When your employees work in Canada: Income tax help for non-Canadian employers

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There are several tax issues to consider when employees work in Canada (temporarily or on a more permanent basis) for a foreign employer under the *Income Tax Act* (the Tax Act):

1. Issues for employees

Employees who are resident in Canada under the Tax Act are taxed on their worldwide income from all sources, including employment income earned for work performed inside or outside the country. An employee is considered resident in Canada for the year if they spend 183 or more days in the country in any calendar year, or are otherwise resident by virtue of the employee's factual ties (*e.g.* social, economic) to Canada.

Employees who are not resident in Canada must file tax returns and pay income tax on certain income they receive from sources in the country, including employment income earned for work performed inside Canada. Employees may also be taxable on the Canadian employment income in their home country of residence.

2. Issues for foreign employers

Under the Tax Act, foreign employers with employees working in Canada are required to obtain a Canadian tax identification number and open a payroll account with the Canada Revenue Agency. Foreign employers will then be responsible for deducting and remitting Canadian income tax from the employee's remuneration, and may be required to make further deductions for Canada Pension Plan (CPP) premiums, employment insurance (EI) remittances and pay the employers' required CPP and EI amounts.

Depending on the type of work performed by the employee in Canada, the foreign employer may also be considered to be "carrying on business" in Canada, such that the foreign employer may have obligations register for commodity and sales taxes (federally and in Canadian provinces) and file federal and possibly provincial income tax returns reporting income earned in Canada. Additional provincial registrations and licensing may also be required.

3. Issues for customers

Under Tax Act regulations, any person (a Canadian resident or not) paying a fee, commission, or other amount to a non-resident (*i.e.*, the foreign employer) for services of any nature rendered in Canada is required to withhold 15 per cent of the amount paid and remit it to the CRA in respect of the non-resident's tax. The foreign employer may be able to recover this fee by filing a Canadian income tax return for the year.

4. Impact of income tax treaties and social security agreements

Canada has a network of international social security agreements with other countries designed to exempt certain Canadian work from begin considered pensionable employment for CPP purposes and insurable employment for EI purposes in cases where the employee is covered by the social security regime of another country. If the employee provides the employer (foreign or not) with a certificate of coverage issued by other jurisdiction (confirming the Canadian-based employment is considered employment for the purposes of that other jurisdiction's social security regime), the employer needs to deduct or remit EI or CPP premiums in respect of the Canadian based employment.

Canada also has a wide network of tax treaties that may apply to change the income tax liabilities described above of employees and foreign employers.

a. For employees:

In certain circumstances, a tax treaty may limit the ability of a country to tax employment income. For example, under the Canada-U.S. Treaty, if a U.S. resident (who is not a resident of Canada) performs employment in Canada for a foreign employer, the employee will not be subject to tax in Canada on the employment income if the employee:

1. earns no more than C$10,000; or
2. is present in Canada for a period not exceeding 183 days in any 12-month period commencing or ending in the fiscal year concerned, and the remuneration is not paid by, or on behalf of a person who is a resident of Canada and is not borne by a permanent establishment in Canada.

Employees entitled to treaty benefits can claim such benefits in their Canadian tax filings and obtain refunds of any tax withheld.

b. For foreign employers:

As noted above, a foreign employer who "carries on business" in Canada may be subject to various income tax, commodity tax and business registration requirements. Tax treaties generally limit Canada's ability to impose income tax on a foreign employer's business income unless the foreign employer has a permanent establishment in Canada. A permanent establishment is a fixed place of business through which the business of the foreign employer is wholly or partly carried on, and specifically includes a place of management, an office, a factory, a workshop or a place of extraction or natural resources (*i.e.*, mine, oil well, etc.). An employee physically

working in Canada for the foreign employer can give rise to a permanent establishment if the employee habitually exercises in Canada an authority to conclude contracts on behalf of the foreign employer. Note that tax treaties generally do not provide any relief from commodity or sales tax obligations, business registration obligations or the obligation to comply with income tax reporting and compliance.

5. Canada's tax waiver system

To avoid the income tax withholding and remitting obligation for a non-resident employee performing employment in Canada, the foreign employer may apply to be a qualifying non-resident employer at least 30 days before the employee commences employment in Canada. If approved, the CRA will issue the foreign employer an approval letter that will relieve them from the obligations to withhold and remit income tax from the remuneration. To qualify, the foreign employer and the employee must both be resident in a country with which Canada has a tax treaty, and be exempt from Canadian tax on the employment income by virtue of the tax treaty. The foreign employee must also work in Canada for less than 45 days in the calendar year that include the payment and less than 90 days in any 12-month period that includes the payment.

As an alternative, a non-resident employee who does not meet the conditions above or whose foreign employer does not become a qualifying non-resident employer, may also apply for an individual waiver to exempt the employee's Canadian remuneration from income tax withholding and remittance. In addition, if the employee ceases to qualify under the test above (*i.e.*, because they work more than the maximum number of days), this process can apply.

Finally, if the foreign employer does not have a permanent establishment in Canada, it can apply for a waiver of the 15 per cent withholding tax that its customers are required to deduct for all amounts paid for services rendered in Canada.

The above waivers do not eliminate any income tax reporting obligations, such as the obligation on the foreign employer to issue T4 slips, or the obligation on each of the non-resident employee and foreign employer to file Canadian income tax returns (claiming benefits under a tax treaty as applicable).

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