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## **New Cross Border Tax Rules**

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**PRICEWATERHOUSECOOPERS** 



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## **Agenda**

- Overview
- Changes impacting employers
  - Income from Employment (Article XV)
    - Stock Option Sourcing
  - Pensions and Annuities (Article XVIII)
- Changes impacting independent contractors
  - Independent Personal Services (Article XIV)
- Questions



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## **Overview**

- Fifth Protocol signed September 21, 2007
- Ratified by Canadian authorities
- Awaiting ratification by US authorities
- Most provisions effective from January 1 following ratification by both countries
- Could therefore be effective from January 1, 2009



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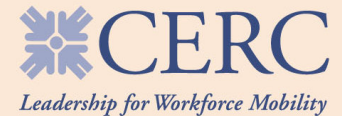
## Income from Employment (Article XV) Old Rules

- Exemption from taxation in host country available if:
  - Remuneration earned in host country <\$10,000;or
  - recipient is present in host country for  $\leq 183$  days in the calendar year **and** remuneration is not borne by an employer resident in the other country or a PE/fixed base of the employer in the other country



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## **Income from Employment (Article XV) New Rules**

- Exemption from taxation in host country available if:
  - Remuneration earned in host country <\$10,000;
  - or
  - Recipient is present in host  $\leq 183$  days in any 12-month period beginning or ending in year; and
  - Remuneration is not “paid by” or on behalf of a person resident of host country
  - Remuneration is not “borne by” a P/E in host country



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## **Income from Employment (Article XV) New Rules**

- New wording includes “paid by” test
- Reference to “employer” removed and replaced by “person”
- “Borne by” means allowable as a deduction in computing taxable income
- Expanded definition of “Permanent Establishment” (P/E)



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## **Permanent Establishment (Article V) New Rules**

- Existing determination of P/E unchanged
- Special rule added to “deem” a P/E where substantial services are being performed in host location but no P/E by virtue of existing tests
- Only applies to provision of services to third parties (whether related or not)
- Only applies to services actually performed in host location



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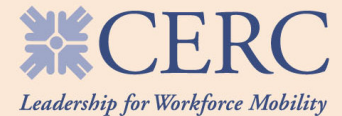
## **Permanent Establishment (Article V) New Rules**

- Two tests – if either is met, enterprise is deemed to be providing services through permanent establishment



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## **Permanent Establishment (Article V) New Rules**

Test 1 “Natural Person Test”- if both conditions are met:

- Services performed by individual present in other country for  $\geq 183$  days in any 12-month period; and
- In the same period, more than 50% of gross active business revenues are derived from services performed in host country

Permanent establishment “deemed” to exist



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## **Permanent Establishment (Article V) New Rules**

Test 2 “Enterprise Test” – if both conditions are met:

- Services provided in other country for  $\geq 183$  days in any 12-month period; and
- Services provided with respect to same or connected projects for customers who are either resident or have a permanent establishment in other country and the services are provided in respect of that P/E

Permanent establishment deemed to exist



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## **Income from Employment (Article XV) Impact on Employers**

- Individuals who were previously exempt from tax in Host country may no longer be exempt
- Could lead to increased compliance requirement and related costs
- Potential penalties/interest for failure to withhold on employee wages
- Systems and processes will need to be created to track workers – increased administrative burden



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## **Sourcing of Stock Options Old Rules**

- Article XV (Income from Employment)
- Sourcing not discussed in current treaty
- Rely on domestic law
  - Canada: Source based on past service (default)
  - US: Source based on workdays between grant and vest
- Double taxation may occur



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## **Sourcing of Stock Options Old Rules**

Example 1:

- Options granted to Canadian based employee
- Employee sent on 1 year assignment to US
- Employee exercises options when back in Canada
- 100% of benefit taxable in Canada (as a resident at exercise)
- Canada - 100% of benefit viewed as Canadian source
- US - % of benefit viewed as US source
- No foreign tax credit on Canadian return



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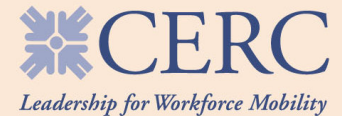


## Sourcing of Stock Options New Rules

- Article XV (Income from Employment)
- Specific guidance on sourcing of stock options
- Allocate income between countries based on location of “principal place of employment” between grant and exercise
- # days principal place of employment between grant/exercise  
total days of employment between grant & exercise



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## **Sourcing of Stock Options New Rules**

Example 2:

- Same facts as Example 1
- 100% of benefit taxable in Canada (as a resident)
- Canada and US agree on allocation of benefit
  - Location of “principal place of employment” will determine source of income
  - Allocation of work days between grant and exercise
- US tax can be claimed as a credit against Canadian tax

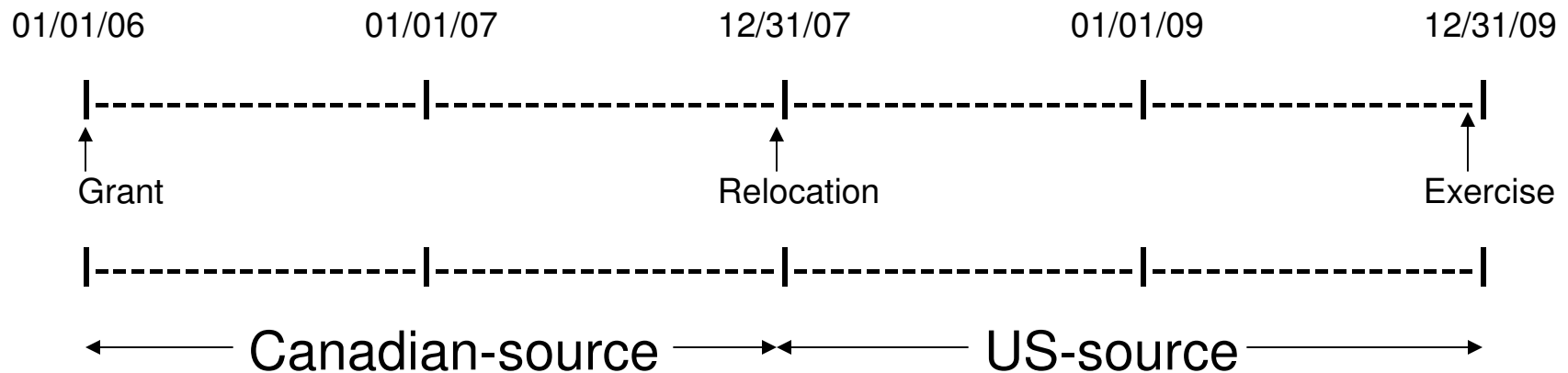


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## **Sourcing of Stock Options New Rules**

Example 3:





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## **Sourcing of Stock Options New Rules**

- Allocation is clear in scenario where individual relocates from one country to the other in the period between grant and exercise
- What about assignees / business travelers / dual contracts?
- No definition of “principal place of employment”
- Awaiting further guidance



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## **Sourcing of Stock Options Impact on Employers**

- Eliminate double tax
- Requirement to track “principal place of employment”
- Could lead to increased compliance requirement and related costs
- Potential penalties/interest for failure to withhold on stock option benefits



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## **Pensions and Annuities (Article XVIII) Old Rules**

- Only addresses receipt of pension and annuity income



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## **Pensions and Annuities (Article XVIII) New Rules**

- Contributions made to, or benefit accrued under, a qualifying retirement plan in one country shall be deductible or excludible by individual in other country
- Employer contributions allowed as deduction in other country and determined under laws of home country
- Affects:
  - Short term assignees
  - Cross border commuters
  - US citizens resident in Canada



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## **Pensions and Annuities (Article XVIII) New Rules**

Definition of “qualifying retirement plan”:

- Must have employer involvement
- Includes Canadian registered pension plans, group RRSPs, deferred profit sharing plans
  - **NOT** retirement compensation arrangements
- Includes US 401(k) plans, individual retirement accounts part of simplified employee pension plan, SIMPLE retirement accounts



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## **Pensions and Annuities (Article XVIII) New Rules**

### Short term assignees

- Applies to work assignments up to 60 months
- Contributions to Plan in Home country are deductible by employee and employer contributions not taxable in host country if:
  - Remuneration is taxable in host location
  - Individual was participating in plan before assignment
  - Individual was not resident in host location before assignment



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## **Pensions and Annuities (Article XVIII) New Rules**

Additional conditions:

- Contributions must relate to services performed
- Contributions must be made during same period
- No “double dipping” for contributions to plans in both countries



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## **Pensions and Annuities (Article XVIII) New Rules**

- Relief cannot exceed amount that would have been claimed if employee remained resident in home country
- US citizen cannot claim a greater amount than if he was contributing to US qualified plan



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## **Pensions and Annuities (Article XVIII) New Rules**

Cross border commuters

- Resident of home country providing employment services in host country
- Contributions to Plan in Host country are deductible by employee and employer contributions not taxable in home country if :
  - Individual is performing services in host location
  - Remuneration is taxable in host location
  - Remuneration is borne by host location employer



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## **Pensions and Annuities (Article XVIII) New Rules**

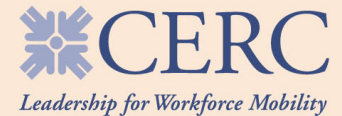
Additional conditions:

- Contributions must relate to services performed
- Contributions must be made during same period
- Relief for Canadian resident cannot exceed RRSP limit for year after taking actual RRSP contributions into account
- Relief for US resident cannot exceed maximum allowed under US tax law



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## **Pensions and Annuities (Article XVIII) New Rules**

US citizens resident in Canada

- Applies where US citizen works in Canada and contributes to Canadian qualifying plan
- Contributions deductible for US purposes if:
  - Individual is performing services in Canada
  - Remuneration is taxable in Canada
  - Remuneration is borne by Canadian employer



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## **Pensions and Annuities (Article XVIII) New Rules**

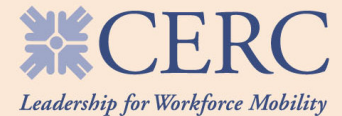
Additional conditions:

- Contributions must relate to services performed
- Contributions must be made during same period
- Relief for US citizen cannot exceed amount that would have been deductible if he was contributing to US plan
- Relief cannot be claimed in respect of contributions relating to income excluded under Foreign Earned Income rules



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## **Pensions and Annuities (Article XVIII) Impact on Employers**

- Assignment costs should decrease for tax equalized employees
- Administration of pension plans may need to change
- May need to consider payroll administration if usual position is to switch to host payroll
- Need to review company policies and existing pension arrangements



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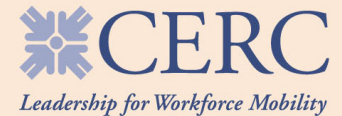
## **Independent Personal Services (Article XIV) Old Rules**

- Income derived by an independent contractor is taxable in host country if the individual has/had a fixed base regularly available in host country
- Only income attributable to that fixed base is taxable in host country
- “Fixed base” interpreted to mean same as PE (Article V)



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## **Independent Personal Services (Article XIV) New Rules**

- Article XIV deleted by Protocol
- Income dealt with by Articles V (Permanent Establishment) and VII (Business Profits)
- Business profits are taxable in host country if business is carried on in host country through a PE situated therein
- Only income attributable to that PE is taxable in host country



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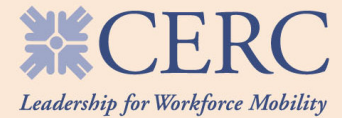
## **Independent Personal Services (Article XIV) Impact to Payors**

- Could lead to increased compliance requirement and related costs
- Potential penalties for failure to report fees paid
- Systems and processes will need to be created to track contractors - increased administrative burden



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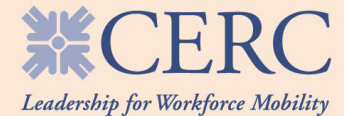
## **Question**

Do you think that your company will be affected by changes to the new Protocol to the Canada-United States Income Tax Convention?

1. Yes
2. No
3. Not Sure



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## **New Cross Border Tax Rules**

Any questions?

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