INCENTIVES AND BENEFITS

U.S. to Canada employment transfers – tax considerations

U.S.-based businesses often send their U.S. employees to Canada to solicit business or to fulfill contracts. The Canadian assignment may be short-term or could be a permanent transfer. The American employer will face two main Canadian tax issues. First, there is the question of the employer’s Canadian tax withholding and reporting obligations with respect to remuneration paid to the employee. Secondly, there is the question of whether the presence of the U.S. employees in Canada may give rise to a permanent establishment in Canada for the employer, if the employer does not already have a permanent establishment. From the employee’s perspective, the employee will need to understand his or her liability for Canadian income taxes. Jennifer Hanna summarizes the key Canadian income tax considerations both for the U.S. business enterprise and the U.S. resident employee working in Canada. The author reviews the legislative requirements, the relief afforded by the Canada-U.S. Income Tax Convention, as amended by the recently signed Fifth Protocol and the Canada Revenue Agency’s administrative practices in responding to waiver requests.

PENSIONS

Tips on designing supplemental retirement plans

There are many things that should be kept in mind when designing supplemental executive or employee retirement plans. Because these plans are generally not subject to pension standards legislation, they can be designed in such a way that enhances flexibility and the achievement of goals such as employee retention. As Lorraine Allard explains, the drafting of the documentation such as the plan text, any related trust agreement and employee communications is of particular importance. Care and attention in the drafting of these documents may prevent certain pitfalls. One of the major issues concerning supplemental retirement plans is the decision to fund or secure the benefit promise. Where a retirement compensation arrangement trust is used, the terms of the trust agreement can increase the employer’s flexibility with respect to the distribution of trust assets.

PRACTICE

When is remuneration “paid?”

The question of when remuneration could be said to be “paid” by an employer has ramifications for tax purposes, both for the employer and the employee. Marie-Emmanuelle Vaillancourt examines a recent case dealing with the employer’s tax liability under the Ontario Employer Health Tax Act. In IBM Canada Ltd. v. The Minister of Finance of Ontario, the Ontario Supreme Court considered whether IBM Canada was the employer for Employer Health Tax Act purposes of expatriate employees on secondment to foreign affiliates of IBM Canada. The author reviews the judgement and considers its implications for interpreting Article XV of the Canada-U.S. Income Tax Convention, as amended by the recently signed Fifth Protocol.
Topical Summary

INCENTIVES AND BENEFITS

EMPLOYMENT TRANSFERS
• Tax Considerations for Cross-border Employees and Their Employers 831
  by Jennifer Hanna

PENSIONS

SERPs
• Tips on Supplemental Executive or Employee Retirement Plans Design 836
  by Lorraine Allard

PRACTICE

EMPLOYEE SECONDMENT
• Paid or Not Paid, That Is the Question 839
  by Marie-Emmanuelle Vaillancourt
Incentives and Benefits

This regular feature is edited by Julie Y. Lee, of Osler, Hoskin & Harcourt LLP. It examines major trends and tax planning issues pertaining to executive incentive and benefit plans and arrangements.

EMPLOYMENT TRANSFERS

Tax Considerations for Cross-border Employees and Their Employers

Jennifer Hanna
Ernst & Young LLP

U.S.-based businesses often send employees to Canada, either temporarily or permanently. This article summarizes some of the Canadian tax considerations both for the business and the employee. The employer will need to ensure that it is compliant with Canadian tax withholding and reporting obligations with respect to the employee’s remuneration and will generally want to avoid becoming liable for Canadian tax itself. The employee will usually be interested in minimizing his or her Canadian taxes and tax reporting obligations.

U.S. Employers

Under Canada’s Income Tax Act,¹ subject to an overriding tax treaty, a non-resident will be liable for income tax on income from a business that it carries on in Canada. The Act contains a definition of “carrying on business in Canada” that broadens the meaning established by case law.² Both the common law and defined meaning must be considered. The meaning of “carrying on business in Canada” has been the subject of several articles and is beyond the scope of this article.³ Briefly, however, under the Act, a non-resident person will be deemed to be carrying on a business in Canada if the person (a) produces, grows, mines, creates, manufactures, fabricates, improves, packs, preserves or constructs, in whole or in part, anything in Canada; or (b) solicits orders or offers anything for sale in Canada through an agent or servant.⁴

U.S. businesses often send employees to Canada to solicit business or to fulfill contracts for goods or services. In either case, the employees will often cause the corporation to be “carrying on business” in Canada for purposes of the Act. However, the Canada–United States Income Tax Convention (1980)⁵ provides that a resident of the United States is not subject to Canadian income tax on income from its business activities in Canada unless the income is derived from a permanent establishment in Canada.⁶ As a result, generally, U.S. employers will want to avoid creating a “permanent establishment” in Canada in order to avoid Canadian taxation of their business income.

A “permanent establishment” of a U.S. resident corporation in Canada means a fixed place of business in Canada through which the business of the U.S. resident is wholly or partly carried on.⁷ The Treaty specifies that the following are permanent establishments:

- a place of management, branch, office, factory, or workshop;
- a place where natural resources are extracted;
- a building site or construction or installation project if, but only if, it last more than 12 months; or

---

¹ R.S.C. 1985, c. 1 (5th Supplement), as amended, hereinafter referred to as the “Act.” Unless otherwise stated, statutory references in this article are to the Act.
² Section 253 of the Act.
⁴ The Act also deems a person to carry on business in Canada with respect to certain dispositions of Canadian real, resource, or timber property.
⁶ Article VII of the Treaty. Hereinafter, references to “Articles” are of the Treaty.
⁷ Article V.
• an installation or drilling rig or ship in Canada to explore for or exploit natural resources used if, but only if, such use is for more than three months in any twelve-month period.8

In addition, a person acting in Canada on behalf of a U.S. resident will be deemed to constitute a permanent establishment of the U.S. resident if the person has, and habitually exercises in Canada, an authority to conclude contracts in the name of the U.S. resident.9 This does not, however, apply with respect to a broker, general commission agent or other agent of independent status acting in the ordinary course of the agent’s business.10

Notwithstanding the foregoing, a fixed place of business in Canada that is used solely for, or a person engaged solely in, one or more of the following activities is deemed not to be a permanent establishment of a U.S. resident:

• the use of facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the U.S. resident;

• the maintenance of a stock of goods or merchandise belonging to the U.S. resident for the purpose of storage, display or delivery, or for the purpose of processing by another person;

• the purchase of goods or merchandise, or the collection of information, for the U.S. resident; or

• advertising, the supply of information, scientific research or similar activities that have a preparatory or auxiliary character for the U.S. resident.11

The Fifth Protocol12 to the Treaty was signed by the Canadian Minister of Finance and the U.S. Secretary of the Treasury on September 21, 2007. Among various other changes, the Protocol amends the Treaty to provide for two additional situations in which a person who provides services in Canada will be deemed to have a permanent establishment. In particular, new Article V, paragraph 9 of the Treaty will provide that, if a U.S. enterprise providing services in Canada would not otherwise be deemed to have a permanent establishment in Canada, the enterprise will be deemed to provide the services through a permanent establishment if (and only if):

• the services are performed in Canada by an individual who is present in Canada for a period or periods aggregating 183 days or more in any 12-month period, and during that period or periods, more than 50% of the gross active business revenues of the enterprise consists of income derived from the services performed in Canada by that individual; or

• the services are provided in Canada for an aggregate of 183 days or more in any 12-month period with respect to the same or connected project for customers who are either residents of Canada or who maintain a permanent establishment in Canada, and the services are provided in respect of that permanent establishment.

We do not know whether there is intended to be any substantive difference between the words “services performed in,” used in the first part of amended paragraph 9, and the words “services are provided in,” which are used in the second part. Presumably, both sections will apply only where services are performed (or provided) in a physical location in Canada.

This amendment was apparently negotiated by Canada with the intention of overruling the decision of the Canadian Federal Court of Appeal in Dudney.13 The Court held that Mr. Dudney, a U.S. resident, did not have a “fixed base” available to him in Canada and was therefore exempt from Canadian taxation from the independent personal services business that he carried on in Canada.14 For a period of two consecutive years, Mr. Dudney provided training to

---

8 Article V, paragraphs 2-4.
9 Article V, paragraph 5.
10 Article V, paragraph 7.
11 Article V, paragraph 6.
12 Hereinafter the “Protocol.” As of the date of writing, the Protocol has not yet been ratified.
13 Dudney v. The Queen, [1999] 1 CTC 2267 (TCC); aff’d. [2000] 2 CTC 56 (FCA); leave to appeal to the Supreme Court of Canada denied November 2, 2000.
14 Under the Treaty prior to the Protocol, the term “fixed base” was used in respect of individuals acting as independent contractors while “permanent establishment” was used with respect to businesses. Because it was determined that there was no substantive difference in the meaning of “fixed base” and “permanent establishment,” the Protocol amends the Treaty to replace “fixed base” with “permanent establishment.”
employees of his client and spent considerable time at the client’s premises in Canada. However, as he “had no control over the premises in which he worked, nor was he identified with them in any way,” the Court held that Mr. Dudney did not have a fixed base in Canada, and therefore was not subject to Canadian tax on his business income. The amendment to Article V, paragraph 9 of the Protocol will result in a U.S. enterprise being deemed to have a permanent establishment in Canada in situations like Mr. Dudney’s.

In certain cases, it may not be known at the outset whether the employees of a U.S. business will create a permanent establishment of the business in Canada. For example, under the Protocol amendments, an employee who provides services in Canada may create a permanent establishment after 183 days spent in Canada in any 12-month period. Similarly, the deeming rule with respect to construction sites applies only after 12 months. In either case, the U.S. business may not discover that it had a permanent establishment in Canada, and had Canadian taxes payable, until after its tax return was due for the taxation year.

Where a U.S. person provides services in Canada, the person paying for the services will be required to withhold and remit tax from the service fees at a rate of 15%. The Canada Revenue Agency (“CRA”) may provide written waivers from this “Regulation 105” withholding tax in two circumstances as discussed below. Unless a waiver is obtained, a Canadian payer is potentially liable for failing to withhold, even if there was a reasonable basis for the belief that the U.S. service provider was exempt from tax pursuant to the Treaty. This differs from certain other withholding tax situations, such as the payment of interest or dividends, where the payer is entitled to apply any reductions or exemptions available under the Treaty without the CRA’s prior approval. Generally, the CRA requires that applications for waivers be submitted at least 30 days before the first payment is made.

A “treaty-based” waiver from Regulation 105 withholding may be issued if the CRA is satisfied that the U.S. company will not likely have a permanent establishment in Canada. The treaty-based waiver will authorize the Canadian payer not to withhold or remit any tax. The CRA will look at the contract for services, the company’s history of conducting business in Canada, and the method by which the company proposes to provide the services in question. As noted above, in some circumstances, it may not be known at the outset whether or not the U.S. resident will eventually be deemed to have a permanent establishment in Canada.

In informal discussions with CRA officials, it was indicated that, in that circumstance, a waiver may generally be obtained for the initial period, until it is determined that the U.S. resident will in fact create a permanent establishment. This generous administrative concession may vary between CRA offices.

The second type of waiver from Regulation 105 withholding is known as an “income and expense” waiver. If a U.S. enterprise does not qualify for a treaty-based waiver, it may apply for a reduction of the rate of tax withheld on the basis that 15% is excessive. The U.S. enterprise will need to demonstrate that the Canadian tax applicable to the company’s net income, after deductible expenses, will be less than the 15% withholding tax applied to the gross income. Income and expense waivers are particularly useful for companies with strict cash-flow requirements and narrow profit margins. The CRA will require the U.S. resident to provide a detailed projection of its income and expenses from the project.

The CRA’s issuance of either treaty-based or income and expense waivers does not exempt the U.S. entity from filing a Canadian tax return. A treaty-based exemption from Canadian tax must be formally claimed by filing a Canadian tax return. Even if no taxes are owed, the preparation and filing of a tax return can be an onerous process for the non-resident.
INCENTIVES AND BENEFITS

Employees

Subject to the Treaty, under the Act, U.S. resident employees are subject to income tax on their income from offices or employment in Canada. The Treaty provides that remuneration derived from a U.S. resident (other than an “Artiste or Athlete”) from an employment exercised in Canada will be taxable only in the U.S. if:

- such remuneration does not exceed ten thousand Canadian dollars; or
- the employee is present in Canada for an aggregate of 183 days or less in that fiscal year and the employee’s remuneration is not borne by a person who is a resident of Canada or by a permanent establishment in Canada.

A U.S. resident employee who regularly works in both countries on a ship, aircraft, motor vehicle or train operated by a U.S. resident will only be taxable in the U.S.

The employer is required to withhold payroll taxes from the employee’s remuneration from employment exercised in Canada, unless the employee has obtained a waiver from the CRA. The CRA will generally issue payroll tax waivers if it is satisfied that the employee qualifies for one of the Treaty exemptions mentioned above.

The $10,000 amount in the first exemption is measured only against each employment, not total employment, exercised in Canada. Prior to the Protocol’s amendment of Article XV, paragraph 2 of the Treaty, an employee could receive more than $10,000 from continuous employment in Canada if it was earned in more than one calendar year. The Protocol’s deletion of the words “in a calendar year” in the preamble of this clause appears to mean that if an employee will earn more than $10,000 from an employment exercised in Canada over any period of time, Canadian tax will apply.

With respect to the second exemption, the CRA has taken the position that “borne by” means that the remuneration is deductible as an expense in calculating taxable income. As a result, remuneration is “borne” by a Canadian employer if it is charged directly or indirectly, through a management fee or otherwise, even if the employee is paid from the U.S.

For purposes of the 183-day test, days or parts of days in which the person was physically present in Canada are included, including holidays and weekends. The words “calendar year” were used in the pre-Protocol version and referred to the year in which the employment was exercised, not necessarily the year in which the remuneration was received. It is not clear whether the “fiscal year” referred to in the amended version under the Protocol is the fiscal year of the employee or the employer.

Whether the second exemption is available also depends on whether the employer has a permanent establishment in Canada. As a result, it can be tricky to apply this definition, due to the difficulty in determining whether the employer has a permanent establishment or not. As discussed above, the presence of the employee can create a permanent establishment, and in many cases, it will not be known at the outset whether or not the employer will have a permanent establishment. It may be uncertain if the employee will be in Canada for more than 183 days, or if the employer will eventually be considered to have carried on the business through a permanent establishment due to the deeming rules under the Treaty. In either case, the CRA may be willing to grant a payroll withholding waiver for the initial 183-day period. This may vary between CRA tax services offices.

---

18 Under the Act, an “office” includes the office of a director or corporate officer.
19 The tax treatment of “Artiste and Athlete” is beyond the scope of this article. The Act contains specific rules pertaining to actors, and the Treaty Article XVI of the Treaty applies generally to actors, musicians, athletes and other performers.
20 Article XV, paragraph 2. The Protocol amended this provision to delete the reference to “in a calendar year” in the preamble section, to replace “calendar year” with “fiscal year” in the second exception, and to amend the reference to the person or permanent establishment which bears the remuneration, such that the relevant person or permanent establishment does not necessarily have to be the employer.
21 Article XV, paragraph 3 of the Treaty.
22 Including income tax, employment insurance premiums and Canada pension plan premiums. Under Article XVII of the Treaty, the withholding should not exceed 10% on the first $5,000 of remuneration. However, the CRA generally indicates that full payroll withholding applies unless a waiver is obtained.
23 Prescott v. The Queen, [1995] 2 CTC 2068 (TCC).
24 CRA Information Circular IC 75-6R2, paragraph 95.
Regardless of whether a waiver has been issued, the employer should prepare and file T4 information returns with respect to the remuneration earned by the employee in Canada. A copy of the T4 slip is issued to the employee and must be filed with the CRA along with a T4 summary form. These forms are due by the last day of February in the year following the year in which the remuneration was paid.

In addition, non-resident employees are normally required to file a Canadian income tax return to calculate their tax liability and to obtain their refund, if any. If, pursuant to the Tax Convention, no Canadian tax is payable on the remuneration, the non-resident employee will obtain a refund for the taxes withheld. The granting of a waiver from payroll withholding does not affect the requirement for the employee to file a Canadian income tax return. Where an employee obtained a waiver in a previous year but failed to file a Canadian tax return, the CRA may take that fact into consideration if the employee requests a waiver in the future.

It remains to be seen whether the Protocol amendments to the Treaty will significantly change the CRA’s waiver review process, with respect to waivers from Regulation 105 withholding, or for payroll withholding. The rule of thumb in both situations is to withhold (or expect payers to do so) unless the CRA has issued waivers. As a result, as with most tax matters, some advance planning can reduce tax headaches down the road.

25 For more detailed information regarding withholding, remitting and reporting obligations, see the CRA’s Information Circular IC 75-6R2.
Pensions

This regular feature is edited by Randy V. Bauslaugh of Blake, Cassels & Graydon LLP. This feature reviews current developments pertaining to pensions and other deferred plans.

SERPs

Tips on Supplemental Executive or Employee Retirement Plans Design

Lorraine Allard
McCarthy Tétrault LLP

Supplementary or supplemental executive or employee retirement plans ("SERPs") are an increasingly standard and useful element of the compensation package, particularly for executives. They can serve to retain high-level employees and, because there is ongoing consideration for the SERP promise, non-compete provisions tied to a SERP may be more likely to be upheld by a court.

An employer who wishes to establish a SERP, whether for an individual employee or for a group of employees, should wish to retain the greatest amount of flexibility in designing the plan. In doing so, it is well-advised to keep certain issues and principles in mind.

First, because it should be generally more tax-efficient, any underlying registered pension plan ("RPP") should provide as large a part of the benefits as possible. It must also be determined whether pension standards legislation applies to the SERP since, if it does, compliance will be necessary and the prefunding of the supplemental benefits may be required. Pension standards legislation generally does not apply to benefits or contributions in excess of the Income Tax Act\(^1\) limits, but there are slight nuances from jurisdiction to jurisdiction. The pension standards legislation that would potentially apply would be that of the province where the SERP member is employed (except where the SERP member’s employment is federally regulated, in which case the legislation would be the federal equivalent).

It must be remembered that a SERP is merely a part of the employee’s terms and conditions of employment. This allows the SERP to be designed to provide the greatest amount of flexibility and integration with the underlying RPP. It need not slavishly adopt all of the features of the RPP. A SERP may be designed to provide that no benefits will be paid if the SERP member is dismissed for cause or unless the SERP member remains employed until a certain triggering event such as a pre-determined number of years of service.

The earnings to be recognized under the SERP may be different from those recognized in the underlying RPP. The SERP may reduce the supplemental benefits by any surplus amount that may become payable to the SERP member from the underlying RPP following its termination. The SERP benefit may be paid in one lump sum or in periodic amounts.

It is good practice to commit the terms of the SERP to proper written form. The lack of applicable legislation makes this especially important. Since the SERP should not be subject to pension standards legislation, there will be no legislation to “fill in” the gaps. The SERP should be written clearly in order to avoid ambiguities. Too often, SERPs are either insufficiently documented, or are drafted as if they were RPPs and contain provisions that inadvertently impede the employer’s ability to revise the SERP terms. For example, it is not necessary for a SERP to prohibit amendments that reduce accrued benefits.

Because the SERP is not only a part of the employee’s terms and conditions of employment but a relatively complex one at that, the employer should provide a copy of the SERP document to the SERP member in order to ensure that its terms are known. Even

---

\(^1\) R.S.C. 1985, c. 1 (5th Supp.), as amended, hereinafter referred to as the “Act.”
where the terms of the SERP and the RPP are similar in terms of the recognition of earnings, vesting and the timing of benefit payments, the employer should also ensure that the employee understands what constitutes the SERP promise and what constitutes the RPP promise. Doing this will manage expectations in several ways. SERPs need not be funded and are therefore inherently different from RPPs. Confusing SERP members with "integrated" pension statements that do not make adequate distinction between benefits provided under the RPP on the one hand and the SERP on the other may serve to undermine the employer's right to SERP flexibility.

The employer who maintains a SERP should also revisit the terms of a SERP on a periodic basis. This allows the employer to ensure that the SERP continues to fulfill the original objectives, and that the SERP liabilities have not become overly significant. Too often, SERP promises reveal themselves to be an unexpectedly expensive proposition when the time comes to pay supplemental benefits. Having reserved the desired level of flexibility, where periodic review discloses that SERP liabilities threaten to balloon out of proportion, the employer may elect to amend the terms of a SERP, for example, to limit the recognition of bonuses or put a cap on the value of the pensions payable from the RPP and the SERP.

The ability to pay SERP benefits over time may help in managing the cost of the promise. To ensure this, the employer may wish to prohibit giving the SERP member the option of electing to receive a lump sum on termination of employment or retirement. The employer should also consider whether the financial exposure created by the SERP promise should be managed by pre-funding or securing all or part of the promise. Deciding to set aside assets to guarantee the SERP promise will result in a retirement compensation arrangement ("RCA"), and may occur at any time.

Employee demands or industry practice may also influence this option and may weigh against costs typically associated with maintaining an RCA, most notably the loss of investment return on the part of RCA contribution held by the Canada Revenue Agency in its refundable tax account. It may also be possible to manage the SERP liability by making corporate investments to be used to help pay the SERP benefits, but employers must keep in mind that the Act includes a concept of a "deemed" RCA. To prevent the inadvertent creation of an RCA, care should be taken not to segregate the investments from other corporate assets and earmark them solely for the SERP. Ideally, the investments should not even be officially allocated to the purpose of supporting the payment of SERP benefits.

If it is determined that the SERP should be funded or secured, the assets in the case of a funded RCA and the letter of credit in the case of a secured RCA are typically held in trust. Although the Act does not require that the RCA "custodian" be a trustee, and there are other ways of segregating assets or holding a letter of credit to pay SERP benefits, a trust offers certain advantages, particularly to the SERP member. For example, in case of the employer's eventual insolvency, the employer's creditors will not have access to the trust assets. Creating a trusted RCA can, of itself, foster retention of executives.

An employer who creates an RCA trust should pay attention to the terms of the trust agreement. The case law dealing with RPP trusts should be kept in mind, and the employer should ensure that the RCA trust agreement provides it with maximum flexibility, which may include the ability to revoke the trust without need for consent from the SERP members who are beneficiaries of the trust. As in the SERP document itself, the trust agreement should contain an amendment provision that allows the employer to amend the terms of the trust as it sees fit.

If it is determined that beneficiary consent should be required where the proposed amendment may potentially reduce the rights of the beneficiaries, the trust agreement provides it with maximum flexibility, which may include the ability to revoke the trust without need for consent from the SERP members who are beneficiaries of the trust. As in the SERP document itself, the trust agreement should contain an amendment provision that allows the employer to amend the terms of the trust as it sees fit.

If it is determined that beneficiary consent should be required where the proposed amendment may potentially reduce the rights of the beneficiaries, the trust agreement should be drafted so that consent of contingent beneficiaries (e.g., a spouse who may be entitled to SERP benefits upon the SERP member’s death) is not required. Such an amending provision can also be drafted so that fewer than the totality of the beneficiaries are required to consent (e.g., 50% plus one).

There are other tax issues that must be kept in mind when designing a SERP. For example, to avoid any hint of an argument of constructive receipt, the SERP should not
empower a SERP member who is in receipt of the SERP pension to unilaterally accelerate the remaining payments by electing to receive them at any time in a lump sum.

In addition, the Canada Revenue Agency has recently indicated that RCAs that provide for contributions or benefits which it believes to be excessive may endanger the deductibility of benefit payments or lead to the determination that the SERP, whether an RCA or not, constitutes a salary deferral arrangement.
EMPLOYEE SECONDMENT

Paid or Not Paid, That Is the Question

Marie-Emmanuelle Vaillancourt
Davies Ward Phillips & Vineberg LLP

Whether a person is an “employee” has been the object of much discussion and debate over the years. A recent decision of the Ontario Superior Court of Justice sheds some light on the issue in the case of secondments and further anticipates the obstacles lying ahead for the interpretation of Article XV of the Canada-U.S. Income Tax Convention (the “Treaty”) as modified by the Fifth Protocol (the “Protocol”) issued on September 21, 2007.

“Remuneration Paid” Under Employer Health Tax Act

In IBM Canada Ltd. v. The Minister of Finance of Ontario,1 the Court had to determine whether IBM Canada was the employer of expatriate individuals under temporary foreign work assignment with affiliates of IBM Canada for the purposes of the Employer Health Tax Act (Ontario) (the “Health Tax Act”), and whether the wages received by the seconded individuals were to be included in the “total Ontario remuneration” of IBM Canada. Generally, the Health Tax Act subjects “employers” with payrolls over $400,000 to a health tax equal to 1.95% of their “total Ontario remuneration.” “Employer” is defined as a person who pays remuneration to an employee, while “total Ontario remuneration” refers to the total remuneration paid (a) to or on behalf of all of the employees of the employer who report for work at a permanent establishment of the employer in Ontario; and (b) to or on behalf of all of the employees of the employer who are not required to report for work at a permanent establishment of the employer but whose remuneration is paid from or through a permanent establishment of the employer in Ontario.

Although the factual information contained in the judgement is sketchy, it appears that IBM Canada was responsible for the remuneration of the expatriate individuals during their secondment to the foreign affiliates. There was, however, an agreement between IBM Canada and its affiliate requiring the affiliate to reimburse all the expenses incurred by IBM Canada in respect of an expatriate individual. While working abroad, the expatriate individual was under the direct control of the affiliate and provided services solely to the affiliate. On the other hand, IBM Canada needed to authorize the secondment for the individual to be entitled to participate in the secondment program, thereby retaining a certain control over the individual. Furthermore, IBM Canada continued to accrue pension benefits in respect of the individual while the individual worked abroad and was bound, upon the return of the individual to Canada, by pay increases and other benefits granted by the affiliate to the individual during the secondment.

Various arguments were advanced by IBM Canada to support the position that it was not liable under the Health Tax Act in respect of the seconded individuals, including (i) that it was not the “employer” of the individuals; and (ii) that no remuneration was “paid” by IBM Canada.

The Court concluded that IBM Canada, although an “employer” within the meaning of the Health Tax Act, was not liable for tax under the Health Tax Act with respect to the seconded individuals, on the basis that remuneration was not “paid” to them by IBM Canada. The Court disagreed with the Minister, who argued that, whether or not a person bears the actual economic cost of the remuneration is irrelevant for these purposes,

---

as the word “paid” only required that payment be enforceable under the laws of Ontario, which was the case. Using a purposive and contextual interpretative approach, Campbell J. concluded that it could not be said that IBM Canada had “paid” remuneration to the expatriates, as IBM Canada was acting solely as paying agent for the affiliates.

Although it is questionable that IBM Canada remained the “employer” of the seconded individuals while they were working abroad, the findings of the Court in respect of the “payment” issue are sensible, considering that IBM Canada did not bear the economic burden of the seconded individuals’ remuneration. This aspect of the case is particularly interesting in light of the proposed amendments to the Treaty.

Payment of Remuneration
Under the Treaty

Under the current provisions of the Treaty, a U.S. resident person who is employed in Canada at any time in a taxation year may be taxed in Canada unless the conditions of paragraph 2 of article XV of the Treaty are met, that is, if:

(a) the remuneration does not exceed US$10,000; or

(b) the recipient is present in Canada for a period or periods not exceeding in the aggregate 183 days in the (calendar) year, and the remuneration is not borne by an employer who is a resident of Canada or by a permanent establishment or a fixed base of the employer in Canada.

Under the Protocol, the second arm of the exemption is not available if, inter alia, the remuneration is paid by, or on behalf of, a Canadian resident, or borne by a permanent establishment in Canada. As such, to be eligible for the exemption, not only must the remuneration not be borne by a person liable for tax in Canada, but it also cannot be paid by or on behalf of a Canadian resident. This change begs the question of whether a U.S. resident employee of a U.S. employer, paid by a Canadian resident affiliate of the U.S. employer for work performed in Canada on behalf of the U.S. employer would be subject to Canadian taxation even if the Canadian resident corporation is fully reimbursed by its U.S. affiliate. In other words, does the word “paid” in this context imply an economic burden or simply requires a transfer of funds?

Neither the Treaty nor the Protocol defines the word “paid.” As such, “paid” has the meaning it has under the domestic law of the state applying the treaty, unless the context otherwise requires. The Income Tax Act does not define the word “paid” either.

There is only a handful of tax cases dealing with the meaning of the word “paid” and most of them refer to the definition of “paid” in legal and current English dictionaries. The Black’s Law Dictionary provides that “payment” is “the performance of an obligation by the delivery of money or some other valuable thing accepted in partial or full discharge of the obligation” while the Oxford Dictionary of English instructs us that to “pay” is to “give money that is due for work done, goods received, or a debt incurred.” These definitions suggest that, for an amount to be “paid,” there must be a discharge of a legal obligation. However, there does not seem to be a requirement for the payor to ultimately “bear” the costs arising from the payment or transfer of funds.

These definitions of the word “pay” are consistent with case law. In Gillette Canada v. The Queen, Rip J. for the Tax Court of Canada wrote that “where money or money’s worth is delivered to discharge an obligation, in my view that is a payment.”

In Regina v. Kern’s Motor Town Sales Ltd., the British Columbia Court of Appeal needed to determine whether a taxpayer had committed an offence under the 1952 Income Tax Act by failing to “pay” to the Receiver General for Canada taxes deducted from its employees’ wages. The Court confirmed that, in this context (i.e., equivalent to section 153 of the Act), “pay” was not a technical word.

---

2 Article 3(2) of the Treaty.
3 R.S.C. 1985, c. 1 (5th Supplement), as amended, hereinafter referred to as the “Act.” Unless otherwise stated, statutory references in this article are to the Act.
6 2001 DTC 895 (TCC), confirmed for different reasons by the Federal Court of Appeal, 2003 DTC 5078 (CFA).
7 [1968] CTC 221 (BCSC).
with a precise significance. Rather, its meaning was to vary with the context and the circumstances.

Another case dealing with the word “paid” is Blais et Poliquin v. M.N.R., in which the appellant Poliquin (ex-husband) failed to make alimony payments that were provided for in a separation agreement. As a result of his inaction, a judgment was rendered by a civil court ordering a set-off of the unpaid alimony against a debt owed to him by the appellant Blais (his former wife). The Minister assessed the appellant Blais under paragraph 56(1)(b) of the Act for the amounts which were to have been paid to her as alimony and which were set off against the debt owing by her. Blais appealed the assessment, arguing that she should not be taxed on moneys that she did not receive. The ex-husband Poliquin also appealed the Minister’s assessment claiming that he was entitled to deduct under paragraph 60(b) of the Act the amounts which he was to have paid and which were set off against the debt owed to him by Blais. The Court found that the amount was neither “received” by Blais nor “paid” by Poliquin within the common and usual meaning of the words “paid” and “received.” Garon J. wrote that the alimony owed by Poliquin and deducted against Blais’ debt was not “paid” because the word “pay” in the context of paragraph 60(b) of the Act meant a “transfer of money, a handing over of funds […], the idea of a physical operation involving a transfer of funds.”

A similar issue was raised in Stocker v. M.N.R., where the Tax Review Board had to determine whether the taxpayer had “paid” a commission on the sale of his residence and was therefore entitled to a deduction for moving expenses. The taxpayer had first listed his home for sale with a real estate agent for $44,900 and the listing agreement stated the commission to be 5 1/2 per cent. The house was purchased a month later for $38,000 by a corporation the shares of which were held by the real estate agent. In filing his return, the taxpayer claimed moving expenses on account of the payment of a real estate commission but admitted that there was no actual transfer of funds with respect to such commission. Du Brule, assistant chairman, concluded without reasons that no amount had been “paid” by the taxpayer, presumably on the basis that there was no “physical” transfer of funds from the taxpayer to the real estate agent.

Although the conclusion adopted by the Court in Stocker and Blais et Poliquin to the effect that there is no payment when an amount is set-off is questionable, all the definitions and cases referred to above confirm that the word “paid” does not require that the payor bear the ultimate economic burden of the transfer of funds for the latter to be a “payment.” As set out in Gillette, as long as there is a legal obligation to transfer an amount, there is a “payment.” In IBM, the Court did not directly discuss whether IBM Canada was legally obliged towards the expatriate individuals. However, finding that IBM Canada was the agent of the affiliates is equivalent to concluding that the payments made by IBM Canada to the seconded individuals were in discharge of the obligations of the affiliates vis-à-vis the individuals or, in other words, that the amounts in question were “paid” by the affiliates, not IBM Canada. If IBM Canada was performing any obligation, it was vis-à-vis the affiliates, not the seconded individuals.

Reverting to the new version of Article XV of the Treaty, this would mean that a Canadian resident paying an amount to a U.S. resident employee of a U.S. employer for services rendered on behalf of the U.S. employer in Canada could, in certain circumstances, result in the U.S. resident employee being subject to Canadian income tax on his or her employment income, even if the Canadian resident “payor” is reimbursed for the expense in question by the U.S. employer. This may be the objective behind this new provision – otherwise, why use the word “paid” instead of the word “borne?” However, subjecting a U.S. resident employee to Canadian tax even though the salary expense is not deductible in Canada to the Canadian “payor” is clearly misguided in terms of tax policy. The employment income should be taxable in Canada only if Canada, through a tax deduction, bears the cost of the employment income.

---

9 The case was rendered under the laws of the province of Quebec but Garon J. wrote that he would have come to the same conclusion had the private law applicable been the common law.
10 82 DTC 1078 (TRB).
The current provisions of the Treaty properly reflect the appropriate tax policy. In the case where a U.S. employer has a permanent establishment in Canada, the exemption for employment income is not available to the U.S. resident employee rendering services in Canada, as the salary expense incurred by the U.S. employer is deductible by the U.S. employer in computing its Canadian tax liability.

It is interesting to note that an extension of the right to tax employment income has already been done by amending the permanent establishment provisions of the Treaty (Article V) to clarify that a U.S. employer with U.S. employees in Canada may in certain additional circumstances have a permanent establishment in Canada (and vice-versa). As such, there was no need to modify Article XV by adding the word “paid,” which could lead to asymmetrical results with Canada having the right to tax amounts that are not deductible in Canada. Given these changes to the Treaty, taxpayers will have to carefully assess the consequences of secondments and other employee exchanges in order to avoid the new pitfalls of Article XV of the Treaty.

For example, to ensure that the amendments to Article XV do not result in a Canadian tax liability for a U.S. resident employee working in Canada for a U.S. employer [provided of course that the employer’s activities do not come within the extended rules of Article V with respect to permanent establishment] in the case where the U.S. resident employee is “paid” by a Canadian affiliate of the U.S. employer, the agreement between the U.S. employer and its Canadian affiliate should make it clear that (i) the Canadian affiliate is acting only as paying agent for the U.S. employer; (ii) any contractual recourses of the U.S. employees can only be exercised against the U.S. employer; and (iii) the Canadian affiliate is under no legal obligation to pay the U.S. employee while the U.S. employee is in Canada, its sole obligations being towards the U.S. employer.

---

11 See article 3 of the Protocol. For a more detailed analysis of these new provisions, see Kevin Nightingale, “The CRA Finally Asks for Water” in CCH Tax Topics Number 1859, October 25, 2007.

12 Ibid.