

## TaxBreaks December 2009 (09-5)

### Payroll processes for a mobile workforce: Is your payroll compliant?



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**A**n effective payroll system involves more than ensuring that employees are paid their wages. The global economy and the enhanced sophistication of tax regimes around the world have resulted in a much more complex payroll regime, particularly in the area of tax compliance.

There was a time where it was routine for organizations to relocate employees in response to business needs. Due to the cost of such relocations and a variety of other factors, the increasingly prevalent practice is for organizations to send employees on relatively short foreign assignments or for employees to remain at home and commute to their foreign locations. While these practices significantly complicate the associated payroll tax obligations, many organizations are blissfully unaware of their payroll obligations in these situations. Adequate processes are required to ensure complete and accurate reporting, as well as withholding and remittance, of the taxes that are due to the appropriate taxing jurisdictions. To compound matters, heightened sensitivity surrounding cross-border travel and data sharing between government tax departments increases the risk of detection where payroll processes fall short.

#### Risks of non-compliance

Taxation authorities demand their share. Failure by an organization to comply with such demands in a timely manner can result in not only penalty costs, but also in reputational risks and questions regarding internal controls and corporate governance.

Without intervention, organizations often have inadequate payroll processes in place – until the shortcomings of a company's payroll system are revealed upon audit by the Canada Revenue Agency (CRA) or other taxing authority. The consequences of this audit, aside from the money involved, are the negative effects on the morale of affected employees and an inordinate amount of management time consumed by this process. It does not have to be this way.

#### An effective payroll system – preliminary issues

At its core, an effective payroll system involves ensuring that the appropriate processes are in place to facilitate the required tax withholdings and remittances. Once the correct processes are in place, payroll becomes largely mechanical unless circumstances change.



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Generally, responsibility for payroll compliance resides with the employer. Thus, the first issue to consider is which entity has the payroll obligations. The obligation to withhold tax on payments is very broad under Canadian law. As a general principle, every person paying salary, wages or other remuneration is required to withhold and remit the employee's tax in accordance with the regulations. It is important for the employer to understand that the payroll reporting and withholding obligations are generally independent of an employee's ultimate liability for Canadian tax.

Another step in determining payroll obligations is identifying the various sources of compensation and ensuring that all compensation payments are appropriately considered in calculating the required payroll withholdings and remittances. In a cross border situation, sources of remuneration may emanate from home or host country payroll, finance or third parties. Additional elements of remuneration in the cross border assignment context may include, among others, stay-at-home pay, assignment cash allowances or benefits, tax reconciliation settlements and tax refunds or payments.

### Challenges

Achieving payroll compliance is a constant source of frustration for many global organizations, especially in connection with various categories of employees, including international assignees and business travelers. As well, challenges arise in dealing with global compensation structures that give rise to different tax consequences depending on the country of assignment.

Payroll obligations relating to mobile employees are complex and will be determined by a number of factors, including:

- Who is the employer?
- Who is the payer of the remuneration?

- What is the tax characteristics of the benefits conferred on the employees?
- Does the company conduct business in Canada?
- What is the residency status of the employees in Canada?
- Is a social security agreement applicable?

For example, when a U.S. company sends a U.S. employee to Canada for five months to assist its Canadian subsidiary, the U.S. employer will be required to withhold and remit tax to the CRA. The U.S. employee would likely remain on the U.S. payroll for the duration of his assignment in Canada. Often in these situations it is neither necessary nor desirable to remove this employee from the U.S. payroll. However, a mechanism must be in place to ensure that the necessary tax payments are made to the Canadian authorities on a timely basis. This can often be accomplished by running a phantom or "shadow payroll", which is a notional Canadian payroll set up to ensure that the appropriate withholdings and remittances are made. In addition to income tax, the Canada Pension Plan (social security), employment insurance and provincial payroll taxes must be considered. Different and more onerous requirements may apply in the Province of Quebec.

Proper planning and implementation will facilitate compliance with all payroll requirements in all relevant jurisdictions, while mitigating unnecessary costs such as penalties or excessive tax payments. Planning also involves following the appropriate procedures to obtain a waiver of payroll withholdings in cross border circumstances, thereby improving the organization's cash flow situation.

It is important to remember that while payroll service providers may administer your payroll, they will not typically consider whether you have withholding and reporting obligations in particular situations. A payroll consultant with a comprehensive knowledge of all applicable tax laws is the most appropriate resource for these types of process issues.

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## Ontario and British Columbia harmonized sales tax (HST) – transitional rules

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On October 14, 2009, Ontario and British Columbia concurrently released information notices outlining the transitional HST implementation rules to deal with

transactions that straddle the July 1, 2010 start date. The information notices are available on their respective websites (<http://www.rev.gov.on.ca/en/taxchange/index.html> and <http://www.gov.bc.ca/hst/>). This article summarizes the general transitional rules common to both provinces.

It will be important for businesses and public service bodies to understand these rules as they will likely have an impact on information systems and procedures for complying with the various taxes.

### Why are the transitional rules important?

The transitional rules deal with determining when a supplier or a vendor is required to collect HST (13% in Ontario, 12% in British Columbia) versus GST (5%) plus applicable Ontario and B.C. provincial retail sales tax (RST) for supplies that straddle July 1, 2010, as well as when a business or public service body acquiring property or services is required to self-assess the HST. The rules also deal with the phase-out of the RST and specific matters such as the availability of transitional rebates, special filings and adjustments.

### Key dates

- October 14, 2009 – announcement date
- May 1, 2010 – specific pre-implementation date, which comes into play in certain of the transitional rules
- July 1, 2010 – implementation date

### General HST transitional rules

#### Tangible personal property (TPP)

The HST will generally apply to a supply of goods by way of sale to the extent that the goods are delivered, and ownership of the goods is transferred, to the recipient on or after July 1, 2010.

#### Services

The HST will generally apply to a supply of a service to the extent that the service is performed (90% or more) on or after July 1, 2010. The HST will generally not apply

to a supply of a service if 90% or more of the service is performed before July 2010.

#### Intangible personal property (IPP)

The HST will generally apply to consideration that becomes due, or is paid without having become due, on or after July 1, 2010 for a supply of IPP (e.g., intellectual property or contractual rights) by way of sale.

In addition to the above, there are general transitional rules for TPP and IPP supplied by way of lease, license or similar arrangement. Furthermore, special rules apply and, therefore, caution must be exercised where certain prepayments are made (by businesses or public service bodies) or are collected (by suppliers) between October 14, 2009 and July 1, 2010.

### Specific HST transitional rules

- Subscriptions to newspapers, magazines or other periodical publications
- Prepaid funeral and cemetery services
- Transportation services
- Commercial parking passes
- Memberships
- Admissions
- Residential real estate

### Winding down of Ontario and B.C. RST

Generally, the RST will no longer apply where property, services, admission or accommodation are provided on or after July 1, 2010. However, there are certain exceptions to this rule and, therefore, an understanding of these rules is necessary for proper planning and preparation, as well as for utilizing tax efficient transition strategies.

## A lack of trust

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The Canada Revenue Agency (CRA) has announced plans to audit *inter vivos* trusts. Their main targets are trusts established to facilitate income-splitting with lower income spouses and children. The CRA will focus primarily on three issues:

### 1. Has the trust issued promissory notes to

**beneficiaries?** Trust beneficiaries are frequently paid through the issuance of a promissory note. In certain circumstances, these notes may be viewed as being legally unenforceable, which could result in unintended and adverse tax consequences for the trust and/or beneficiaries.

### 2. Has the trust deducted any amounts withdrawn by trustees for their own use?

The CRA may challenge the deduction to the trust or assess a taxable benefit to the trustees (usually the parents).

### 3. Are proper accounting records, trustee minutes and the original settlement property readily available?

The CRA may disallow expenses or beneficiary allocations that cannot be supported.

Timely action is critical. With the CRA's lack of trust in the tax compliance history and records of *inter vivos* family trusts, an audit of any family trust may be imminent. It is therefore important to ensure that your trust is in order. Deloitte's experts can assist in this regard.

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