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## **Regulation 105 Withholding tax for Services**

### **Regulation 105 Withholding Tax for Services Rendered in Canada by Non-Resident**

Do you engage foreign individual or company (collectively referred to as “**non-resident person**”) as independent contractor to provide services in Canada? Are you the non-resident person providing independent contractor services in Canada? If you answer yes to either question, do you know that payments made in respect of services rendered in Canada by non-residents are subject to Regulation 105 withholding at a rate of 15%? There is an additional 9% withholding if the services are rendered in the province of Quebec by non-residents. These withholding requirements simply act to ensure that non-resident recipients of the service payments pay any Canadian income tax duly owing.

### **Payer’s Withholding Obligation under Regulation 105**

Every payer (including non-resident person) making a payment of fees, commissions, or other amounts to a non-resident person for services provided in Canada must withhold 15% from such payment. The withheld tax must be remitted to the Canada Revenue Agency (“**CRA**”) no later than 15<sup>th</sup> of the month following the month of payment.

For bundled payments made to non-resident person for services rendered in Canada as well as services rendered outside of Canada, reimbursement for specific out-of-pocket expenses, sale of goods or others, Regulation 105 withholding tax only applies to the portion of payment for services rendered in Canada. Note that general expense allowance and reimbursement of expenses with a mark-up are regarded by the CRA as payments for service. Hence, the non-resident service provider should keep track of and itemize separately on invoices the various billings for proper determination of the Regulation 105 withholding.

Multiple layers of withholding obligations are possible where there are multiple sets of services being provided. For example, where one non-resident is contracted to perform services in Canada and in turns subcontracts the work to another non-resident, the subcontract in this case would give rise to two layers of withholding obligation.

### **Penalties and Interest for Non-Compliance with Regulation 105 Withholding**

Failure of the payer to deduct or remit the withholding tax may result in the payer being liable for the tax owing, which may be assessed on a gross up basis equivalent to 15/85 of the payment to the non-resident service provider. There are also penalties and interest for failure to withhold. The penalties can be as high as 10% or 20% in cases of gross negligence. The non-resident service provider is technically jointly and severally liable for the tax owing, interest and penalties. However, many payers would find it difficult and time consuming to ask the non-resident service provider to refund the tax. Any unrecovered Regulation 105 withholding (unless covered by a contractual gross-up clause) as well as penalties and interest cannot be deducted to reduce the payer’s Canadian income tax liability.

### **Payer's Reporting Obligation**

In respect of all payments made to non-residents for services rendered in Canada, the payer is required to file an information return T4A-NR with the CRA and issue a T4A-NR supplementary slip to each non-resident on or before the last day of February of the year following the year in which the payments were paid. There are penalties for non-compliance with these reporting requirements.

### **Regulation 105 Waiver**

There is a process for the non-resident service provider to apply for a waiver to eliminate or reduce the withholding tax. The waiver is available in situations where the non-resident person can demonstrate that the withholding is more than its Canadian tax liability, either because of protection under the income tax treaty between Canada and the resident country of the non-resident person or its estimated income and expenses. The waiver applications have to be submitted no later than 30 days before the period of service begins, or 30 days prior to the initial payment for the related services. The waiver application process can be cumbersome. The waiver is effective on a prospective basis from the date of grant.

### **Non-Resident's Canadian Tax Filing Obligation**

The Regulation 105 withholding tax is not the final tax to the non-resident. The withheld tax is treated as an instalment remitted by the payer on behalf of the non-resident against the non-resident's final Canadian tax liability. The non-resident has to apply to CRA for a Business Number (BN).

If the non-resident is considered as carrying on a business in Canada under the domestic tax law, the non-resident would be required to file a Canadian non-resident income tax return to determine its final Canadian tax liability. Any taxes withheld in excess of the non-resident's final Canadian tax liability are refundable to the non-resident.

### **We Can Help**

We are a Chartered Accountant firm with 20 years of specialized experience in Canadian domestic and international taxation. We can assist with

- Cross border taxation and business planning;
- Canadian personal and corporate tax returns;
- Corporate tax planning and reorganization;
- Retirement planning; and
- Estate planning and inheritance tax advice.

Contact us to schedule an appointment.

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