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Tax Policy Branch
Department of Finance
90 Elgin Street
Ottawa, Ontario
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Re: Proposed Amendments to non-resident employee withholding obligations

We are writing to provide our comments on the proposed legislative changes to the Income Tax Act (the Act) and Income Tax Regulations (the Regulations) with respect to the Canadian withholding of source deductions from non-resident employees working for non-resident employers. These changes were originally announced in the April 21, 2015 federal budget, and draft amendments and explanatory notes were released by the Department of Finance on July 31, 2015.

We applaud and appreciate the Department's receptiveness to concerns raised by the tax community in this area. We are grateful to see that a significant number of concerns were addressed in the current version of the proposals.

In this letter, we offer a number of suggestions for your consideration that we believe will further improve the efficacy of the withholding proposals.

The "days" test for purposes of determining who is a "qualified non-resident employee"

The July 31, 2015 amendments remove from the earlier proposed definition of a "qualified non-resident employer"[1] the requirement that the employer *"does not, in its taxation year of fiscal period that includes that time, carry on business through a permanent establishment (as defined by regulation) in Canada"*. This amendment will be welcomed by the business community as it provides additional simplicity for employers, especially for those operating in the service industry from countries with which Canada has a tax treaty that includes a "services PE" provision[2]. However, the additional simplicity for employers created by this amendment is diminished by the revised proposed definition of a "qualified non-resident employee"[3].

The proposed definition of "qualified non-resident employee" requires that the employee meet all of the following criteria:

[1] In subsection 153(6) of the Income Tax Act (the Act).
[2] A common example of a services PE provision is Article V(9) of the Canada-United States Income Tax Convention (the Canada-US treaty).
[3] In subsection 153(6) of the Act.

(a) At that time is a resident in a country with which Canada has a tax treaty;
(b) Is not liable to tax under this Part in respect of the payment because of that treaty; and
(c) Works in Canada for less than 45 days in the calendar year that includes that time or is present in Canada for less than 90 days in any 12–month period that includes that time.

The explanatory notes articulate that the criterion in paragraph (c) can be satisfied in either of the two ways (i.e., less than 45 workdays in Canada during the calendar year or less than 90 days (for any purpose) in Canada over any 12-month period).

The proposed definition would thus require employers who wish to minimize their withholding obligations to track their employees' travel to Canada using two different methodologies (workdays and physical presence days) as well as over two different time periods (calendar year and any 12-month period). This need to track using two different methodologies/time periods creates additional administrative complexities for employers since the employers will be required to track the personal time of employees, information that may not be readily available. If they are unable to do so, they could be disadvantaged *vis a vis* other employers who have the capacity to implement a sophisticated tracking mechanism.

To ensure simplicity and equity to all employers, we recommend that the definition be revised to include only one test – a 90-day work day test – and that it be based on the number of days worked in Canada during the calendar year rather than any 12-month period. This test is much more practical for an employer to implement and monitor, and far less time consuming for the CRA to audit.

It should be noted that in addition to qualifying under either of the proposed 45 or 90 days tests, an employee must also meet the 183 day presence test found in all of Canada's treaties. While the employee is thereby technically required to track all of his or her days of presence regardless of the proposed test (45 or 90 day) that the employer has chosen to utilize, the vast majority of non-resident employees with work days in Canada do not come close to exceeding the 183 day limit; consequently, this test is generally not an issue. In cases where it is an issue, the employer would be obligated to track days of presence in addition to work days for the 90 day test.

De minimus threshold for reporting

Generally speaking, an employer is required to file an information return (T4 slip) to report the amount of remuneration paid to the employee regardless of whether or not withholding on such payment is required. The tax community provided feedback that such reporting requirement places an undue administrative burden on employers in circumstances where the income is exempt from withholding. In response, the proposals were revised to include new subsection 200(1.1) of the Regulations which provides generally that T4 slip reporting is not required for an amount that is exempt from withholding under subparagraph 153(1)(a)(ii) of the Act (i.e., an amount paid by a qualifying non-resident employer to a qualifying non-resident employee) if the employer, after reasonable enquiry, has no reason to believe that the employee's total amount of taxable income earned in Canada under Part I of the Act during the calendar year is more than $10,000. In other words, if the payment of remuneration to the employee is exempt from withholding and is equal to or less than $10,000 then no T4 slip is required to be issued by the employer.

This exemption is welcome. However, we recommend that greater efficiency and clarity would be achieved if the reporting exemption criteria would match the withholding exemption criteria. As such, should an employee's wages be eligible for a withholding exemption under the Act, such payment should

then also be exempt from the reporting obligation prescribed by the Regulations. The linking of such exemptions would be beneficial for both the employer, as the administrative cost of producing T4 slips for employees is reduced, as well as for the Canada Revenue Agency (CRA) who has to process such T4 slips where the employee is eligible for a withholding and tax exemption. The following example illustrates the additional administration that may be relieved for all parties involved.

> *An executive of a non-resident employer is a resident of a treaty country. He works in Canada for 30 days during the calendar year and these are the only days in which he has ever been physically present in Canada. His compensation for these 30 days worked in Canada is $15,000 CAD. Under the terms of Canada's tax treaty with the executive's country of residence, his Canadian source remuneration is exempt from Canadian tax. The definitions of Qualified Non-resident Employer and Qualified Non-resident Employee are otherwise satisfied. Under the current proposals, the executive's employer would be exempt from withholding on such Canadian source remuneration. However, because the executive's compensation is in excess of $10,000 for the calendar year, the employer is still required to file a T4 slip. In order to prepare the T4 slip, the executive is required to supply his employer with a CRA Individual Tax Number (ITN) and thus he is required to apply for such ITN. Upon receipt of the T4, the CRA must process it through its normal processing means. The executive does not file a Canadian personal income tax return to report such remuneration since it is exempt under the relevant treaty[4]. Although the taxpayer is exempt from filing a tax return, the CRA understands that he has Canadian source income (as reported on the T4) and is unaware of the exemption from filing, and thus issues a Demand to File notice requiring the executive to file a Canadian tax return pursuant to subsection 150(2) of the Act. The executive must now take the necessary means to prepare and file such return in order to comply with the demand even though such return is a "nil return".*

Had the T4 reporting exemption been consistent with the withholding exemption, then all of the parties would have their administrative burdens and associated costs reduced. The employer would not have been required to prepare the T4, the CRA would not have been required to process the ITN application and T4 slip, possibly believing that a personal tax return was necessary and thus issuing a Demand to File notice, and subsequently would not have been required to assess the treaty based nil tax return. In addition, the executive would not have been required to prepare a nil tax return.

We can appreciate that the Department of Finance must create laws that preserve information with respect to income earned in Canada so that the CRA can use such information to maintain the integrity of the self-assessment system. We believe that aligning the withholding and reporting exemptions allows for this. However, should you disagree, we offer other alternatives for consideration. One alternative would be to increase the $10,000 exemption limit to a higher amount, thereby reducing the potential for an employee to fall into one reporting exemption criterion but not the other. The $10,000 exemption threshold in the context of United States and Canada has not been adjusted for many years – perhaps a higher threshold is appropriate today. Another approach could be to change the reporting methodology for qualified non-resident employers paying remuneration to qualified non-resident employees. For example, an employer could provide the CRA with a schedule listing the names, foreign tax identification numbers and Canadian source remuneration meeting the reporting threshold paid to qualified non-resident employees. By removing such reporting from the T4 slip regime, the increased administration regarding ITN applications and personal tax return filing requests can be avoided.

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[4] The executive would be exempt from filing a personal tax return pursuant to subsection 150(1.1) of the Act given that he does not have a tax payable under Part I of the Act as his only Canadian source income is exempt under the relevant tax treaty.

CRA ITNs

As noted above, in order for an employer to file a T4 slip to report an employee's Canadian source wages, the employee must apply for an ITN. This requirement increases the administrative costs for employers since they must ensure that their non-resident employees obtain such ITNs and follow up where necessary in order to be able to comply with the T4 slip reporting obligations. The need to obtain an ITN is also burdensome on the individual as well as the CRA. Elimination of this requirement would alleviate the administrative costs for all parties and can be easily accomplished by adjusting the reporting exemption criteria to be the same as that which applies for withholding. Ideally, the ITN requirement should not apply for any individual not subject to Canadian tax. While we understand that this is CRA's main means of identifying individuals and is therefore an important aspect of its enforcement programs, we point out the Department has provided a withholding exemption to certain individuals, thereby identifying them as low risk from a tax base erosion perspective; removing this identifier on such individuals should not jeopardize protection of the Canadian tax base.

We can appreciate that the ITN application process falls under the jurisdiction of the CRA as opposed to the Department. We would appreciate your assistance in raising this issue with your colleagues at the CRA so that the administration of the legislation is also conducted in an efficient and effective manner.

Relief for limited liability companies (LLCs) or other non-treaty eligible entities

The definition of qualified non-resident employer requires the employer to be a resident of a country with which Canada has a tax treaty. However, it is possible that some employers are legally organized as entities which are not "residents of a Contracting State" under the relevant Canadian tax treaties. For example, a US based employer may be organized as a limited liability company under US corporate law. The employees that work for these entities may still be eligible for treaty relief under Article XV of the Canada-US treaty either because their Canadian source remuneration for the year is equal to or less than $10,000 or they were present in Canada for less than 183 days in a 12-month period and their compensation was not borne by a PE in Canada regardless of the corporate structure. Given that the employees would otherwise be qualified non-resident employees under the proposed definition, disqualification of the employees from the withholding and reporting exemptions simply because of the legal organization of their employer does not appear to be in accordance with the purpose of the proposal to promote efficiency and reduce administration costs. For these reasons, we would recommend that the definition of qualified non-resident employer be clarified to address its application in the case of fiscally transparent or other similar entities. This may include expanding the definition as the proposed legislation has done for partnerships.

Amendments to the waiver system

It is foreseeable that although the parties may anticipate that an employee will not be present in Canada for either 45 workdays or 90 total days over the relevant time periods, the commitments of the business will later require the employee to exceed such thresholds and thus no longer be eligible for the withholding exemption. We appreciate that the Department has considered this practicality by adding proposed subsection 227(8.5) of the Act which indicates that failure to withhold penalties will not be assessed where the employer made reasonable enquiry and had no reason to believe that the employee did not exceed such thresholds at the time of the payment. However, additional guidance is necessary as to what action an employer should take once it becomes aware that the employee has in fact lost his or her status as a qualified non-resident employee as a result of surpassing the relevant thresholds. From the

wording of proposed subsection 227(8.5), it would appear that no penalties would apply for failing to withhold on remuneration already paid to the employee (i.e., when the employee met the requirements of a qualified non-resident employee). However, it is not clear as to whether or not the employer would subsequently be required to make a "catch-up" remittance once it becomes aware of the change in the employee's status. Presumably, the current waiver program would be available to the parties from the point in time that the employee is no longer a qualified non-resident employee. This should be confirmed in guidance to employers.

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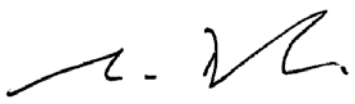
We appreciate the Department's continued support and its cooperation with the international business community to design and implement a system that will allow for the reduction of administrative costs while at the same time protecting the Canadian tax base from erosion. The most recent amendments to these proposals continue to move all parties towards a system which meets these objectives. We would welcome the opportunity to work with you and the CRA in order to further refine these proposals and to determine the necessary modifications to the current waiver process.

Yours very truly,



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