

Human Resource Services Webcast

**Director's Fees:
An overview of corporate and
personal tax compliance for
Canadian companies and
their directors**

June 28, 2011

Administrative Information

- 60 minute webcast
- Audio with slides
- For a better viewing experience, close all other applications
- For better sound quality, use headphones
- To print this entire PowerPoint presentation, click on the “Download Files” area of this screen
- If you have questions during the live program, type them in the “Ask a Question” box located on the left side of screen and click “Submit”
- This presentation will be archived and available for later viewing as an on-demand presentation

Administrative Information

- In order to receive CPE credit for this program, you must:
- Stay on for the entire live program and participate by responding to all interactive polling questions
- CPE credit cannot be awarded for participants who are not logged on to this webcast as themselves, who participate over the phone, or attend the on-demand version
- For those qualifying for CPE credit, a certificate will be sent shortly after the webcast to the email address used for registration
- The certificate will acknowledge one hour of structured learning towards the Institute of Chartered Accountants of Ontario CPE requirement or similar accreditation
- For those webcast participants outside Canada, you should follow up with your local governing body to confirm if it meets requirements

Director's Fees

Agenda

- **An Overview of Director's Fees**
- **Director's Fees Paid to Residents of Canada**
- **Director's Fees Paid to Non Residents of Canada**
- **Emerging Issues and Other Considerations**

Polling Question #1

Why are you attending this webcast?

- I am a director
- I am responsible for corporate governance
- I have payroll responsibilities
- PwC Employee
- None of the above, but the topic is of interest to me

Director's Fees – What's Included?

Director's fees are simply fees paid by a corporation to its directors for providing services to the corporation

There are various types of remuneration a director can receive, listed below are common income types:

- Annual retainer
- Committee Chair fee
- Meeting Fee
- Stock Options
- Deferred Stock Units
- Restricted Stock Units

Director's Fees

How are they taxed?

- Director's fees are viewed as being earned in the course of, or relation to, the position of an "office"
- The corporate director is an "officer " and thus an employee of the corporation
- A director can only be a natural person
- Director is representing a corporation or partnership
- A corporation is incorporated only to receive director's fees

Director's Fees Paid to Residents of Canada

Scenario 1:

Paul , a Canadian has been offered a position as Director of Canco, a Canadian corporation.

He is expected to attend 4 board meetings in Toronto a year and he will be paid \$40,000 in director's fees.



Employer Reporting and Withholding Requirements

- Canadian source earnings and withholding is required to be reported on Form T4
- Form T4 reporting is due by February 28th
- Historically, CRA had allowed a 15% withholding rate
- Now required to deduct income tax at regular graduated income tax rates
- Deduct CPP but not EI

Employer Reporting and Withholding Requirements – Penalties and Interest

Income tax

- Failure to deduct and remit
 - 10%-20% of the amount you fail to deduct
- Failure to file or distribute Form T4
 - Penalty is a daily amount determined by number of slips
 - Range is from \$100 to \$7,500
- Interest
 - Prescribed rates from the date the payment was due
- Directors, along with the corporation, are liable for payment of tax plus any penalty or interest
- Voluntary Disclosure Program

Employee Filing Requirement

Income Tax

T1 General – Income Tax and Benefit Return

- Employee is required to file a Canadian individual income tax return to report the income

Polling Question #2

What is the make-up of your board of directors currently?

- Canadian resident directors
- Non-resident directors
- A combination of resident and non-resident directors
- Do not know
- PwC Employee

Director's Fees Paid to Non Residents of Canada

- Sourcing
- Treaty Implications
- Withholding and Reporting Requirements
- Some Examples

Director's Fees - Sourcing of Income

- Non-resident taxed on “Canadian source” income
- Source of income not defined
- Income generally sourced to location of physical presence while performing duties (workday allocation)
- Director's activities may include one or more of:
 - Attending meetings
 - Preparing for meetings
 - Keeping abreast of industry developments

Director's Fees - Sourcing of Income

- Requires a reasonable and appropriate approach for allocating between Canada and elsewhere
 - Annual fee
 - Meeting attendance fee
 - Retainer fee
 - Equity-based compensation
- Important to keep track of workdays and document allocation approach adopted

Director's Fees – Treaty Considerations

Treaty exemption will usually not affect the company's withholding obligation

- Director's fees may or may not be separately addressed in a Treaty (typically Article XVI)
- If not, Article XV Dependent Personal Services (Employment) will apply
- OECD Model Treaty Article XVI allows the corporation's country of residence to tax the income
- Specific wording varies by Treaty

Employer Withholding Requirement – Non-residents

- All employers (resident or non-resident) generally required to withhold in accordance with regulations
- Withhold at regular graduated rates (as for any resident employee)
- Former policy allowing flat 15% withholding no longer applies
- Withholding *may* be eliminated if Treaty exemption applies (waiver required)
- Subject to CPP only if duties performed wholly in Canada
- Not subject to EI
- Withholding may be required in country of residence!

Employer Reporting Requirement - Non-residents

- Employer must report on Form T4
- Multiple T4 slips are required if:
 - Services performed both within and outside Canada; or
 - Services performed in more than one province
- For US resident directors, employer required to issue Form 1099

Director's Requirements – Non-residents

- Director must file a Canadian tax return to report the Canadian source income
- Director may also be taxed in country of residence; foreign tax credit may be available to eliminate double taxation

Polling Question #3

Have you experienced any audit activity with respect to director's fees?

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

Director's Fees Paid to Non-Residents of Canada

Scenario 2:

Sam, an American citizen who lives in the U.S. has taken a position as director of Canco, a Canadian corporation. He will be required to attend 4 meetings in the year, 2 of which he plans to attend in person in Toronto and 2 he will attend remotely by conference call from the U.S. Sam will receive \$50,000 in meeting fees and no other payments for the year.



Director's Fees Paid to Non-Residents of Canada

- Canco is required to report the Canadian source portion of Paul's workdays on a Form T4 and withhold and remit tax based on graduated rates
- Canadian source income may be calculated as:
 $2/4 \times \$50,000 = \$25,000$
- What if days are spent preparing for meetings?
- Treaty relief application

Director's Fees Paid to Non-Residents of Canada

Scenario 3:

Lisa has the same facts as Paul, except that she also receives a retainer fee of \$40,000 for the year



Director's Fees Paid to Non-Residents of Canada

- All points described in Scenario 2 apply
- Retainer fee may be excluded from Canadian taxation if fee is not paid for services rendered and would have been paid whether or not the director is expected to attend meetings
- If the retainer fee was all that was paid and represented meeting time as well as fees to reserve the director's time, the company would be required to apportion the time between meeting time and true retainer type fees

Director's Fees Paid to Non-Residents of Canada

Scenario 4:

Sharon, has the same facts as Lisa except that she also receives long term compensation in the form of stock options.



Director's Fees Paid to Non-Residents of Canada

- All points described in Scenario 2 and 3 apply
- All facts must be considered when determining the sourcing period for options
- Be mindful of Salary Deferral Arrangement (SDA) rules in Canada and Section 409A rules in the U.S.

Polling Question #4

Do you currently have directors who attend some meetings by phone or other means?

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

Emerging Issues and Other Considerations

- Increased audit activity by both CRA and IRS around cross-border activity
- CRA continues to study sourcing approach where non-resident director's participate by electronic means
- Possible 409A issues for US resident directors regarding deferred compensation
- 2010 Federal Budget- withholding now mandatory on non-cash benefits (stock options)
- Requirement for proportionate fees between “outside “ and “inside” directors
- Fees paid to director's employer (where director acts on behalf of the employer) taxable to employer, not to director; Reg 105 may apply
- Increasing use of non-cash benefits – consider taxability

Summary of Key Points

- Directors are Employees – same basic principles apply
- Some unique attributes require special attention
 - Various types of fees may require different sourcing approach
 - Challenges in determining where services are performed
 - CRA administrative practice evolving
 - Corporations should comply with withholding and reporting obligations to eliminate risk of penalties and interest
 - Directors should understand their personal obligations to minimize income taxes and eliminate risk of penalties and interest

Q&A

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