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Tax Alert – Canada

CRA guidance on international income tax issues resulting from COVID-19 travel restrictions

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 19 May 2020, the Canada Revenue Agency (CRA) published guidance on various international income tax issues resulting from COVID-19 related restrictions on travel (the Travel Restrictions) and CRA service interruptions. The administrative guidance is intended to address concerns raised by taxpayers and their representatives and covers the following Canadian income tax topics:

- Income tax residency
- Carrying on business in Canada and permanent establishments
- Cross-border employment income
- Waiver requests relating to payments to non-residents for services provided in Canada
- Dispositions of taxable Canadian property by non-residents of Canada

The temporary relieving positions outlined in the guidance will apply for the period 16 March to 29 June 2020 but may be extended if necessary or rescinded if no longer required.

The guidance and relieving measures are described below.

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1. Income tax residency

The COVID-19 travel restrictions may result in issues concerning an individual's or corporation's residency status for Canadian income tax purposes, since an individual (including directors of a corporation) may have been required to remain in Canada.

Individuals

The CRA has indicated that if an individual visiting Canada from another country has had to remain in Canada solely because of the Travel Restrictions, this factor alone will not cause the CRA to consider the individual to be a resident of Canada under the common-law factual residency test.

In addition, on a temporary administrative basis, the days during which an individual is present in Canada and is unable to return to their country of residence solely as a result of the Travel Restrictions will not count towards the 183-day limit for the deemed residency test. This position will apply if (among other things) the individual is usually a resident of another country and intends to return, and does in fact return, to their country of residence as soon as they are able to do so.

Corporations

Under common law, a corporation may be considered resident in Canada if its "central management and control" is located in Canada. One of the key factors considered in applying this common-law residency test is the jurisdiction in which the meetings of the board of directors take place. A corporation that was resident in a foreign jurisdiction prior to the implementation of the COVID-19 Travel Restrictions may have one or more directors present in Canada and unable to travel to the foreign jurisdiction to attend board meetings. There is concern that this may result in a corporation being considered resident in Canada while also resident in the foreign jurisdiction.

Where the issue of dual residency is resolved under one of Canada's income tax treaties that contains a residency tie-breaker rule that looks to the corporation's place of effective management (among other factors), the CRA has indicated that it will not consider the corporation to be resident in Canada solely on the basis that one or more directors of the corporation had to participate in a board meeting from Canada because of the Travel Restrictions. As the location of board meetings is only one element in determining the location of a corporation's place of effective management, the CRA cautions that they could still conclude a corporation is resident in Canada if other factors point to Canada as the place where the actual central management and control of the corporation takes place.

In the case of dual residency with non-treaty countries, the CRA will determine residency on a case-by-case basis.

The CRA will apply the same position in respect of other foreign entities that are considered corporations under Canadian income tax law (such as limited liability companies). In addition, where appropriate, a similar approach may be applied in determining the residency of a commercial trust.

2. Carrying on business in Canada and existence of a permanent establishment

As a result of the Travel Restrictions, individuals who normally work outside of Canada for a non-resident entity may have been required to exercise their employment duties in Canada. In certain circumstances, this may result in a non-resident entity carrying on business in Canada or may cause the entity to have a permanent establishment in Canada.

Carrying on business in Canada

If a non-resident entity is resident in a treaty country and is carrying on business in Canada in a taxation year but does not have a permanent establishment in Canada, the non-resident entity is required to file a treaty-based income tax return for that year in order to claim the treaty exemption from Canadian income tax. The CRA has indicated that this filing obligation will continue to apply for any taxation year of a non-resident entity that overlaps with the period during which the Travel Restrictions are in place.

If a non-resident entity is resident in a non-treaty country and it can be demonstrated to the CRA that the non-resident entity meets the threshold of "carrying on business in Canada" solely because of the Travel Restrictions, the CRA will consider whether administrative relief from the obligation to file a Canadian income tax return (and presumably pay tax in Canada) is appropriate on a case-by-case basis.

Permanent establishment determination

On an administrative basis, a non-resident entity will not be considered to have a permanent establishment in Canada if its employees perform their employment duties in Canada solely as a result of the Travel Restrictions. In addition, the CRA will not consider an "agency" permanent establishment to exist solely due to a dependent agent concluding contracts in Canada on behalf of the non-resident entity while the Travel Restrictions are in force, provided that such activities are limited to that period and would not have been performed in Canada but for the Travel Restrictions.

The CRA will also exclude from the 183-day presence test in the "services permanent establishment" provision of Canada's tax treaties (e.g., Article V(9)(a) of the Canada-US treaty) any days of physical presence in Canada that are solely the result of the Travel Restrictions.

3. Cross-border employment income

The Travel Restrictions may also result in taxation issues relating to cross-border employment income. The CRA has provided the following guidance for employees that are resident in the US or in other treaty countries and Canadian resident employees.

Employees resident in the US or in other treaty countries

As a result of the Travel Restrictions in place, US residents who regularly exercise their employment in Canada but would normally not be present in Canada for more than 183 days

(and, for that reason, are not normally taxable in Canada on their employment income under the Canada-US treaty) may now be exercising their duties in Canada for an extended period of time.

The CRA has indicated that where such individuals are present in Canada, and are exercising their employment duties in Canada, solely as a result of the Travel Restrictions, those days will not be counted toward the 183-day test in the Canada-US treaty. As such, these individuals will continue to benefit from the treaty relief provided under the tax treaty.

For employees that are resident in other countries with which Canada has a tax treaty, the CRA will take the same administrative approach when applying the days of presence test in the relevant tax treaty.

Canadian resident employees

For Canadian income tax purposes, a non-resident employer is generally required to deduct withholding tax at source from the salary and wages it pays to Canadian-resident employees (regardless of where the services are rendered). The CRA may, however, issue a "letter of authority" to an employee that authorizes the non-resident employer to reduce the Canadian deductions at source to account for any foreign tax credit available to the employee.

Where a Canadian resident employee of a non-resident entity is required to perform their employment duties in Canada on an exceptional and temporary basis as a result of the Travel Restrictions and that employee has been issued a letter of authority for the current taxation year (during which the Travel Restrictions were in place), the CRA has indicated that the letter of authority will continue to apply and the withholding obligations of the non-resident entity will not change in Canada. This relieving measure applies only if there are no changes to the withholding obligations of the non-resident entity in the other jurisdiction.

4. Regulations 102 and 105 waiver requests

Due to the COVID-19 crisis, the processing of requests to waive the withholding requirement under Regulation 102 (for remuneration paid to a non-resident officer or employee for services performed in Canada) and Regulation 105 (for payments for services rendered in Canada by non-resident service providers) was temporarily interrupted. While the CRA has since resumed processing in a limited capacity, the processing times have been longer than usual.

The CRA had indicated that as a result of the interruption and the Travel Restrictions, urgent waiver requests may be submitted electronically on a temporary basis. Further information on this process is currently under development by the CRA.

In circumstances where a Regulation 102 or 105 waiver request was submitted to the CRA but (as a result of the interruption) was not processed by the CRA within 30 days, the payer will not be assessed for failure to deduct, withhold or remit any amount as required by Regulations 102 and 105, in respect of an amount paid to a non-resident person covered by the particular waiver request. However, to qualify for this relief, the person paying the amount must demonstrate that they have taken reasonable steps to ascertain that the non-resident person was entitled to a reduction or elimination of Canadian withholding tax under

an income tax treaty with Canada. Also, the non-resident and the person paying the amount must otherwise fulfil their Canadian reporting and remitting obligations in respect of the waiver application.

Other situations where a waiver request could not be submitted due to the Travel Restrictions, or other consequences of the COVID-19 crisis, and no amounts were withheld under Regulations 102 or 105, will be reviewed by the CRA on a case-by-case basis.

5. Section 116 compliance certificates for dispositions of taxable Canadian property

The processing of requests for section 116 compliance certificates was temporarily interrupted due to the COVID-19 crisis. While the CRA has since resumed processing in a limited capacity, the processing times have been longer than usual.

If a vendor has submitted a request for a section 116 compliance certificate and the certificate has not been issued by the time a purchaser's remittance is due (i.e., within 30 days after the end of the month in which the property was acquired), the purchaser or vendor may request a comfort letter from the CRA.

The comfort letter advises the purchaser/vendor/representative to retain the funds they have withheld but not remitted to the CRA until the CRA's review is complete and the CRA requests the purchaser to remit the required tax. No penalty will be assessed by the CRA provided the tax is remitted when requested.

Urgent requests for comfort letters may be submitted on a temporary basis. Requests for a comfort letter can be made by contacting the CRA's individual tax enquiries line at +1 800 959 8281.

Learn more

For further details, refer to the CRA guidance, which is available on the CRA website.

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