WeirFoulds LLP

Mind the tax: Considerations for ex-patriot employees working in Canada

November 30, 2010

By Maralynne Monteith

The allocation of talent is always a concern in this global economy, and for employers with an interest or operations in Canada, many choose to transfer one or more employees to work in Canada rather than hire locally. This can give rise to a myriad of tax implications, both to the employee and the employer. Here are some key issues you should address before making the decision to transfer an employee to work in Canada.

Tax implications for employees

As a general rule, any individual who receives income from employment that is exercised in Canada is subject to Canadian income tax on that income.

If an "Ex-pat" employee crosses the threshold and becomes a Canadian resident, then that individual will become subject to Canadian income tax on his worldwide income. If the Ex-pat does not cross the threshold for Canadian residency, then the individual will only be liable to Canadian income tax on Canadian source income, including income from employment exercised in Canada.

If there is a tax treaty between Canada and the individual's country of residence, this treaty will impact the determination of residence, as Canada's tax treaties do not permit an individual to be a dual resident. An applicable tax treaty may also provide relief from Canadian income tax and reduce exposure to double taxation.

If there is no applicable income tax treaty with Canada, particular care must be taken to avoid dual residency and ensure that the arrangement is structured so that the individual has only one tax residence recognized as the sole tax residence by each jurisdiction under its local laws.

There are two other issues that should be addressed before transferring an employee to Canada:

- **Foreign benefit plans:** If the Ex-pat employee wants to continue to participate in a foreign benefit plan, the plan must be reviewed to ensure the terms allow continued eligibility. The plan should also be reviewed to determine how it will be treated under Canadian tax laws and what the tax implications are for the employee.
- **Foreign Social Security:** Canada has entered into Social Security Agreements with most of its major trading partners that allow an Ex-pat employee working in Canada to remain on the social security system in the individual's home country for up to five years. Whether this option makes sense should be examined for each potential Ex-pat employee.

Tax implications for employers

If a non-resident enterprise carries on business in Canada, it is liable for Canadian income tax on its profits. The threshold for determining whether an enterprise is “carrying on business” is low, so the Ex-pat employee’s employment activities in Canada should be examined to determine whether this threshold is met.

If the threshold has been met, and a tax treaty applies, the foreign enterprise will be protected from Canadian income tax unless it has a permanent establishment located in Canada. The applicable tax treaty will set out the rules for determining whether a permanent establishment exists. Care should be taken to ensure that the activities of the Ex-pat employee do not unnecessarily cause a permanent establishment to arise.

The employer will also need to address several other tax-related issues:

- **Source deductions:** For employment income that is subject to Canadian income tax, the payor (whether the actual employer or not) must make and remit source deductions for income tax, Canada or Quebec Pension Plan contributions and Employment Insurance. Canada also imposes another refundable source deduction (equal to 15% of the gross fees) on account of Canadian income tax on foreign enterprises that are paid fees by a Canadian resident for services rendered in Canada.
- **Payroll taxes:** Payroll taxes are imposed by many of Canada’s provinces and are typically used to help fund health care. The proposed activities and structure of the Ex-pat employee’s conduct in Canada should be examined to determine whether payroll tax issues need to be addressed.
- **Goods and Services Tax (“GST”):** The GST is Canada’s 5% federal sales tax. Several provinces, including Ontario and British Columbia effective July 1, 2010, have harmonized their provincial sales tax systems with GST, so that a single harmonized sales tax (HST) applies. A non-resident enterprise will generally be brought into the GST system if it supplies goods or services in the course of carrying on business in Canada. The GST and HST implications of the Ex-pat employee’s activities should be reviewed to determine whether it is possible to meet the business objectives of the foreign enterprise without bringing it into the GST or HST system.

Planning makes perfect

Advance planning is the key to ensuring there are no tax surprises when sending an Ex-pat employee to Canada. There are many different ways to structure a “work in Canada” arrangement, and by factoring tax issues into the planning process, you’ll be able to minimize the tax impact for both the employer and employee.

WeirFoulds LLP

www.weirfoulds.com

Toronto Office
4100 – 66 Wellington Street West
PO Box 35, TD Bank Tower
Toronto, ON M5K 1B7

Tel: 416.365.1110
Fax: 416.365.1876

Oakville Office
1320 Cornwall Rd., Suite 201
Oakville, ON L6J 7W5

Tel: 416.365.1110
Fax: 905.829.2035