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SOMMAIRE

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US PARENT CORPORATIONS SENDING EMPLOYEES INTO CANADA TO SUBSIDIARIES – GENERAL TAX ISSUES AND REMEDY

Emmanuel Sala, Carolyne Corbeil and Luc Pariseau

Where a corporation is a resident of the United States (the "US") for the purposes of the Convention Between Canada and the United States of America With Respect to Taxes on Income and Capital ("**Treaty**") (the "**US Parent**") and sends US-based employees (the "**US Employees**") in Canada to perform services for the benefit of a Canadian corporate subsidiary (the "**Canadian Subsidiary**") under a service agreement, all parties involved may become subject to Canadian federal and Quebec provincial tax obligations and the US Parent and the Canadian Subsidiary may become subject to federal and Quebec sales tax obligations

TAX ISSUES

Consequences to US Parent

When the US Parent sends US Employees to work in Canada, it may be considered as carrying on a business in Canada for Canadian federal income and sales tax purposes, triggering the application of the following income and sales tax compliance obligations:

- Withholding of federal income tax source deductions, remittance thereof to the Canada Revenue Agency ("**CRA**")

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and compliance with payroll filing obligations in connection with the portion of the remuneration paid to the US Employees attributable to duties performed in Canada.

- Registering for federal and Quebec sales tax purposes ("**GST/QST**") and fulfilling compliance obligations in this regard, including charging to and collecting from the Canadian Subsidiary GST/QST on any fees charged by the US Parent to the Canadian Subsidiary in consideration for the work performed by the US Employees for the benefit of the Canadian Subsidiary ("**Chargeback Fees**").
- Maintaining a business number together with a payroll and corporate income tax program accounts with the CRA.
- Filing a Canadian federal income tax return with the CRA within 6 months after the end of its taxation year

Should the US Parent be carrying on this business through a "permanent establishment" ("**PE**") situated in Canada, as this term is defined under the Treaty, liability for Canadian federal income tax obligations and Canadian payroll taxes and employer contributions could arise.

Essentially, the US Parent may have a PE in Canada under the Treaty should it be determined that the US Parent has a Fixed Base PE, an Agency PE, a Construction Site PE or a Service PE, as such expressions are defined below. The following provides examples of situations where the CRA may argue that the US Parent has a PE in Canada under the Treaty

- An office space is made available to the US Employees in the premises of the Canadian Subsidiary – **Fixed Base PE**.
- Presence in Canada of the US Employees who exercise the authority to conclude contracts in the name of the US Parent – **Agency PE**.
- The US Employees perform planning and supervising activities at a construction site which will be in place for a period of more than 12 months – **Construction Site PE**.
- Services are provided in Canada by one or more US Employees for an aggregate of 183 days or more during a 12-month period – **Service PE**.

Particular attention must be given to Construction Site PE and Service PE which have been given a broad interpretation by the CRA.

A US Parent may be deemed to have a Service PE in Canada under the Treaty if the US Employees and, in certain circumstances, US subcontractors, enter into Canada to provide services to the Canadian Subsidiary. Under the Service PE rules, the US Parent would have a PE if the services provided in Canada, by one or many US Employees, continue for an aggregate of 183 days or more in any twelve-month period. However, the determination of a Service PE remains subject to the rules applicable to the Construction Site PE. In general, it is the CRA's view that the Construction Site PE rules override the Service PE rules and that only services rendered in Canada, but away from the Construction Site PE, can be considered when making the determination of a Service PE.

In other words, if the US Parent has employees or agents (including directors of the board of directors) in Canada for a total of more than 182 days in a 365-day period in connection with a project, excluding the days during which the US Parent's employees, agents or subcontractors render services at the Construction Site PE of the US Parent, if any, the US Parent will be deemed to have a PE in Canada, and any profits attributable to that PE will be taxable in Canada. In computing the number of days for the purposes of the Service PE 183-day threshold, where the US Parent sends individuals simultaneously in Canada to provide services to the Canadian Subsidiary, their collective presence during one calendar day will count for one day only. From a Quebec provincial income tax perspective, should the US Parent have a PE situated in the Province of Quebec which constitutes an "establishment" for Quebec income tax purposes, the US Parent will also be liable for Quebec provincial income tax, Quebec income tax source deductions and Quebec payroll taxes/employer contributions. However, since the notions of Construction Site PE and Service PE do not exist for Quebec income tax purpose, the threshold for US Parent to have an

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“establishment” in the Province of Quebec is higher than at the federal level.

Consequences for Canadian Subsidiary

From the Canadian Subsidiary’s perspective, service agreements with the US Parent should not result in any significant adverse income and sales tax consequences other than the combined federal and Quebec 24% tax withholdings that will have to be withheld and remitted to the tax authorities with respect to the Chargeback Fee. GST/QST would also likely be payable by the Canadian Subsidiary to US Parent with respect to those amounts, but a corresponding GST input tax credit and QST input tax refund should generally be available to the Canadian Subsidiary.

Consequences for US Employees

To the extent that the US Parent has a Fixed Base PE, an Agency PE, a Construction Site PE or a Service PE in Canada, Treaty relief for Canadian taxes on Canadian-source income should not be available to the US Employees and their portion of income that will be derived from services rendered or duties performed in Canada should be subject to tax in Canada. Consequently, the US Employees will generally also be subject to Canadian income tax compliance obligations.

REMEDY: SECONDMENT ARRANGEMENT

To mitigate most of the foregoing PE issues and other tax issues associated with carrying on a business in Canada, the US Parent could enter into a secondment arrangement with the Canadian Subsidiary and the US Employees. A secondment arrangement generally consists in a written agreement where the legal terms of the secondment and the factual relationship between the seconded US Employees and the Canadian subsidiary are established.

CONCLUSION

In conclusion, careful consideration must be given at any time a US Employee or a US-based consultant enters Canada to render services or perform duties for the benefit of a Canadian Subsidiary. Efficient tax planning such as putting in place a secondment arrangement can, subject to US transfer pricing considerations, usually minimize the US Parent’s Canadian tax liability but the key is to plan any significant presence of US Employees and/or US-based consultants prior their entry in Canada.

BUSINESS TRIPS TO CANADA: BUSINESS VISITOR STATUS OR WORK PERMIT?

Nadine Landry

With the globalization of commerce, the number of people travelling for business purposes is on the rise. Many will think that a business trip does not have much to do with immigration given that it may seem as simple to enter Canada for business purposes as it is to enter as a tourist. However, there are important differences and the distinction between who qualifies as a business visitor and who is considered a foreign worker is not always clear.

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The main exemption category is the business visitor. To benefit from this exemption, the company in question's main places of business and sources of income and profits must be situated outside of Canada. Theses activities include, but are not limited to, the following:

- Purchasing Canadian goods or services on behalf of a foreign business or government
- Taking orders for goods or services
- Attending business meetings, conferences, conventions and fairs
- Being trained by a Canadian parent company for which the person works outside Canada
- Training employees of a Canadian affiliate of a foreign company
- Being trained by a Canadian business that sold the visitor's foreign employer equipment or services

After-sales service is also exempt from the work permit requirement, subject to certain conditions. Maintenance or repair of specialized equipment purchased or leased outside of Canada is permitted only if the service was provided for in the initial contract of sale. It is important to note that manual installation of equipment is not included and normally requires hiring local employees or obtaining work permits.

The North American Free Trade Agreement has broadened the scope of permissible activities for American or Mexican nationals to include, among others, certain activities related to research, marketing and general services. This same agreement will facilitate the obtaining of work permits for certain professionals as well as for individuals who have specialized knowledge or who hold management positions and who are transferred to a Canadian subsidiary.

In conclusion, entering Canada for business purposes must not be taken lightly and businesses would be well-advised to make sure that their employees have the appropriate status based on the purpose of their trip when travelling to Canada for business. Border officials are strict and there is strong political will to protect the labour market and to crack down on offenders.

Moreover, the federal government has announced the enactment of certain legislative amendments which provide for more severe penalties in cases involving false statements. More specifically, the period of inadmissibility to Canada will be five years instead of two. Considering that Canadian border officials have broad powers to search, a person would be very ill-advised to attempt to enter Canada under false pretenses. The classic business meetings scheduled over the next two weeks will not be very convincing if it is not adequately supported by sufficient evidence.

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