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When to Worry about Canada

These days many US businesses are looking north to Canada for new markets. American tax professionals are often asked when to advise when a US business needs to worry about the Canadian tax system.

The short answer comes from some of the oldest provisions in the *Income Tax Act*.[1] US businesses need to worry about Canadian tax when they have a physical presence in Canada.

This means if a US business sends personnel into Canada to perform services, then the Canadian who is paying for those services must withhold 15 per cent of the total cost of services rendered.[2] In the long run, the US business may be able to avoid the withholding tax if it obtains a waiver from the Canada Revenue Agency (CRA). Typically US businesses will apply for a waiver because the withholding tax isn't a permanent tax and is therefore not credible in the US.[3] If withholding does occur, then the US business must file a Canadian tax return to request the withholding tax.

Fixed place of business – what counts?

If a US business does more than send personnel north of the border, and actually carries on business in Canada and maintains a fixed place of business, then it must also file a Canadian tax return. The definition of a fixed place of business is generally intuitive. It includes offices, mines and other physical locations in Canada be they owned or leased. It also includes the physical locations of the US business' Canadian customers if the US business has personnel at the customers' physical location for more than half of any year.[4] However, a fixed place of business does not include a warehouse used to store inventory or sales samples.

It's important to keep in mind what does and does not count as a fixed place of business because it also is relevant for the waiver of withholding tax in respect of services provided in Canada. If the US business can show that it does not have a fixed place of business in Canada, then the CRA will issue a waiver of withholding tax otherwise required against any fee for services rendered in Canada.

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[1] R.S.C. 1985 Fifth Supp. C.1, as amended (the "Act"). Canada's federal income tax is imposed by the Act.

[2] Withholding tax is imposed under Income Tax Regulation 105

[3] The "CRA". The CRA is empowered to administer the Act in much the same way as the IRS administers the Internal Revenue Code.

[4] A year is meant to be any consecutive twelve month period. The number of days is cumulative in the period and need not be consecutive.

If a US firm can demonstrate they have no fixed place of business in Canada, then it will not be subject to Canadian income tax. Although the obligation to file returns is imposed under the *Income Tax Act*, the obligation to pay tax is relieved by the terms of the Canada-US Tax Treaty.[5]

What constitutes *carrying on* business in Canada?

If a US business carries on business in Canada at a minimum, it must register with the CRA and file Canadian tax returns. So what exactly does "carrying on business" in Canada mean?

One definition, established through the courts deems business in Canada as the regular and repetitive physical presence in Canada where there is either a profit making centre in the country[6] or a relevant contract has been signed in Canada.

Another definition, created by an amendment to the *Income Tax Act* says anyone who regularly solicits or offers anything for sale in Canada is considered to be carrying on business in Canada.

General and harmonized sales taxes

When it comes to GST and HST, it is important that US businesses register and collect the GST/HST from its Canadian customers. The amount of tax to be collected is dependant on the geographical location of the customer in Canada.[7] The Canada-US Tax Treaty does not apply so the obligation to collect these taxes applies, regardless of the US businesses' fixed address. If a Canadian business charges a US business GST/HST, it is important to keep in mind, the US business will get a recovery of any GST/HST paid.

At the end of the day, there are a variety of ways that minimize your exposure to Canadian tax if you are a US business. The first step is to try to avoid carrying on business in Canada. If that is not possible then try to avoid having a fixed place of business in Canada. If that's not possible then US businesses should consider structured alternatives to avoid having its main US entity file tax returns in Canada.

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[5] Treaty cite.

[6] It is this requirement that knocks out the periodic existence of sales personnel in Canada from constituting the carrying on of a business in Canada.

[7] CRA link for various GST/HST rates: http://www.cra-arc.gc.ca/tx/bsnss/tpcs/gst-tps/rts-eng.html.