

# *Human Resource Services Webcast*

**Doing Business in the United States**

**U.S. state tax issues facing Canadian  
companies and their employees**

**December 1, 2011**

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## ***Administrative Information***

- 60 minute webcast
- Audio with slides
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- For better sound quality, use headphones
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## ***Administrative Information***

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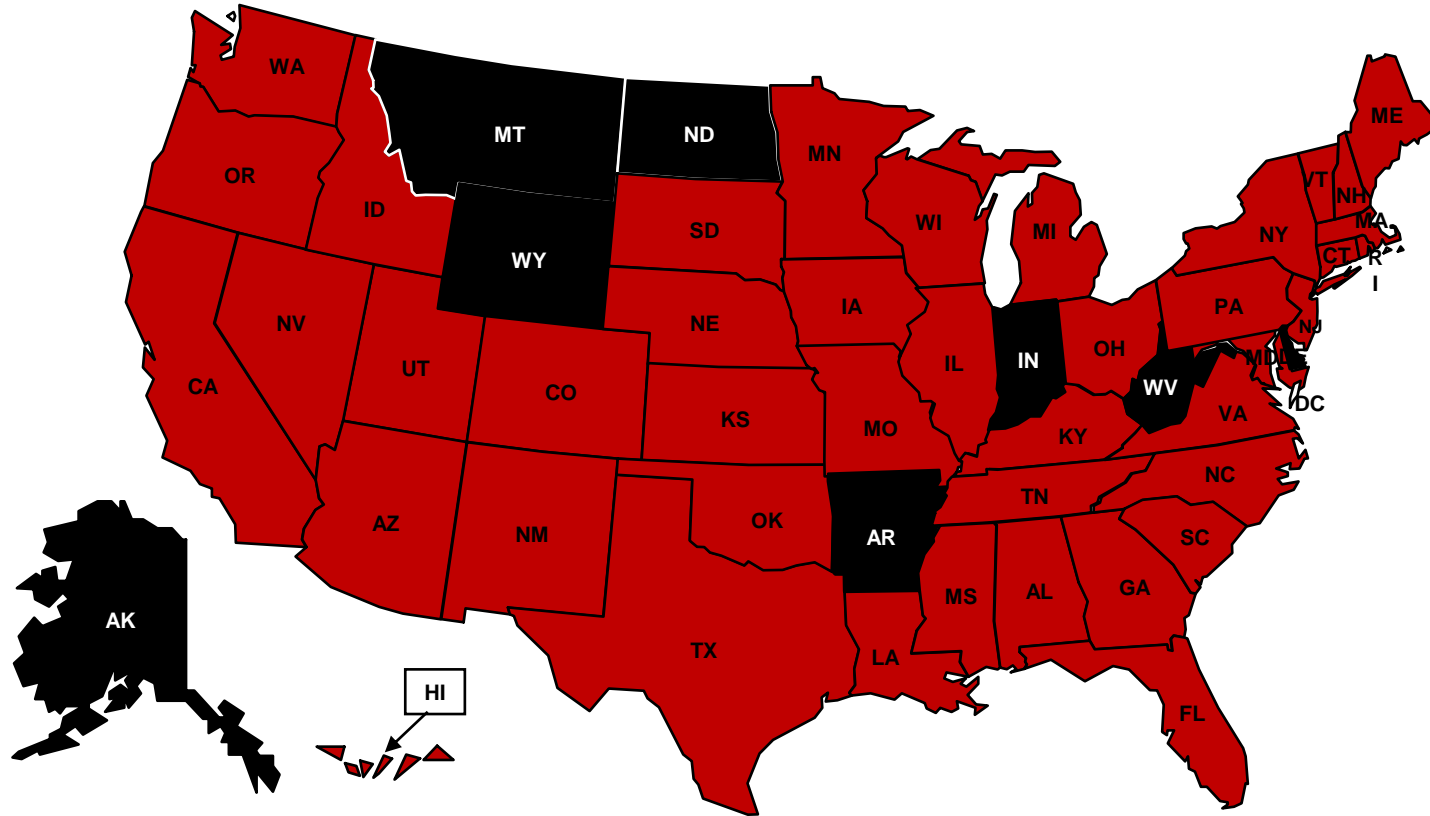
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# ***Introduction/Agenda***

- Current State Tax Environment
- Basic Nexus Concepts
  - Corporate Income Tax Nexus
  - Sales and Use Tax Nexus
  - Franchise/Net Worth Tax Nexus
- Non-Compliance Considerations
- Individual Income Tax Considerations
- Employer Payroll Compliance
- Individual Tax Implications for Canadians Relocating to U.S.
- Closing Thoughts

# *Current State Tax Environment*

## State Budget Deficits – Projected Shortfalls



Source – McNichol, Elizabeth, Oliff, Phil, and Johnson, Nicholas. "States Continue to Feel Recession's Impact." **Center on Budget and Policy Priorities**. 17 June 2011 <[www.cbpp.org](http://www.cbpp.org)>.

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## ***Basic Nexus Concepts***

### Types of State Taxes

- Majority of states levy corporate income tax
- In addition to the corporate income, some of the states also levy a franchise/net worth tax
  - In lieu of a corporate income tax, the following states levy a gross receipts tax: Ohio, Texas and Washington
  - 45 states impose sales/use tax

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## ***Basic Nexus Concepts***

### Nexus – What is it?

- Differs from PE concept
- A state has jurisdiction to tax a corporation organized in another state only if the out-of-state corporation's contacts with the state are sufficient to create nexus
- A sufficient contact may exist even though taxpayers do not have a physical presence within the states

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## ***Basic Nexus Concepts***

### Examples – Activities Creating Nexus

- **Tangible Personal Property such as:**
  - Consigned inventory in a state
  - Demo equipment at a customer site
  - Tooling, dies and special tools in a state
- **Resident employees**
  - Canco having U.S.-based employee working from home office

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## ***Basic Nexus Concepts***

### **Examples – Activities Creating Nexus**

#### **Non-Resident Employees**

- **Activities such as:**
  - Sales of any services
  - Rented space, even shared space, including servers
  - Quality control and inspection activities
  - Warranty or repair services, even by third party
  - Installation/implementation services (e.g., hardware/software)
  - Trade Shows

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## ***Polling Question #1***

**Question: Does your company have employees travelling to the United States?**

- Yes
- No
- Do not know
- N/A / PwC Participant

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# ***Corporate Income Tax Nexus***

## **Framework**

- Steps to determine whether Canco is subject to income tax:
  - Step 1 – Exempt under U.S. domestic law?
  - Step 2 – Does state adopt Income Tax Treaty (i.e. Canada-U.S. Treaty)?
  - Step 3 – If treaty not adopted – branch vs. worldwide?

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# ***Corporate Income Tax Nexus***

## **Step 1 - Exempt under U.S. Domestic Law**

- State's power to levy corporate income tax limited by Public Law 86-272
- Public Law 86-272 exempts Canco from corporate income tax if all the following met:
  1. Instate activities of nonresident employees limited to mere solicitation;
  2. Solicitation is for sale of tangible personal property;
  3. Order is approved outside the state; AND
  4. Inventory shipped from outside state

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# ***Corporate Income Tax Nexus***

## **Step 1 - Exempt under U.S. Domestic Law**

### **Example 1 – Is Canco subject to income tax?**

- **Facts**
  - Canco does not have U.S. PE
  - Canco sells widgets to U.S. customers.
  - Canco employees travel to Illinois to solicit sales.
  - Canco approves orders outside of Illinois
  - Canco ships inventory from Canada to U.S. customer
- **Conclusion**
  - Canco exempt from Illinois corporate income tax because met requirements under Public Law 86-272

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# ***Corporate Income Tax Nexus***

## **Steps 2 & 3 – State Application of Treaty**

- States not party to Canada-U.S. treaty because federal document
- Some states adopt treaty, while other states do not
- Examples of states that adopt the treaty: Connecticut, Michigan, Tennessee
- Examples of states that do not adopt the treaty and require state tax returns calculated on a U.S. branch basis: Arizona, Pennsylvania, Washington, Wisconsin
- States that do not follow the treaty and require state tax returns calculated on a worldwide basis: California, New Jersey, New York

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# ***Corporate Income Tax Nexus***

## **Steps 2 & 3 – State Application of Treaty**

### **Example 2 – Is Canco subject to income tax?**

- **Facts**
  - Canco does not have U.S. PE
  - Canco sells widgets and performs installation services at U.S. customer site
  - Canco's employees travel to Connecticut to solicit sales  
Canco approves orders outside of Connecticut
- **Conclusion**
  - Public Law 86-272 does not apply – installation services not protected activity
  - However, Canco not subject to corporate income tax because Connecticut adopts treaty

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# ***Corporate Income Tax Nexus***

- Expansion of income tax nexus
  - Economic Nexus
    - *Geoffrey v. South Carolina*
  - Factor Presence Nexus
    - California

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## ***Sales and Use Tax Nexus***

- Imposed by 45 states except Alaska, Delaware, Montana, Oregon, New Hampshire
- Sales tax rates range from 0% to 9.41%
- Major source of revenue for most states
- Not Treaty Protected
- Not Public Law 86-272 Protected
- Expansion of Sales Tax Nexus: Click-Thru Nexus

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## ***Franchise / Net Worth Tax Nexus***

- “Privilege” tax
- Generally based on capital stock or net worth
- Lowest nexus standard – qualifying or registering
- Qualifying or registering to do business is a legal act
- Taxpayer may be exempt from income tax nexus under PL 86-272 but still subject to franchise tax nexus

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## ***Polling Question #2***

**Question: Has your company received any nexus questions and/or notices from the states?**

- Yes
- No
- Do not know
- N/A / PwC Participant

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# ***Non-Compliance Considerations***

## Risks of Non-Filing

- Reps and Warrants for financing or funding may be incorrect
- Financial statements may be incorrect
- If non-filing, Statutes of Limitation does not run
- Need state tax clearance to sell or IPO U.S. operations
- May need tax clearance for preferred vendor status
- Officer liability for some types of tax – sales tax
- Penalties and interest can be substantial

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# ***Non-Compliance Considerations***

## How States Identify Non-Compliant Taxpayers

- Information sharing between states
- Request for websites on tax return forms
- Customs activity
- Nexus squads/Discovery activity
- IRS and State Memos of Agreement
- Internet browsing – California, New Mexico
- Customer audits
- Nexus mailings

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# ***Individual Income Tax Considerations***

## **Basis for Taxation**

- Individual State Income Tax
  - Residents – worldwide income
  - Non-residents – state source income
  - States with no income tax (e.g. Alaska, Florida, Nevada, South Dakota, Texas, Washington, etc.)

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# ***Individual Income Tax Considerations***

## **Residency**

- Most states have a two-pronged definition of tax residency. An individual will be resident by either:
  - Being domiciled in the state, or
  - Spending more than a certain number of days in the state
- “Domicile” - fixed, permanent home and principal establishment; place to which the individual intends to return.
  - Common indicators include:
    - Property ownership
    - Presence of family
    - Driver’s license and vehicle registration, etc.

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# ***Individual Income Tax Considerations***

## Compensation Sourcing

- Compensation for services performed in the states
  - Generally sourced based on workdays
    - Current Year
    - Prior Year
    - Multiple Year
  - Some states may not follow the federal sourcing rules

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# ***Individual Income Tax Considerations***

## Compensation Sourcing

### Example

- Facts
  - Canadian employee (US non-resident) has 30 incidental workdays in IL out of total of 240
  - Compensation for the year is \$200,000
- Conclusion
  - Taxable US Federal source compensation - \$25,000
  - IL State source compensation - \$0

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## ***Polling Question #3***

**Question: Does your company monitor multiple state business travel?**

- Yes
- No
- Do not know
- N/A / PwC Participant

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# ***Employer Payroll Compliance***

## **Withholding Requirements**

Similar to federal rules - employers are required to withhold and remit employment taxes

- **Income Tax**

- employers (including non-US employers) required to withhold and remit on wages paid to an employee (including non-US employee)
- taxes to be withheld in accordance with prescribed rates
- employees must provide a completed withholding allowance form (separate from the federal form)
- local taxes may apply

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# ***Employer Payroll Compliance***

## **Withholding Requirements**

- States generally require withholding from non-residents who enter the state to work. Exceptions based on:
  - length of time employee works in state (e.g. NY and CT – 14 days; AZ – 60 days), OR
  - amount of compensation earned in the state (e.g. ID - \$1,000 in the year, OK - \$300 in a calendar quarter, etc)
  - reciprocal agreements
- Employee may still need to file and pay tax with annual tax return

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# ***Employer Payroll Compliance***

## **Withholding Requirements**

- **SUTA (State Unemployment Tax Act)**
  - Paid only by employer
  - SUTA rates vary by state between .10% to 5.4% or more
  - Not the same rate for all employers
  - Applies to first \$7,000 employer pays to employee
- **Other payroll deductions**
  - State disability insurance
  - Other taxes or funds may be applicable – vary by state

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# ***Employer Payroll Compliance***

## **Reporting Requirements**

- **Employer Identification Number (EIN) required (including foreign entities)**
  - Separate state registration for tax withholding and unemployment insurance
  - Federal EIN may be required for state registration
  - Foreign companies - use of US subsidiary/related entity or US payroll service companies as agent

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# ***Employer Payroll Compliance***

## **Reporting Requirements**

- **Required to report state source earnings and withholdings**
  - Varies state by state:
    - Quarterly reporting
    - Annual reporting, Form W-2
    - Quarterly reporting for SUTA
- **Unemployment Tax Relief**
  - Relief possible under 1942 Agreement between Canada & US

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# ***Employer Payroll Compliance***

## Reporting Requirements

- Penalties for failure to file a quarterly or annual reporting form
- Late filing penalty – assessed based on unpaid tax
- Late payment penalty and interest - assessed based on unpaid tax
- Withholding tax fraud penalty
- Additional penalties and interest under Unemployment Insurance Law

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# ***Implications for Canadians Relocating to U.S.***

- General
  - Deferred compensation
    - Credit for foreign taxes
    - Trailing liabilities
- Treaty Protection
  - Not all states follow federal tax treaties (e.g. Alabama, California, Connecticut, New Jersey, Pennsylvania, and others)
    - RRSP deferral not available in non-treaty states
    - Pension deduction not available in non-treaty states

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## ***Polling Question #4***

**Question: Has your company been audited by any US revenue authorities in relation to business travellers?**

- Yes
- No
- Do not know
- N/A / PwC Participant

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## ***Closing Thoughts***

- There is heightened awareness of cross-border travel of individuals by both state and local authorities
- States are more and more aggressive in audit activity at the corporate and personal level
- Tax authority investigations at the corporate level can lead to personal tax implications and vice versa
- Increasingly important for companies to understand corporate and individual tax impacts of operating in a particular state
- Need to be proactive - use of technology tools can help in establishing a process to stay in front of the issues

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# Q&A

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