

Elimination of Regulation 105 Withholding Tax (Payments for Services Rendered in Canada by a Non-resident)

Section 105 of the Canadian *Income Tax Regulations* stipulates that "every person paying to a non-resident person a fee, commission or other amount in respect of services rendered in Canada, of any nature whatsoever, shall deduct or withhold 15 percent of such payment" and remit it to the Canada Revenue Agency (CRA).

Tax withheld pursuant to section 105 of the Regulations operates, in effect, as an installment in respect of the non-resident's potential Canadian tax liability for regular tax. Potentially significant penalties and interest charges could apply in respect of a failure to withhold, remit and report as required under the *Income Tax Act*.

A payer may reduce or eliminate the withholding when the CRA issues either an income and expense waiver or a treaty-based waiver to the non-resident.

The non-resident can apply to the CRA for a refund if the amount earned was not taxable in the non-resident's hands. For example, pursuant to the Canada-US Income Tax Convention, a U.S. resident taxpayer with no permanent establishment in Canada is not taxable on business income earned in Canada. It is also possible to apply for a treaty-based waiver of the obligation to withhold on the ground that the non-resident recipient earns less than C\$5,000 for the current calendar year; or his/her presence is not recurring and who performs services in Canada for less than 180 days pursuant to a service contract; or whose cumulative presence is less than 240 days during the "period" and less than 180 days pursuant to the service contract. Even with a waiver, the non-resident is still required to file a Canadian income tax return to report its Canadian-source income and expenses.

It is becoming increasingly common for organizations to staff projects based on a global skill set rather than looking only to the resources available in their home jurisdiction. The present withholding requirements, as set out in Regulation 105, are severe deterrents to allowing Canadian organizations to effectively compete for global resources. The burden resulting from compliance with the requirements is carried by the organization contracting for services in terms of withholding, tracking, reporting and remitting. This impairs Canadian businesses' ability to effectively procure the skills needed for them to effectively compete on a global basis. There is also an undue burden on the service provider in terms of additional reporting requirements and cash flow, and on the CRA in their administration of the program. Additionally, the requirement drives an unintended result in that many nonresident suppliers merely increase their prices to account for the withholding taxes levied under this regulation.

The OECD has recognized that the implementation of withholding taxes in situations where a permanent establishment does not exist can lead to excessive taxation.

Concerns regarding regulation 105 were also raised during consultations undertaken by Advisory Panel on Canada's System of International Taxation. The Panel heard that the costs associated with complying with regulation 105 are significant; service providers commonly gross-up their fees to offset the withholding tax, which can result in additional costs to Canadian businesses and hamper their ability to engage skilled workers from outside Canada; the waiver process is cumbersome and so it is not used as

often as it should be; and the service provider may suffer reduced or delayed revenues and cash flow problems if the service provider has not received a gross-up from the payer.

The Advisory Panel recommended the elimination of withholding tax requirements related to services performed and employment functions carried on in Canada where the non-resident certifies the income is exempt from Canadian tax because of a tax treaty.

Recommendation

That the federal government eliminate Regulation 105.