



# On The Inside

Volume 1, Issue 5

June 4, 2009

## MINIMIZING THE HIDDEN CORPORATE COSTS AND RISKS OF INTERNATIONAL EXECUTIVE RELOCATION

By David S. Kerzner<sup>1</sup>, Vitaly Timohkov<sup>2</sup>, and Sunita Doobay<sup>3</sup>

### Overview

Many CFOs and controllers in companies in Canada and the U.S. are not directly involved in managing the tax aspects of cross border transfers of their executives and other employees between Canada and the United States. Traditionally, human resources quarterbacks this function and works together with employment and immigration law specialists in the respective jurisdictions at "home" and "abroad". At large multinationals, external international tax planning support may also be obtained. However, for midsize and smaller companies who may not make the Fortune 500 or 1000 list (and even for some that do) incorporating cross border tax planning before an executive or employee transfer is not always a part of the standard checklist—but it should be.

While a detailed account of the applicable tax rules for this subject is beyond our objective and scope, a brief summary is warranted. The summary and discussion below focus on corporate rather than individual taxpayer's domestic and tax treaty issues. Senior management should take care to note the new service permanent establishment rules and anti-hybrid rules which can limit benefits under the Canada-U.S. Tax Treaty (the "Treaty").

### Executive Relocation to Canada

Very generally, Canadian withholding rules differ depending on whether they relate to fees paid to non-residents for services provided in Canada (e.g., independent contractor under Regulation 105) or whether they are in regard to remuneration paid to non-resident employees who perform services in Canada (under Regulation 102). In the latter case, any person paying another person salary, wages, commissions, bonuses or other remuneration in respect of an office or employment in Canada must withhold and remit and report such amounts to CRA. These obligations apply to non-residents of Canada employing either Canadian residents or non-resident employees for services performed in Canada.

Where an executive is working in Canada part time, to the extent she is a resident under the residence rules of the Treaty, or any other Canadian tax treaty, of her residence country, she will also be considered a non-resident for purposes of the Income Tax Act (Canada) (the "Act"). For a non-resident employee the allocation of employment income for the purposes of Canadian income taxation is generally done on a per diem basis (rather than arbitrarily by the employer). Where the individual is determined resident in Canada, all of her employment income will be subject to wage withholding and subject to tax in Canada, whenever earned.

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## What's New?

### Course Updates!

**602 – Business Expenses, Deductions & Credits**

Instructor: **Richard Edmunds**

Filming schedule: June 15-17, 2009

**603 – Tax Accounting**

Instructor: **Richard Edmunds**

Filming schedule: July 20-22, 2009

### Congratulations!

We want to thank those students, faculty and Alumni that have registered to use the Forum. We are so excited about the opportunity to provide this tool to everyone on our website. The following winners will receive a FREE Washington Institute for Graduate Studies steel thermal mug! Don't wait – register on the Forum today! See you on the boards!

**Dolores Sheets!** 1st Week Winner

**Karim Walji!** 3rd Week Winner

## Feedback

*Washington Institute for Graduate Studies is dedicated to creating and constantly improving the educational experience of busy tax professionals*

When do you think the recession will end?

In the last issue of *On the Inside*, we asked: "When do you think the recession will end?" We'd like to thank everyone who offered their thoughts and responses on this very pertinent question. We received almost 175 responses! Here are the results:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
2009				15%
2010	38%	14%	20%	
2011	7%	5%	1%	

Feel free to contact the school any time with suggestions for improvement, ideas for new courses to pursue, and anything that is of interest and importance to you.

Let us raise a standard to which the wise and honest can repair.  
– George Washington

# Happy Birthday June!

Abby Eisenkraft	6-01
Peter Greco	6-01
Selena Howard	6-03
Mathew Wong	6-03
Tai Leung	6-04
Marina Malan	6-04
Robert Tomasko	6-04
John Himmelright	6-09
Tino van den Heuvel	6-09
Joseph Wood	6-11
Joseph Yung	6-11
Marie-Line Nadir	6-12
Sheila Johnson	6-14
Jason Meredith	6-15
Dee Battis	6-16
Diana Stolin	6-16
Ron Childress	6-17
Jennifer Hager	6-17
Andrew Haykin	6-18
Miguel Sepulveda	6-18
Alice Azzaro	6-20
Nadine Malpas	6-24
Curtis Holliman	6-27
John Raspante	6-27
Tim Moseley	6-30

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In certain fact scenarios, an American executive will work in Canada for the Canadian affiliate, but will remain on the payroll of the U.S. company. While in some instances (e.g., certain 'secondments'), the Canadian company may be relieved of Regulation 105 withholding on reimbursement payments by the Canadian affiliate to the U.S. affiliate, such withholding relief does not eliminate the wage withholding requirements under Regulation 102.

Many companies that are indeed managing their Canadian withholding obligations are unaware that the executive relocation arrangement may have created a permanent establishment in Canada of the lending U.S. (or foreign) employer. This may occur, for example, where the executive is performing her duties related to the U.S. employer on a continuous basis from a fixed base in Canada, and such duties are not activities exempt under the Treaty. As described below, permanent establishments arising from the executive's presence in Canada can be costly for small and mid-size companies.

As a general matter, a U.S. company (or a foreign company) is liable to tax on its income only from Canadian sources, unless foreign source income is received in the course of its carrying on business in Canada. Under the Treaty however, the business profits of a U.S. resident carrying on business in Canada are only taxable in the U.S., unless the U.S. resident carries on the business through a permanent establishment in Canada. Where a particular business is carried on by a U.S. company in Canada through a permanent establishment, Canada may impose income tax on business profits, but only to the extent that these profits are attributable to the permanent establishment in Canada. A unique rule under the Treaty may limit the attribution of business profits arising from the mere provision of certain executive services to a permanent establishment in Canada (or the U.S.).

Branch profits taxes may also apply to the extent not excluded by the Treaty. It is important to note that Treaty relief is available only to the U.S. companies considered to be resident in the U.S. and so called "qualifying persons" for the purposes of the Treaty. As such, a U.S. company formed as a fiscally transparent U.S. LLC may avail itself to Treaty relief only in limited circumstances. In such a case, even very limited business activities carried on by a U.S. LLC in Canada, such as entering into a contract in Canada or even offering anything for sale, may attract Canadian taxation. A detailed discussion of the new anti-hybrid rules (which may limit treaty benefits) is found in Chapter 4.5 of The Tax Advisor's Guide to the Canada-U.S. Tax Treaty.

Under the Treaty, a permanent establishment may arise where a U.S. resident has a fixed place of business through which its business is wholly or partly carried on. Examples may include a place of management, a branch, an office, or the presence of high-ranking employees. A permanent establishment may also arise due to the presence in Canada of agents (including executives or other employees of a U.S. company) who habitually exercise in Canada the authority to conclude contracts in the name of the U.S. company. Generally, for permanent establishment determination, a non-resident should have a certain degree of control over the premises used in Canada for its business activities, such as the right of entry or occupancy. This degree of control may arise where, for example, a U.S. executive has day to day unrestricted access to the offices of its Canadian affiliate.

The taxpayers should also heed the emergence of a so called "service permanent establishment." According to the recent amendments to the Treaty, in certain circumstances a U.S. company may be deemed to have a permanent establishment and become subject to tax in

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Canada where it provides services and its employees, including executives, are present in Canada for at least 183 days in any 12 month period.

The new rules are quite complex and become effective in 2010. However, a U.S. company providing services in Canada will be prudent to prepare by reviewing the facts concerning the deployment of its personnel in Canada under these new rules to adapt and if necessary implement proper HR tracking procedures. The failure to prepare for these new rules may result in income tax consequences both for the U.S. company itself and its employees providing services in Canada. A detailed discussion of the new service permanent establishment rules is found in Chapter 5.5 of *The Tax Advisor's Guide to the Canada-U.S. Tax Treaty*.

## Executive Relocation to the United States

### (i) Federal Withholding

The United States generally imposes withholding obligations on wages paid to U.S. citizens, residents, and non-residents for services performed in the United States. These obligations also apply to foreign employers. The three primary areas of federal withholding are: income tax withholding, Federal Insurance Contribution Act withholding (FICA), and Federal Unemployment Act withholding (FUTA). Certain exceptions may apply under the Internal Revenue Code (the "Code") and the Treaty. These rules contain detailed withholding and reporting requirements. The Code imposes civil penalties for various kinds of noncompliance with the provisions concerning the reporting and payment of employment and withholding taxes, including some directed to the board of directors level.

### (ii) U.S. Taxation of Foreign Corporations

Article VII of the Treaty limits the taxation by the United States of the business profits of a Canadian resident to business income that is attributable to a permanent establishment in the U.S. Under Article V of the Treaty, a permanent establishment may take many forms. A Canadian resident may have a U.S. permanent establishment if it has an office or other fixed place of business through which it carries on business in whole or in part. The office may include space made available to the Canadian resident, regardless of whether the Canadian resident leases the space, or pays for it. A Canadian resident may also have a permanent establishment in the U.S. if the taxpayer has a U.S. agent with authority which is habitually exercised, to enter into contractual relationships in the name of the taxpayer. Additionally, if a Canadian corporation maintains employees at an office or facility in the U.S. (including a home office), in connection with its business operations, it may also have a U.S. permanent establishment. As noted above, recent changes to the Treaty add a new permanent establishment provision that under certain circumstances, deems an enterprise of a Contracting State to have a permanent establishment in the other Contracting State by virtue of providing services in that other Contracting State. The provision may deem a Canadian enterprise to have a permanent establishment in the U.S. notwithstanding that it does not have a permanent establishment under the general rules of Article V.

A foreign corporation is generally required to file a U.S. return if it is engaged in a trade or business in the U.S. at any time during the taxable year, or if it has income that is subject to U.S. taxation. The performance of personal services in the U.S., generally constitutes carrying on a trade or business in the U.S. A corporation that fails to file such a return within the proscribed time (and to disclose treaty based positions) may be subject not only to applicable penalties and interest, but may also forfeit deductions and credits.

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## News Around The World

For more information and to read full articles visit [www.tax-news.com](http://www.tax-news.com)

### OECD Removes Last Three Jurisdictions From Blacklist

by Ulrika Lomas, Tax-News.com, Brussels

Monday, June 01, 2009

The Organization of Economic Cooperation and Development has announced that Andorra, Liechtenstein and Monaco have been removed from its list of 'uncooperative tax havens'.

### IRS Announces Spring 2009 Statistics Of Income Bulletin

by Mike Godfrey, for LawAndTax-News.com, Washington

June 01, 2009

The Internal Revenue Service has announced the availability of the spring 2009 issue of the Statistics of Income Bulletin, which features information on high-income individual income tax returns filed for tax year 2006.

### Australian Government Attempts To Stimulate Deceased

by Mary Swire, Tax-News.com, Hong Kong

Friday, May 29, 2009

The Australian government has defended its economic stimulus package after it emerged that tax cheques worth AUD900 were sent to 16,000 deceased citizens.

### FDI In Caribbean To Drop Significantly During 2009, Says Report

by Phillip Morton, Investors Offshore.com

Friday, May 29, 2009

Foreign Direct Investment (FDI) flows to Latin America and the Caribbean in 2008 reached USD128.3bn but are expected to decline dramatically considering the current economic difficulties, according to the Economic Commission for Latin America report Foreign Direct Investment in Latin America and the Caribbean 2008, presented on May 27 by Commission Executive Secretary Alicia Bárcena.

### Singapore To Align Tax Code With International Standards

by Mary Swire, Tax-News.com, Hong Kong

June 01, 2009

Singapore's government has announced it is looking at ways of amending its tax code so that it meets new international standards.

### UK Music Licensing Fees Slashed

by Robin Pilgrim, LawAndTax-news.com, London

May 29, 2009

The UK's music royalty collection agency, PRS for Music, has announced a major reduction in the rates it charges for on-line streaming services.

## RIDDLE:

WHOEVER MAKES IT, TELLS IT NOT.  
WHOEVER TAKES IT, KNOWS IT NOT.  
WHOEVER KNOWS IT WANTS IT NOT.  
WHAT AM I?

# Spotlight...

Washington Institute for Graduate Studies' spotlights some of our amazing students, staff members or faculty. It's a great way to get to know the people who make this institution the success that it is.

## David Kerzner – Instructor

If David Kerzner, the professional, could be summarized in one word, it might be this: caring. He receives strong evaluations from his students at Washington Institute for Graduate Studies, and also Queen's University School of Law, where he also teaches tax law. He built one of the largest youth shelters in North America which has cared for over 15,000 kids ages 16 - 21. More recently, he served honorably in the U.S. Navy Chaplain's Corps, in the U.S. Marine Force Reserves. Today, David acts on behalf of men and women in all six branches of the U.S. Armed Forces as an Ombudsman for the Employer Support of the Guard and Reserve Agency in Washington D.C. David has shared his passion for international tax with students at Washington Institute since 2003, teaching course 709 - International Taxation, and further in course 607 – Estate and Gift Taxes, Trust Taxation, and Estate Planning. Additionally, he recently accepted a position on the newly developed Advisory Committee at Washington Institute for Graduate Studies and we are confident that his input will prove invaluable.



David knew he wanted to study international law and as such, attended New York University School of Law pursuing a Master of Laws in International Legal Studies after earning his undergraduate degrees from Ivey Business School and Queen's Law School in Canada. At the advice of one of his professors, he continued at NYU to obtain an additional Master of Laws in Taxation. It wasn't long before he noticed that the first question in any international business transaction is: What are the tax consequences? To that end, he pursued a career in international corporate taxation with KPMG and worked in their national headquarters in Washington D.C. David has co-authored a book with Dr. Arthur Cockfield, JSD (Stanford) titled, *The Manager's Guide to International Taxation* scheduled for publication by Thomson-Reuters in a few months. It is designed to teach business executives and MBA students the principles of international tax planning—in a tax novel setting. David says: "I'm hoping to share my big picture experiences because tax can have such a huge hit on the bottom line, and many[business] schools and law schools unfortunately do not teach international tax." David is licensed to practice law in Ontario, Canada; New York State; as well as in England and Wales.

In addition to his book, *The Manager's Guide to International Taxation*, Thomson-Reuters recently published *The Tax Advisor's Guide to the Canada-U.S. Tax Treaty*. This two volume loose-leaf treatise of which David is the Editor in Chief and Principal Co-author, addresses the tax laws of both Canada and the U.S. in the context of cross border investment between the two countries. When asked which achievements he is particularly proud of, David says wearing the uniform, and helping out in the community. David believes that the first lesson anyone must learn from their professional education is how to use their skills to give back to their communities and country: "I have met no finer people than the men and women who wear the uniform so we can live in freedom."

Outside of his busy professional life, David especially enjoys Mexican fare at the popular Café Rio restaurant whenever he is in Utah, and he also loves to hike. He is heading to the Wind River Range in Wyoming in a few weeks to hike 100 miles!

Professor Kerzner offers a final note: "To my students, including alumni, please feel free to call if you have any questions, it's always a pleasure to speak with you. The Washington Institute provides a very essential link in our educational system and I'm proud to be affiliated with the school since 2003, and look forward to working with the very caring and devoted staff to continue to enhance the quality of the educational experience in all of its aspects..."

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### (iii) State Compliance Issues

Canadian companies must also navigate the different rules of 50 state jurisdictions relating to nexus and obligations to file a state income tax return; the calculation of any applicable income taxes; and the reporting and withholding for state unemployment taxes (SUTA). The presence of personnel from a Canadian company in a state may also trigger other state compliance obligations such as sales and use taxes depending on the facts. Moreover, in some jurisdictions (e.g., New York State), extremely severe penalties (which can easily and rapidly run into the six figures) apply for non-compliance with state disability insurance requirements.

### Managing Withholding and Permanent Establishment Risks

The lack of vetting cross border executive (and employee) relocations with tax counsel is one of the major origins of tax complications in this area. Another, is the misconceptions on how some of the rules work. For example, a Canadian company may unilaterally allocate remuneration for executives working in both Canada and the U.S. rather than following CRA guidelines. Canada

generally has a per diem allocation rule, and the U.S. has its own rules relating to such fact patterns. This in turn can create withholding problems in the U.S. Some U.S. companies may be unaware that they have wage withholding obligations to CRA for services performed by their employees working in Canada, notwithstanding these U.S. companies remit fully on federal and state wage withholdings in the U.S. Likewise, absent exceptions, a Canadian company may be equally unaware of withholding obligations for employees working in the U.S. Companies that are not sure about their past or existing withholding obligations should also consult their tax advisors to identify whether there is a problem, its magnitude, and to discuss appropriate next steps.

Perhaps the lesser known of the two risks are those associated with permanent establishments. Quite often, a company will transfer an employee to work for assignments in the offices of a foreign affiliate. Depending on the circumstances, performing the day to day operations of the company (the lending employer) in the offices of the foreign affiliate, can create a permanent establishment. For example, the executive of a U.S. based venture

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capital company assumes the presidency of a Canadian company, and performs services for the U.S. based company in Canada in tandem with her responsibilities as president of the Canadian company. The executive lives and works part time in Canada, and part time in the U.S. In so doing, depending on the facts, she may also inadvertently create cross permanent establishments for each entity in both countries. Permanent establishments can involve both costly and administratively burdensome compliance obligations (including income tax returns and transfer pricing determinations), and may involve a second level of tax –the branch tax (if not exempted under a treaty). These costs can be exponentially greater on audit for non-compliant companies.

A goal of business optimization planning is to have function drive form rather than the other way around. A logical starting place is for businesses to confer with their tax advisors to explain the role, objectives, and job description of the executive/manager who is going to be relocated. A company's tax, immigration, and employment counsel need to work together as part of the same team to provide the company with some uniform recommendations that enable the company to achieve its business goals while ensuring compliance with multi-jurisdictional withholding obligations, and minimizing permanent establishment risks.

### Concluding Observations

The hidden corporate costs of executive relocations can be found in exposure to potential taxes, penalties and interest surrounding both the withholding obligations and the income tax obligations applicable to the corporations involved. These costs can be taken to a new level where the facts give rise to a branch operation (permanent establishment) in the country of foreign assignment. Beyond the potential cascade of fiscal and related costs, a corporation which has exposure to past or present delinquencies in withholding, or has a permanent establishment which it is ignoring, may pay a heavier price down the road as a result of due diligence relating to a prospective financing (IPO/PE/VC), or in an M&A or divestiture context. A prospective financier or purchaser may require a significant holdback, reduction in price, or wonder what else "was missed" or "swept under the rug" by this company's treasury function, and perhaps decide to go elsewhere. Prevention through planning is the best course for senior management to follow to reduce both costs and risks relating to cross border executive relocation.

### Endnotes:

- 1 David S. Kerzner, LL.M. (Tax) NYU is the Editor-In-Chief of *The Tax Advisor's Guide to the Canada-U.S. Tax Treaty*, a two volume loose-leaf service (Thomson-Reuters-Carswell), and practices tax law in Toronto and New York. David can be reached at Kerznerlaw.com
- 2 Vitaly Timohkov, LL.M. (Tax) NYU is Senior Editor of *The Tax Advisor's Guide to the Canada-U.S. Tax Treaty*, a two volume loose-leave service (Thomson-Reuters-Carswell), and practices tax law in Toronto. Vitaly can be reached at Kerznerlaw.com
- 3 Sunita Doobay, LL.M (Tax) NYU is a contributing author to the *Tax Advisor's Guide* a two volume loose-leaf service (Thomson-Reuters-Carswell).

## RIDDLE ANSWER: COUNTERFEIT MONEY

# Over Taxed...

## When the Only Thing Left to do is Laugh

"How have you managed to buy such a luxurious villa while your income is so low?" asked the IRS auditor.

"Well," the taxpayer answered, "while fishing last summer I caught a large golden fish. When I took it off the hook, the fish opened his mouth and said, 'I am a magical fish. Throw me back to the sea and I'll give you the most luxurious villa you have ever seen'. I threw the fish back to the sea, and got the villa."

"How can you prove such an unbelievable story?"

"Well, you can see the villa, can't you?"

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### You might be an Accountant if...

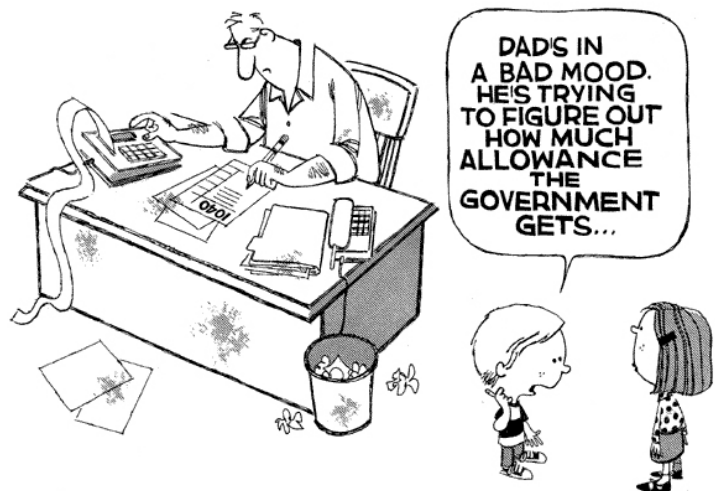
- you refer to your child as Deduction 214
- you have no idea that GAP is also a clothing store
- at the movie Indecent Proposal you did a NPV calculation
- your idea of trashing your hotel room is refusing to fill out the guest comment card
- you have a petty cash box at home and actually refer to it as such
- you've ever made a joke about a double-entry bookkeeping method
- you consider it normal not to see your spouse or children from February to April 15<sup>th</sup>

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The kid had swallowed a coin and it got stuck in his throat, and so his mother ran out in the street yelling for help. A man passing by took the boy by his shoulders and hit him with a few strong strokes on the back, and so he coughed the coin out.

"I don't know how to thank you, doc..." his mother started.

"I'm not a doctor", the man replied, "I'm from the IRS".



Have a humorous anecdote or story to share? Read a great article? We'd love to put it in *Over Taxed*. Email it to [Heidi@wsltax.org](mailto:Heidi@wsltax.org).