Mitigating the Risks of Permanent Establishments and Increased Compliance

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Issues to cover today through case studies

- How governments are sharing tax and immigration information through technology
- The risks of permanent establishment and increased compliance issues
- The impact on corporate mobility programs
- The increasing frequency of immigration and tax audits globally
Global/Cross Border Mobility Issues

• Individual's personal and social security tax

• Corporate tax considerations including permanent establishment issues

• Payroll matters

• Mobility policy

• Immigration
Primer on Permanent Establishments (PE)

• Non resident corporations are subject to tax in Canada under domestic law if carrying on business in Canada
  • Definition of ‘carrying on business’

• Tax treaties provide relief from Cdn tax unless the corporation carries on business through a PE

• What is a PE?
  • Under Canada - US treaty (similar clauses in other Treaties)
    • Fixed place of business (bricks and mortar);
    • Employee who contracts on behalf of the company; or
    • Services provided in Canada in certain conditions
    • Building site, construction site or installation project if it lasts more than 12 months
Primer on Permanent Establishments (PE)

• Services PE under Canada US Treaty

**Test 1**
• Individual is present for >183 days in 12 month period; and
• more than 50% of revenues in the period are from services in Canada; or

**Test 2**
• Individuals provides services for more than 183 days in a 12 month period;
• for the same or connected project in Canada
Case Study 1

US consulting firm is engaged by a Canadian company to provide services in Canada on an Alberta-based infrastructure project. Twenty (20) engineers will spend between three (3) to six (6) months in Canada.

If project is extended to nine (9) months does this change the answer?
What are the implications if certain of these engineers are self-employed contractors rather than employees?
Corporate Tax Analysis

• US entity will be carrying on business in Canada under domestic Act
• Analysis of Canada-US Treaty provisions and Liability for tax
  • No fixed place of business
  • No employee contracts in Canada on US Co’s behalf
  • Construction site-not >12 months and not US Co’s site
  • Concern re services PE paragraph
    • Connected project as all employees are at one location and one particular project
    • Project is for 3-6 months so possible that US Co employees in Canada will be present in Canada for less than 183 days so will not create a services PE
    • If project extends to 9 months then will have a PE and US Co will be liable for Canadian income tax on net profit from activity

• Canadian tax withholding requirements
  • Canadian entity issuing the contract is required to withhold Regulation 105 withholding of 15% (if project in Quebec there is an additional 9% withholding required)
  • US Co can file a return and claim Treaty exemption to get a refund of 15%/24% withholding
  • Schedule 91 attached to the Treaty return outlines the nature of the activities, the number of employees present in Canada and the number of days in Canada
Corporate Tax Analysis cont’d

• US entity is employing non-residents in Canada
  • Need to register for business number with CRA
  • Required to withhold and remit Canadian income taxes unless employees get waivers for withholding (potential double withholding in US and in Canada)
  • Report Canadian earnings on T-4s at year end and employees will have to file return to claim refund of taxes assuming they are exempt from tax

• 2015 Budget changes
  • US entity may apply to become “approved employer” for an exemption from the withholding requirement
  • Employees must spend less than 90 physical presence days or less than 45 workdays in Canada to qualify for a withholding exemption
  • T-4 Reporting and tax return for employees still required
Corporate Tax Analysis cont’d

• Tax compliance issues
  • Increased audit activity by CRA
  • Using Corporate tax return data from Schedule 91 to audit employers
  • Requiring compliance at employee level for withholding tax, filing T-4s and filing returns even though exempt from tax
  • CRA will administratively accept non-compliance on a cases by case basis for employees who earn less than $10,000 in a calendar year
Corporate Tax Analysis cont’d

- Tax Implications for Independent contractors
  - May be taxable in Canada under services PE article
  - Corporation required to withhold Regulation 105 withholding from payments to them
Immigration matters

• Business visitor vs work permit
• Canada-US border data exchange program announced in June 2014
  • Ottawa and Washington to share citizen travel and biographical data
  • Data will be shared with other Federal departments - possible taxation?
Immigration matters cont’d

- NAFTA: Professionals or the Intra-company Transfer categories (LMIA Exempt)

- NAFTA Professional
  - US or Mexican citizen
  - Listed Profession, i.e., Engineer, Management Consultant, Computer Systems Analyst, etc.
  - Minimum educational qualifications (most categories require a post-secondary degree in a field related to the profession)
  - Proof of pre-arranged work (e.g. the signed consulting agreement)
  - Validity: up to three (3) years, linked to consulting agreement/statement of work.
  - No requirement that US consulting firm have a related Canadian entity, or that individuals be placed on payroll in Canada
  - US citizens -> Port of Entry; Mexican citizens -> Canadian visa office abroad
  - Can be self employed
Immigration matters cont’d

• Intra-Company Transfer
  • individual criteria:
    • Must have “Specialized Knowledge” or work in managerial/executive capacity;
    • Entry to work in a parent, subsidiary, branch or affiliate of a multi-national company;
    • Employed by the company outside Canada in a similar full-time position for one year in the last three years; and
    • Is currently employed by the multinational company outside of Canada.
  • No requirement that individuals be placed on payroll in Canada, but does require a Canadian entity that directs and controls the individual while in Canada
  • Visa-exempt nationalities -> Port of Entry; visa-requiring nationals -> Canadian visa office abroad
  • Not available to self employed contractors
Immigration matters cont’d

• Labour Market Impact Assessment (LMIA)
  • Employer must demonstrate that there is no qualified, willing, or able Canadians:
    • Publicly advertise for a period of four (4) weeks, and if no Canadians qualify for role, apply for the LMIA,
  • LMIA processing time: eight (8) to 12 weeks
  • Only once in receipt of LMIA can individual apply for Work Permit
  • Not available to self-employed contractors
Mobility Policy Issues

• Business Travel Policy vs Global Mobility Policy (Business Trip or Assignment)
• *per diem* vs allowance (location premium and cola)
• Compensation
  • if ICT: prevailing wage met?
  • if not: payment of allowance vs reimbursement of expense
• Tax Equalization
• Running shadow payroll in host country
• Employees need to apply for Certificate of Coverage (COC)
• Tax filing assistance
• Raise awareness on importance of tax and immigration compliance
Case Study 2

Multinational company operates its US and Canadian entities as integrated operations. Senior executives hold dual roles in each of the Canadian and US entities.

• Executives perform 70% of their service in home country and 30% in the other

• Costs are allocated proportionately between the two entities based on a factor such as sales, # of employees or other measure depending on the function
Corporate and Personal Tax issues

- Potential that 2 executives could create PE in host jurisdiction because of their role and ability to contract on behalf of the entities.

- Under Employment Services Article of the Canada-US Treaty the US and Canadian entity would each be the economic employer and the employees will be taxable on earnings in each jurisdiction.

- Double personal tax will be avoided due to foreign tax credit mechanism in each country but messy withholding and reporting.

Recommendation:
- Dual contracts for their roles in each jurisdiction or alternatively a secondment agreement for the host jurisdiction role.
Immigration matters

• Most facilitative Work Permit option would be under the Intra-Company Transfer Category.

• Eligibility Requirements for ICT:
  • Employee is seeking entry to work in a parent, subsidiary, branch or affiliate of a multi-national company;
  • Have been employed by the company outside Canada in a similar full-time position for one year in the last three years; and
  • Is currently employed by the multinational company outside of Canada.

• Senior Manager or Executive - initial WP up to three (3) years, renewable up to a total seven (7) years maximum time actually spent in Canada (long term need to keep track of your time, can claim back time spent outside of Canada, travel logs are key in allowing applicants to reclaim time)

• No requirement that individual be on Canadian payroll
Immigration matters cont’d

• Would likely not qualify as B1 Business Visitors – increased scrutiny of senior level executives entering the US
  • Do you have any direct reports in the US?
  • Do you oversee staff or company functions while in the US?
  • Do you provide input, guidance or provide direction with respect to hiring or firing of staff in the US?
  • Do you set compensation for staff in the US?
  • Do you perform activities while in the US that generate revenue for the US entity?
  • Do you receive any compensation from the US entity while in the US?
  • Do you have a US title?
  • Do you create policies and procedures on behalf of the US entity?
  • Do you hold yourself out as an employee of the US entity? (they may ask to see a business card)?
Immigration matters cont’d

• L1-A Intra-company transfer is better option
• Greater frequency of questioning of frequent business travelers by US Customs and Border Protection about filing of personal and corporate taxes
Mobility Policy Issues

• Commuter assignment or dual contracts outlining role and responsibilities
• Ensure employees are aware of issue of entering into contracts on behalf of the Canadian entity while in US jurisdiction and vice versa
• Generally permanent roles so not typical expatriate:
  • Compensation
    • Pension and other benefits
    • Currency issues
  • Tax Equalization
  • Running shadow payroll in host country
  • Employees need to apply for Certificate of Coverage (COC)
  • Tax filing assistance
Case Study 3

Two foreign national employees of an energy company were in Italy at a client site on behalf of their employer. They entered as business visitors. Both are visa nationals. Applications for work permits were filed. They remained in Italy beyond 90 days. They were advised by their employer’s client that applications for business visa extensions had been obtained. They left Italy and travelled home indirectly through Germany...Guess what happened next.....
Corporate Tax Analysis

• Need to review provisions of relevant Tax Treaty-using Canada-Italy Treaty as example;
• PE provisions-similar to Canada-US Treaty except no services clause
  • Fixed place of business (bricks and mortar);
  • Employee who contracts on behalf of the company; or
  • Building site, construction site or installation project if it lasts more than 12 months
• Activities of employees would be unlikely to create a PE
Immigration matters

• Although Italian visa had been extended it did not constitute a Schengen area extension
• Charged with criminal violations for overstaying in the Schengen area when transiting

• Issues:
  • Received advice from customer HR in Italy
  • Impact on ability to travel
  • Potential financial and personal consequences
  • Jeopardy to Italian work permits?

• Charges dismissed pursuant to section 153 of the German Code of Criminal procedure
Mobility Policy Issues

- Educating employees and management on importance of tax and immigration compliance
- Employees have to follow internal compliance and mobility policies
- Internal Risk Committee (importance of having one)
Case Study 4

Canadian company is working with a major European multinational. The engagement requires it to have a number of foreign nationals on site at the client location in Germany – a substantial facility where manufacturing, repair and testing takes place. At any one time, there are foreign nationals visiting for meetings and to undertake short term technical activities. Inspectors arrive at the site requesting immigration status documents of all foreigners. The inspectors request proof of the purpose of each individual’s stay.
Corporate Tax Analysis

• Need to review provisions of relevant Tax Treaty, eg Canada-Germany Treaty;
• PE provisions are similar to Canada-US Treaty except **no services** clause
  • Fixed place of business (bricks and mortar);
  • Employee who contracts on behalf of the company; or
  • Building site, construction site or installation project if it lasts more than 12 months
• Activities of employees would need to be analysed but unlikely a PE created or a liability for personal tax
• Tax withholding required if the employees are liable for taxation-may need to submit formal application to German authorities for Treaty relief
Immigration matters

• Sharing of information: work permit exemption filings -> Federal Employment Agency -> Hauptzollamt of city location (Customs office)
• Advance notice of inspection?
• Document availability – PASSPORT (!) etc
• Necessity to ensure that all conditions of each application are met (eg working hours)
• Involvement of customer in monitoring compliance and sharing of information
Mobility Policy Issues

• Educating employees and management on importance of tax and immigration compliance
• Employees have to follow internal compliance and mobility policies
• Internal Risk Committee (importance of having one)
Thank You!

Questions?
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