

**Guidelines for Treaty-Based Waivers
Involving
Regulation 105 Withholding**

Purpose of Treaty-Based Regulation 105 Waiver Guidelines.

These guidelines are to be used only when a Regulation 105 waiver application requesting relief under a tax treaty is submitted by a non-resident based on the absence of a fixed base or permanent establishment in Canada. The guidelines are not intended to determine whether a non-resident person has a fixed base or permanent establishment in Canada. However, the guidelines will assist officers at the tax services offices in making a determination whether or not to waive the Regulation 105 withholding tax where the waiver applicant meets specific criteria.

Who do these guidelines apply to?

These guidelines apply, with the noted exceptions, to all non-resident applicants to whom section 105 of the Income Tax Regulations is applicable, and who are performing services in Canada either as an independent person, an artiste/athlete, a loan-out (star) or other corporation, or through a partnership or joint venture.

It is incumbent upon the waiver applicant making a claim for a treaty-based waiver to establish their residency in a treaty country and their entitlement to treaty benefits.¹ A standardized treaty based Regulation 105 waiver application form (which includes accompanying instructions / information) has been developed to assist in this regard, by detailing the type of information and supporting documentation waiver officers will require in order to process the applications. Copies of this treaty based application form are available from any Tax Services Office (TSO) and is available from the Canada Revenue Agency (CRA) website at: www.cra-arc.gc.ca.

¹ For example, payments for services in Canada of U.S. Limited Liability Companies (LLC) are not normally entitled to treaty exemption pursuant to Articles V (Permanent Establishment) and VII (Business Profits) of the Canada-U.S. Income Tax Convention (“the Convention”). This is because the Canada Revenue Agency (CRA) generally does not consider such an entity to be resident of the U.S. for purposes of paragraph 1 of Article IV (Residency) of the Convention, as it is not liable to tax in the U.S. In our view, generally an LLC is purposely structured to be treated like a partnership under the Internal Revenue Code. An LLC structured in such a manner will not be liable for tax in the U.S. Therefore an LLC would not normally be entitled to a treaty-based exemption from Regulation 105 withholding tax. The LLC may, however, be considered for an Income and Expense type waiver.

If the LLC elects in the U.S. to be classified as a corporation and is therefore taxable in the U.S. on its world income, it would be considered a resident of the U.S. for purposes of the Convention. The CRA considers that the U.S. LLC would then be “liable to tax” in the U.S. for the purposes of paragraph 1 of Article IV of the Convention. It is our position that a U.S. LLC which is unable to provide documentation from the IRS substantiating that it has elected to be taxed as a corporation (i.e. the IRS has confirmed that the appropriate form (Form 8832) has been filed and accepted, or a U.S. income tax return has been filed), should not be treated as a resident of the U.S. for purposes of the Convention. Where the applicant has indicated that it has filed Form 8832 but has not yet filed a tax return as a corporation and is awaiting IRS confirmation that the election has been made, the TSO may require a bank letter of guarantee in lieu of the withholding which may otherwise be waived based on the treaty-based guidelines.

Where, when and by whom are the waiver applications to be presented?

In cases where the services of the waiver applicant are to take place at numerous locations in Canada, the complete waiver application may be presented to any TSO that serves one of the locations where the services are to be provided. Otherwise, the waiver application should be presented to the TSO that serves the area where the services are to take place.

In order to ensure consideration of a treaty-based waiver application, it should be submitted at least 30 days prior to the commencement of the services in Canada or 30 days prior to the initial payment for the related services. These timeframes are necessary in order to provide sufficient time for the TSO and the non-resident to properly establish whether a waiver or a reduction from the required withholding taxes is warranted. The CRA is committed to processing all waiver submissions received 30 days or more prior to the commencement of, or payment for, the services in Canada, provided all the required documentation and information is included with the waiver submission.

The TSO will make every effort to process properly documented waiver submissions, however, there may be situations where a waiver application not received within the 30 days timeframe may not be able to be processed by the TSOs.

Waiver applications are required to be in the format of a written submission from the waiver applicant, or the applicant's authorized representative, preferably using the treaty based Regulation 105 waiver application form, referred to earlier in these guidelines. All waiver applicants must provide clear and concise information and documentation which support the reasons for the waiver request, in order to establish that the required tax on the taxable income to be earned in Canada is less than the withholding otherwise required under the Income Tax Act ("the Act").

General Waiver Requirements:

Secondary Level Withholding Tax

The approval or granting of a treaty-based Regulation 105 waiver request does not relieve the waiver applicant from their requirement to withhold, remit and report all secondary withholding tax amounts with respect to remuneration paid to other persons (such as sub-contractors and employees), either resident or non-resident, in respect of services provided in Canada or with respect to payments subject to Part XIII withholding such as rental of equipment outside Canada for use in Canada. Only when a waiver is issued by the TSO in respect of those secondary withholding tax requirements may the waiver applicant make full payment to the recipient(s) without withholding. Otherwise withholding of taxes on such payments is required.

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Therefore all secondary withholding issues must be concluded to the satisfaction of the TSO prior to the issuance of a treaty-based waiver, including:

- Regulation 102 withholdings (which can include income tax, as well Canada Pension Plan (CPP) contributions and Employment Insurance (EI) premiums, in certain circumstances) from employees (both resident and non-residents of Canada) employed in Canada;
- Regulation 105 tax withholdings on amounts paid by the applicant for services subcontracted to other non-residents; and/or
- Part XIII withholding tax requirements on amounts, such as interest or rentals.

Guarantee in Lieu of Withholding

Even if a treaty-based waiver application is approved according to these guidelines, a Canadian bank guarantee, or other appropriate security for an amount equivalent to the potential Canadian tax liability of the non-resident in Canada may be requested by the TSO. This may arise in cases, where there are secondary withholding tax issues, as described earlier, affecting the non-resident applicant.

Also, if there is a requirement for secondary withholding tax to be deducted and remitted during the period of the services provided in Canada and subsequent follow-up discloses that the waiver applicant has not fulfilled their obligations under the Act, the treaty-based waiver will be cancelled and the payer(s) advised accordingly. If a guarantee is in place when the waiver is cancelled, it may remain so depending on the tax issues relating to the non-resident.

Outstanding Canadian Tax Liabilities

All outstanding tax liabilities of the waiver applicant must be reviewed by the TSO and a payment must be made or a satisfactory resolution must be established, prior to the issuance of any waiver.

Canadian Income Tax Returns

The application of these guidelines will not affect any requirement under the Act to file an income tax return. If a waiver was provided in a previous year and a return has not been filed for that year and the time specified under section 150 has passed in respect of that previous year, the TSO will consider the requirements for a return to be filed prior to any subsequent waiver to be issued.

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Waiver Guidelines (refer to attached Schedule A):

Treaty-based waivers will be granted if the applicant meets one of the following tests:

A) a non-resident independent individual who earns *less than CAN\$5,000 for the current calendar year* (including expenses reimbursed or paid on the waiver applicant's behalf);

B) a non-resident person whose *presence in Canada is not "recurring"* and who performs services in Canada *for less than 180 days under the current contract/engagement*; or,

C) a non-resident person whose *presence in Canada is "recurring"*, but whose cumulative presence is *less than 240 days during "the period", and less than 180 days under the current contract/engagement*.

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Schedule A

**Treaty-based waiver guidelines for non-residents
providing non-employment services in Canada**

| | Test A | Test B | Test C |
|--|--|--|---|
| Type of Non-Resident Applicant | Individuals with income less than CAN\$5,000 in calendar year. | Individuals or corporations | Individuals or corporations |
| “Recurring” | N/A | No | Yes |
| Days in current contract/engagement less than 180 | N/A | Yes | Yes |
| Days in “the period” less than 240 | N/A | N/A | Yes |
| Waiver Determination | Waive withholding. | Waive withholding unless facts fit exception category. | Waive withholding, unless facts fit exception category. |

Waivers will only be granted in those cases where the applicant meets one of the above tests or in specific circumstances depending on the type of activities they are to be performing in Canada and any applicable treaty provisions based on their country of residence – see exception 2 below.

Waivers may still be denied where the waiver applicant satisfies one of either test B or C, but falls into one of the following exceptions.

Where the waiver applicant meets the conditions of test A, the following exceptions will not be considered.

Exceptions to the Treaty-Based Regulation 105 Waiver Guidelines:

The treaty-based waiver guidelines do not apply to the following exceptions:

1. Residents of non-treaty countries. Such persons are taxable in Canada on income earned in Canada from employment or from carrying on business. The concepts of permanent establishment and fixed base are not relevant for residents of non-treaty countries. However, an individual who is a resident of a non-treaty country may apply for a waiver when his or her income for the calendar year is less than CAN\$5,000.
2. Residents of countries whose treaty with Canada specifies a deemed permanent establishment. Examples of activities include:
 - a) construction, installation or assembly types of services (most treaties provide a twelve-month rule for deeming a permanent establishment);
 - b) specified offshore activities for residents of Denmark, the Netherlands, the United Kingdom and the United States;
 - c) international transportation operations.

In cases where the non-resident applicant is involved in any of the above activities, a review of the appropriate treaty article may be made to ensure the type of services being rendered are included therein. If the treaty article is determined to apply, then the appropriate waiver determination may be made based on that specific article rather than the general guidelines.

- For example, an applicant is performing certain specified offshore activities for a period of 45 days and the relevant article in the tax convention applicable to their country of residence deems such services to be attributable to a permanent establishment once a period of 30 days has been exceeded, the waiver application will be denied even though it would otherwise (in the absence of the treaty article) have been approved based on the general guidelines (i.e. less than 180 days).
 - Conversely, an applicant may be performing services (such as construction) for a period of 260 days and be a resident of a country whose treaty with Canada specifies such services to be attributable to a permanent establishment only once a 12 month period has been exceeded. In such a case, the waiver application will generally be approved (assuming all other requirements are met) even though it would otherwise (in the absence of the treaty article) have been denied based on the general guidelines (i.e. more than 180 days).
3. U.S. resident individual artistes or athletes, or each “marquee” artiste/athlete of a “star” corporation earning in excess of CAN\$15,000 gross fees in Canada, including expenses reimbursed or paid on the artiste’s or athlete’s behalf, for the calendar year concerned. Such persons are taxable in Canada regardless of the absence of a fixed base or permanent establishment.

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- If gross income is less than CAN\$15,000 for the calendar year, a waiver may be considered based on these guidelines.
4. Non-resident artistes or athletes, or each “marquee” artiste/athlete of a star corporation, resident in a treaty country, other than the US. A fixed base or permanent establishment is irrelevant for purposes of applying the artiste/athlete article of their treaty. The treaty article should be reviewed in light of the facts, especially where there are elements of state-sponsored visits or cultural exchanges, or the involvement of non-profit organizations.
 5. Multi-year engagements under a single contract which will occur at one or more sites over a number of years (e.g. theatrical productions). Waivers denied on this basis will be limited to situations where the non-resident has a contract to provide such services in Canada in two or more years. In reviewing the number of years contracted for, rights of renewal provided in the contract will be considered exercised.
 6. Services of a repetitive nature, such as airshow participants, rodeo riders, combine harvesting, etc., where services performed by the non-resident person(s) are performed in the same or “similar” locations, and there is a history of presence in Canada of carrying on those services in two or more previous calendar years. The previous calendar years do not have to be consecutive.
 7. Non-resident persons who have previously been determined by the CRA to have a permanent establishment in Canada, and who have not had a break in presence from Canada for two or more previous calendar years.
 - Non-residents with a previously determined permanent establishment who had a break in presence of two or more previous calendar years will be reviewed under the guidelines.
 8. Where services are provided in Canada by a non-resident related to the Canadian payer, or where a bundle of services are provided by related non-residents, and/or the effect of the overall arrangement is such that Canadian tax is potentially avoided, a waiver will not be provided. Services provided by related non-residents, wherein there is no perceived element of avoidance, should be considered under the guidelines.
 9. Where a non-resident has a contract to perform services in Canada but sub-contracts with either residents of Canada or other non-residents to undertake the actual performance of those services, a treaty-based waiver will not be granted in respect of the contract unless the activities of the sub-contractors, along with any other activities which the primary contractor undertakes in Canada, falls within the guidelines.

For the purpose only of applying the guidelines in this situation, the activities of Canadian resident contractors shall be viewed as if they were non-resident, and their only activities in Canada were those under the sub-contract. Payments to sub-

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contractors will be considered for deduction under an alternative income and expense waiver application.

Definitions of terms used in the guidelines:

“Non-resident applicant”

The “non-resident applicant” is the non-resident individual, unincorporated group, corporation, (including ‘star’ corporations), partnership, or joint venture who / which will be providing non-employment services in Canada, and is seeking a waiver or reduction in the amount of the prescribed withholding tax ordinarily required on these amounts. Non-residents providing services through corporations, partnerships, or joint ventures or who have done so in the past, will be reviewed under the guidelines taking into consideration the total of their services provided in Canada in the period both as an individual, and through the corporation, partnership or joint venture. This review will be limited to situations where the individual is not at arm’s length from the corporation, partnership or joint venture in question.

“180 and 240 days in Canada”

Means the number of days, or any part thereof, which the non-resident applicant is required pursuant to the contract to have physical presence in Canada in order to perform the services in “the period” by one or more persons, resident or non-resident, employees or otherwise (e.g. independents). Normally the days are calculated pursuant to the service contract which would be provided at the time of the submission of the waiver application. Days in Canada will generally include the days of arrival and departure of the non-resident applicant or its employees or agent; and all other days of physical presence in Canada, such as weekends, national holidays, etc.

It is accepted that there will be days which will be spent outside of Canada during the period which may decrease the service period in Canada. However, as these days outside of Canada are not always predictable at the beginning of the contract period, the total days of the contract are generally required for calculation of the number of days in Canada. To provide for exceptional cases where time will be spent outside of Canada during the contract period, we will allow for a decrease in the number of days of presence in the period if the time spent outside of Canada will be five or more consecutive days per occasion.

Generally pre-contractual presence of the non-resident applicant to make proposals on contracts will not be counted unless work performed in this period will form part of the compensated services. Once compensated services have commenced, all days of presence will be counted.

The days in Canada do not have to be within one calendar year, and may include a period or periods extending over two or more calendar years (e.g. October 1, 1998 to April 15, 1999).

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The information provided by the non-resident applicant should be detailed enough for the waiver officer to determine the number of days of presence in Canada (as well as any expected periods of absence of five consecutive days or more) during any contract/engagement period, and include employment contracts, flight/travel arrangements, sub-contracts, service contracts, rehearsal arrangements, etc.

“The period”

“The period” means the current calendar year, the three immediately preceding calendar years, and the three immediately following calendar years. Activities to be considered for the “following years” should be restricted to those under confirmed/signed contracts unless, in the absence of confirmed/signed contracts, the non-resident applicant can reasonably estimate the level of activity in Canada in those future years.

If the waiver is requested for services which extend into a subsequent year, the *current year* will be the year in which the services commence.

“Recurring”

“Recurring” means a non-resident applicant undertakes to perform services for a second or subsequent contract/engagement in Canada within “the period”. It does not include an instance where the non-resident person leaves and returns to Canada during the same contract/engagement.

In order to establish that there is a “recurring” situation within “the period”, the TSO must be provided with information for all years in “the period”, unless the information has been provided on a previous waiver application. If the non-resident applicant provided services in Canada during the prior three year period, and/or if the non-resident applicant is contracted to provide services within the future three year period, a current waiver application would be “recurring”.

Examples:

- Contract with payer A runs from January 2 to January 31, 1998 and contract with payer B runs from July 13 to September 26, 1998 - this is “recurring”.
- Contract with payer A is for the period January 2 to January 31, 1998. This same contract is extended to March 1, 1998 - this is not “recurring”.

“Recurring” applies whether different locations are used by the non-resident person on the second or subsequent contract/engagement in Canada.

“Recurring” applies whether the services are performed in the same calendar year or over multiple years.

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If successive contracts are with the same payer, “recurring” still applies, as long as the contracts/engagements are not an extension of the same contract.

“Similar location”

“Similar location” refers to a venue or site which is similar in nature or function to another location in the same geographic area where similar services were previously provided. The geographic area to consider is relative to the industry and type of activity under consideration. For example, in respect of a combine harvesting operation, one farm in southern Saskatchewan would be a similar location to another farm on the prairies. Airshow venues for various sites across Canada during May to October of each year would also be considered to fall within this definition of “similar location”.

EXAMPLES OF GUIDELINES APPLICATION

Example A:

Non-Resident applicant providing services in a non-recurring situation and less than 180 days in current contract in Canada.

Facts:

- Today is December 16, 1998;
- Providing services in Canada as a consultant (non-employee);
- Contracted period is from January 24, 1999 to June 15, 1999 (142 days);
- Contracted amount is CAN\$300,000;
- No services provided in Canada during the previous 3 years and none anticipated in the future.

Waiver Review Criteria:

Number of days in Canada:

January 24 to June 15, 1999

Total = **142 days in Canada**

Previous or future services in Canada during “the period” (i.e. the current calendar year, the previous 3 calendar years and the future 3 calendar years)

- Previous service in Canada in the current calendar year = 0
- Future service in Canada in the current calendar year = 0
- Previous service in Canada during the last 3 calendar years = 0
- Future service in Canada during the next 3 calendar years = 0
- No recurring presence to date in Canada.

Waiver Determination:

1. The non-resident is providing services in a non-recurring situation with no previous or future services in Canada, and the total number of days of service in Canada during “the period” is 142.
2. The waiver applicant will meet the “under 180 day rule” (Test B).
3. Provided complete documentation has been provided to the CRA within the time requirements, this application would normally be approved for a waiver.

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Example B:

Non-resident applicant with a recurring presence in Canada, less than 180 days in the current contract and more than 240 days in “the period”.

Facts:

- Today is December 20, 1998;
- Providing services in Canada, as a consultant (non-employee);
- Contracted period is from September 11, 1999 to November 30, 1999 (81 days);
- Contracted amount is CAN\$200,000;
- Previously provided services in Canada through a personal service corporation from January 7, 1997 to March 31, 1997 (84 days);
- Previously provided services in Canada as an individual from July 2, 1996 to September 30, 1996 (91 days);
- Where an individual provides services either through a corporation or as an individual, the cumulative total will be taken of both to determine the number of days in Canada in “the period”;
- No services anticipated in the future.

Waiver Review Criteria:

Number of days in Canada:

| | |
|--|-------------------|
| Current contract (Sept. 11, 1999 to November 30, 1999) | = 81 days |
| Previous contract (Jan. 7, 1997 to March 31 1997) | = 84 days |
| Previous contract (July 2, 1996 to September 30, 1996) | = <u>91 days</u> |
| Total days in Canada during “the period” | = 256 days |

Waiver Determination:

1. Since income exceeds CAN\$5,000 & the non-resident’s services in Canada were of a recurring nature, Test A or B would not apply.
2. The first requirement of Test C is to determine if the current contract under review is for services of less than 180 days. In this case, it is for 81 days.
3. We then consider whether the services provided in “the period” (i.e. the current year, the future 3 years and the past 3 years) are less than 240 days.
4. Since in this instance the total days in “the period” were 256, the second requirement of Test C was not passed.
5. A treaty-based waiver would not be granted in this case, however the non-resident may make application for an income and expense waiver/reduction in the withholding tax.

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Example C:

Non-resident applicant with a recurring presence in Canada, with less than 240 days in “the period” and more than 180 days in the current contract.

Facts:

- Today is March 27, 1999;
- Non-resident providing services in Canada through a personal services corporation as an engineer in the oil/gas industry;
- Current contract runs from June 1, 1999 to December 6, 1999 (184 days);
- Contracted amount is CAN\$173,000;
- Previously provided engineering services in Canada through a personal service corporation from January 7, 1998 to January 31, 1998 (24 days);
- Previously provided engineering services in Canada as an independent individual from March 15, 1997 to April 5, 1997 (21 days);
- Where an individual provides services either through a personal service corporation and/or as an individual, the cumulative total number of days is used for purposes of days in Canada during “the period”;
- No future contracts in Canada anticipated.

Waiver Review Criteria:

Number of days in Canada:

| | |
|---|-------------------|
| Current contract (June 1, 1999 to Dec. 6, 1999) | = 184 days |
| Previous contract (January 7, 1998 to January 31, 1998) | = 24 days |
| Previous contract (March 15, 1997 to April 5, 1997) | = <u>21 days</u> |
| Total days in Canada during “the period” | = 229 days |

Waiver Determination:

1. Since income exceeds CAN\$5,000 & the non-resident’s services in Canada were of a recurring nature, Test A or B would not apply.
2. The first requirement of Test C is to determine if the current contract under review is for services of less than 180 days. In this case, it is for 184 days.
3. Since in this instance, the total days in the current contract are 184 the first requirement of Test C is not passed.
4. It is not necessary to consider the second requirement of Test C in this case (cumulative presence for “the period” is less than 240 days), as the non-resident does not meet the first requirement.
5. A treaty-based waiver would not be granted in this case, however the non-resident may make application for an income and expense waiver/reduction in the withholding tax.

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Example D:

Non-resident applicant with a recurring presence in Canada, with less than 180 days in current contract and less than 240 days in “the period”.

Facts:

- Today is February 21, 1999;
- Non-resident providing services in Canada as an construction engineer;
- Current contract runs from March 31, 1999 to June 18, 1999 (80 days);
- Contracted amount is CAN\$102,000;
- Previously provided independent consulting services in Canada from May 11, 1998 to July 10, 1998 (61 days);
- Previously provided consulting services in Canada from October 9, 1997 to December 20, 1997 (73 days);
- No future contracts in Canada anticipated.

Waiver Review Criteria:

Number of days in Canada:

| | |
|--|------------------|
| Current contract (March 31, 1999 to June 18, 1999) | = 80 days |
| Previous contract (May 11, 1998 to July 10, 1998) | = 61 days |
| Previous contract (October 9, 1997 to December 20, 1997) | = <u>73 days</u> |
| Total days in Canada during “the period” | = 214 days |

Waiver Determination:

1. Since income exceeds CAN\$5,000 & the non-resident’s services in Canada were of a recurring nature, Test A or B would not apply.
2. The first requirement of Test C is to determine if the current contract under review is for services of less than 180 days. In this case, it is for 80 days.
3. It is then necessary to consider the second requirement of Test C (cumulative presence for “the period” is less than 240 days) to determine if the non-resident meets both the requirements of Test C.
4. In this instance, the total days in “the period” are 214 and therefore both requirements for Test C are met.
5. A waiver would be granted, provided complete documentation has been provided to the CRA within the required time frames.