRA will adopt a pragmatic approach to requesting information from non-resident employers. For instance, what type of information will the CRA require to substantiate that a non-resident is entitled to claim the benefits afforded by a treaty that has a "limitation on benefits" clause? Extensive requests for information substantiating eligibility could conceivably inhibit the success of this new measure.

To the extent that the documentation required to obtain certification is onerous, or the reference in Budget 2015 to the need for ongoing compliance with "Canadian tax obligations" to maintain certification is interpreted by non-residents as signaling heightened audit exposure, reliance by non-residents on this new measure may be affected.

Streamlining Reporting Requirements for Foreign Assets

Canadian-resident individuals, corporations, trusts and certain partnerships that, at any time during a year, own "specified foreign property" with an aggregate cost amount in excess of CAD $100,000 are required to file CRA Form T1135, *Foreign Income Verification Statement* ("**Form T1135**") with the CRA by the legislated deadline. The *Income Tax Act* (Canada) defines "specified foreign property" to include most types of income-earning property held outside of Canada, other than certain listed property, including personal property, property used in carrying on an active business and shares in certain foreign affiliates.

In 2013, certain amendments were made to the content of *Form T1135* . The revised Form T1135 requires that additional detailed information be provided by a taxpayer with respect to each specified foreign property. This heightened reporting requirement has created a significantly increased compliance burden for some taxpayers.

In order to reduce the compliance burden borne by taxpayers with relatively limited foreign property holdings, Budget 2015 proposes to simplify the Form T1135 reporting requirements for taxation years that begin after 2014. In particular, the Government has proposed a revised Form T1135 (currently under development by the

mcmillan

CRA), which will provide that, if the total cost of a taxpayer's specified foreign property is less than CAD $250,000 throughout the year, the taxpayer will be permitted to report such property under a new simplified reporting system. Current reporting requirements will continue to apply to taxpayers with specified foreign property that has a total cost at any time during the year of CAD $250,000 or more.

Update on Tax Planning by Multinational Enterprises

In February 2014, the Government outlined the framework for a proposed domestic rule designed to curb what it viewed to be inappropriate "*treaty shopping*" in the context of certain transactions involving non-resident parties. On August 29, 2014, the Government announced that it would await the completion of further work by the Organisation for Economic Co-operation and Development (the "**OECD**") and the G-20 in relation to the OECD's Base Erosion and Profit Shifting ("**BEPS**") initiative, prior to proceeding unilaterally with the implementation of any domestic legislation. (BEPS generally refers to legal tax planning arrangements undertaken by multinational enterprises that exploit the interaction between domestic and international tax rules to shift profits away from the countries where income-producing activities take place.)

Although Budget 2015 does not propose any specific legislative action relating to BEPS, the Government has indicated that it looks forward to the conclusion of the project and to discussions with the international community on the implementation of its recommendations. The Government reiterated its commitment to proceed in this area in a manner that balances tax integrity and fairness with the competitiveness of Canada's tax system. The Government also recognized that taxes are one of the main factors that drive investment decisions and affirmed its commitment to maintaining Canada's advantage as an attractive destination for business investment.

Update on Automatic Exchange of Information for Tax Purposes

In November 2014, the G-20 countries endorsed a new common reporting standard for automatic information exchange developed by the OECD. Under the new standard, foreign tax authorities will provide information to the CRA relating to financial accounts in their jurisdictions held by Canadian residents. The CRA will, on a reciprocal basis, provide corresponding information to the foreign tax authorities on accounts in Canada held by residents of their jurisdictions.

Canada proposes to implement the common reporting standard starting July 1, 2017, allowing a first exchange of information in 2018. As of July 1, 2017, financial institutions must have procedures in place to identify accounts held by residents of any country other than Canada and to report the required information to the CRA. Financial institutions will not be required to report accounts held by residents of Canada with foreign citizenship.

As the CRA formalizes exchange arrangements with other jurisdictions, upon being satisfied that each jurisdiction has appropriate capacity and information safeguards in place, information will thereafter begin to be exchanged on a reciprocal, bilateral basis.

Draft legislative proposals governing the automatic exchange of information are expected to be released for comment over the coming months.

by Michel Ranger

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.

© McMillan LLP 2015