200 - 15300 Croydon Dr.
Surrey, BC V3S 0Z5
www.knv.com

KN&V
Chartered Accountants LLP

Phone: 604-536-7614
Toll Free: 1-800-761-7772
Fax: 604-538-5356

TAX CONSIDERATIONS FOR DOING BUSINESS IN CANADA

This document is a general overview of several income tax and GST/HST issues that non-resident entities should consider relative to doing business in Canada. It is not intended to be advice on any particular matter and, therefore, we recommend appropriate professional advice be obtained when considering a specific transaction.

Corporate Income Tax

Federal Income Tax – Domestic Law

Non-residents that "carry on business" in Canada are subject to tax on the income unless there is relief provided by the treaty. The definition of "carrying on business" is very broad. Generally the rendering of services in return for fees and the solicitation of sales are deemed to be carrying on business.

The general corporate tax rate in B.C. is 26.5% in 2011, and it will be reduced to 25% in 2012. A non-resident entity doing business in Canada may be subject to an additional branch tax if there is no treaty exemption. The branch tax approximates the withholding tax on dividends that a non-resident entity would be subject to if they were doing business in Canada by way of a Canadian subsidiary company.

Federal Income Tax – Treaty Considerations

Treaties will override domestic law if there is no Permanent Establishment ("PE") in Canada. Activities that constitute a PE in Canada include:

- A fixed place of business. For example, a construction or installation project; or dedicated office space such as an office at a customer's premises or the "home office" of a Canadian resident employee;
- A dependant agent in Canada who has the authority to contract; or
- The concept of services PE pursuant to the Canada-US Treaty.

Services PE potentially applies to a US resident that "provides services" in Canada. The test is based on the number of days services are provided in Canada. Generally a US resident will be subject to services PE when the provision of services exceeds 182 days in any 12 month period.

Withholding Taxes – Regulation 105

The Income Tax Act ("Act") levies a 15% withholding tax on fees paid to non-resident contractors for services rendered in Canada. An additional 9% withholding tax applies to services rendered in Quebec. The payer is responsible for withholding and remitting the tax (including any interest and penalties) to the Canada Revenue Agency. The payer is also required to report the gross services and withholding taxes on Form T4A-NR by February 28th of the following year. Regulation 105 withholding taxes apply even if the payer is a non-resident. A waiver to reduce or avoid withholding taxes may be available, but the waiver must be in place before the payments are made. Guidance on obtaining a waiver are contained in CRA information circular IC 75-6R2.

Federal income Tax Filing Obligations

Non-resident corporations that carrying on business in Canada are required to file a Corporate (T2) tax return; as well as, provincial tax return(s) as applicable. The T2 is due six months after the fiscal year-end. A penalty of $2,500 may be assessed if the T2 is more than 100 days late. T2 schedule 91 summarizes information related to treaty positions as well as payments made to employees, contractors and five largest customers. The T2 must be filed within three years of the filing deadline in order for the CRA to issue a refund.

Non-Resident Employees

EMPLOYER WITHHOLDING REQUIREMENTS

The Act provides the basic requirements for an employer (resident or non-resident) to withhold payroll source deductions. Regulation 102 of the Act provides specific rules in relation to determining how much to withhold on salary paid to non-residents that is reasonably attributable to services rendered in Canada. There is no statutory exemption from withholding requirements. A waiver from withholding requirements is available for employees resident in a treaty country.

A regulation 102 waiver of withholding exemption is available if the employee meets the criteria of paragraph 2, Article XV of the Canada-US Tax Treaty, namely:

- The employees remuneration attributable to Canada for the year is less than C$10,000; or
- The employee is present in Canada in any 12 month period beginning or ending in the fiscal year for less than 183 days and the remuneration is not borne by a PE in Canada.

Payroll Taxes

- Canada Pension Plan (CPP) – Employees are required to contribute to CPP unless a Certificate of Coverage (COC) is applied for with the US Social Security Administration.
- Employment Insurance (EI) – Employees are required to contribute to EI unless the laws of any state in the US or foreign country require premiums to be paid on that employment.
- Workers Compensation (WCB) – Workers compensation premiums are required to be paid by the employer.

Employer Reporting Requirements

Form T4 – Statement of Remuneration Paid is required to report Canadian source earnings and any withholdings. A T4 is required for each employee even when a Regulation 102 waiver is granted. The T4 is required to be filed by February 28th of the following year. To facilitate Canadian payroll reporting employees working in Canada need to apply for a Tax Identification Number or Social Insurance Number as applicable.

Penalties and interest in relation to payroll can be harsh. Failure to deduct and remit tax on time may be subject to a penalty of 10% to 20% of the amount failed to be remitted. Failure to file or distribute Form T4 by the required deadline is subject to a daily penalty determined by the

number of slips and can range from a $100 to $7,500. Interest is on amounts owing is calculated at the CRA prescribed rate from the date the payment was due.

Employee Filing Requirement

An employee is required to file a Canadian non-resident individual income tax return (T1) unless he or she does not expect to owe tax. The employee may choose to file a return (voluntarily) if withholding taxes are remitted on his or her behalf and a refund is being requested.

Goods and Services Tax ("GST")/Harmonized Sales Tax ("HST")

If "carrying on business" in Canada, a Non-Resident Importer ("NRI") is required to register for GST/HST when it exceeds the "small supplier threshold". The small supplier threshold is exceeded when world wide sales exceed $30,000 in the previous four consecutive calendar quarters.

If the NRI is not "carrying on business" in Canada they could voluntarily register for GST/HST.

The CRA provides guidance on what constitutes "carrying on business" in Canada for the purpose of GST/HST in GST/HST Policy Paper P-051R2.

Importantly, NRI may be considered to be carrying on business in Canada even though it may not have a permanent establishment in Canada. Generally, NRI has to have significant presence in Canada to be considered to be carrying on business in Canada.

There are a number of factors that need to be considered when determining whether NRI is carrying on business in Canada for GST/HST purposes and these factors would include:

- the place where agents or employees of the non-resident are located;
- the place of delivery;
- the place of payment;
- the place where purchases are made or assets are acquired;
- the place from which transactions are solicited;
- the location of assets or an inventory of goods;
- the place where the business contracts are made;
- the location of a bank account;
- the place where the non-resident's name and business are listed in a directory;
- the location of a branch or office;
- the place where the service is performed; and
- the place of manufacture or production.

The importance or relevance of a given factor in a specific case depends on the nature of the business activity under review.

A NRI without a permanent establishment in Canada is generally required to provide security. The minimum security requirement is $5,000 and the maximum requirement is $1 million. The security requirement is subject to adjustments and is based on 50% of the net tax for a 12-month period.
If a NRI is required to register or voluntarily registers for GST/HST, the NRI is required to collect GST/HST on taxable supplies made in Canada. Depending on the place of supply the tax rate for GST/HST is 5%, 12%, 13% or 15%.

As a GST/HST registrant, the NRI is entitled to claim input tax credits ("ITCs") to recover GST/HST paid or payable on expenses related to its commercial activity in Canada (including GST paid at the border as the importer of record).

Also, as a GST/HST registrant, the NRI has to file a GST/HST return(s), keep books and records, maintain sufficient security and is subject to CRA audit.

If the NRI is not a GST/HST registrant, the NRI may use the flow through method to recover from its customer the GST that it has paid at the border. The NRI must provide the GST/HST registered customer with proof (e.g., B3) that GST was paid. After obtaining the appropriate documentation, the GST/HST registered customer may claim an ITC to recover the tax as if it had actually imported the goods.

Relief from Penalties

A Voluntary Disclosure Program (VDP) is available for corporations and individuals to correct inaccurate information or disclose information not previously reported without penalty or prosecution. The program allows for disclosures in relation to income tax (corporate and individual) and GST/HST. If the submission is accepted the taxpayer will still be subject to the taxes or charges owing, plus interest. However, penalties are generally waived.

THE INFORMATION PROVIDED IN THIS PUBLICATION IS INTENDED FOR GENERAL PURPOSES ONLY. CARE HAS BEEN TAKEN TO ENSURE THE INFORMATION HEREIN IS ACCURATE, HOWEVER, NO REPRESENTATION IS MADE AS TO THE ACCURACY THEREOF. THE INFORMATION SHOULD NOT BE RELIED UPON TO REPLACE SPECIFIC PROFESSIONAL ADVICE.