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Tax Alert – Canada

CRA announces a change in position with respect to Regulation 105 withholding tax on subcontractor fees

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The Canada Revenue Agency (CRA) has announced its new position with respect to subcontractor fees reimbursed to nonresidents for services performed in Canada. More specifically, in a recent external technical interpretation, the CRA stated that fees paid by a Canadian resident corporation to a nonresident corporation as a reimbursement of subcontractor fees for services performed in Canada are subject to withholding tax, reversing its previous position published in 2008. The CRA's new position applies to reimbursements of subcontractor fees made after 30 September 2024.

In this Tax Alert, we provide a brief overview of the CRA's previous and current positions on subcontractor fees reimbursed to a nonresident, as well as what taxpayers should consider to comply with the new position.

Background

Under paragraph 153(1)(g) of the *Income Tax Act* (the Act) and section 105 of the *Income Tax Regulations* (Regulation 105), fees, commissions or other amounts paid to a nonresident person in respect of services rendered in Canada are subject to a 15% withholding tax. As summarized by the Tax Court of Canada (TCC) in a 2007 decision, the purpose of the withholding tax requirement is to ensure that funds are available if an assessment of Canadian income tax is made against a nonresident in respect of income earned in Canada.

In particular, the TCC held that the reimbursement of nonresident contractors' travel costs and other out-of-pocket disbursements is not subject to Regulation 105 withholding tax.¹ The TCC arrived at this conclusion on the basis that Regulation 105 only imposes a withholding tax requirement from payments that have the character of income earned in Canada by the nonresident. While fees and commissions are payments in the nature of income, amounts paid to reimburse contractors for their disbursements are not.

In a 2008 CRA document,² the CRA took the position that Regulation 105 withholding tax would generally not apply to a reimbursement of a nonresident's expenses, including subcontractor fees and travel costs, for services rendered in Canada, provided information regarding the reimbursement was available and documented at the time the payment was made to the nonresident.

In contrast, in a 2019 CRA document,³ the CRA concluded that advance payments made by a Canadian resident corporation to a nonresident corporation for services performed in Canada by a subcontractor would be subject to Regulation 105 withholding tax, since the fact that the nonresident corporation subcontracted its obligations under the agreement with the Canadian resident corporation did not alter the fact that the nonresident corporation was paid for services rendered in Canada. In the same document, the CRA confirmed that Regulation 105 withholding tax would not apply to amounts paid to a nonresident for the reimbursement of travel costs paid by the nonresident to a subcontractor in respect of services performed in Canada.

In a CRA document dated 29 April 2024 but released on 5 June 2024 (the 2024 CRA document),⁴ the CRA stated that the views expressed with respect to subcontractor fees in the 2008 and 2019 CRA documents referenced above are difficult to reconcile.

CRA's new position

In the 2024 CRA document, the CRA was asked to consider the following scenario:

- ▶ A Canadian resident corporation (CanCo) entered into an agreement with an arm's length nonresident corporation (USCo) for the provision of services, some of which were to be performed in Canada.
- ▶ Under the agreement, CanCo agreed to reimburse USCo for all direct and indirect travel and meal costs.
- ▶ USCo subcontracted the services to be performed in Canada to its Canadian resident subsidiary (CanSub).

¹ In this Tax Alert, "Regulation 105 withholding tax" refers to withholding tax required under paragraph 153(1)(g) of the Act and Regulation 105.

² CRA document 2008-0297161E5, dated 16 September 2009.

³ CRA document 2019-0823641I7, dated 16 October 2020.

⁴ CRA document 2022-0943241E5.

- ▶ After the services were rendered, CanSub invoiced USCo, separately identifying its fees for the services performed in Canada and any travel and meal costs, and USCo paid the invoice in full.
- ▶ USCo then invoiced CanCo, separately identifying its fees for services performed outside Canada, travel and meal costs, and the amount invoiced by CanSub for services performed in Canada.

The CRA was asked whether CanCo would be required to withhold tax under paragraph 153(1)(g) of the Act and Regulation 105 in respect of the portion of the amount invoiced by USCo for the reimbursement of fees, travel and meal costs invoiced by CanSub to USCo for services performed in Canada.

The CRA confirmed its view that the 2007 TCC decision stands for the proposition that the reimbursement of travel and meal expenses is not subject to Regulation 105 withholding tax in circumstances similar to the situation in that decision, as the words “fees, commissions or other amounts for services” in paragraph 153(1)(g) of the Act are limited to amounts that have the character of income earned in Canada in the hands of the nonresident recipient.

The CRA concluded that in the scenario provided, and consistent with its position in the 2019 CRA document, the reimbursement of travel and meal costs by CanCo to USCo in respect of services performed in Canada would not be subject to Regulation 105 withholding tax, regardless of whether those amounts were paid by USCo or CanSub and provided that CanCo agreed to reimburse the costs. However, the fees paid by CanCo to USCo for services performed in Canada (i.e., by CanSub) would be subject to Regulation 105 withholding tax.⁵

The CRA acknowledged that its views in the 2024 CRA document represent a change in position from the 2008 CRA document.

Effective date and temporary administrative relief

In a separate CRA document dated 28 May 2024 but also released on 5 June 2024,⁶ the CRA clarified that this change in position set out in the 2024 CRA document applies to reimbursements of subcontractor fees made after 30 September 2024, extending the effective date from after 30 June 2024, as initially set out in the 2024 CRA document.

⁵ The CRA also noted that if CanSub were a nonresident, payments from USCo to CanSub may also be subject to Regulation 105 withholding tax.

⁶ CRA document 2022-0943242E5.

Further, the CRA indicated that for taxpayers who made payments potentially subject to Regulation 105 withholding tax after 16 September 2009, and on or before 30 September 2024, and who relied on the views expressed in the 2008 CRA document, no assessment will be made for additional Regulation 105 withholding tax, interest or penalties, provided the conditions set out in the 2008 CRA document were otherwise met. Those conditions include that information regarding the reimbursement of the subcontractor's fees and travel costs is available and documented at the time the payment is made to the nonresident, and that records are kept of the amounts on which no tax is withheld and the reasons for not withholding.⁷

Finally, the CRA noted that if a nonresident can demonstrate that the normally required withholding tax on a payment exceeds the nonresident's ultimate tax liability, based on treaty protection or the nonresident's estimated income and expenses, the CRA may waive or reduce the withholding tax accordingly on application by the nonresident.⁸

Practical considerations

The CRA's updated position on Regulation 105 withholding on subcontractor fees reimbursed to nonresidents provides clarity to taxpayers.

Taxpayers intending to rely on the CRA's temporary administrative relief from Regulation 105 withholding for payments made to nonresidents on or before 30 September 2024 should ensure that they meet the conditions set out in the 2008 CRA document.

Agreements with nonresident contractors may need to be amended to state that withholding tax will apply on reimbursements of subcontractor fees for services performed in Canada. Such documents should clearly establish which party will bear the withholding tax liability.

Finally, taxpayers should ensure that nonresident contractors submit invoices that separately identify travel expenses and other disbursements, along with any portion of the fee that is not in respect of services rendered in Canada, as these amounts are generally not subject to Regulation 105 withholding tax.

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⁷ The 2008 CRA document also notes that reimbursed subcontractor fees should be included in box 18 (Gross income) of Form T4A-NR, *Statement of Fees, Commissions, or Other Amounts Paid to Non-Residents for Services Rendered in Canada*, issued to the nonresident. Travel expenses are reported separately on Form T4A-NR.

⁸ Under subsection 153(1.1) of the Act. Information on how to apply for a waiver can be found in Information Circular IC 75-6R2, *Required Withholding from Amounts Paid to Non-Residents Providing Services in Canada*.

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