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Tax Update

Employees vs. Independent Contractors
and Cross-Border Employment Issues

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Employee vs. Independent Contractor

Why Relevant?

- Due diligence (e.g., purchase agreements)
 - Tax/payroll audit
 - Hiring/change of worker status
 - Termination
 - Personal services business (“PSB”)
 - Potentially serious tax implications:
- Where CRA finds that independent contractor is actually employee, companies will be subject to significant taxes, penalties and interest
- CRA may assess individual members of company’s Board (jointly and severally) for the income tax, Canada Pension Plan (“CPP”) contributions and Employment Insurance (“EI”) premiums which company was required to withhold and remit, as well as penalties and the interest thereon

Employee vs. Independent Contractor?

- *Income Tax Act* of limited use in determining whether worker is employee or independent contractor
- Requires analysis of facts surrounding relationship between worker and company
- In general, courts and administrative tribunals look at following four factors (*Wiebe Door Services Ltd. v. MNR*, 87 DTC 5025 (FCA)):
 - level of control exercised by company over manner in which individual provides services;
 - ownership of tools, if any, required to perform services;
 - extent to which individual has chance of profit/risk of loss; and
 - degree to which individual is integrated into company's business
- Presence or absence of above factors not necessarily determinative
- Recent court decisions placed more emphasis on legal relationship and common intention of the parties involved (*Royal Winnipeg Ballet v. Canada*, 2006 FCA 87)
- Very recent case law has de-emphasized importance of common intention (*TBT Personnel Services Inc.*, 2011 FCA 256)

Tax Implications

- Company would have failed to withhold and remit to the CRA income tax from remuneration paid to the worker
- CRA could assess the company for penalties (10%) and interest (prescribed rate)
- Penalties and interest assessed would not be deductible to the company
- Company would have failed to report (in a T4 information return) the worker's income from employment for each taxation year at issue
- Penalties could be assessed by CRA in respect of such failure

Tax Implications, cont'd

- Company would have failed to properly withhold and remit CPP contributions (employer and employee portions) and EI premiums (employer and employee portions)
- CRA would assess the company for the employer and employee portions of the CPP contributions and EI premiums which were required to be remitted
- Interest and penalties (10%) would also be assessed by the CRA
- Company may be liable for Employer Health Tax, under the *Employer Health Tax Act* (Ontario) for years at issue if the worker reports to a permanent establishment of the company in Ontario

Tax Implications, cont'd

- Possible that CRA may assess individual members of company's Board (jointly and severally) for the following amounts in respect of remuneration paid to the worker in each year at issue:
 - income tax which company was required to withhold and remit, and penalties and interest thereon;
 - employer and employee CPP contributions which company was required to remit, and penalties and interest thereon; and
 - employer and employee EI premiums which company was required to remit, and penalties and interest thereon.
- Due diligence defence available under ITA, CPPA and EIA

Tax Implications, cont'd

- CRA cannot assess the company for GST/HST/QST purposes (as applicable) for services rendered by worker if worker found to be employee
- From worker's perspective, there could be considerable issues and/or assessments from a GST/HST/QST perspective

What Companies Should Do

- Company should have agreements in place that both confirm and clarify the nature of its relationship with each worker/service provider
- Where worker is an independent contractor, contracts should include provisions confirming worker's status, detailing how and under what circumstances contractual relationship can be terminated by either party, and an indemnity provision making the worker personally liable for any amounts company and its Board could subsequently be found liable for

What Companies Should Do

- Existence of a contract will not eliminate potential for adverse finding to be made against company. However, will put company in better position to defend itself against claims
- Worker should invoice company on regular basis for services provided and GST/HST/QST (as applicable) should be collected, reported and remitted by worker on value of all consideration received from company for supply of taxable services
- Not all workers will be registered for GST/HST/QST
- Contracts should include specific language to protect companies from liability

What Companies Should Do

- Tax counsel for worker should be consulted by worker in order to confirm the tax requirements and collection, reporting and remitting obligations of the worker as well as potential methods of minimizing risks
- If worker or payer is not sure of the worker's employment status, either party can request a ruling from CRA to have status determined

Personal Services Business

- Defined in subsection 125(7) of the ITA, in part, as a business carried on by a corporation through which services are provided by an individual who would, but for the existence of the corporation, be considered an employee of the recipient of the services
- With lower corporate tax rates, PSBs became more popular (deferral opportunities)
- For tax years beginning after October 31, 2011, PSB tax rate increased to approximately 13% higher than general corporate tax rate
- Now, taxes payable may be significantly greater than if individual had earned income directly as employee
- Taxpayers who have PSB should consult with tax advisors
- Incorporated independent contractors should review all contracts

Cross-Border Employment Issues

- Frequent questions arise
- Examples:
 - Non-resident company purchases Canadian company and wants to send employees to Canada for short-term assignments (e.g., training, transition, etc.)
 - Non-resident company wants to assign employee with particular skill set to work in Canada on a key project
 - Non-resident company assigns employees to installation project in Canada

Cross-Border Employment Issues

- Potential Canadian income tax issues can arise for non-resident company, non-resident employee and Canadian company if not properly structured
- Examples:
 - Payroll withholding obligations for non-resident company
 - Non-resident company carrying on business in Canada (tax return filing obligation and potential tax exposure)
 - Non-resident employee creates permanent establishment for non-resident company in Canada (tax exposure)
 - Double withholdings on remuneration
 - Canadian tax reporting requirements for non-resident employee
 - Canadian tax liability for non-resident employee
 - 15% withholding requirements for Canadian resident company
 - 15% withholding requirements for non-resident company (tiered withholding)

Cross-Border Employment Issues and Secondment Arrangements

- Formal transfer of non-resident employee may not be desirable
- Structuring considerations, including possibility of secondment
- Secondment--“the temporary assignment of an employee...to an entity (receiving employer) carrying on business in Canada, supported by the existence of an employer-employee relationship between the individual and the receiving employer... may exist whether or not an employee remains on the payroll of the lending employer, or is transferred to the payroll of the receiving employer” (Para. 35 of IC 75-6R2)
- Properly structured secondment arrangements can minimize tax and compliance problems arising from international business travel

Benefits of Secondment Arrangements

- Secondment arrangements may assist in:
 - helping employer comply with payroll requirements in both Canada and home country;
 - allowing employee to maintain home country benefit plans, even when employee is working in Canada;
 - minimizing risk of application of 15% withholding when Canadian company reimburses non-resident company for services provided by employee in Canada;
 - minimizing risk that non-resident company found to be carrying on business in Canada; and
 - minimizing risk that cross-border employee will create permanent establishment for non-resident company in Canada.

Secondment Agreements

- Written agreement between lending (non-resident) and receiving (Canadian) employers and seconded employee
- Seconded employee may or may not remain on payroll of lending company (preference is often to remain on home country payroll so as to continue benefits, participate in pension/social security plans)
- Legal terms-duration (defined), responsibilities, job description, rate of pay, other benefits
- Canadian company responsible for seconded employee's salary, benefits and withholding and remitting
- Seconded employee reports to Canadian company in respect of services rendered to Canadian company
- Seconded employee does not perform duties for lending company in Canada
- No element of profit included in charge back to Canadian employer by lending employer

Taxation of Seconded Employee

- Non-resident employed in Canada at any time in year subject to Canadian income tax on employment income attributable to employment services rendered in Canada
- Requirement to file Canadian income tax return
- Absent waiver, payroll withholding required
- Requirement to pay Canadian income tax--may be relief under tax treaty, if applicable and depending on circumstances
- Example—Article XV, *Canada-US Tax Treaty* (assuming inbound employee)
 - remuneration doesn't exceed \$CDN10,000; or
 - present in Canada for less than 183 days in any 12 month period and remuneration not paid by, or on behalf of, person who is resident of Canada and not borne by permanent establishment in Canada

Example—Secondment Arrangement

- Cdn company (Canco) requires services of an employee (Mr. A) of its US parent company (USCo)
- USCo seconds Mr. A to Canco
- Mr. A remains employee of USCo, which continues to pay his salary and benefits
- USCo, Canco and Mr. A enter into written secondment agreement, under which USCo agrees to second Mr. A to Canco and Canco agrees to reimburse USCo for the portion of Mr. A's compensation related to services rendered in Canada for Canco
- Reimbursement limited to Canco's expenses (including salary, benefits, and reasonable overhead)--No profit margin
- Secondment agreement provides that Canco takes full employer responsibilities for Mr. A during his workdays in Canada related to Canco's business. The agreement specifies that USCo is not liable for any actions of Mr. A for these services



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