

Tax Consequences of Payments to Non-residents

Payments made or credited to non-residents of Canada on account of certain Canadian source income, for services provided by non-residents in Canada, or as the purchase price of certain properties acquired from a non-resident vendor, may give rise to unexpected Canadian tax withholding and reporting obligations for the payor. Failing to comply with these obligations can have severe consequences.

We briefly address, below, some of the most significant issues that arise.

Non-resident Withholding Tax

Part XIII of the Income Tax Act imposes a 25% tax on non-residents of Canada on certain Canadian source “passive” income including interest, dividends, rents, royalties, management fees, pension benefits, and estate or trust income.

As of January 1, 2008, withholding tax is no longer payable on most interest payments made by Canadian borrowers to arm’s length lenders. Other specific exceptions may apply that are beyond the scope of this article.

The Canadian resident payor is required to withhold 25% from such payments and remit the withheld amount to the Canada Revenue Agency (CRA) by the 15th day of the following month. Typical examples of this include payment of dividends by a Canadian corporation to its non-resident shareholders, rent payments made by a tenant to a non-resident landlord, or payments made for the lease of equipment to a non-resident lessor.

If there is an income tax treaty between Canada and the country of the non-resident, it may have provisions to reduce or eliminate the withholding tax. If there is no tax treaty, the withholding tax is determined solely under Canadian domestic rules.

For each calendar year, the Canadian resident payor must file an information return (called an “NR4 return”) with CRA summarizing the gross amount of payments and the tax withheld during the year and provide each non-resident payee with an NR4 information slip showing the details relevant to them. The NR4 return must be filed by March 31 of the following year.

For 2010, the penalty for monthly late-remittance of taxes withheld is 3% to 10% of the amount required to be remitted to CRA. The rate of the penalty depends on how late the remittance is. The penalty increases to 20% in the case of repeated late-remittances. The payor may also be liable for the actual tax that should have been withheld if CRA is unable to collect the tax from the non-resident.



There is a separate penalty for filing the annual NR4 return after the March 31 deadline. If there are 50 NR4 slips or less accompanying the return, the penalty is \$10 for each day the return is late, for a maximum of 100 days (or \$1,000). The penalty is higher where there are more than 50 NR4 slips.

Effective January 1, 2010, NR4 returns with more than 50 NR4 slips for a calendar year must be filed electronically.

Services Provided in Canada by Non-residents

Whenever services are rendered in Canada by a non-resident person, Canadian tax issues arise. Examples of these situations include a foreign supplier sending staff to Canada to install equipment or foreign professionals providing services to clients in Canada.

Any person paying fees, commissions, or other amounts to a non-resident for services rendered in Canada (with the exception of employment services) must withhold 15% of the payment under Income Tax Regulation 105. This withholding tax is credited against the ultimate tax liability when the non-resident person files a Canadian tax return.

Reimbursement of reasonable travel expenses and payments for the services rendered by a non-resident employee on secondment to a Canadian corporation are exempt from withholding tax under Regulation 105. However, remuneration paid to non-resident employees who provide employment services in Canada is subject to the regular Canadian payroll withholding obligations.

The payor is required to file an annual information return (called a "T4A-NR return") and accompanying information slips with CRA by the last day of February to report the payments and withholdings during the previous calendar year. The payor also must provide each non-resident payee with a T4A-NR4 information slip showing the details relevant to them. The penalties that apply in connection with Regulation 105 are similar to the penalties that apply in connection with the non-resident withholding tax described earlier.

Purchase of Taxable Canadian Property from Non-residents

Non-residents of Canada are taxed on gains from the sale or disposition of certain Canadian assets or specified foreign assets with significant values attributable to underlying specified Canadian assets (referred to as "taxable Canadian properties" or TCP).

TCP most commonly includes real estate located in Canada (both commercial and residential), shares of certain corporations and interests in specified trusts.



MANNING ELLIOTT LLP

CHARTERED ACCOUNTANTS

There is a pre-disposition clearance certificate procedure in place that usually requires withholding tax to be paid on the closing of a transaction involving disposition of TCP. Failure to follow the applicable procedures can expose the purchaser to significant tax liability.

Canadian tax rules and the provisions of an applicable tax treaty must be consulted to determine the appropriate tax withholding and clearance procedures. The rules are complex and professional advice should be sought.

Contact us

As you can see from this overview of the tax consequences of various payments to non-residents of Canada, there can be unexpected and complex tax implications. We encourage you to contact your Manning Elliott representative or a member of our tax group to ensure that you comply with your tax withholding and filing obligations.

