taxnotes® international

Volume 99, Number 3 ■ July 20, 2020

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Reprinted from *Tax Notes International*, July 20, 2020, p. 335

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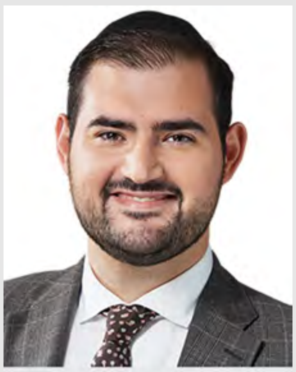

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In this article, the authors review recent Canadian guidance regarding establishing tax residency in Canada, given the travel restrictions resulting from the COVID-19 pandemic.

The COVID-19 pandemic has resulted in the imposition of safety measures worldwide, including in Canada, to protect citizens' health; similarly, businesses have imposed safety measures to protect employees. The measures include, most notably, restrictions on travel and labor mobility.

On May 19 Canada issued its "Guidance on International Income Tax Issues Raised by the COVID-19 Crisis," in which it outlined potential Canadian income tax issues resulting from pandemic-related travel restrictions and the Canada Revenue Agency's proposed response. The administrative positions described below apply only from March 16 to August 31 but may be extended if necessary.[1]

I. Income Tax Residency

A. Individuals

Under the Income Tax Act (Canada), an individual's liability for tax is a function of his status as either a resident or nonresident of Canada. That is ultimately a question of fact determined in accordance with common law principles developed by courts and requires careful consideration of an array of factors, including the duration, object, intention, and continuity of stays in Canada.[2]

The ITA also contains a deemed residence rule if an individual has sojourned in Canada for at least 183 days in a given year. If an individual remains in Canada because of coronavirus-related travel restrictions, the CRA has confirmed that this alone will not cause the individual to be resident in Canada under the common law test of residency. Similarly, in computing the 183-day threshold for deemed tax residency, the CRA will not factor in the days when an individual is present in Canada and unable to return to his country of residence solely because of the travel restrictions.

B. Corporations

Under general Canadian tax principles, corporate residence is determined based on the

[1] As originally published, the relief provided was set to expire on June 29. It was recently extended to cover up to August 31.

[2] *Thomson v. Minister of National Revenue*, [1946] C.T.C. 51 (S.C.C.) (personal residence is "chiefly a matter of the degree to which a person in mind and fact settles into or maintains or centralizes his ordinary mode of living with its accessories in social relations, interests and conveniences at or in the place in question").

locus of the corporation's central management and control (CMC). Specifically, when the CMC of a corporation is exercised by the board of directors, the place where the directors habitually hold their meetings (and make major strategic and policy decisions) will generally determine the corporation's tax residence. However, because of the coronavirus-related travel restrictions, board members living in Canada may be unable to attend meetings in a foreign jurisdiction. In those circumstances, it is possible that a corporation incorporated outside Canada may be considered a tax resident of Canada under the CMC test (as well as resident in the foreign jurisdiction).

For corporations resident in a country with which Canada has a tax treaty, Canada's treaties typically resolve the question of dual corporate residency in one of two ways. Article IV(3) of the Canada-U.S. tax treaty mechanically deems a corporation to be resident only in the country under whose laws it was created.[3] Canada's other tax treaties generally refer corporate dual-residence situations to the mutual agreement procedure. The typical treaty rule requires the competent authorities to consider a list of factors, most notably the corporation's place of effective management and of incorporation. In the second case, the CRA has said that those corporations will not be considered resident in Canada solely because a director participated in a board meeting there because of COVID-19 travel restrictions.

Unfortunately, for corporations that are not resident in a country with which Canada has a tax treaty, the CRA guidance states that corporate residency determinations will be determined on a case-by-case basis. The CRA has also confirmed that that approach will be adopted for other foreign entities that are considered corporations for Canadian tax purposes (for example, limited liability companies). It is also considering a similar approach in determining the residency of a commercial trusts.

The CRA's guidance on the topic concludes with the following passage:

> Notwithstanding that our comments above concentrate on the location of board meetings, there is more to where central management and control of a corporation, or where place of effective management (for income tax treaty purposes) is located than the location of board meetings. The determination of the central management and control of a corporation is based on a number of factors, of which the location of board meetings is only one element. Similarly, the location of board meetings is also only one element in determining the location of a corporation's place of effective management. The Agency may still conclude that a corporation is resident in Canada where the actual management and control of the corporation takes place in Canada even though the board meetings have taken place elsewhere.

That statement is interesting because it seems to hedge the CRA's position on corporate residence in general. While it may cover situations of usurpation of board powers,[4] it may also indicate that one or a few board meetings in a particular location do not necessarily affect the locus of the corporation's CMC.

The June 11 representations submitted by the Joint Committee on Taxation of the Canadian Bar Association and the Chartered Professional Accountants of Canada point out that the guidance does not directly address some foreign affiliate (FA) issues relevant to Canadian multinationals. Under Canada's FA regime, a participation exemption is available for dividends from exempt surplus. Whether an FA's net earnings from a particular active business form part of its exempt earnings and, ultimately, its exempt surplus (which can be distributed to the Canadian parent without further Canadian tax) depends on whether the FA was resident in a designated treaty country (DTC) and the active business was carried on in Canada or in a DTC.[5] For the DTC examination, corporate residency may be determined partly or entirely under common law principles.

[3] The rule does not apply to dual-incorporated companies.

[4] See *Bullock v. The Unit Construction Co. Ltd.*, (1960) 38 TC 712, in which the U.K. parent company assumed the functions of the boards of its overseas subsidiaries.

[5] Briefly, section 5907(11) of Canada's Income Tax Regulations defines a DTC as any country with which Canada has concluded a comprehensive double taxation agreement or a tax information and exchange agreement.

According to the joint committee, Canadian multinationals would benefit from further guidance on the topic. For example, when a corporate director cannot attend a board meeting in person because of the travel restrictions, the CRA should confirm that that will not affect the treatment of active income earned in foreign jurisdictions as exempt surplus. The joint committee recommends that the approach in the guidance be extended to FA situations.

II. Carrying On Business and PEs

A nonresident carrying on business in Canada that benefits from an income tax treaty is subject to tax in Canada on the income from that business only if, and to the extent that, its business activities are carried on through a permanent establishment in Canada. In that regard, the CRA has confirmed that:

- a nonresident entity will not be considered to have a PE in Canada if its employees perform their employment duties in Canada solely as a result of the travel restrictions;
- a nonresident entity will not be considered to have an agency PE solely as a result of a dependent agent entering into contracts in Canada on behalf of the nonresident principal during the period of travel restrictions; and
- it will exclude from the computation of the 183-day presence test under the services PE provision of the Canada-U.S. tax treaty any days of physical presence in Canada resulting solely from travel restrictions.[6]

Despite the foregoing, the joint committee has noted that there are provisions in other tax treaties that could result in similar PE concerns. That is generally the case for building sites and drilling rights, which both reference a 12-month period.[7] Accordingly, the CRA should confirm that no PE will result if the project is delayed because of travel restrictions.

If the nonresident entity's business is not being carried on through a PE in Canada, the entity must file a treaty-based income tax return for that year to claim the treaty exemption from Canadian income tax. The CRA has indicated that that filing obligation will continue to apply for a nonresident entity's tax year that overlaps with the period affected by travel restrictions.

For residents of non-treaty countries, if the nonresident can show that it satisfied the threshold of carrying on business in Canada solely because of travel restrictions, the CRA will consider case by case whether administrative relief from the obligation to file a Canadian income tax return is appropriate.

The joint committee has noted that the CRA guidance fails to address several issues that can arise in the context of the travel restrictions and the computation of foreign accrual property income:

- income earned by a FA through a PE in a nonqualifying country that would otherwise be active business income will be recharacterized as income from a nonqualifying business and consequently included in FAPI (and taxed to the shareholder on a current basis);[8]
- determining whether income from an active business carried on by an FA that is resident in a DTC is included in its exempt earnings will often depend on whether the income is attributable to business activities carried on in a DTC, which can be problematic especially if, because of travel restrictions, employees might be stranded in nonqualifying countries; and
- income earned by an FA from an investment business is included in FAPI, subject to deeming rules that can recharacterize that income as deemed active business income (one of the exceptions from the investment business definition looks to whether the FA's activities are regulated under the laws of each country where the business is carried on through a PE there).

The joint committee has recommended that the CRA confirm that the administrative positions outlined in the guidance will extend to other FA

[6] *See* Article V(9)(a) of the Canada-U.S. tax treaty.

[7] *See id*. articles V(3) and V(4).

[8] ITA section 95(1) defines a nonqualifying business as a business that is carried on through a PE in a nonqualifying country (a country that has neither a tax treaty nor a TIEA with Canada and with which Canada initiated TIEA discussions more than 60 months before that time).

issues, including determining whether an FA is earning nonqualifying business income, carrying on business in a DTC, and carrying on an investment business.

III. Cross-Border Employment

A. Nonresident Employees

Under the Canada-U.S. tax treaty, U.S. residents that regularly perform employment duties in Canada but would not normally be present in Canada for more than 183 days are generally not subject to Canadian tax on their employment income. However, current travel restrictions may cause U.S. employees to be in Canada beyond the 183-day limit. The CRA guidance confirms that if those individuals are physically present in Canada, and are performing their employment duties from Canada, solely as a result of current travel restrictions, those days will not be counted toward the treaty's 183-day limit. A similar administrative approach will be applied in computing the days of presence test for employees who are resident in other countries with which Canada has a tax treaty.

The joint committee has correctly pointed out that there are other situations in which an individual's status may depend on the number of days she spends in Canada, such as the 45- and 90-day periods applicable in determining whether an individual resident in a treaty country is a qualifying nonresident employee under ITA section 153(6).[9] Accordingly, the CRA should confirm that when computing the applicable time limits, it will not count days spent in Canada as a result of travel restrictions.

B. Canadian Resident Employees

Nonresident employers paying Canadian resident employee salaries or wages are generally required to deduct withholdings at source, regardless of where the employment services are being rendered. Even so, the applicable Canadian deductions at source may be reduced to account for any foreign tax credits available to the Canadian employee by obtaining a letter of authority from the CRA. If a Canadian employee must perform employment duties in Canada as a result of travel restrictions and has already been issued a letter of authority for the current tax year, the CRA has indicated that the Canadian withholding obligations of the nonresident employer will not change and that the letter of authority will continue to apply, provided that the employer's withholding obligations in the other jurisdiction remain unchanged.

IV. Procedural Matters

A. Regulatory Waiver Requests

As a general rule, salaries and other forms of remuneration paid to nonresident employees rendering employment services in Canada are subject to the same withholding, remitting, and reporting obligations as those applicable to Canadian resident employees. That can impose onerous payroll compliance obligations on nonresident employers who send employees to Canada temporarily, particularly when the employee's income would not be subject to tax by virtue of a tax treaty with Canada. As a relieving measure, however, the employee — or in some circumstances, the employer — can apply to the CRA for a waiver to be relieved from the withholding obligations imposed by the ITA and regulation 102.

Service fees paid to nonresident independent contractors are similarly subject to Canadian withholding requirements. Specifically, fees earned by nonresidents for services rendered in Canada will be subject to a 15 percent withholding obligation by the payer under regulation 105, even if those service providers will ultimately have no Canadian tax liability by virtue of a tax treaty with Canada.[10] However, if the nonresident can establish both residence in a treaty jurisdiction and entitlement to benefits under a treaty, the CRA will grant a waiver relieving the payer of its withholding obligations.

The CRA guidance acknowledges that the pandemic has caused a temporary interruption in

[9] For discussion of what constitutes a qualifying nonresident employee, see Rhonda Rudick and Reuben Abitbol, "Witholding Relief for Nonresident Employees in Canada," *Tax Notes Int'l*, Mar. 21, 2016, p. 1047.

[10] Further, if the services are rendered in Québec, the provincial tax authorities require the payer to withhold an additional 9 percent on amounts paid to the nonresident service provider.

processing regulation 102 or 105 waiver requests. To address the backlog resulting from that interruption, the CRA is developing a process that will enable applicants to temporarily submit urgent waiver requests electronically.

Moreover, when a regulation 102 or 105 waiver request was submitted, but because of the interruption of service was not processed in 30 days, the payer will not be assessed for failure to deduct, withhold, or remit any amount as required by the regulation for amounts paid to a nonresident person covered by the waiver request. That relief is available only if the nonresident person can demonstrate that the applicable waiver could not be obtained because of the interruption of services and that she took reasonable steps to ascertain that she was entitled to a reduction or elimination of Canadian withholding tax by virtue of an income tax treaty with Canada. The CRA will examine other situations in which a waiver request could not be submitted because of the travel restrictions (or other pandemic-related consequences) case by case.

B. Dispositions of Taxable Canadian Property

When a nonresident of Canada disposes of taxable Canadian property, ITA section 116 imposes filing obligations on the vendor and withholding obligations on the purchaser for any disposition of taxable Canadian property that is not tax exempt under a treaty. In general terms, the vendor will be required to obtain a certificate of compliance from the CRA for the disposition, failing which the purchaser will be required to withhold and remit 25 percent of the gross purchase price. The clearance certificate does not necessarily eliminate the withholding obligation; rather, it reduces the withholding to 25 percent of any inherent gain in the asset being disposed.

When a nonresident vendor submits a request for a certificate of compliance and the certificate was not issued by the time the purchaser's remittance was due — that is, in 30 days after the end of the month in which the property was sold — the parties may request that the CRA issue a comfort letter. That letter advises the parties to a transaction to retain amounts withheld from the purchase price until the CRA completes its review of the file and instructs the purchaser to remit any withheld amounts. So long as the amount of tax payable is remitted when requested, the CRA will not assess penalties or interest on said amounts. ■