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Canadian tax alert

COVID-19 – Observations on recently released CRA guidance on international tax issues

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The global COVID-19 pandemic has given rise to numerous unprecedented implications for corporate and individual taxpayers due to the various measures, both deliberate and reactionary, implemented by governments around the world. These measures range from travel restrictions to operational changes, which affect the manner in which taxpayers interact with authorities. Many governments, together with the Organisation for Economic Co-operation and Development, have released guidance for taxpayers to help them understand what these aforementioned changes will mean from a tax perspective.

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The Canada Revenue Agency (CRA) recently released welcome guidance for Canadian taxpayers, but a number of questions remain unanswered. In this document, we summarize the guidance provided, highlight important questions that remain unanswered, and provide some practical suggestions for individuals and companies attempting to mitigate tax-related risks stemming from the pandemic.

Background

The CRA guidance addresses the following matters: (i) income tax residency – corporate and individual, (ii) carrying on business in Canada/permanent establishment (PE), (iii) cross-border employment income, (iv) Regulation 102 and Regulation 105 waiver request delays, and (v) section 116 clearance certificate delays. A link to the CRA's guidance may be found here.[1]

The period for which the guidance is currently applicable appears to be intended to align with the period during which travel restrictions are in place. The guidance released on May 20 is applicable from March 16 until June 29, 2020, with the CRA leaving open the possibility of extending the applicable period at that time if necessary. The CRA also acknowledged that travel restrictions could have an effect on certain tax issues even after such restrictions have been lifted. These situations will be considered on a case-by-case basis.

Finally, it should be noted that CRA acknowledges that this guidance only pertains to issues considered "thus far" and it is clear there are a number of additional considerations that will need to be addressed as the fallout from COVID-19 continues to manifest.

Tax residency - corporations

For Canadian tax purposes, the residency of a corporation is determined by applying statutory rules, common law principles, and treaty provisions. The residency of a corporation determines not only the jurisdiction with primary taxation rights over the corporation's income, but also, under Canada's foreign affiliate rules, the taxability of dividends paid by that corporation to a Canadian corporate shareholder.

The residence of a corporation incorporated outside of Canada is determined with reference to the place of its "central management and control" under common law principles or, under most treaties, its "place of effective management." The CRA guidance specifically addresses only the latter concept and suggests that determinations of residency for entities in non-treaty countries (i.e., under common law principles) will continue to be made on a case-by-case basis. In addressing a corporation's place of effective management, the CRA notes that one of the main tests is the country in which the directors of a corporation meet to exercise their powers as members of the board. As an administrative matter, the CRA will not consider a corporation to be resident in Canada solely because board members were required to attend a board meeting from Canada due to travel restrictions. The CRA goes on to point

[1] https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/guidance-international-income-tax-issues.html

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out, however, that there are additional factors that should also be considered in making the determination. While not specifically listed by the CRA, such factors may include the location of persons with signing and contracting authority, location of books and records, location of corporate banking, etc.

Practically speaking, it is important to note that many of the factors relevant to the determination of a corporation's place of effective management are similar to those that determine the place of its central management and control. However, the fact that CRA specifically declined to apply its guidance in a non-treaty context, opting instead for a case-by-case determination, means that the value of such guidance is quite limited. While the intention may have been to provide comfort that COVID-19-related travel restrictions should not adversely impact a determination of a corporation's residency, it would have been helpful if the CRA had clarified that such comfort is intended to apply with respect to the determination of a foreign affiliate's residency for surplus purposes as well.

Accordingly, foreign corporations should be extra vigilant in planning and conducting board meetings while travel restrictions are in place. Where directors must attend from Canada, foreign corporations should consider, for example, whether the call can be initiated and moderated by a director outside of Canada, whether documents can be signed by the local director(s), whether temporarily appointing a proxy would be beneficial in the circumstances, or whether the meeting may be delayed (though delays beyond June 29 may prevent reliance on the limited relief provided by the CRA, pending an extension of said relief). In addition, considerations should be given to the impact of the location of upcoming board meetings relative to historical practices, the overall frequency of meetings, and other indicia of residency as outlined above.

Tax residency - individuals

An individual's residence status in Canada is a question of fact and this determination generally includes a review of the individual's residential ties to Canada. Additionally, an individual who spends 183 days or more in Canada during a taxation year will be deemed a resident of Canada throughout the year under what are commonly known as the sojourner rules. An individual considered to be resident in Canada for either reason will be subject to taxation in Canada on worldwide income in the absence of treaty relief.

The CRA has confirmed that where an individual has remained in Canada solely as a result of COVID-19-related travel restrictions, this factor alone would not give rise to factual residency. In addition, the CRA has further confirmed that days of presence in Canada as a result of travel restrictions would be excluded from the 183 day test for deemed residents under the sojourner rules.

It will be important for each individual to monitor their time spent in Canada and to demonstrate that he/she intended to and, in fact, did return to his/her country of residence at the earliest available opportunity. It is also recommended that individuals avoid establishing secondary residential ties in Canada, which could otherwise be indicative of factual residence. Such ties include, among others, the ownership of personal property, social ties (such as memberships in various organizations), Canadian bank accounts or credit cards, and obtaining a Canadian driver's license.

It will also be key for the individual to ensure that he/she has considered the domestic legislation in his/her typical country of residence and to consult the relevant provisions of the various tax treaties Canada has signed in the event that residency status is disputed by the various tax authorities.

Carrying on business in Canada/PE

By default, a non-resident that carries on business in Canada is subject to Canadian income tax on the associated income. A tax treaty may provide relief where that business is not carried on through a PE. In general, a PE may exist in various circumstances, including where the business is carried on through workspace at the corporation's disposal ("fixed place of business"), a person in Canada habitually exercises authority to conclude contracts (agency PE), and the provision of services in Canada for a period exceeding specified thresholds (services PE).

Once again, the CRA's guidance only provides comfort for organizations benefiting from the provisions of an applicable tax treaty. As an administrative matter, where travel restrictions are the sole reason for employees performing their duties in Canada or dependent agents concluding contracts in Canada, the CRA will not consider a non-resident entity to have a fixed place PE or an agency PE, respectively. Similarly, days spent in Canada because of travel restrictions will not count toward the applicable thresholds in determining whether a services PE exists. Treaty-based returns are still required to be filed for taxation years that overlap with the travel restriction period. It is recommended that organizations take steps to proactively document, in detail, the factors which, in the absence of the CRA's administrative relief, might give rise to a PE, as well as the circumstances beyond the company's control which caused such circumstances to arise. It is not evident that a simple reference to the existence of travel restrictions would be sufficient.

Where there is no applicable tax treaty, the CRA will consider administrative relief on a case-by-case basis only. In such situations, the non-resident must file a tax return and be able to demonstrate that it carried on business in Canada only because of the travel restrictions. No other information is provided on how a taxpayer might demonstrate such facts to the CRA.

A non-resident may be considered to carry on business in Canada based on common law principles or statutory rules. The threshold for carrying on business in either case is generally considered low. As with the common law determination of residency, as described above, the common law determination of where a business is carried on should take into account a number of factors – e.g., the place of delivery of goods or services, the place of payment, and location of an inventory of goods. One of the most significant factors is generally considered to be the place where contracts are entered into.

It is noteworthy that the CRA's guidance does not address the extent to which the income attributable to a business carried on in Canada may be increased as a result of COVID-19-related travel restrictions. Canadian tax law provides that income from a business carried on in a particular place (e.g., Canada) is to be computed as if the taxpayer had no income except from the part of the business that was carried on in that particular place and taking into consideration those deductions as may reasonably be considered wholly applicable to that part of the business. In the absence of treaty relief, where a

corporation's degree of activity in Canada increases as a result of travel restrictions, great care should be taken to analyze and document the amount of the non-resident corporation's income that is attributable to such activities, in order to avoid undue levels of Canadian taxation.

Cross-border employment income

1. Resident in another treaty jurisdiction

Canada's various tax treaties contain specific provisions concerning the taxation of income from employment where the individual in question is resident in one jurisdiction but providing services in another. For a non-resident individual working in Canada, whether Canada has the right to tax the associated employment income generally depends on whether an individual's days of presence in Canada are 183 or less in a given period. The CRA has confirmed that an individual's days of presence in Canada that are solely due to travel restrictions will not be counted towards the applicable threshold and therefore, relief under the treaty will still apply to exempt employment income from Canadian tax. The guidance, while applicable to individuals resident in any treaty jurisdiction, provides specific details concerning the relevant tests contained in Article XV(2)(b) of the Canada-US Income Tax Convention. Individuals and employers should carefully review the relevant provisions of the particular tax treaty in question, as some treaties reference 183 days in any twelve-month period beginning or ending in the year whereas others stipulate that the threshold is 183 days in a particular calendar year. Additionally, most treaties will also grant Canada taxation rights over employment income where the cost of the individual's remuneration is borne by a PE in Canada. In this regard, the guidance referenced above concerning the impact of travel restrictions on the creation of a PE should also be taken into account.

2. Canadian resident employees

Both resident and non-resident employers who employ Canadian resident individuals are subject to withholding and remittance requirements in respect of remuneration paid to such individuals irrespective of where the services are performed. Employees normally performing services partially outside of Canada may apply for a "letter of authority" through the filing of Form T1213 *Request to Reduce Tax Deductions at Source* in order to allow employers to withhold less tax from their salary or wages in order to take into account the impact of any anticipated foreign tax credit claims.

Due to travel restrictions, services generally performed outside Canada may now be required to be performed within Canada on an exceptional and temporary basis. In such circumstances, where a letter of authority has already been issued, the CRA has confirmed that the permission to reduce source deductions will continue to be applicable. While this might initially be considered as welcome news for employees relying on the extra funds made available due to reduced source deductions, such individuals should be aware that this situation may result in a shortfall of Canadian taxes remitted, compared with their final tax liability determined on the filing of their personal tax return. As such, employers may wish to advise their employees to take steps to ensure they have sufficient funds on hand to pay this final tax liability on April 30, 2021.

Relief due to CRA processing delays

1. Withholding under Regulation 102 and 105

Payments made to non-resident employees reporting to work in Canada and to non-residents for services rendered in Canada are subject to Canadian withholding tax under Regulation 102 and 105, respectively. Where such withholdings are expected to exceed the taxpayer's final tax liability, due to treaty relief or other factors, the taxpayer may apply for a waiver to exempt the payer from the withholding requirement. Typically, such waivers must be granted before a reduction from withholding may proceed without the payer being liable to penalties.

Due to COVID-19, the CRA has experienced delayed processing times in respect of Regulation 102 and Regulation 105 waiver applications. Temporary measures are being developed which would allow for electronic submission of such applications. Additionally, where a taxpayer has not received a waiver within 30 days and the payer can demonstrate reasonable steps have been taken to ascertain that the non-resident is entitled to benefits under the relevant tax treaty, the CRA will not impose penalties for a failure to deduct, withhold or remit an amount as required by Regulation 102 or Regulation 105. This relief is available only where the waiver request has been submitted to the CRA on a timely basis. Presumably, to satisfy this due diligence requirement, payers will need to provide evidence that they took steps to project a recipient's days of presence in Canada and potentially preliminary evidence as to the recipient's residency, which may impact eligibility for treaty benefits.

Where a waiver request is not submitted on a timely basis because of travel restrictions and amounts are not withheld pursuant to Regulations 102 and 105, the CRA will review on a case-by-case basis to determine whether relief could be available in each such situation.

The CRA has not, as yet, provided guidance concerning the impact of travel restrictions on certain programs aimed to ease administrative burdens for employers of non-resident individuals; namely, the Non-Resident Employer Certification. Under this program, qualifying employers need not withhold income tax for employees who meet certain conditions. One such condition is that the employee in question must work in Canada for less than 45 days in the calendar year that includes the time of the payment or is present in Canada less than 90 days in any 12-month period that includes the time of the payment. The CRA has not clarified whether days of unanticipated Canadian presence resulting from travel restrictions will be excluded for purposes of determining whether an employee satisfies such requirements. Additionally, the CRA has not specifically provided relief where processing delays result in applications for employer certification not being approved at least 30 days prior to the provision of services in Canada by a qualifying employee.

We would expect additional guidance to be released concerning these issues. But in the meantime, it is recommended that employers continue to file the appropriate applications for certification and document any delays due to service interruptions in the event that incorrect assessments are issued at a later date.

2. Issuance of section 116 clearance certificates

A non-resident of Canada is taxed on the disposition of taxable Canadian property and, in general, is required, pursuant to section 116 of the Income Tax Act, to notify the CRA of the disposition within ten days of the disposition. Upon receipt of the notification and an amount equal to the tax on the resulting gain, or appropriate security for the tax, the CRA issues a Certificate of Compliance that is provided to the purchaser and relieves the purchaser from the obligation to withhold taxes from the purchase price. The purchaser's remittance of such taxes is otherwise due within 30 days after the end of the month in which it acquires the property.

The issuance of section 116 clearance certificates by the CRA has also been delayed as a result of COVID-19. Where a vendor has submitted a request for a clearance certificate, but the certificate has not been issued by the purchaser's remittance due date, as a temporary measure, the CRA will permit the purchaser or the vendor to make an urgent request for a comfort letter (instructions for making this request are included in the guidance). The comfort letter will advise the parties to retain the funds until the CRA has completed its review. No penalties or interest will be assessed.

Although this guidance is helpful, the process of requesting a comfort letter and retaining the funds, which would otherwise be required to be remitted in the absence of a certificate of compliance, can still result in undue hardship for the vendor in certain circumstances. This is especially the case where the vendor may not otherwise have sufficient funds to satisfy obligations to third parties resulting from the sale (including mortgages and debts owing to other investors/creditors). It is thus recommended that vendors make arrangements to file the request for the certificate of compliance as soon as possible to ensure that the request is placed in the queue as far in advance of closing as possible to account for these service delays. Where feasible, non-resident vendors may also consider extending the closing of the transaction to obtain an extended period of time to obtain the certificate of compliance to avoid undue financial hardship as a result of service delays.

3. Additional instructions concerning applications for waivers and certificates of compliance

The CRA has also commented on temporary measures with respect to the filing of international waivers and notifications for certificates of compliance including details on how to submit documents electronically via email.

For more information, please refer to CRA's guidance here.[2]
Please contact your Deloitte advisor to discuss any of these matters in further detail.

[2] https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/international-waiver-compliance-certificate.html

For more information on COVID-19, see our [Canadian COVID-19 information hub] and our [global COVID-19 information hub]

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