Important income tax considerations for foreign residents working in Canada

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Introduction

For foreign residents who are physically working in Canada either permanently or temporarily, there are several Canadian tax issues to consider.

If you are an employer, please see our article entitled When your employees work in Canada: Income tax help for non-Canadian employers for relevant considerations.

What you need to know

Key considerations for determining where a foreign resident will pay taxes while they are based in Canada include tax residency, Canadian tax liability, and tax compliance.

Tax residency

Generally, non-Canadian resident individuals are not taxable in Canada nor required to file Canadian tax returns unless they are employed physically in Canada, in which case their salary and benefits from working in Canada are taxable in Canada, subject to relief under an applicable tax treaty. Conversely, if an individual is resident in Canada, then they are subject to Canadian tax on their worldwide income. Therefore, it is important to determine whether a particular individual who is physically relocating to Canada while earning employment income is a tax resident of Canada, and whether that characterization applies for the whole year or a portion of a year.

An individual can be classified as a resident or non-resident of Canada for the purpose of income tax under three different tests: a common law test, a statutory test, or a bilateral tax treaty. If an individual is considered a Canadian resident under either the common law or statutory test, they would be considered a resident of Canada unless the provisions of an applicable income tax treaty deem them to be resident of another country.

Common law test

The common law test for Canadian residency for individuals asks whether a person is "ordinarily resident" in Canada. "One is 'ordinarily resident' in the place where in the settled routine of his life he regularly, normally or customarily lives…".[1]

This is not a bright line test, and the determination is based on various factors. The most important factor to be considered is having significant residential ties with Canada, such as a home, spouse or common-law partner, and dependants.

Secondary residential ties are looked at collectively to evaluate the significance of any one such factor, such as the location of one's mailing address, vehicle, employer, driver's license, bank accounts, health care and social ties such as membership to organizations.

Statutory test

If an individual who is not ordinarily resident in Canada under common law sojourns in Canada for 183 days or more during a calendar year, they are deemed to be a resident of Canada for that year.[2] When someone is deemed a resident under this paragraph, they are typically not considered a resident of any specific province for provincial income tax purposes, but only for federal income tax and surtax.

Treaty residency

If, under a bilateral tax treaty with Canada, a person is deemed to be resident in the other country, that person is deemed not to be a resident of Canada under Canadian tax legislation. The determination of residency under such a treaty often involves looking at concepts such as the permanent home or centre of vital interests of the individual.

Permanent home

For purposes of tax treaties, a "permanent home" may be any kind of dwelling place that the individual retains for his or her permanent (as opposed to occasional) use, whether that dwelling place is rented, purchased or otherwise occupied on a permanent basis.

Centre of vital interests

For employees who have a permanent home in both countries and do not clearly sever ties with the first country, it is necessary to determine where their "centre of vital interest" lies. If a person has a home in both the original country and a new country, retaining the first home where they have always lived, worked, and where they have family and possessions, can generally demonstrate that they have retained their centre of vital interests in the first country.

Canadian income tax liability

Where an employee does not become a tax resident of Canada, they are still subject to Canadian income tax if they are physically present in Canada while providing services of employment. Tax treaties between Canada and a non-resident's country of residence can provide exemptions under specific conditions. These treaties may allow Canada to

tax a non-resident on employment income earned in Canada even if they are present for 183 days or less in a year, the employer is not Canadian, and/or the employer does not have a permanent establishment in Canada. It is necessary to review the specific provisions of the particular tax treaty, since provisions dealing with employment income differ from treaty to treaty.

Regardless of treaty exemptions, non-residents' employment income earned while working physically in Canada is subject to payroll withholding, including deductions for Employment Insurance (EI), Canada Pension Plan (CPP),[3] and income tax for all resident and non-resident employers paying employees in Canada. If the upfront payroll tax withholdings required by the statute are materially greater than the employee's expected tax liability in Canada based on relief available under a tax treaty, it may be possible for either the employer or the employee to obtain a waiver from the Canada Revenue Agency to reduce or eliminate the required payroll withholdings.[4]

Tax compliance

An employee has unique tax filing requirements, separate from those required by an employer, including:

1. Temporary Social Insurance Number (SIN) or Individual Tax Number (ITN) – An individual that is classified, for immigration purposes, as a temporary resident of Canada can apply for a SIN, which will be valid only until the expiry date noted on their immigration document. A non-resident individual who does not qualify for a SIN must apply for an ITN.[5]
2. T1 – An employee must complete a T1 income tax return annually to report their taxable income earned in Canada. If the employee is a resident of Canada, the T1 return would report the employee's world-wide income. Subject to relief under an applicable tax treaty, non-residents pay federal income tax on employment income earned in Canada, including a surtax for not being resident in a province. If they are subject to tax in excess of previously remitted payroll deductions, they must make a payment by April 30 the year following the taxation year, or they will be subject to interest and late-payment penalties. If the payroll remittances exceed the tax payable under the T1, they should receive a refund from the Canada Revenue Agency.

Takeaways

When considering whether an employee should move to Canada to work, it is crucial to consider whether and when they become a tax resident of Canada, which impacts both the employee and the employer's tax liability and compliance obligations. Depending on the circumstances, a non-resident employer may wish to consider different tax structures to manage such an employee.

For additional questions about Canadian taxation of foreign employees, please reach out to any of the authors or key contacts listed below.

[1] *Thomson v Minister of National Revenue*, 1946 CanLII 1 (SCC), [1946] SCR 209.

[2] The term "sojourned in Canada" refers to a casual, intermittent, or temporary visit or stay in Canada.

[3] If the employee is covered by a social security program and/or an employment insurance program in their home country, they may be

exempt from CPP or EI contributions.

[4] An employer may be exempt from filing a T4 in respect of employees in Canada if the employer obtains an RC473 and Canadian source income is $10,000 or less. Otherwise, a tax treaty does not generally reduce or exempt T4 compliance requirements.

[5] A Canadian resident would also need to fill out a Form TD1, which indicates the personal tax credits to which they are entitled. An employee usually completes a TD1 and provides it to their employer at the start of their Canadian employment.

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