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# Tax Alert – Canada

## CRA issues supplemental guidance on international income tax issues resulting from COVID-19

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 1 April 2021, the Canada Revenue Agency (CRA) published supplemental guidance on various international income tax issues resulting from COVID-19-related restrictions on travel (the Travel Restrictions). The administrative guidance updates measures announced in 2020 for the Initial Relief Period of 16 March to 30 September 2020 and covers the following Canadian income tax topics:

- Income tax residency for individuals
- Permanent establishment determination
- Cross-border employment income for US and Canadian resident employees

Minor updates were also provided on the following topics:

- Waiver requests relating to payments to non-residents for services provided in Canada
- Dispositions of taxable Canadian property by non-residents of Canada

The supplemental guidance is intended to address potential income tax issues resulting from the continued Travel Restrictions and clarify certain income tax reporting obligations for 2020 and 2021. The CRA also intends to provide examples and answers to frequently asked questions shortly.

The guidance and relieving measures are described below. For information on the original measures announced for the Initial Relief Period, see EY Tax Alert 2020 Issue No. 35.

## 1. Income tax residency for individuals

The COVID-19 Travel Restrictions[1] may result in issues concerning an individual's residency status for Canadian income tax purposes, since an individual may have been required to remain in Canada.

For the Initial Relief Period, 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 such situations, 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.

The supplemental guidance, which is restricted to individuals only, extends the period to which this relief applies until the earlier of the date on which the Travel Restrictions are lifted and 31 December 2021.

The relief applies only in respect of the individual's physical presence in Canada. For purposes of the common-law test of residency, other indicators, such as a permanent home in Canada or enrolment in government programs for Canadians, may lead to a conclusion that the individual is factually resident in Canada.

## 2. Permanent establishment determination

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 cause the entity to have a permanent establishment in Canada.

For the Initial Relief Period, 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. The relief also applies to the determination of an "agency" permanent establishment. 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.

[1] As previously published in the international tax guidance (as part of the update released on 15 October 2020), the CRA generally views the Canadian government's recommendation to Canadians to return to Canada as a travel restriction. This position would apply in a situation where an individual would have been permitted under the laws of their country of residence to remain in (or return to) that country.

### Fixed place of business

In the supplemental guidance, the CRA confirmed that the administrative relief provided for the Initial Relief Period no longer applies to determinations of whether or not the non-resident employer has a fixed place of business in Canada.

The revised guidance affects non-resident employers with employees who have continued to exercise their employment duties in Canada beyond the Initial Relief Period as a result of the Travel Restrictions. For example, a Canadian resident employee may have continued to exercise their employment duties from a Canadian home office rather than return to their US-based office location.

The CRA expects that the application of the relevant treaty provisions to non-resident employers in these situations will generally not result in the finding of a permanent establishment for the employer. In the CRA's view, the fact, on its own, that an employee works remotely from their home or a short-term residence in Canada while the Travel Restrictions remain in place will generally not be sufficient to meet the threshold of a permanent establishment. There must be a semblance of permanence to the site, which must be at the "disposal" of the employer, to be considered a fixed place of business through which the business of the employer is wholly or partly carried on.

However, this conclusion may differ if the employee continues to exercise their employment duties in Canada after the Travel Restrictions are lifted or a workspace is further established in Canada as an office of the employer.

### Agency and services permanent establishments

The supplemental guidance includes a similar conclusion in respect of "agency" permanent establishments on the basis that the requirement to "habitually exercise" the right to conclude contracts on behalf of the employer would not be met if the employee remains in Canada solely as a result of the Travel Restrictions. This conclusion may differ, for both the period of time during the Travel Restrictions and afterwards, if the employee remains in Canada after the Travel Restrictions are lifted and continues to conclude contracts on behalf of the employer.

Lastly, for purposes of the "services permanent establishment" under the Canada-US treaty, most employees performing their employment duties in Canada solely as the result of the Travel Restrictions would not meet treaty thresholds for a permanent establishment to be created if they are not working on projects for Canadian customers.

Affected individuals are advised to assess their personal situation.

## 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 updated guidance for employees that are resident in the US and Canadian resident employees.

## Employees resident in the US

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.

For the Initial Relief Period, 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.

The supplemental guidance extends this relief until 31 December 2020. However, if an individual remains in Canada after this date, the individual must include each subsequent day present in Canada toward the 183-day test. Furthermore, where the individual continues to work remotely from Canada as of 1 January 2021, the employer is required to withhold and remit taxes in respect of the individual or request a withholding requirement waiver from the CRA.

Where the conditions in subsection III.D of the original 2020 guidance are met, the non-resident employer is not required to file a T4 slip for 2020 in respect of the affected non-resident employee. However, the non-resident employer must maintain a record of the number of days during which the non-resident employee was present or worked in Canada as a result of the Travel Restrictions and the corresponding employment income for those days.

## 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.

The original 2020 guidance indicated that where a Canadian resident employee of a non-resident entity was required to perform their employment duties in Canada on an exceptional and temporary basis as a result of the Travel Restrictions and that employee had been issued a letter of authority for the taxation year (during which the Travel Restrictions were in place), the letter of authority would continue to apply and the withholding obligations of the non-resident entity would not change in Canada. This relieving measure applied only if there were no changes to the withholding obligations of the non-resident entity in the other jurisdiction.

The supplementary guidance issued on 1 April 2021 identifies an issue that could arise because an employee's income subject to tax in the United States may be relatively lower (and their income subject to Canadian tax correspondingly higher) even though the employer's withholding obligations did not change. This is a result of the operation of the sourcing rules in the Canada-US treaty. Employees who find themselves in this position because the Travel Restrictions forced them to perform employment duties from home in

Canada instead of from their employer's US workplace may choose to prepare their 2020 Canadian T1 personal income tax return on the basis of a new administrative concession.

The administrative concession allows the employee to treat employment income received from the US employer as being sourced from the United States for 2020 instead of from Canada.[2] This treatment is optional, and an employee may instead choose to report income from work performed in Canada as being sourced in Canada. However, an employee whose 2020 income tax withholdings were changed to reflect the sourcing rules in the Canada-US treaty will not have the option of using the administrative concession and must file their return using the sourcing rules in the treaty.

The supplementary guidance sets out how the CRA will treat certain amounts that are frequently relevant to cross-border employees resident in Canada, such as contributions made to the US under the *Federal Insurance Contributions Act* or contributions to a US retirement plan. See the CRA guidance for more details.

Administrative relief for 2020 may also be available with respect to state income tax paid. More specifically, if an employee paid state income tax in 2020 and the applicable state retained its right to tax the employee, the employee will be permitted to claim a foreign tax credit in respect of the amount paid even though the income was earned in Canada. In such cases, the employee's non-business income would consist of the portion of employment income that would have been earned in the state if the employee continued to commute to work in the US in 2020. The employee is required to file an amended T1 return if the state tax paid is refunded at a later time.

In recognition of the fact that employees who file their 2020 Canadian income tax return in accordance with the sourcing rules in the Canada-US treaty may experience cash flow issues while they wait for withholding taxes paid to the US to be refunded to them, the CRA confirmed that relief from all or part of the interest or late-payment penalties on the 2020 balance owing may be available. Similarly, employees may receive a 2021 instalment notification as a result of income being sourced to Canada instead of to the US for 2020; the CRA stated it would cancel instalment penalties and interest if charged. Refer to the CRA supplemental guidance for information on submitting requests for relief of interest and penalties.

## 4. Regulation 102 and 105 waiver requests

The CRA clarified that previously announced relief (as described in EY Tax Alert 2020 Issue No. 35) from assessments for failure to deduct, withhold or remit amounts as required by Regulation 102 or 105 applied only to waiver requests sent to the CRA between 1 March 2020 and 30 June 2020. 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 Regulation 102 or 105, will continue to be reviewed by the CRA on a case-by-case basis, regardless of whether these arose during the period from 1 March 2020 to 30 June 2020 or later.

[2] Filing in accordance with the concession would mean that the individual would follow the same method as in prior years, claiming a foreign tax credit for amounts paid in the United States.

Further, the temporary process allowing urgent waiver requests to be submitted to the CRA by email was terminated on 31 March 2021. All waiver and non-resident employer certification applications must now be sent by mail or fax or be submitted online.

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

As previously announced, during the COVID-19 pandemic, processing times for section 116 certificates have been longer than usual; a vendor or purchaser may ask the CRA for a comfort letter in a case where a section 116 certificate has been requested but has not been issued by the time the purchaser's remittance is due. A temporary process allowing a vendor to make such an urgent comfort letter request by email was terminated on 31 March 2021. Comfort letter applications must now be made directly to a CRA officer (if one has been assigned), by contacting the CRA's individual tax enquiries line at +1 800 959 8281, by fax or online.

## Learn more

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

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