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Canadian Tax & Legal Alert

CRA provides further guidance on international income tax issues

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The Canada Revenue Agency (CRA) provided supplemental guidance on April 1, 2021 with respect to certain international income tax issues arising due to COVID-19 and impacting 2020 income tax obligations. The CRA also advised that examples and answers to frequently asked questions will be posted shortly. The following is a brief summary of the key updates.

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Individual income tax residency

For the initial relief period, covering March 16, 2020 to September 30, 2020, the CRA guidance provided that an individual's days physically present in Canada will not count towards the 183-day limit for deemed residency where the individual stayed in Canada only because of travel restrictions. The supplemental guidance extends the relief period until the earlier of (i) the date of the lifting of the travel restrictions and (ii) December 31, 2021.

In this guidance, the CRA stipulated that this relief is only with respect to physical presence in Canada for purposes of the common-law test of residency. Where an individual establishes other ties of residence, they may in fact have become a factual resident of Canada; the CRA guidance provides examples of ties, such as having a permanent home in Canada or enrollment in government programs intended for Canadian residents.

It is important to highlight that the days physically spent in Canada may only be excluded where they arose solely as a result of travel restrictions. Every individual's situation must therefore be evaluated based on the specific facts and circumstances. Moreover, even where an individual may exclude days spent in Canada, they may have established sufficient ties in Canada to be considered a factual resident for at least part of 2020. It is interesting that the CRA provided December 31, 2021 as a potential end date, indicating that – for individual income tax residency at least – this relief will apply for both the 2020 and 2021 tax years.

Permanent establishment

In the supplemental guidance, the CRA advised that the administrative relief previously provided is no longer applicable to determinations as to whether or not the non-resident employer has a fixed place of business in Canada. The CRA's view is that when the relevant provisions of a tax treaty are applied, a non-resident employer would generally not be viewed as having established a permanent establishment in Canada either through a fixed place of business or agency arrangement due to the inherent lack of permanence where such an arrangement arose as a result of an individual working in Canada due to travel restrictions.

In the case of a *fixed place of business* (for example, a home office or other workspace), the CRA commented that there must be a semblance of permanence to the site and the site must be at the "disposal" of the employer. The CRA clarified that an individual who otherwise works remotely from their home in Canada would generally not give rise to a permanent establishment, although this conclusion could change if the employee continued to work remotely in Canada after the lifting of the travel restrictions or if the individual and their employer take action to establish the workspace in Canada as an office of the employer which has a semblance of permanence and is at the disposal of the employer.

Similarly, in order to meet the requirements of an "agency" permanent establishment, an individual must not only have the right to conclude contracts on behalf of an enterprise, they must also habitually exercise that right. The CRA clarified that this habitual requirement would not be met where an individual has the right to conclude contracts on behalf of their employer and is

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doing so from Canada solely because of the travel restrictions. This conclusion could change for both the period during which the travel restrictions were in place, and afterwards, if the employee remained in Canada past the lifting of the travel restrictions and continued to exercise their right to conclude contracts.

With respect to a "services" permanent establishment under the Canada-United States income tax treaty, a non-resident employer would not exclude any days of presence for purposes of determining whether the 183-day test has been met. However, the CRA commented that where employees are not working on projects for Canadian customers, a "services" permanent establishment will not be created where the employee is working remotely due to travel restrictions. This conclusion would change should employees be working on Canadian projects.

From the supplemental guidance, it is clear that the CRA generally does not expect a permanent establishment to have been created where employees are temporarily working from Canada due to travel restrictions given there should be no degree of permanence to such an arrangement. This would also be the case with respect to a services permanent establishment where individuals are not working on Canadian projects. However, it will be imperative for employers to remain aware of the activities being performed in Canada by employees working remotely; if the nature and duration of their activities change, a permanent establishment may be created. It is highly recommended that non-resident employers diligently monitor all remote work cases and reassess on a regular basis, while providing clear guidelines on activities that can (and should not) be performed while in Canada.

Cross-border employment income of United States resident employees

The CRA extended the initial relief period from September 30, 2020 to December 31, 2020 for US resident individuals who are present in Canada and exercising their employment duties in Canada solely as a result of the travel restrictions. These days will not be counted toward the 183-day test for the employment income exemption under Article XV of the Canada-United States income tax treaty. An individual in this situation who has remained in Canada after December 31, 2020 must include each subsequent day present in Canada in calculating whether the 183-day test has been met.

The CRA clarified that a non-resident employer will not be required to submit a T4 slip for the 2020 taxation year in respect of the particular non-resident employee where the non-resident employee continues to be eligible for tax treaty benefits (including no change in the non-resident employee's duties of employment or employer-employee relationship with non-resident employer) and could not return to their jurisdiction of residence due solely to travel restrictions. However, the CRA expects the non-resident employer to track and document, among other things:

- the days during which the non-resident employee was working or present in Canada and cannot return to their country of residence due to travel restrictions, and
- the employment income pertaining to these days of work in Canada.

The CRA also clarified that an employer of an individual who continues to work remotely from Canada as of January 1, 2021 must, in accordance with Canadian legislation, either withhold and remit tax in respect of the employee or have the withholding requirement waived by the CRA.

The extended relief period will certainly help individuals (and their non-resident employers) who remained in Canada past September 30, 2020 due to travel restrictions and who would otherwise be taxable on the remuneration received. At this time, it is unclear whether similar relief will be available for the 2021 tax year. Moreover, it is interesting that the supplemental CRA guidance extended the relief period for US resident employees only, and not residents of other countries.

Cross-border employment income of Canadian resident employees

In the initial guidance, CRA stated that where a letter of authority was issued by the CRA, there would be no change to the Canadian withholding obligations of the non-resident employer as long as there are no changes to the withholding obligations of the non-resident employer in the other jurisdiction. Accordingly, the supplemental guidance provides the following two options for Canadian resident individuals who, as a result of travel restrictions, may have been forced to perform their employment duties from home in Canada instead of from the US at the office of their US employer.

- **Option 1:** the employment income from the US employer would be considered sourced from the United States for 2020 (irrespective of the fact that services were performed in Canada). The individual can file their tax returns as they did in prior years and claim a foreign tax credit for amounts paid in the United States. Income that was not subject to withholding in the United States must be reported as if it was sourced to Canada. In addition, should any amounts paid to the United States be refunded at a later time, the employee must file an amended return adjusting the amount of the foreign tax credit claimed in Canada. Note this option is only available where the US employer continued to withhold US taxes on the full amount of remuneration paid.

- **Option 2:** the individual may file their 2020 Canadian income tax return using standard sourcing rules based on where the services were performed (i.e., if the individual performed the services in Canada, the income would be sourced to Canada and therefore not eligible for a foreign tax credit). As noted above, for individuals whose 2020 income tax withholdings were changed to reflect standard sourcing, they must file their 2020 income tax returns on this basis, considering the following:

    - If the individual has paid income tax to the United States after application of the sourcing rules, the individual may claim a foreign tax credit in respect of the US income tax paid.
    - For foreign tax credit purposes, the individual may include any valid contributions made under the Federal Insurance Contributions Act (FICA). The CRA clarified that the entire amount of the individual’s employment income on which the FICA contributions were based may be included in the individual’s 2020 foreign non-business income.
    - If the individual has paid state income tax in 2020, and the payee state has refused to give up its right to tax the

individual, the individual may claim a foreign tax credit in respect of those taxes paid, despite the income being earned in Canada. For purposes of claiming the credit, the foreign non-business income of the individual would consist only of the portion of the employment income the individual would have earned in the state had they continued to commute to work in the United States in 2020.
    - If the individual has made contributions to a US retirement plan in 2020, they may determine the amount deductible on form RC268 as if the individual had continued to exercise their employment duties in the United States throughout all of 2020.

For individuals who file their tax returns under Option 2, the CRA advised that they will cancel all or part of the late-payment penalties or interest that may arise where an individual is waiting for a US tax refund to pay the Canadian taxes due. If individuals receive income tax instalment notice(s) in 2021, the CRA will also cancel instalment penalties and interest if charged. It should be noted that relief from penalties and interest is not automatic and would need to be applied for by the individual.

This flexibility with how to file Canadian tax returns for 2020 will be helpful for individuals whose US withholdings were not adjusted to reflect that they were working from home in Canada, as it may simplify the tax return filings and mitigate potential cash flow issues. It is again important to note that this relief was specific to Canadian resident employees working for US employers and, seemingly, this relief would not apply to a Canadian resident employee who would ordinarily work for an employer in another country. In situations involving countries other than the United States, where the employer continued to remit taxes in the other country, options may include:

- employer recovering foreign taxes remitted via amended payroll filings;
- employee filing a personal tax return in the foreign jurisdiction to claim a refund of excess taxes remitted; and
- employee claiming treaty relief on their Canadian tax return to resource the income as foreign sourced and therefore eligible for a foreign tax credit.

These situations can become quite complicated where the foreign taxes remitted are treated as a "final tax", where the country is one with which Canada does not have a tax treaty, or where the foreign country imposes taxes on some basis other than where the services were performed. In such cases, where the above options may not fully rectify the situation, an employer may need to consider compensating the employee for any potential double taxation.

Except for comments on individual income tax residency, the supplemental guidance and reliefs pertain to the 2020 tax year only. The CRA did advise that additional guidance will be provided for the 2021 tax year but stipulated that individuals should expect to apply standard sourcing rules for 2021 should their working arrangements change to allow them to work permanently from Canada.

Deloitte's perspective

As noted, the supplementary guidance from the CRA provides some administrative concessions with regards to the international tax issues arising for taxation of cross-border employment income in the context of the pandemic.

Some key considerations for employers of Canadian resident employees or with employees working remotely from Canada include:

- **Tracking employee workdays for 2020:** while the CRA relieved some of the requirements to issue T4 slips for non-resident employers with treaty exempt employees who worked in Canada during the 2020 tax year, the CRA confirmed that employers should still track and document the employee workdays in Canada.
- **No withholding relief for 2021:** there is no relief for the 2021 taxation year on an employer's compliance obligations for employees working in Canada. It is recommended that if the employees continue to be treaty exempt for the 2021 tax year, the employer should apply for Employer Certification or obtain Regulation 102 waivers. Where an employer fails to withhold and remit Canadian taxes due, the employer may be liable for the unremitted tax, plus penalties and interest. The employer should therefore establish a process to comply with employer obligations in Canada including withholding, remitting and reporting of taxes, and other corporate tax obligations. If the employees are not treaty exempt in Canada, the foreign employer should reassess their withholding obligations in the country where services would otherwise have been performed and from where the employees are paid, to ensure remittances are not inadvertently made to the incorrect jurisdiction.
- **Review existing remote work scenarios**: while certain relief was available to individuals for the 2020 tax year that may permit them to remain exempt under a tax treaty, despite the number of days spent in Canada, no such relief is currently available for 2021. For individuals who continue to work remotely in Canada, employers should assess each situation based on the current legislation to determine their payroll and other tax obligations.

How can Deloitte help you?

Deloitte's Global Employer Services professionals can help you understand how this supplemental guidance may impact your business.

If you have any questions on any of the above, please reach out to your Deloitte representative or any of the individuals noted on this alert.

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