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Dave Peters

Calgary
403 509 7481

Chantal Farrell-Carter

Montreal
514 205 5370

Jerry Alberton

Toronto
416 365 2746

Anne Kestenbaum

Toronto
416 365 8169

Diane Akelaitis

Vancouver
604 806 7011

Getting the full picture

HRS insights:
Canadian payroll requirements
for tax treaty exempt cross border travellers

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Background

There has always been a requirement for all employers (resident or non-resident in Canada) to maintain a Canadian payroll system, withholding prescribed Federal and Provincial income tax, for all staff who reside in Canada and/or are physically working in Canada from the very first dollar of remuneration. These rules are found under Regulation 102 of the Canadian Income Tax Act. This requirement applies to those employees who are eligible to claim an exemption from paying tax in Canada under an income tax treaty.

Audit issue

In the past, many companies did not maintain a payroll system for business travellers to Canada. The Canada Revenue Agency (“CRA”) was not known to penalize those employees or pursue the matter. The audit landscape has changed dramatically over the past few years. When performing transfer pricing and payroll reviews, the CRA auditors are now regularly cross checking to ensure that there is proper payroll reporting for all cross-border travel, regardless of the amount of time physically expended in Canada. Although the CRA has tried to work with employers to ensure they are reporting properly, there has been little leniency with respect to the costs. The cost of the penalties as well as the large amount of administrative time can be quite substantial both in terms of time and monetary cost.

Regulation 102 waiver requests and CRA initiatives

Although the administration of having a business traveller placed upon the Canadian payroll system will always remain, it is possible for the employee to obtain a Regulation 102 waiver from the CRA, if he or she is eligible to be tax exempt under a Tax Treaty with Canada.

The historical method of obtaining the Regulation 102 waiver from tax withholding when eligible for tax treaty exemption is by having the employee make a written request in advance to the CRA asking for approval for exemption from tax withholding. Until the CRA gives this approval and the employee forwards the approval to the employer, the employer must withhold tax as if there was no tax treaty exemption. There is no set time limit for approval by the CRA; however experience is that they are generally approved within a six week time frame. Needless to say, the business traveller may have left Canada well before approval is obtained. The employer

is then required to take full tax withholding on the earned employment income. The only way to get the tax withholding refunded is for the employee to file a Canadian individual tax return after the end of that calendar year.

The CRA has recognized that there are problems with this traditional methodology, particularly due to the increasing volume of cross border travel in recent years. In the near future, the CRA will be issuing a new form that will be available for use by an employee to request a waiver from withholdings due to a Tax Treaty exemption. Further, the onus to get the waiver request has been on the employee. Due to present legislative rules, it is not possible for the employer to request the waiver on behalf of the employees without the employee’s written approval. In May 2010, the CRA established a new form, R102-J, which allows for a joint employee/ employer request for reduction in tax withholdings. Unfortunately, its use is restricted for those situations where an employee is expected to earn less than CDN\$5,000 in Canada if the employee is from a treaty country or CDN\$10,000 if the employee is a US resident. One of the benefits of this type of request is that its application is retroactive up to 60 days, and therefore, allows some time for the employer to determine that an employee actually travelled to Canada for business purposes. Further, it allows the CRA to send approval for a Regulation 102 waiver directly to the

employer in a standard format, thereby improving the timing for employers to apply the waivers. A final benefit is that as the form is not a prescribed one, it is possible to design the form to work into a specific employer’s payroll system for time efficiency purposes. So far, our experience has been that the form is somewhat confusing, and we have been working with the CRA to make it more user-friendly. We have been told that a revised R102-J form will be issued in the near future addressing these concerns.

Finally, the CRA is working on an initiative to reduce the administrative burden by designing a certification process by which non-resident employers could administer a Regulation 102 blanket waiver process themselves, without the need for employee specific waivers if under a certain day limit working in Canada. One very important item to keep in mind is that for certification to occur, an employer will be required to maintain a full Canadian payroll process from the onset of each employee entering Canada. As it has been determined that certain legislative changes will be needed for this process to occur, we do not expect the CRA to put it into place until calendar year 2012.

What should employers do?

Employers with employees who travel to Canada for business will need to ensure that they have a real-time payroll system in place in order so they can comply with Canadian payroll tax requirements on a timely basis.

This includes:

- Ensuring their employees accurately track their business time in Canada, including the provinces involved;
- Setting up a formal shadow payroll system that accumulates the information of Canadian business travel by employee on a regular and timely basis;
- Assisting the employees in requesting the appropriate Regulation 102 waivers for those who are Canadian tax exempt due to an Income Tax Treaty;
- Assist the employees in obtaining a Canadian taxpayer identification number if they do not already have one;
- Preparing and filing all annual payroll reporting slips to the employee and CRA;
- Assisting the employees with the filing of any Canadian individual tax returns.
- Further, if employers have not been compliant to date, they should be assessing whether a voluntary disclosure to the CRA is required.