TAX LETTER

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PAYING NON-RESIDENTS — WATCH OUT FOR WITHHOLDING TAX!

Under our Income Tax Act, non-residents of Canada are subject to Canadian withholding tax on various kinds of income paid to them by Canadian residents. If you are a Canadian resident making such payments to a non-resident, you **must withhold** the required amount and remit it to the Canada Revenue Agency within a prescribed period. These rules cover, for example:

- **Rent** for the use of property in Canada
  Example: you rent a house from a landlord who lives in Hong Kong and purchased the property as an investment, and who does not use a rental agent in Canada to collect the rents.

- **Royalties**
  Example: you license a software program from a company in Italy.

- **Dividends**
  Example: your corporation pays dividends to a non-resident who invested in the business as a shareholder, whether through common shares or preferred shares.

  (Taxable shareholder benefits are deemed to be dividends for this purpose.)

- **Estate or trust income**
  Example: you are executor of an estate, and income earned since the deceased's death is payable to a beneficiary in Mexico.

- **Pension income**

- **RRSP/RRIF withdrawals**

- **Commissions or fees** for services rendered in Canada. (While the rest of the non-resident withholding tax rules are in section 212 of the Income Tax Act, this one is buried in section 105 of the Income Tax Regulations and is often overlooked, even by many accountants.)

  Example: a motivational speaker who now lives in the Bahamas comes to Canada to lecture to your employees.

(The withholding for services rendered is not required if the non-resident has received a tax treaty waiver from the CRA,)

Interest payments were formerly subject to withholding tax in all cases. Since 2008, the tax no longer applies in most cases. However, it does apply to interest paid to a person with whom you don't deal at arm's length, such as a relative; or where the interest is "participating debt interest", meaning (in very general terms) that the interest rate is calculated by reference to revenue, profit, cash flow, commodity price or dividends.

Alimony, spousal support and child support were formerly subject to withholding tax. This was eliminated in 1997, and so you do not have to worry about withholding tax on any such payments you make to a spouse or ex-spouse who now lives outside Canada.

The non-resident withholding rules are very complex, and there are many exceptions and qualifications, both in the Income Tax Act and in Canada's tax treaties with other countries.

Amount to be withheld

The amount to be withheld is, according to the Income Tax Act, **25%** (15% for commissions or fees on services rendered in Canada). If the payee is resident in a country with which Canada has no tax treaty (e.g., Bahamas, Bolivia, Cayman Islands, Paraguay, Saudi Arabia), you must normally withhold the full 25%, and send those funds to the CRA.

For most countries, however, you must find out whether the **tax treaty** between Canada and that country reduces the withholding tax. The rate that applies will depend on the type of payment as well as the country of residence of the payee. Canada has tax treaties with 93 countries.

For example, here are some of the reduced rates of withholding tax provided by the **Canada-United States** tax treaty:

Dividends 15%
(reduced to 5% if the shareholder is a corporation that owns at least 10% of the Canadian company's voting stock)

Rent (real property) 25%
(no reduction, as the treaty does not deal with such payments)

Royalties 10%
(0% for most payments for use of a patent, computer software or technology)

Estate/trust income 15%
(for income arising in Canada)

Interest on participating debt interest; otherwise (i.e. on interest to a non-arm's length person which would otherwise be subject to Canadian withholding tax)	15% 0%

The tax treaty reductions often have detailed exceptions and special rules, and so **the specific treaty must be consulted** in each case. (The rates above apply *only* to payments to genuine residents of the U.S.)

You can find the text of all of Canada's tax treaties on the Department of Finance website, at <www.tinyurl.com/fin-treaties> (scroll down to "Status of Tax Treaties").

Can the non-resident get back the tax?

Generally, no. The non-resident withholding tax on passive income is normally the actual tax, not a prepayment on a tax to be calculated later (as is the case with employee payroll deductions that are withheld at source, or the withholding tax on RRSP withdrawals by Canadian residents). The non-resident normally does not and cannot file a tax return in Canada to report the income.

There are some exceptions, however. The most significant is for **rent on real property**. The non-resident can elect to file a regular Canadian tax return to report the income, and to pay tax at normal Canadian rates on the *net* income from the property, rather than having 25% withheld on the *gross*. Where the expenses of the property are significant (e.g., mortgage interest, utilities, property taxes, property management fees and insurance), the non-resident will normally do this. In such cases, arrangements can be made in advance to reduce the amount that has to be withheld from each payment of rent.

For commissions or fees on services rendered in Canada, the non-resident does file a Canadian tax return, and pays regular Canadian tax, with a credit for the 15% tax withheld by the payer.

What happens if you don't withhold or don't remit?

If you fail to withhold the required percentage from each payment, you are liable for that percentage (or possibly more, if the amount you pay is considered to be a "net" amount after withholding tax). You are also liable for **interest and penalties**, which can be quite substantial. Interest compounds daily at a prescribed rate which changes quarterly (currently 5%). The penalty is normally a flat 10% of the amount you failed to withhold, but can be much higher for repeated violations or intentional failure to withhold. Criminal sanctions can also apply if you know about these rules and your failure to withhold is deliberate.

Similarly, if you withhold tax but fail to remit it to the CRA by the due date, you will be liable for the tax plus interest and penalties. The funds that you have withheld are considered to be held in trust for the federal government; you must not consider this as your own money.

If you are making any payments to non-residents, it is important to obtain accurate advice as to your possible obligation to withhold and remit withholding tax.

FOREIGN BANK ACCOUNTS TO BE REPORTED WORLDWIDE

As part of a worldwide crackdown on tax evasion co-ordinated by the Organisation for Economic Cooperation and Development

(OECD), over 100 countries have committed to **"automatic exchange of information" about bank accounts** and accounts at other financial institutions including investment dealers. Generally, any person in one country who has an account at a financial institution in another country can expect to have this information disclosed to their home country.

In Canada, the legislation to implement this "Common Reporting Standard" is included in Bill C-29, the 2016 Budget second bill currently before Parliament, which is expected to be enacted in December. New sections 270-281 will be added to the Income Tax Act. Generally, Canadian financial institutions will be required to report any accounts over a certain size owned by non-residents, and will be required to ask all their account holders to identify whether they are resident in Canada, or whether the real (beneficial) owner of the account (or of the account owner) is resident in Canada.

Non-residents' accounts will thus be reported to the CRA, which starting 2018 will automatically provide this information to the countries of which the account owners are resident. In general, for an existing client, the institution will not be required to inquire as to residence status if all accounts total less than US$250,000 as of June 30, 2017. New clients will be required to "self-certify" as to where they are resident for tax purposes. (This description is highly simplified. There are many special rules and exceptions.)

For example, if a resident of Italy has $1 million in a Canadian investment account, the CRA will automatically report that to the Italian tax authorities.

Each country in the system will enact similar legislation, so Canadian residents with accounts in foreign countries will find that this information is reported to the CRA. If they are not reporting the account and the income earned in it, they will find themselves subject to harsh penalties.

These rules are similar to the Canada-US "FATCA" rules, but on a global scale.

Not only is Swiss banking secrecy a thing of the past, but all international banking secrecy is pretty much gone. There is nothing wrong with having a bank account or investment account overseas, as long as you report the account (if you have total foreign property costing over $100,000) and report the income from it!

DO YOU HAVE TO CHARGE GST/HST IF YOU HAVE ONLY A LITTLE BUSINESS INCOME?

Most people know that, under the GST/HST, a "small supplier" with sales under $30,000 per year does not need to charge GST/HST on their sales.

However, the rule is not that simple.

First, **if you are GST/HST registered**, you must charge and collect GST/HST on your sales, and remit it to the CRA (Revenu Québec, in Quebec). You might be registered because in a past year you crossed the $30,000 threshold, and you have not cancelled your registration. Or you might have chosen to register even as a small supplier, so that you can claim input tax credits on your purchases (and because your customers are businesses that do not mind if you charge them GST/HST). Either way, once you're registered you are "in the system" and the $30,000 threshold is not relevant. You must charge GST/HST on

all your sales (unless they are exempt or "zero-rated").

Second, when counting the $30,000 threshold, you must total up not only your own sales, but also those of other persons with whom you are **"associated"**. This includes **any corporation you control**; as well as any partnership from which you (and associated persons) are entitled to more than half the profits; and certain trusts. Your spouse is not normally "associated" with you.

Example:

You are not GST/HST-registered. You have a small consulting business in which you bill only $5,000 per year. However, you also own 60% of the shares of a corporation which operates a carpentry business, with $100,000 of sales a year.

Because you and the corporation are "associated", with combined sales exceeding $30,000, you must register for GST/HST and charge GST or HST on your consulting fees.

If you neglect to do this, so that you don't file GST/HST returns, **there is no time limit** for the CRA to assess you, even if you have correctly reported the income for income tax purposes. If the CRA discovers this situation 10 years from now, you could end up with a very large assessment for all the uncollected tax, plus interest, plus penalties for not filing.

So beware this situation!

SIMPLIFIED INSTALMENTS IF YOU HAVE THE CASH

If you are required to pay the CRA personal or corporate instalments for income tax or GST/HST purposes, here is a useful tip that can simplify your payments. It is only worth considering if you have ample cash available and no concerns about running short of cash.

Personal income tax instalments are payable quarterly. Corporate tax installments are payable monthly. GST/HST instalments, if you are a registrant that files GST/HST returns annually, are payable quarterly. Instalments are normally based on your previous year's tax, although if your current year's tax is lower, you can use that figure instead.

If you pay an instalment late, interest is charged for each day that your payment is late. The interest rate is currently 5% annual rate, compounded daily. This rate has been basically unchanged since April 2009 (except for one quarter in 2013 when it was 6%). The rate is the base commercial T-Bill rate, rounded up to 1%, plus 4 percentage points. It is adjusted quarterly: see www.cra.gc.ca /interestrates for the current and past rates.

(Personal income tax instalments for March and June are based on two years back, so the CRA can send you a statement in February telling you how much you need to pay to ensure you won't be charged interest. Your notice for September and December will then tell you how much to pay so that your total instalments for the year equal your last year's tax.)

Normally, refunds owing to you from the CRA bear only minimal interest after 30 days, of 3% for individuals and 1% for corporations.

However, if you pay an instalment early, the CRA will credit you with "offset interest" or "contra interest", *at the same high rate of interest* that applies to your late

payments. This "offset interest" is offset only against late instalments; it is never paid out to you.

What this means is that, if your total "late payment" interest on instalments matches your total "early payment" offset interest, the two will cancel each other out.

As a result, if you make a **single payment at the midpoint** of all your instalment obligations for the year, then provided the interest rate does not go down after mid-year (and at the current 5% it cannot go any lower), you will not be assessed any interest.

Example:

You report GST/HST using the calendar year. Your GST/HST net tax remittance last year was $20,000, and you expect to have a similar net tax total this year.

Normally you would be required to pay instalments of $5,000 one month after the end of each quarter, i.e, on April 30, July 31, October 31 and January 31.

Instead, however, you make a single GST/HST instalment payment, covering the entire year, of $20,000. You make this payment before September 15, which is the midpoint of your four instalment due dates.

The CRA will calculate late-instalment interest for the April and July instalments, but will offset that interest with the "contra" interest earned from your early payment of the October and January instalments. The net result will be that you have no interest owing.

As noted above, you should not postpone your instalments unless you are sure you will have the $20,000 available in September to make the single instalment payment. If you do, however, you might find that this simplifies the amount of attention you have to devote to paying tax instalments.

CORRECTION: BANKS NEED NOT ACCEPT CHEQUES FOR INCOME TAX PAYMENTS

In our September 2016 letter, we wrote that Canadian chartered banks are required to accept cheques in payment of income tax accounts. This was based on section 229 of the Income Tax Act.

It turns out on further research that section 229 was repealed many years ago, through an obscure process of proclaiming into force a new version of the Act which included a provision repealing the section. (Some commercially published editions for the Act did not reflect the repeal.)

Section 229 has been replaced with subsection 159(2) of the *Financial Administration Act*, which provides that "no bank ... shall make a charge ... in respect of any cheque or other instruction for payment drawn in favour of the Receiver General ... and tendered for deposit to the credit of the Receiver General".

Notably, the new provision does not say that a bank must *accept* a cheque payable to the Receiver General. It says only that it must not *charge* for accepting such a cheque.

While the law is not entirely certain, it appears that a bank is entitled to refuse to accept a cheque, which is what some banks now do.

We apologize for the error.

AROUND THE COURTS

Knowing when and how to object or appeal is crucial

If you disagree with an income tax or GST/HST assessment, you must file a Notice of Objection (internal appeal within the CRA), before you can appeal to the Tax Court of Canada. If you aren't satisfied with the CRA's decision on your objection, you can then appeal to the Tax Court. (You can also appeal to the Tax Court after 90 days (180 days for GST/HST) with no decision from the CRA.)

For both an objection and a Tax Court appeal of a GST/HST matter, you have only **90 days** to file (from the assessment date or from the date of the CRA's decision on your objection, respectively). If you miss that deadline, an extension of time *may* be available for up to one year, but only if you meet certain conditions. After one year, you cannot object or appeal.

If the CRA issues new assessments while you have objections outstanding, it's easy to get confused as to the right procedure.

In the recent case of *Beima v. the Queen*, Beima was assessed for GST/HST for 2006 through 2011, in three assessments. He did not object to any of them within the 90-day objection period, though he did apply within the one-year extended deadline for an extension of time to object to the last assessment (for 2010-2011). That extension was granted.

Beima was then reassessed in September 2013 for *all* of 2006 through 2012. He filed a Notice of Appeal of these assessments to the Tax Court. The Tax Court quashed his appeals for all years except 2010-2011, because Beima had not filed Notices of Objection for those other years.

Beima appealed to the Federal Court of Appeal, which upheld the Tax Court's decision. One cannot appeal to the Tax Court without objecting first, and there was no mechanism available to fix Beima's error.

Beima had misunderstood a CRA letter explaining the procedure for 2010-2011, which was that he could appeal directly to the Tax Court where he had already filed an objection and a reassessment was issued. That process is not available if one did not object in the first place, and so he could not use it for any years other than 2010-2011.

While the Court's decision is correct, Beima is not the first taxpayer to be tripped up by the technical requirements of the objection and appeal process. Taxpayers often do not realize that the deadlines in the legislation are fixed and firm, and that missing a deadline *to take a specific step* often means losing appeal rights. (In this case, appealing when Beima could have objected was a fatal error.) Taxpayers who are acting for themselves in disputes with the CRA are best advised to consult at least briefly with a tax litigator, to make sure they are on the right track in their procedures.

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