5. Taxation

All foreign businesses that are considering entering into Canada should consider the federal and provincial tax issues that could arise from doing business in Canada.

The federal income tax legislation is the *Income Tax Act* (ITA), which sets out rules for individuals, corporations, and other entities. The provinces have their own personal and corporate income tax statutes. Income tax is generally administered by the federal Canada Revenue Agency (CRA) on behalf of the provinces, except for Québec and Alberta in the case of corporate income tax.

While Canadian residents are subject to income tax on worldwide income, non-residents of Canada are generally taxed on employment income in Canada, carrying on business in Canada, and dispositions of "taxable Canadian property". Non-residents may also be subject to non-resident withholding taxes under Part XIII of the ITA.

The federal *Excise Tax Act* (ETA) imposes excise taxes in connection with the sale or production for sale of certain goods. In addition to excise taxes specific to petroleum products, cigarettes, and other products, Part IX of the ETA sets out Canada's goods and services tax (GST). GST is a value added tax that is charged on taxable supplies in Canada. In many provinces, the GST has been "harmonized" with the provincial sales tax (PST) to become a harmonized sales tax (HST). However, British Columbia, Saskatchewan, and Manitoba each impose their own form of PST and each of the aforementioned provinces has a slightly different set of PST exemptions. Lastly, Québec imposes a Québec sales tax (QST), which is administered by a separate tax authority under legislation distinct from GST/HST.

Canada is a signatory to a number of international tax treaties, one purpose of which is to mitigate double taxation. Tax treaties are generally bilateral agreements between countries, except for certain multilateral instruments that have been entered into by Canada, including the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (MLI).

The remainder of this chapter discusses certain Canadian tax consequences for corporations that are not resident in Canada and that may have employees in Canada or are doing business in Canada without incorporating a Canadian subsidiary. This chapter does not discuss the consequences of a non-resident disposing of taxable Canadian property or who may be subject to non-resident withholding tax pursuant to Part XIII of the ITA.

Employees in Canada

An employee that is resident in Canada is taxed on his or her worldwide income, including income from employment in Canada. An employee that is a non-resident of Canada is subject to Canadian income tax on remuneration from employment in Canada subject to the availability of a tax treaty exemption.

For example, remuneration paid to an employee who is a resident of the United States, and is entitled to benefits under the Canada-United States Tax Treaty (US Tax Treaty), is generally exempt from Canadian tax under the US Tax Treaty if either: (a) the amount paid in respect of Canadian employment is less than CDN $10,000 in the year; or (b) the employee was present in Canada for less than 183 days in any twelve-month period that includes the year, and the amount was not paid or, on behalf of, a Canadian resident person or borne by a permanent establishment in Canada. Other tax treaties have similar provisions.

All employers, both resident and non-resident of Canada, are required to withhold Canadian tax from remuneration paid to employees working in Canada, including, for non-resident employees, amounts that may be exempt under a tax treaty, unless a waiver is obtained from the CRA.

For non-resident employees, one available waiver is a “Regulation 102” waiver based on an applicable tax treaty exemption. Certain non-resident employers can also apply for a “Qualified Non-Resident Employer Certification”, which is generally applicable for all non-resident employees of such employers who work in Canada less than forty-five days in the calendar year or is present in Canada for less than ninety days in any twelve-month period that includes the relevant time.

Regulation 105 Withholding

Pursuant to section 105 of the Income Tax Regulations, every person paying a non-resident in respect of services rendered in Canada must withhold and remit 15% of the payment (Regulation 105) absent a waiver. The non-resident can file an income tax return to apply the withheld amount to its corporate tax liability or obtain a refund if there is an excess.

A Regulation 105 withholding issue can arise, for example, if the non-resident corporation charges its clients or customers for services that are performed by the employee in Canada. In such circumstances, the clients or customers would have the obligation to withhold and remit the 15% withholding tax, which could be inconvenient in many situations.

Corporate Residency in Canada

A foreign corporation that was not incorporated in Canada, and that has activities in Canada, should be mindful of the risk that it could be considered to be a resident in Canada. A corporation that is resident in Canada is taxed on its worldwide income. A non-resident corporation is taxed in Canada, in the first instance, on income from carrying on business in Canada and on dispositions of taxable Canadian property.

The main test of whether a non-resident corporation is considered to be resident in Canada is whether its central management and control is in Canada. The meaning of central management and control is from common law jurisprudence and generally refers to where corporate directors exercise their management and control responsibilities. Usually, central management and control is where the members of the board of directors meet and hold their meetings. However, it is possible that if the functions of the corporate directors are usurped,

and management and control is exercised in fact by a person who is not a director, the corporation may be found to be resident where such person resides or operates. In general, a foreign corporation can mitigate the risk of being treated as a resident of Canada by ensuring that its central management and control occurs outside of Canada, such as ensuring that the board of directors meets and makes its decisions outside of Canada.

A corporation that is resident in a country that has a tax treaty with Canada, and that is eligible for benefits under such tax treaty, may also rely on a "tie-breaker rule" to the extent that it is also found to be dual resident in Canada and another country. For example, in the US Tax Treaty, a corporation is deemed to be resident in the country in which it was incorporated.

Carrying on Business in Canada

For purposes of determining whether or not a non-resident corporation is carrying on business in Canada, both the common law test and the statutory test are relevant. The statutory test is relevant for determining a non-resident's Canadian income tax liability under the ITA. The question of whether a non-resident is required to register pursuant to Part IX of the ETA for GST/HST is also a common law "carrying on business" test interpreted for purposes of the relevant legislation.

Common Law Test

In determining where a business is carried on, courts have first looked at the place where contracts are concluded as the key factor and then considered all the factors that indicate where the operations take place from which the profits in substance arise, including the location of a bank account or directory listing, the place of payment, the place from which transactions are solicited, the place where inventory is stored, the place of delivery, the place where agents and employees are located, the place where goods are delivered or services performed, the place of soliciting, marketing or advertising, the place where equipment or business assets are located, etc.

Generally, only profit-making contracts are considered, and contracts that are preliminary or ancillary to the profit-making contracts, such as leases, purchase of supplies, or labour agreements, may not be determinative.

Accordingly, a non-resident who habitually negotiates profit-making purchase and sale agreements in Canada would be considered to be carrying on business in Canada. However, even if such contracts are not concluded in Canada, the non-resident could still be considered to be carrying on business in Canada, based on the significance of the business operations or activities that are exercised in Canada.

Statutory Test

In addition to the common law interpretation of carrying on business in Canada, a non-resident may be deemed to be carrying on business for purposes of income tax under section 253 of the ITA if it:

- Produces, grows, mines, creates, manufactures, fabricates, improves, packs, preserves or constructs anything in Canada;
- Solicits orders or offers anything for sale in Canada through an agent or employee, whether the contract or transaction is completed inside or outside of Canada; or
- Disposes of certain resource properties (other than depreciable property) or Canadian real estate (other than capital property – i.e. that is inventory).

Under this broad definition, projects undertaken in Canada and short-term employment assignments in Canada could result in non-resident entities being subject to Canadian income tax and filing obligations.

Although paragraph 253(b) can deem many non-residents to be carrying on business in Canada, such non-residents are often not required to pay Canadian income tax because they do not have a permanent establishment in Canada and are eligible for protection under a tax treaty.

Income Tax Consequences of Carrying on Business in Canada

A non-resident corporation is liable to pay Canadian income tax on income from carrying on business in Canada. If the non-resident corporation is resident in a country that has a tax treaty with Canada, and qualifies for benefits under that treaty, then it is taxed only to the extent that such income is attributable to a "permanent establishment", as defined in the applicable tax treaty, of the non-resident in Canada.

A non-resident that is carrying on business in Canada must file a Canadian income tax return regardless of whether it is exempt from Canadian income tax under a tax treaty.

GST/HST Consequences of Carrying on Business in Canada

All persons that carry on business in Canada, whether resident or non–resident, are required to register for and to collect GST/HST in respect of property and services rendered in Canada if it has exceeded the small supplier threshold as defined under subsection 148(1) of the ETA. Pursuant to section 143 of the ETA, where a non-resident of Canada is not registered for GST/HST and does not carry on business in Canada, all supplies made in Canada by the non-resident will be deemed to be made outside Canada and will not be subject to GST/HST.

Non-residents entering Canada should be aware that the threshold for carrying on business in Canada for GST/HST purposes is different from the threshold for corporate income tax purposes. As a result, a multinational could be subject to Canadian GST/HST obligations even if no Canadian income tax liabilities arise and vice versa, for example, if the non-resident is deemed to be carrying on business for income tax purposes due to the statutory deeming rule in the ITA.

In addition, effective as of July 1, 2021, certain non-residents who are not carrying on business in Canada for GST/HST purposes may still be required to register for a GST/HST account under the new Subdivision E of Division II of Part IX ETA. Types of non-resident businesses that could be subject to this new regime include cross-border digital products and services (non-resident vendors or non-resident distribution platform operator vendors who sell taxable digital products or services), supplies of qualifying goods in Canada (non-resident vendors or non-resident distribution platform operator vendors who make the supply of qualifying tangible personal property), and platform-based short-term accommodation in Canada.

Permanent Establishment

General Test Under Canadian Bilateral Tax Treaties

While the wording of tax treaties varies, a "permanent establishment" is generally defined as:

- A fixed place of business through which the business of the non-resident corporation is wholly or partly carried on
- A place of management, a branch, an office, a factory, and a workshop; a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources; a building site, construction, or assembly project that exists for a specified period
- A dependent agent or employee who has and habitually exercises an authority to conclude contracts in the name of the non-resident corporation

Most treaties carve out specific exceptions for certain types of fixed places of businesses, including certain activities of a "preparatory or auxiliary character". The amendments to certain bilateral tax treaties due to the MLI should also be considered when determining if a permanent establishment exists in Canada.

The Canada-U.S. treaty also includes the concept of a "services permanent establishment", which provides that a non-resident corporation that does not otherwise have a permanent establishment in Canada is deemed to provide services through a permanent establishment in Canada if such services are performed in Canada for at least 183 days in a twelve-month period and certain other conditions are met.

In general, a foreign corporation can mitigate the risk of carrying on business in Canada, or having a permanent establishment in Canada, by minimizing the amount of business activities carried on in Canada by its employees or agents, not having any fixed places of business in Canada, as well as restricting the authority of its employees or agents to conclude contracts on its behalf while in Canada.

Tax Consequences of a Permanent Establishment in Canada

Part I: Corporate Tax

A non-resident that is resident in and eligible for benefits under a tax treaty that carries on business in Canada through a permanent establishment would be subject to Canadian income tax on all profits attributable to that permanent establishment. Profits should generally be attributed to a permanent establishment based on the "arm's length principle" and in accordance with guidance from the Organisation for Economic Co-operation and Development.

Although a foreign tax credit should presumably be claimed in the non-resident's home jurisdiction, the non-resident would generally remain liable to pay the higher of the two tax rates and would be required to file a Canadian income tax return.

Part XIV: Branch Tax

A 25% tax is imposed on the after-tax income that non-resident corporations earn in Canada, to the extent that such earnings are not reinvested in the Canadian business. The 25% rate may be reduced under a tax treaty between Canada and the country of residence of the non-resident corporation. For example, under the Canada-U.S. tax treaty, the rate of branch profits tax is reduced to 5%.

A tax treaty may exempt the first $500,000 of a non-resident corporation's cumulative income from branch tax, providing some relief at the earlier stages of operations in Canada.

GST/HST

To the extent a non-resident has a permanent establishment in Canada, the non-resident is considered to be a resident in Canada for GST/HST purposes in respect of activities carried on through that permanent establishment. Therefore, if the non-resident is considered to have a permanent establishment in Canada, it must register for the GST/HST in respect of the activities carried on through that permanent establishment, unless the non-resident is a small supplier. As a result, the non-resident would need to charge and collect GST/HST on all taxable supplies it makes in Canada while carrying on a business in Canada through such permanent establishment.