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Cross-Border Employment Issues: Ensuring a Successful Assignment to Canada

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Abstract

The authors discuss some of the critical income tax issues arising from the assignment of a foreign executive to Canada, including the tax residence of employees, the existence of an employer's permanent establishment in Canada, the potential application of both corporate and personal levels of withholding tax, and the implementation of an appropriate compensation and benefits strategy having regard to the tax laws of different jurisdictions.

Keywords Compensation; cross-border; US-Canada; employees; withholding taxes; allowances.

The hardest thing in the world to understand is the income tax.

Albert Einstein (and, presumably, many mobile executives)

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Introduction

In the 2013 global marketplace, it is increasingly common for an executive to live and work in more than one country during some portion of her career. In this article, we present an overview of issues arising under the Income Tax Act and regulations[1] that may be of particular interest to mobile executives who have been assigned to Canada and to their employers. Because of our common language, similar culture, and linked economies, there is a constant flow of employees across the Canada-US border.[2] For this reason, our paper focuses on Canada-US issues, although similar concerns and solutions are applicable for assignments to Canada from other countries.[3]

The issues raised by a cross-border assignment to Canada are numerous, including the tax residence of employees, the possibility of an employer's permanent establishment (PE) in Canada, the potential application of both corporate and personal levels of withholding tax, and the implementation of an appropriate compensation and benefits strategy, having regard to the tax laws of different jurisdictions.[4] These issues are surveyed below.

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A Typical Example

As with all areas in tax, the application of the rules depends on the particular factual context. Accordingly, rather than discuss the rules in a vacuum, we have focused the discussion on a somewhat typical example involving a US multinational corporation (Parentco), which is a resident of the United States, and a qualifying person, for the purposes of the Canada-US tax treaty,[5] with subsidiaries in Alberta and Ontario. Parentco intends to transfer two senior executives, Chuck and Pauline, to Calgary and Toronto respectively, each for a period of three years. Both Chuck and Pauline are citizens of the United States.

Chuck moves to Calgary with his family and establishes Canadian residence for tax purposes. His only permanent home is located in Canada, and he severs most of his social ties to the United States. In contrast, Pauline moves to Toronto and resides in employer-provided short-term rental accommodation. Her family remains in Rochester, New York, where her husband is gainfully employed. Pauline returns home to Rochester on most weekends and holidays and maintains a permanent home there. A discussion of personal residence for tax purposes is beyond the scope of this paper, but our example is based on Chuck becoming a resident of Canada for tax purposes and Pauline not becoming a resident of Canada. While she is present in Canada for more than 183 days in a year, and thus deemed to be resident under the sojourning rule in paragraph 250(1)(a) " " ", Pauline should be deemed to be a resident of the United States pursuant to the treaty tie-breaker rules in article IV(2) and pursuant to subsection 250(5) " " ".[6]

Parentco is in the process of establishing a relocation and reimbursement policy. It provides a moving allowance to both Chuck and Pauline, provides Pauline with accommodation in Toronto, and reimburses Pauline for trips back and forth to see her family.

In addition to ordinary salary, Parentco's typical compensation plan relies heavily on restricted stock and stock options, although its plan also contemplates cash-settled restricted share units. For various securities and other reasons, stock-settled restricted share units are not contemplated and are not discussed here.

Parentco wishes to avoid having a Canadian PE and will not send any employees, other than Chuck and Pauline, to Canada. It is considering whether Chuck and Pauline should be employed by the subsidiaries or remain employees of Parentco.[7] To demonstrate its commitment to investment in Canada, Parentco also intends to have at least one directors' meeting in Canada. The intent is to charge all costs (except for stewardship) to the Canadian subsidiaries.[8]

The first part of our paper outlines general tax considerations arising from this example. Later, we provide a more detailed review of certain tax issues arising from the assignments that should be considered by Parentco and a discussion of common employer practices in cross-border assignments.

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The Basics: Right To Tax and Sourcing Rules

A comparison of US and Canadian income tax laws discloses fundamental differences in the right to tax claimed by federal authorities[9] and significant differences in their sourcing rules.

Canada reserves the right to tax residents of Canada on their global income[10] and non-residents of Canada on income earned from employment in Canada, derived from carrying on a business in

Canada, or arising from the disposition of a taxable Canadian property.[11] Given the disparity in the Canadian taxation of residents and non-residents, it is not surprising (at least from a Canadian tax practitioner's perspective) that Canadian income tax legislation contains provisions that can trigger taxation on the deemed disposition[12] of certain assets[13] when an individual ceases to reside in Canada. However, when an individual has resided in Canada for less than 5 out of the last 10 years before the most recent cessation of Canadian residence, the property held by the taxpayer before becoming a resident of Canada or acquired by inheritance or bequest is not subject to the deemed disposition rules.[14]

The US Internal Revenue Code[15] contains no comparable departure tax rules because the United States taxes employees who fall into the following categories:

- US citizens and resident aliens (permanent residents and individuals with a substantial presence in the United States)[16] and
- individuals rendering employment services in the United States who are neither US citizens nor resident aliens.

The Canada-US tax treaty does not substantially modify the right of Canada to tax residents of Canada or the right of the United States to tax US citizens and resident aliens on their employment income.[17]

The disparity in the Canadian and US rules can create unfortunate tax consequences when transferring executives from the United States to Canada. These should be addressed before the assignment begins. For example, we typically see employers restricting Canadian assignments to less than five years to limit the application of the deemed disposition rules to assets owned before the Canadian assignment. Similarly, employers should consider establishing policies to reimburse the assignee for any additional taxes incurred as a result of the deemed disposition of assets on departure from Canada.[18]

Distinctions in sourcing should also be recognized and addressed in designing a transferred executive's remuneration and benefits. The sourcing of income is relevant in two contexts:

- When a resident receives income derived from activities such as employment in another state, will the state in which the individual resides recognize the income as foreign-sourced in order to determine the foreign tax credits?
- When income is distributed to a non-resident, what portion of the payment is sourced to and taxed in the state from which the payment is made, and when is the income amount taxed?

For example, if an executive is resident in Canada at the time the benefit is taxable, the entire benefit is included in the executive's Canadian income. If the executive has also rendered services as a non-resident of Canada, the portion of income allocable to periods of foreign service and thus subject to foreign tax must be reviewed in order to determine the appropriate application of foreign tax credits on the Canadian tax return. While there are general principles that the tax authorities use, sourcing is governed by the actual facts of a situation, except where specifically mandated.[19]

Irrespective of whether the benefit is attributable to services that are rendered in the year or during a multi-year assignment, the Canadian tax authorities typically base sourcing on the location in which the services that give rise to the benefit are rendered.[20] The Canadian guidelines on sourcing compensation are not, however, formally articulated, leaving unanswered the question of whether the year of grant, grant to vest, or grant to receipt is the relevant service period.

The Canadian tax authorities and the courts have tended to focus on compensation derived from stock options and similar awards and have not explicitly addressed other compensation, such as multi-year bonuses or other cash-settled awards. Further, the position has been modified over the years. The Canada Revenue Agency (CRA) recently confirmed that it will modify the default domestic method of allocating cross-border stock option benefits for stock options exercised after 2012 and allocate the stock option benefit on the basis of work days from the date of grant to the date of vest.[21]

In contrast, the US guidance regarding the sourcing of benefits is significantly more detailed. Certain listed fringe benefits (housing, education, local transportation, tax reimbursement, hazard pay, and moving expenses) are sourced on the basis of geographic location.[22] In the context of a cross-border assignment from the United States to Canada, the most relevant benefits are housing costs, which are sourced on the basis of principal place worked; tax reimbursements, which are sourced on the basis of the jurisdiction for which the imposed tax is being reimbursed; and moving expense reimbursements, which are sourced on the basis of the principal place worked. Other compensation attributable to services rendered partly within and partly outside the United States is generally sourced for US taxpayers on the basis of work days during the relevant time period.[23] In the United States, multi-year payments are generally assumed to be made in respect of services from the date of grant to the date of the vesting[24] of the award, and thus the award is sourced on that basis. If, however, the award is dependent on performance criteria assessed before the award is made, the award should be sourced from the first day that the performance criteria are judged (even if this occurs before the grant date). As a matter of practice, attempts are made to match the sourcing methodologies from a US and Canadian perspective. However, as discussed later in this paper, there are certain benefits for which reconciliation is not possible as a result of the timing of the benefit recognition. Further, the factual situation must always be examined to determine the appropriate sourcing.

In our example, Chuck and Pauline will be taxed in both Canada and the United States; therefore, in the absence of a tax equalization program, they will pay tax at the higher marginal tax rate. As discussed later in our paper, it should be possible to coordinate the timing of the recognition of benefits; however, not all benefits are taxable on both sides of the border. This could lead to situations in which their taxes may be substantially higher as a result of the transfer to Canada, unless the structure of the benefit programs is thoroughly reviewed.

Services Permanent Establishment

When a foreign corporation such as Parentco intends to provide services to or for the benefit of its Canadian subsidiaries, one of the first issues to consider is whether the rendering of these services will cause Parentco to be deemed to be carrying on business in Canada through a PE in Canada (assuming Parentco does not otherwise have a Canadian PE). This issue is critical, both from an employer perspective and from an employee perspective, since exemptions from Canadian income tax under the Canada-US tax treaty depend, in part, on the non-resident employee not being paid by or on behalf of a Canadian resident or the employee's remuneration not being borne by a Canadian PE.[25]

Although there is no definitive judicial authority on whether the threshold for carrying on business is met solely when a non-resident corporation provides services to a related corporation in Canada, as a general matter the business is usually considered to be carried on in the jurisdiction where the services are performed. The focus tends to be on the length of time that the services are performed and the significance that the services have in relation to the non-resident's overall business activities. The CRA's longstanding view is that the provision of consulting services to a Canadian subsidiary by sending employees to perform work in Canada on a project-by-project basis constitutes carrying on business by the non-resident corporation.[26] On the basis of these positions and general principles, the provision of services in Canada by Parentco should constitute carrying on business in Canada, particularly when Chuck and Pauline's services are provided to the Canadian subsidiaries for more than a nominal period and can be said to constitute a profit-making activity of Parentco that is more than nominal or ancillary to its other business operations. It is thus necessary to consider whether Parentco will be considered to have a Canadian PE.[27]

The fifth protocol to the Canada-US tax treaty introduced a new rule in article V(9), which provides as follows:

> [Except for a building site or construction or installation project], where an enterprise of [the United States] provides services in [Canada], if that enterprise is found not to have a permanent establishment in [Canada] by virtue of the preceding paragraphs of this Article, that enterprise shall be deemed to provide those services through a permanent establishment in [Canada] if and only if:
>
> (a) those services are performed in [Canada] by an individual who is present in [Canada] for a period or periods aggregating 183 days or more in any twelve-month period, and, during that period or periods, more than 50 percent of the gross active business revenues of the enterprise consists of income derived from the services performed in [Canada] by that individual; or
>
> (b) the services are provided in [Canada] for an aggregate of 183 days or more in any twelve-month period with respect to the same or connected project for customers who are either residents of [Canada] or who maintain a permanent establishment in [Canada] and the services are provided in respect of that permanent establishment.

Article V(9) provides two distinct rules that can deem a US resident to have a PE in Canada. According to the 2008 technical explanation,[28] the test in article V(9)(a) is to be employed in determining whether an enterprise is deemed to have a PE by virtue of the presence of a single individual in Canada. This test also includes a requirement that more than 50 percent of the active business revenues of the enterprise consists of income derived from services performed in Canada by that single individual. Presuming that Parentco has other operations, it is unlikely that the 50 percent revenue test would be satisfied if only Chuck and Pauline provide services in Canada.

The second test in article V(9)(b) deems an enterprise to have a Canadian PE if two requirements are satisfied: (1) the enterprise provides services in Canada for an aggregate of 183 days or more in any 12-month period and (2) the services are provided with respect to the same or a connected project for customers who are Canadian residents or who maintain a Canadian PE, and these services are provided in respect of the PE. In assessing the potential applicability of article V(9)(b) to Parentco, the key questions are whether Parentco is providing "services" in Canada to a "customer" resident in Canada in respect of the "same or connected project" simply by virtue of Chuck and Pauline providing services to the Canadian subsidiaries.

If Parentco supervises, controls, and directs Chuck and Pauline and earns some profit from their services in Canada, it appears relatively clear that Parentco is rendering services in Canada. The technical explanation notes that article V(9) "applies only to services provided by an enterprise to third parties." In its report, the US Joint Committee on Taxation indicated that this statement means that article V(9) does not apply to "intercompany services."[29] In commenting on this matter, the CRA has stated that the term "third party" should be interpreted to mean any person, including a related person, other than the person operating the enterprise in question,[30] indicating that it does not believe this view to be contrary to the view expressed in the joint committee report. The CRA may be basing its position on commentary of the Organisation for Economic Co-operation and Development (OECD), which indicates that the third-party requirement in the comparable provision in the 2008 OECD model tax convention is intended to ensure that article V(9) does not apply to services provided by an individual to her employer without that employer performing any services.[31] Thus, the CRA's position is that article V(9) can apply to intercompany services, provided that the services are rendered to a distinct legal entity. By providing ongoing services to a Canadian subsidiary, Parentco could be caught under article V(9)(b) if the services are attributable to a commercially and geographically coherent project and last the requisite length of time.

Although the matter is not discussed in the technical explanation or other supporting documentation, it appears on the basis of the position taken by the CRA at the 2009 Canadian Tax Foundation conference that the situation would be different if Parentco were to second Chuck and Pauline to the Canadian subsidiaries for the same period (with Chuck and Pauline under the control and direction of the Canadian subsidiaries) and if Parentco were to be reimbursed (without a profit element) by the Canadian subsidiaries.[32] The basis for the CRA's position in this regard appears to be that Parentco is not providing services in Canada.

Because Chuck and Pauline will presumably provide services in Canada for more than 183 days in a 12-month period and the business of a Canadian subsidiary could be seen to be the "same or connected project," it is advisable to structure Chuck and Pauline's tenure in Canada as a secondment arrangement to avoid the potential application of article V(9). The requirements for a secondment are discussed below.

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Regulation 105 Withholding

Paragraph 153(1)(g) " " " and regulation 105(1) " " " require a withholding tax of 15 percent any time "fees, commissions or other amounts for services" are paid to non-residents in respect of services rendered in Canada (other than employment services). Therefore, any payments made by the Canadian subsidiaries to Parentco in respect of services rendered in Canada (by either Chuck or Pauline) are prima facie subject to 15 percent withholding tax, irrespective of the fact that Parentco may ultimately be exempt from Canadian tax by virtue of the Canada-US tax treaty.[33]

Again, however, on the basis of CRA commentary, Parentco should be able to avoid this 15 percent withholding tax by seconding Chuck and Pauline to the Canadian subsidiaries.[34] Regulation 105's non-application in a secondment scenario is based on the premise that Parentco is not providing services in Canada. This position has two key conditions: (1) the employees must be under the control and direction of the Canadian subsidiaries (that is, the Canadian subsidiaries must act as the factual employers), and (2) Parentco must not make a "profit" from the provision of the services of the employees so that Parentco is not seen to be carrying on business in Canada.

The CRA has specific requirements for a secondment, which include the following:

- there must be a factual employer/employee relationship between the assigned employee and the Canadian receiving employer;
- the secondment and employment agreements must be in writing and signed;
- the secondment agreement must specify the legal terms of secondment (for example, duration of project, employee and employer responsibilities, job description, rate of pay, and other benefits);
- the Canadian employer must be responsible for the employee's salary and benefits (including, for example, medical, pension, and travel and relocation costs); and
- the foreign lending employer must be reimbursed only on a reimbursement-of-costs basis, without any element of profit or markup (for this purpose, the CRA accepts a charge for the overhead costs of the lending employer in the amount of $250 per month).

Where the secondment requirements are satisfied, there should be no applicable withholdings under regulation 105 " " ", but the Canadian receiving employer is responsible for Canadian payroll tax withholdings.

Regulation 102 Withholding

It follows from the above that Chuck and Pauline's assignment to Canada should be structured as a secondment. While a secondment arrangement should eliminate cross-border withholding issues, the Canadian subsidiaries must still make Canadian-source withholdings from employment income paid to Chuck and Pauline. Parentco may also need to make Canadian-source withholdings on fees paid to non-resident directors for attendance at directors' meetings in Canada.

Paragraph 153(1)(a) " " " requires "every person" paying salaries and wages or other remuneration to make, and remit to the CRA, source withholdings in respect of Canadian income tax from these payments. Pursuant to regulation 102 " " ", withholding is to be made on a graduated basis, depending on the amount of the payment. Because paragraph 153(1)(a) applies to "every person," the withholding obligation applies equally to Canadian-resident employers and to US-resident employers (such as Parentco). The next portion of the paper discusses these requirements.

Directors' Fees

Non-resident directors of Parentco who attend directors' meetings in Canada are subject to Canadian income tax, pursuant to subparagraph 115(1)(a)(i) " " ", on the portion of their fees attributable to the Canadian meetings. While there is no bright-line test applicable to apportioning these fees, the CRA has indicated that it is the employer's responsibility to make the allocation. The CRA's de facto allocation methodology appears to divide the aggregate directors' fee by the proportion of meetings held in Canada.[35] This methodology may, in our view, result in an overallocation to Canada, particularly when the bulk of the work is performed by the Parentco directors outside Canada in preparation for the meetings. If directors retain adequate records to support their claim for time spent in these activities, as opposed to the time spent actually attending meetings, an alternative allocation methodology should be viable.

Treaty Relief

As noted above, it is expected that Pauline will remain a non-resident of Canada. As a consequence, it is necessary to consider whether she will be entitled to any relief from Canadian taxation under the provisions of article XV(1) of the Canada-US tax treaty. The same issue arises in relation to the US-resident directors of Parentco who come to Canada for directors' meetings.

While Canada retains the right to tax the income of a non-resident arising from employment exercised in Canada pursuant to article XV(1), an important limitation is contained in article XV(2), which provides that a resident of the United States (such as Pauline or a US-resident director) is not subject to Canadian tax in respect of Canadian employment income if

- the remuneration does not exceed Cdn$10,000 per calendar year, or

- the individual is not present in Canada in excess of 183 days during any 12-month period that begins or ends in the particular calendar year and the individual's remuneration is not paid by or on behalf of a person resident in Canada or borne by a Canadian PE.

In Pauline's circumstances, treaty relief is unlikely to be available because she will presumably earn more than $10,000 per year, and her remuneration is being paid or reimbursed by the Canadian subsidiary. Under the second leg of the test, the exemption from Canadian income tax is inapplicable if Pauline's remuneration in respect of the Canadian employment is "paid by, or on behalf of," a Canadian resident. This wording (in contrast to the wording in the pre-2007 protocol) does not contain the word "employer"; rather the reference is merely to a "person," and it is unclear whether this person must have any employment-type relationship with the individual. However, the CRA has indicated that, except in cases of abuse involving international hiring companies, it will apply article XV(2)(b) to require an employment relationship between the Canadian resident and the US employee.[36] Regarding which entity will be seen to be the "employer," the CRA generally refers to principles developed under Canadian jurisprudence and has indicated that the determining factor is which entity effectively directs the employee on a day-to-day basis rather than which entity pays the employee's salary. The secondment arrangement should be clear that the Canadian subsidiary has the ability to control and direct Pauline's activities.

The situation should be different for any US-resident directors of Parentco who attend directors' meetings in Canada. It is possible that these directors will be paid less than $10,000 in respect of the meetings. Even when this threshold is exceeded, the test in article XV(2)(b) should nevertheless be satisfied.

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Withholding Waivers

Even when the treaty exemptions from Canadian income tax are available, the CRA had long adopted the position that the requirement to withhold tax on employment income under paragraph 153(1)(a) " " " nevertheless applies to the employer unless there is a waiver.[37] This position, while seemingly harsh, is technically correct in our view, at least under article XV of the Canada-US tax treaty, since the article applies only to an individual's substantive Canadian tax liability; it does not refer to the payer's Canadian employment withholding, remittance, or reporting responsibilities.[38]

Consequently, notwithstanding the potential availability of treaty relief, the requirement to make Canadian-source withholdings nevertheless applies. Any US-resident directors who are entitled to treaty relief should then be able to recover the Canadian withholding tax by filing a Canadian income tax return—an administrative nuisance for all concerned.

Subsection 153(1.1) " " " provides the minister of national revenue with the authority to reduce the prescribed withholding under subsection 153(1) " " " if satisfied that the withholding will cause undue hardship. A non-resident performing employment services in Canada who can demonstrate that she will not be subject to Canadian income tax because of treaty protection can make a request to the applicable tax services office for the reduction or elimination of the withholding.

When treaty relief is claimed, the CRA has adopted two waiver application forms. The first, used when the applicant relies on article XV(2)(a), is form R102-J (Regulation 102 Waiver Application—Joint Employer/Employee). The most recent release of this form indicates that it must be submitted 30 days before the commencement of services in Canada or 30 days before the first payment for these services; however, the CRA has adopted a more flexible position. If a waiver application is approved, the CRA will issue a letter to the employee and the employer authorizing the employer not to withhold tax on payments made to the employee. The authorization is effective on the later of the start date for the services provided by the employee in Canada that year and 60 days before the date that the CRA received the complete waiver application. This method allows an employer to receive a waiver that has an effective date preceding the waiver application date.

The second form, which is used when the applicant relies on the test in article XV(2)(b), is form R102-R ("Regulation 102 Waiver Application"). While the CRA has not extended the foregoing retroactive waiver process to these situations, it has indicated that it is continuing to review its procedures. It is also discussing potential legislative changes with the Department of Finance.[39]

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Social Security and Other Benefits

Employment carried out in Canada is generally subject to employer and employee contributions in respect of employment insurance (EI) premiums and either Canada Pension Plan (CPP) contributions or Quebec Pension Plan (QPP) contributions. Similarly, employment carried out in the United States typically generates an obligation on the employer and employee to contribute pursuant to the Federal Insurance Contribution Act (FICA) to fund Social Security and Medicare and requires employer contributions pursuant to the Federal Unemployment Tax Act (FUTA).[40]

FICA contributions continue to be required when US citizens and other individuals otherwise subject to FICA work abroad for an "American employer"[41] or for a foreign affiliate of an American employer and the appropriate election has been filed.[42] Similarly, wages paid to US citizens employed outside the United States are generally subject to FUTA tax if the employer is an American employer.[43] However, wages paid to US citizens employed outside the United States by subsidiary corporations are generally not subject to FUTA contributions.[44]

Chuck and Pauline are employed by Canadian subsidiaries while rendering services in Canada. Consequently, there is a risk that, without appropriate planning, there could be a doubling of contributions to government social security and employment insurance regimes. In administering this assignment, it is accordingly advisable for the Canadian subsidiaries to address and eliminate an otherwise inefficient interaction of the Canadian and US regimes.

Fortunately, both Canada and the United States have concluded numerous social security agreements, generally referred to as totalization agreements, which prevent an employee and employer from having to contribute to social security in both home and host countries.[45] Generally, pursuant to these agreements, when an employer obtains a certificate of coverage from a home jurisdiction, coverage under the home country's social security system continues, and contributions are not required to the host country's systems. For example, the agreement on social security between Canada and the United States provides that home country coverage continues if a certificate of coverage is obtained and if an individual is on temporary assignment in the host country for not more than 60 months.[46] Pauline and Chuck's employment satisfies the requirements, and the period of coverage should be adequate. While applications for a certificate of coverage may be filed retroactively to the commencement of the assignment or secondment, filing before the commencement is obviously preferable.

The certificate of coverage does not apply to EI or FUTA contributions.[47] EI contributions are not required to the extent that the employment in Canada relates to the employment of a non-resident person and the unemployment insurance laws of any foreign country require someone to pay premiums for that employment.[48] Because both Chuck and Pauline are unlikely to continue the FUTA coverage, it is likely that EI remittances will be required.

Social security issues are somewhat easier to deal with in respect of US-resident directors of Parentco who attend directors' meetings in Canada. In particular, CPP withholdings should not be required on the basis that the employment is not "pensionable employment" since the directors are not ordinarily resident in Canada, they are "employees" only by virtue of serving as directors, and their directorship duties are performed partly outside of Canada.[49] Similarly, because directors are not in a "contract of service," the services of a director should not constitute "insurable employment," and thus should be exempt from EI.[50]

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Tax Equalization Programs

To implement a successful cross-border assignment, many companies develop specific policies and programs to facilitate executive transfers.

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Equalization Policy

Tax equalization[51] can be a key component of a successful international assignment program.[52] In essence, tax equalization assures the executive that she will not be tax-disadvantaged by the assignment and will not suffer a significant cash flow reduction as a result of the application of host country taxes. It also ensures the assignee's compliance with the home and host country tax obligations.

In establishing a tax equalization program, a number of issues regarding the scope of the policy should be considered, including the following:

- *Application of the policy to investment income.* Since Pauline is a non-resident of Canada, her investment income is not subject to additional Canadian taxation as a result of her assignment. However, Chuck's investment income is subject to Canadian taxation after he becomes a resident of Canada. Certain investment income, such as dividends paid by corporations other than a Canadian corporation, could be taxed at a higher rate in Canada than in the United States. Increasingly, many employers do not reimburse executives for the rate differential on the taxation of investment income. This should be communicated before commencement of the assignment.

- *Application of the policy to departure taxes.* Since Pauline will not become a resident of Canada, this issue need not be addressed in her assignment agreement. However, the potential levy of departure taxes if Chuck actively trades investments while on assignment in Canada or if he resides in Canada for longer than five years should be reviewed before the assignment commences. While steps can be taken to mitigate the impact of the departure tax by ensuring that Chuck's assignment does not extend beyond five years, his investment activities could still trigger a liability. Many employers do not equalize the employee for the departure tax. It is quite common for employers to arrange a "tax entrance interview" with a transferred executive on the commencement of a new foreign assignment. During that meeting, the implications of the Canadian departure tax are discussed, and the executive receives information regarding the implications of the departure tax. The employer's policy should be disclosed to the executive before the transfer.

- *Application of the policy to trailing employment income.* As discussed later in this paper, a portion of deferred income awards granted to an individual residing or rendering services in Canada will likely be sourced back to Canada and subject to Canadian taxation even when the benefits are not received until after the individual ceases to reside or render services in Canada. This issue should be considered in the case of both Pauline and Chuck.

Under a tax equalization program, the employer assumes the responsibility for paying the host country taxes (in this case Canadian taxes) in exchange for the employee agreeing to a reduction in her salary equal to the hypothetical tax calculation. In essence, the hypothetical tax calculation equals the taxes that the individual would have paid if she had not accepted the foreign assignment. This amount is not remitted by the employer in satisfaction of the employee's taxes; rather, it is retained by the employer to help defray expenses. The hypothetical tax amount should not be included in the employee's income because the individual has neither received nor benefited from the amount.[53] Of course, the tax actually paid by the employer constitutes a benefit and is included in the employee's income.[54]

Depending on the level of detail, the hypothetical tax calculations can be extremely complicated, and a number of issues should be considered in determining the scope of the hypothetical calculation, particularly when dealing with US assignees.

In determining the hypothetical tax, the US foreign-source income exclusion[55] is typically ignored. Because an equalization policy treats the executive as if she still resided in the United States, applying the exemption would create a policy contradiction. Also, there are pragmatic reasons for ignoring these exemptions in the calculation of the hypothetical tax:

- To the extent that the exclusions reduce the US income that can be applied as a foreign tax credit on the Canadian return, they are irrelevant to the employer's total cost.
- Claiming the exemptions may increase the risk of US alternative minimum tax[56] applying to the individual's income for the year, which will complicate the determination of the ultimate tax liabilities and foreign tax credits.

In constructing the policy, the employer should also consider what deductions are to be applied in determining the hypothetical tax, including the following:

- *Mortgage interest deduction.* It is quite common for US taxpayers to claim a mortgage interest deduction against normal income. If, however, a transferred executive is renting out her US residence while on assignment, the deduction is applied against the revenue generated from the property and not employment income; therefore, there are arguments for ignoring the deduction.
- *State and local taxes.* In determining US federal taxes, a citizen and resident alien can claim a deduction on the federal return for state and local income taxes paid. If, however, the executive has broken residence ties with her home state, generally no future state returns need to be filed.[57] As a result, the deduction is typically excluded from the hypothetical tax calculation unless the calculation actually includes a reduction for hypothetical state and local taxes. It is likely that Chuck has terminated his residence ties with his home state, whereas Pauline is likely to remain a resident of New York State. Thus, it is likely that their hypothetical tax calculations will differ, unless Parentco's calculation continues to incorporate state and local taxes.
- *Foreign tax credits.* If an executive is subject to a tax equalization program, the employer is paying the actual foreign taxes. While foreign tax credits are claimed on the actual tax returns, the credits are typically excluded in the hypothetical tax calculations.

Once the employer has finalized the hypothetical tax methodology and the "tax" has been calculated, the individual's remuneration will be adjusted. These adjustments usually occur at the beginning of the year or on commencement of the assignment. Subsequently, the hypothetical taxes are compared with the actual taxes paid by the employer on behalf of the employee, which may result in further adjustments to the compensation.

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Shadow Payroll

As previously noted, the reduction in individual employment income determined using the hypothetical tax reduction is retained by the employer. However, taxes on the net income must still be remitted through the regular and shadow payroll. Chuck and Pauline are likely to remain on the payroll of the US employer, although employed by the Canadian subsidiaries, to ensure that they can continue to participate in Parentco's 401(k) plan and other benefit plans (including those that depend on seniority). As a result, the US employer will make the local remittances, and the Canadian subsidiaries will administer the shadow payroll for Canadian tax remittances.[58]

As previously noted, these remittances are treated as a taxable benefit, and thus there is typically a gross-up of the benefit that will ultimately be reported on CRA form T4 ("Statement of Remuneration Paid") and IRS form W-2 ("Wage and Tax Statement"). The gross-up ensures that the individual's ultimate net income is not affected by the employer's tax payments. Alternatively, some employers occasionally treat the tax remittances as loans that are to be repaid when the individual gets a refund. For reasons discussed later in this paper, these programs are not commonly applied in tax equalization programs.

If the employer is paying both the US and the Canadian taxes, there can be significant overpayment of taxes after the foreign tax credits have been applied. As previously noted, reduction in the Canadian taxes may be obtained through the waiver process. However, because these applications can be time-consuming, some employers adopt a simpler approach and require that the assignee pay any tax refund to the company. The CRA, however, cannot issue the cheque for the refund directly to the employer.[59] In the event that the employee is dismissed, this approach has certain risks.

As a final step under the tax equalization process and to ensure that the tax credits and exclusions are appropriately applied to mirror the payroll remittances,[60] the employer typically arranges for a third party to prepare the Canadian tax returns, US tax returns, and equalization statements.

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Equity Compensation in the Cross-Border Context

Chuck and Pauline enter Canada with stock options, restricted stock, and other incentives. They are also eligible for subsequent grants while rendering employment services in Canada. Although their assignment in Canada may be relatively short, it is necessary to consider the Canadian income tax implications of the employees' participation in these incentive compensation plans. It is also important to include, in the tax equalization policy adopted by Parentco, the consequences (if any) of any incremental tax liability realized through the grant, exercise, or sale of the equity incentives.

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Restricted Stock

Restricted stock awards, under which shares of the employer corporation are issued to employees subject to restrictions and to the risk of forfeiture during a stipulated forfeiture period, are fairly common in the United States. Under the Code, the tax event arises when the restrictions lapse, unless the employee makes an election to recognize the income at the time of grant.[61] In contrast, under Canadian tax rules, the difference between the fair market value of the shares and the price paid for them (generally nil in the case of restricted stock) must be included in the employee's income in the taxation year in which the shares are "acquired."[62] The question whether restricted stock is acquired is not subject to explicit legislation in Canada; rather, the issue is determined by reference to common-law principles. These principles generally provide that if an employee has the right to vote shares and receive dividends, the employee has acquired the shares, notwithstanding that she cannot transfer or otherwise dispose of the shares and that the shares are subject to divesture.[63] In accordance with these common-law principles, the CRA has taken the view that an employee is subject to an immediate income inclusion at the time of receiving an award of restricted stock, despite the transfer restrictions.[64] Further, when the restricted stock is subsequently forfeited, the employee generally realizes only a capital loss, which does not offset the previous employment income inclusion, resulting in tax being paid by the employee even when no economic benefit is received.

The difference in the timing of the taxation of restricted stock in Canada and the United States can also lead to foreign tax credit problems. As noted above, the employment income from a grant of restricted stock is recognized in Canada in the year of the grant but is not recognized in the United States until the year in which the restrictions lapse. The result is that in the year in which Canadian income tax is paid, there is no foreign tax paid and hence no foreign tax credit. Correspondingly, in the year that the US tax is paid, there is no foreign income recognized in Canada, and hence no foreign tax credit.[65]

Because of these difficulties, it is advisable that, in lieu of grants of restricted stock, Chuck and Pauline be granted some sort of equivalent award in respect of services rendered in Canada. These awards could be structured to provide for economic benefits similar to those of restricted stock in a manner that is more tax-efficient in Canada. While these equivalent plans can take many forms, we have limited the discussion in this paper to two possibilities: a restricted stock trust using treasury shares and cash-settled restricted stock units.

Restricted Stock Trust

Under a restricted stock trust arrangement, Parentco settles a trust whose beneficiaries are generally itself (as the employer) and the employees (primarily Chuck and Pauline, although others might also participate) who will participate in the compensation plan. Parentco then issues shares to the trust.[66] The trustee allocates the shares notionally for the benefit of the employees and holds the shares until the forfeiture restrictions have lapsed, at which time the shares are distributed to the employees. The trust agreement generally provides that before the satisfaction of the vesting conditions, an employee has no interest or entitlement in the shares or in any other assets of the trust.

This type of trust is generally structured to be governed by subsection 7(2) " " ", which applies when a trust holds shares absolutely, conditionally, or contingently for an employee. The subsection provides that an employee is deemed to have acquired a share at the time the trust acquired it; as a consequence, the employee is required to include the fair market value of the shares in her income pursuant to subsection 7(1) " " ".[67] This is the same result in a typical restricted stock award. To the extent that the rules do not conflict with the specific results mandated by section 7, the trust should also be governed by the employee benefit plan rules in the Act.[68]

The key advantage of a restricted stock trust compared with a standard restricted stock award is that if there is a subsequent forfeiture and Parentco reacquires the shares, subsection 8(12) " " " should allow for an employee deduction, which offsets the earlier income inclusion, although the deduction is in the later year of forfeiture. Thus, the possibility of Canadian tax without any economic benefit is alleviated, although the prepayment of tax is not. Given, however, that there is an immediate income inclusion, this type of arrangement is generally viable only when the current fair market value (that is, the income inclusion) is small or the vesting period is short. Otherwise, arrangements must be made to provide the employee with the cash necessary to fund the immediate tax, which could take the form of a loan or bonus.

In implementing this sort of arrangement, it must be kept in mind that the trust is a taxpayer and accordingly is subject to tax on all income earned in the trust,[69] including dividends paid on the shares held by the trust, unless the income is allocated and paid to a beneficiary of the trust in the year in which it is earned.[70] Thereafter, the amounts that are distributed to the employee participants are also subject to tax in the employees' hands.[71] To avoid double taxation, arrangements of this type should be structured so that the trustee is required to allocate all income earned by it to a beneficiary in the year in which the income is earned. The income could be allocated and paid to employees as income beneficiaries of the trust, in which case the employee gets the benefits of distribution. In this situation, the employee is subject to tax on the full amount of the income, at regular employment income rates, notwithstanding the original source of the income as dividends. In other words, the character of the amount of the dividend does not carry through in the hands of the recipient employee. Alternatively, the amounts of income could be distributed to the employer as income beneficiary of the trust, and the employer could then (if desirable) use the funds to declare and pay a bonus to the employees. In this circumstance, the bonus should be deductible and offset the income inclusion realized by the employer on the receipt of the distribution from the trust.

As is the case with all equity-compensation plans governed by section 7 " " ", the costs of restricted shares, granted directly or through a trust, is not deductible to the Canadian subsidiaries pursuant to paragraph 7(3)(b) " " ", even if the costs are reimbursed by the Canadian subsidiaries to Parentco. The result, if Parentco expects such a reimbursement, is double tax.

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Restricted Stock Units

A second alternative to a restricted stock award is the grant of restricted stock units (RSUs). RSUs are structured so that the arrangement does not constitute a salary deferral arrangement (SDA) for Canadian tax purposes. If RSUs are settled in cash or part cash, the exception that is generally relied on is contained in paragraph (k) of the definition of SDA in subsection 248(1) " " ". Under this exception, the employee has the right to receive the payment by December 31st of the third year following the year in which the relevant services were rendered. Thus, the arrangement generally provides for a three-year or shorter vesting period that is comparable to the vesting period under Parentco's restricted stock plan. At the end of the vesting period, the cash payment is made or the requisite number of shares is issued to the employees.[72] As long as the arrangement does not constitute an SDA, the employee should be subject to tax only when the RSUs vest and are settled by cash or shares. In this way, the economic and tax consequences of RSUs can be made to match those of restricted stock.

If Chuck is granted RSUs but ceases to be resident in Canada before the RSUs are settled, the RSUs should be exempt from the deemed disposition rules noted above, by virtue of being an arrangement under which an individual has a right to receive remuneration in respect of services rendered by the individual in a prior year.[73] On settlement, the RSUs should be sourced back to Canada.

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Stock Option Considerations

Properly structured, stock options can offer significant tax advantages to Canadian option holders. In the right circumstances, option benefits are generally taxed at a lower rate in Canada than in the United States because of the paragraph 110(1)(d) " " " deduction. This tax arbitrage can help minimize the employer's equalization costs. There are, however, a number of issues to consider in determining whether this preferential tax treatment is available.

It is not uncommon for US stock option plans to breach the prescribed share rules. For example, when plan participants can tender previously issued shares in satisfaction of the exercise price or tax-withholding obligation, the prescribed share tests may not be satisfied, resulting in a loss of the stock option deduction.[74] In the appropriate situation, the option award agreements issued to Canadian taxpayers can be amended to address these issues.

Tax disadvantages can also arise when an executive holds qualified stock options (frequently referred to as "incentive stock options" or "ISOs") as a result of the potential mismatch in the timing of taxation. In Canada, the option holder is taxed at exercise, with no deferral available.[75] Provided that the executive holds the shares for at least one year from the date of acquisition and two years from the date of option grant and is an employee at least until 3 months before the exercise of the option (or 12 months in the case of death), the appreciation in the value of the shares is taxed in the United States at the capital gains rate on the disposition of the shares.[76]

Further, in modelling the costs of the benefits and the assignment, Parentco has probably assumed that the option benefit is deductible to the Canadian subsidiaries, provided that they are required to reimburse Parentco for the expenses.[77] Unfortunately, the terms of the Act are sufficiently broad to deny the Canadian corporate deduction for the benefits provided under most option plans.[78]

As a result of tax-withholding requirements, the option administration group in the United States should be involved in setting up mechanisms to ensure that the Canadian remitter is informed of the exercises on a timely basis and to confirm tax remittance processes. Depending on the frequency with which the Canadian subsidiaries must remit withholding taxes, it may not be possible to arrange for the sale of shares to cover the tax before penalties start to accrue. In this situation, Parentco should consider the following alternatives:

- Employees partially surrender options for a cash payment that is used to fund the tax-withholding obligation.[79]
- The employer advances the funds to cover the taxes. In this case, the US bona fide loan requirements and the Canadian shareholder loan requirements must be reviewed. While employee loans[80] are relatively easy to administer from a Canadian tax perspective, the US bona fide loan requirements are significantly more difficult to satisfy.[81] In particular, to qualify as a bona fide loan, an arrangement must be a written unconditional obligation of the employee to repay the advance with specific repayment terms, and both parties to the agreement must intend for the employee to repay the advance. The repayment terms must be consistently enforced, even if the employee dies, becomes disabled, or terminates employment, and the employer should account for the advance as a receivable. If the loan agreement so states, any excess taxes paid, as determined under the annual reconciliation, can be used to offset required advance repayments.
- The employees prefund the tax when they pay the exercise price.
- The employees sell the shares in the open market and remit sufficient proceeds to satisfy the tax-withholding obligation.

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Common Relocation Benefits

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Moving Expenses

In Canada, an employee can rarely claim a deduction for a move from a foreign country to Canada,[82] and Chuck does not qualify for the Canadian deduction. However, arguments can be made that if the employer pays the moving expenses or reimburses Chuck, the benefit is not taxable because the costs were incurred primarily for the benefit of the employer.[83]

In contrast, for US purposes Chuck could deduct qualifying moving expenses associated with the move from the United States to Canada or with a subsequent move between foreign jurisdictions for employment reasons.[84] As an alternative, if Chuck's qualified moving expenses are reimbursed, no benefit is included in his US gross income. In developing the international assignment policy, Parentco should structure the moving policy to obtain symmetrical tax treatment in Canada and the United States by either directly paying certain moving expenses or reimbursing Chuck for these expenses.

However, even after the employer implements a reimbursement or direct pay program, discrepancies may remain between the Canadian and US taxation of the benefits as a result of the differences in the definition of "qualifying moving expenses" and "eligible moving expenses." Qualifying moving expenses under the US rules include[85]

- household goods shipments, customs clearance expenses, insurance on goods, reimbursement for damaged goods to the extent that the employer self-insures, and installation and/or removal costs;
- transportation expenses of the individual and family, visa costs, and medical examinations required by the company; and
- other moving expenses, such as storage of household goods while the employee is on foreign assignment.

The US taxation of long-term storage costs is more generous than the Canadian taxation of these costs. A US assignee can deduct storage costs when it is not practical to transport the household effects. These expenses are not deductible by Chuck in Canada. However, it is arguable that an employer reimbursement of these costs is not a taxable Canadian benefit because the expense is not incurred primarily for the benefit of the employee.

As a general rule, however, Canada is more liberal in the tax treatment of moving expense reimbursements. The following items should not be taxable in Canada if reimbursed by the employer but may be taxable in the United States:

- costs incurred in acquiring or disposing of property,
- penalties for breaking leases,
- mortgage penalties,
- costs of house-hunting trips,
- temporary living expenses while waiting to occupy the new residence, or
- meal expenses.

In implementing the shadow payroll, it is critical to understand the components of Chuck's relocation reimbursements to ensure that non-taxable benefits are not included in his Canadian income.

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Housing Benefits

Another common relocation benefit is a housing allowance or relocation premium to compensate an executive for moving to a higher-cost jurisdiction. Such an allowance is taxable in both Canada and the United States. However, in some circumstances, an employer may choose to provide lodgings. Parentco provides Pauline with accommodation in Toronto while Pauline maintains her home in the United States during her three-year assignment.

In Canada, rent-free or low-cost housing is excluded from employment income[86] if

- the executive is required to work temporarily[87] at a special work site for periods of not less than 36 hours, the executive maintains a principal residence that she may occupy at any time and is not rented out, and, by reason of distance, the executive cannot be expected to commute daily from the principal residence; or

- the executive is required to work at a remote location in which it is unreasonable (as a result of the remoteness) to expect the executive to establish a self-contained domestic establishment, and the executive is required to be away from her personal residence for a period of at least 36 hours.

The term "special work site" has been reviewed in a number of situations. It has been determined that it need not be isolated or remote.[88] However, the work site must be sufficiently distant from the executive's residence that it is not reasonable for the executive to commute to the site.[89]

In Pauline's situation, it is likely that Toronto qualifies as a special work site. Further, arguments can be made that Pauline's assignment is temporary.[90]

In the United States, lodging expenses are deductible, and reimbursements or employer-paid lodgings are not a taxable benefit if

- the employee is required to accept lodgings on the employer's business premises as a condition of employment;[91]
- the expenses constitute reasonable "away from home charges" for an individual on temporary assignment (the assignment is anticipated to last less than one year and in fact does so);[92] or
- the lodging satisfies certain criteria in very restricted circumstances, as in the case of campus housing that is for the employer's benefit.[93]

Further, qualifying taxpayers[94] may elect to exclude from their income an amount equal to certain housing costs as long as the housing costs are not "lavish or extravagant" under the circumstances. Qualifying housing expenses include rent, utilities, the fair rental value of housing provided in the foreign country by the employer, and residential parking provided by the employer. The housing cost exclusion is capped at 30 percent of the maximum foreign earned income exemption. Typically, the exclusion is not claimed on tax returns of transferred executives because electing the exclusion does not reduce the ultimate aggregate Canada-US tax liability.

The accommodations provided to Pauline by Parentco will be characterized as a taxable benefit for US tax purposes because her assignment is initially anticipated to last longer than one year. However, the benefit may not be taxable in Canada, thus reducing Canadian tax remittances. If Pauline is being equalized to the tax position that she would have been in without the assignment, Parentco will reimburse her for the additional US tax costs. However, as a result of the diminishment in Canadian taxes, that cost may be relatively insignificant.

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Cost-of-Living Allowance

It is not uncommon for international assignees to receive a relocation premium or a cost-of-living allowance. The cost-of-living allowance is viewed as a taxable benefit by both the Canadian and US tax authorities.

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Other Fringe Benefits

An executive's global assignment agreement may also provide for continuation of the fringe benefits that she received in the United States. In analyzing the cost of the assignment program, Parentco should review the differences in the taxation of common benefits.

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Employer-Provided Parking

In Canada, employer-provided parking is typically characterized as a taxable benefit. However, qualified parking—namely, employer-provided parking on or near the business premises—is excluded for US tax purposes, subject to a monthly monetary cap.[95] Thus, in preparing the Canadian tax reporting slips and determining Canadian tax remittances, these amounts should be excluded in determining the hypothetical US tax credits.

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Health and Medical Benefits

In both the United States and Canada, employer-provided health benefits are often excluded in employment income.[96] However, the United States imposes additional requirements. If the plan discriminates in favour of highly compensated executives, the amounts paid to these employees are subject to US federal income tax.[97] No similar requirement is imposed in Canada.

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Tax Return Preparation

As part of the transfer program, an employer frequently arranges for home and host tax returns to be prepared by third parties, with the professional fees being borne by the employer. While these services ensure that the employer is able to accurately review whether payroll obligations and equalization policies are satisfied, the issue remains whether this constitutes a benefit to the executive.

Tax return preparation provided directly or indirectly by an employer normally produces a taxable benefit to an employee for Canadian tax purposes.[98] For US tax purposes, the value of employer-provided tax return preparation services for employees cannot be excluded from income. The value of tax return preparation is generally subject to income tax withholding.[99]

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Group Term Life Insurance

Employer-paid premiums in respect of the first US$50,000 of death benefits provided under a qualified group term life insurance policy are excluded from US employment income.[100] The following requirements must be satisfied:

- the plan provides a death benefit that is not included in income;
- the plan is provided to a group of employees, generally at least 10 full-time employees at

some time in the year;[101]

- insurance coverage is determined on the basis of a formula ensuring no individual preference; and
- the benefit is provided under a policy sponsored directly or indirectly by the employer.

No similar exemption is provided under Canadian tax rules. Further, in determining the taxable benefit for Canadian purposes, the US taxable benefit on death benefit coverage in excess of US$50,000 is determined on the basis of formulas provided by the US tax authorities.[102]

Conclusion

The Canadian and US tax rules relating to internationally mobile executives are increasingly complicated. As many poorly advised employees and employers can attest, tax authorities are more and more aware of the issues involved and are acting forcefully to ensure that their jurisdictions collect the amount of tax owing to them (or even more, having regard to the withholding rules). This heightened attention can result in substantial penalties for employers and executives who fail to comply with relevant rules and procedures. In addition to monetary penalties and the prohibition against applying for withholding waivers in the future, concerns about individual and corporate reputations also arise.

Notes

1 Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this paper are to the Act.

2 United States, Department of the Treasury, *Circular* no. 230, "Regulations Governing Practice Before the Internal Revenue Service," disclosure: to ensure compliance with requirements imposed by US Treasury Regulations, the authors inform the reader that any US tax advice contained in this paper is not intended or written to be used, and cannot be used, for the purpose of (1) avoiding penalties under the Internal Revenue Code (infra note 15) or (2) promoting, marketing, or recommending to another party any transaction or matter addressed herein.

3 Except as necessary to provide context, we do not discuss tax issues relating to business travellers to Canada. These issues have been discussed in detail at previous conferences; see, for example, Jim Yager, "Managing the Risks of Business Travellers," in *Report of Proceedings of the Sixty-Third Tax Conference*, 2011 Conference Report (Toronto: Canadian Tax Foundation, 2012), 23:1-31; and Matt Smith and Natalie Churchill, "Update on Employee Compensation—A Changing Environment," in *2010 Atlantic Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2010), 9:1-16.

4 Of course, it is also necessary to consider various non-tax issues, such as immigration and health insurance.

5 The Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14,

1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007 (herein referred to as "the Canada-US tax treaty"). Unless otherwise stated, references in this paper to articles are to articles in the Canada-US treaty.

2012 CR 35 Footnote-6 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

6 For a thorough overview of Canada's residence rules, see, for example, Paul Lefebvre, "Canada's Jurisdiction To Tax: Residency and the Thomson Decision 60 Years Later," Personal Tax Planning feature (2006) 54:3 *Canadian Tax Journal* 762-80.

2012 CR 35 Footnote-7 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

7 For the purposes of this paper, it is important to recognize the distinction between being employed by a company and being on the payroll of a particular corporation.

2012 CR 35 Footnote-8 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

8 Stewardship costs should, for example, include the expenses of the directors' meeting in Canada because these are costs incurred by Parentco in its custodial capacity (that is, as a shareholder managing its investments). The costs should therefore not be charged back to subsidiaries since they are of primary benefit to Parentco. We are advised that this is consistent with US transfer-pricing methodology.

2012 CR 35 Footnote-9 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

9 It is beyond the scope of this paper to discuss the basis of taxation exerted by the various states in the United States.

2012 CR 35 Footnote-10 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

10 Subsection 2(1) " " ".

2012 CR 35 Footnote-11 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

11 Subsection 2(3) " " ".

2012 CR 35 Footnote-12 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

12 Subsection 128.1(4) " " ".

2012 CR 35 Footnote-13 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

13 When the departing taxpayer is an individual, certain assets are exempted from the deemed disposition provisions pursuant to paragraph 128.1(4)(b) " " ". These exempted assets include excluded rights or interests. The definition of "excluded rights or interests" set out in subsection 128.1(10) " " " is extensive. For our purposes, it is relevant to note that these rights include superannuation or pension funds or plans, employee benefit plans, stock options and other agreements governed by section 7, and certain other employment-related programs.

2012 CR 35 Footnote-14 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

14 Subparagraph 128.1(4)(b)(iv) " " ".

2012 CR 35 Footnote-15 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

15 Internal Revenue Code of 1986, as amended (herein referred to as "the Code").

2012 CR 35 Footnote-16 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

16 To retain a green card, an alien must remain a permanent resident of the United States. Historically, many aliens have declared themselves to be permanent residents of the United States in order to retain their working status when a factual argument could be made that neither were they permanent residents nor had they a substantial presence in the United States.

2012 CR 35 Footnote-17 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

17 Article XV(1) of the Canada-US tax treaty expressly protects the right of the state in which the employee is resident to tax the individual on employment income earned in the other contracting state. Article IV(1) clarifies that the term "resident" includes a person who is liable to tax by virtue of citizenship or other criteria of a similar nature. Revisions arising from the 2007 protocol have clarified that a US citizen or green card holder may claim

treaty benefits only if she has a substantial presence, permanent home, or habitual abode in the United States and her personal ties and economic relations with the United States are closer than those with any third country.

2012 CR 35 Footnote-18 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

18 These reimbursements are infrequent and typically reflect an arrangement negotiated between Parentco and a key executive.

2012 CR 35 Footnote-19 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

19 For a discussion of the locality of employment income, see Michael J. Welters, "Foreign Tax Credits and the Locality of the Source of Employment Income" (2010) 21:8 *Taxation of Executive Compensation and Retirement* 1278-79.

2012 CR 35 Footnote-20 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

20 The Canadian tax authorities require an individual to claim the relevant treaty relief to minimize the impact of foreign taxes. Failure to claim this relief results in the denial of the foreign tax credit on the ground that the tax was a voluntary payment. See, for example, CRA document no. 8M18146, October 19, 1998; and CRA document no. 2003-0019751E5, December 7, 2004. See also articles XXIV(4) and (5) of the Canada-US tax treaty for the determination of foreign tax credits for a US citizen residing in Canada. The treaty provisions affect the determination of both US and Canadian taxes for these individuals.

2012 CR 35 Footnote-21 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

21 See CRA document no. 2012-0459411C6, September 25, 2012.

2012 CR 35 Footnote-22 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

22 Treas. reg. section 1.861-4(b)(2)(ii).

2012 CR 35 Footnote-23 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

23 Treas. reg. sections 1.861-4(b)(2)(ii)(A) and 1.861-4(b)(2)(ii)(E). However, all sourcing positions are fact-based, and it is critical to look at the employer's intentions with respect to the payment (was it for past service, future service, or current service) in determining the appropriate sourcing policy.

2012 CR 35 Footnote-24 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

24 In this context, vesting refers to the event after which there is no longer a substantial risk of forfeiture from a US perspective. For example, if an individual would no longer forfeit an award if she resigned after a certain date following the grant of the award, the United States considers there to be no longer a substantial risk of forfeiture once the individual could resign without forfeiting the award. Thus, the US concept of risk differs significantly from Canadian standards.

2012 CR 35 Footnote-25 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

25 See article XV(2)(b) of the Canada-US tax treaty, discussed below.

2012 CR 35 Footnote-26 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

26 See, for example, CRA document no. 9333340, December 7, 1993.

2012 CR 35 Footnote-27 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

27 Although carrying on business in Canada triggers an obligation of Parentco to file a Canadian federal income tax return pursuant to subparagraphs 115(1)(a)(ii) " " " and 150(1)(a) " " "(ii), because Parentco is a resident of the United States and a "qualifying person" (both within the meaning of the Canada-US tax treaty), Canada's right to tax is limited by article VII(1), which provides that business profits of a US resident are taxable in Canada only to the extent that the profits are attributable to a PE through which the US resident carries on business in Canada.

2012 CR 35 Footnote-28 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

28 United States, Department of the Treasury, Technical Explanation of the Protocol Done at Chelsea on September 21, 2007, Amending the Income Tax Convention Between the United States of America and Canada, released July 10, 2008 (herein referred to as "the technical explanation"). The technical explanation has been

acknowledged by the Canadian Department of Finance as accurately reflecting the understandings of Canada and the United States in the course of negotiating the fifth protocol: see Canada, Department of Finance, "Canada Supports U.S. Technical Explanation of the Fifth Protocol to the Canada-United States Income Tax Convention," *News Release* 2008-052, July 10, 2008.

2012 CR 35 Footnote-29 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

29 United States, Staff of the Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Canada*, JCX-57-08 (Washington, DC: Joint Committee on Taxation, July 8, 2008), at 42.

2012 CR 35 Footnote-30 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

30 CRA document nos. 2008-0300941C6, December 9, 2008; 2009-0319441C6, August 5, 2009; 2009-0315151C6, September 28, 2009; and *Income Tax Technical News* no. 44, April 14, 2011.

2012 CR 35 Footnote-31 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

31 See paragraph 42.30 of the commentary on article 5 of Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital: Condensed Version* (Paris: OECD, July 2008).

2012 CR 35 Footnote-32 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

32 "Canada Revenue Agency Round Table," in *Report of Proceedings of the Sixty-First Tax Conference*, 2009 Conference Report (Toronto: Canadian Tax Foundation, 2010), 3:1-30, question 19, at 3:17-18.

2012 CR 35 Footnote-33 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

33 To date, the Department of Finance has not acted on the recommendation of the Advisory Panel on Canada's System of International Taxation appointed by the minister of finance in its report dated December 10, 2008, recommending that regulation 105 withholding tax requirements be eliminated for a non-resident who receives income from services rendered in Canada if the income is treaty-exempt. See Advisory Panel on Canada's System of International Taxation, *Final Report: Enhancing Canada's International Tax Advantage* (Ottawa: Department of Finance, December 2008), at recommendation 7.3.

2012 CR 35 Footnote-34 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

34 See, for example, *Information Circular* 75-6R2 " " ", "Required Withholding from Amounts Paid to Non-Residents Providing Services in Canada," February 23, 2005, at paragraphs 35-39; and CRA document no. 2010-0377501R3, 2010.

2012 CR 35 Footnote-35 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

35 See, for example, CRA document no. 2009-0345151E5, January 25, 2010; and CRA guide T4001, "Employers' Guide: Payroll Deductions and Remittances" (2012).

2012 CR 35 Footnote-36 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

36 See, for example, CRA document nos. 2008-0300571C6, December 9, 2008; 2011-0403541E5, June 17, 2011; 2011-0403551E5, July 15, 2011; and 2011-0418281E5, January 23, 2012.

2012 CR 35 Footnote-37 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

37 For example, see CRA document no. 2012-0440741I7, July 6, 2012. The CRA has adopted an administrative position that the waiver of withholding tax is not required and that it will not assess the withholding tax, penalties, and interest when a non-resident employer sends an employee to a conference in Canada, and the employee will be present in Canada for the conference for 10 days or less (including travel time) and will earn less than

- $10,000 in the year from employment services in Canada if the employee resides in the United States, or
- $5,000 in the year from employment services in Canada if the employee resides in another country with which Canada has a tax treaty.

The exemption only applies to employment income earned while the employee is at the conference. For more details, see www.cra-arc.gc.ca/tx/nnrsdnts/cmmn/rndr/nnrsdtmply-eng.html.

2012 CR 35 Footnote-38 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

38 This should be contrasted, for example, with article 15(5) of the Convention Between the Government of Canada and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, signed at London on September 8, 1978, as amended by the protocols signed on April 15, 1980, October 16, 1985, and May 7, 2003, which provides for relief from double withholding obligations when both countries impose withholding on the same income. In such a case, the country in which the employment income is derived is permitted to make withholdings, but the other country is not.

2012 CR 35 Footnote-39 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

39 For a discussion, see "Canada Revenue Agency Round Table," in *Report of Proceedings of the Sixty-Second Tax Conference*, 2010 Conference Report (Toronto: Canadian Tax Foundation, 2011), 4:1-35, question 7, at 4:8.

2012 CR 35 Footnote-40 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

40 The states also administer separate unemployment insurance programs. To the extent that seconded employees are not rendering services in the home state, contributions to the state unemployment insurance program should be suspended.

2012 CR 35 Footnote-41 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

41 An "American employer" includes a corporation organized under the laws of the United States, any US state, or the District of Columbia, Puerto Rico, the Virgin Islands, Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands. A foreign affiliate of an American employer is any foreign entity in which the American employer has at least a 10 percent interest, directly or through one or more entities. For a corporation, the 10 percent interest must be in its voting stock. For any other entity, the 10 percent interest must be in its profits.

2012 CR 35 Footnote-42 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

42 IRS form 2032 ("Contract Coverage Under Title II of the Social Security Act").

2012 CR 35 Footnote-43 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

43 See Code section 3306(c), which sets out the definition of employer, specifying that the employment of a US citizen by an American employer is employment for FUTA purposes, and Code section 3306(j)(3), which defines "American employer."

2012 CR 35 Footnote-44 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

44 In our example, it is likely that the employer will be the Canadian employer in order to mitigate the PE issues. As a result, FUTA is unlikely to apply.

2012 CR 35 Footnote-45 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

45 A listing of the current social security agreements formalized by Canada can be found on the Service Canada website: www.servicecanada.gc.ca/eng/isp/ibfa/summarytoc.shtml#u. Information with respect to the US international social security agreements can be found on the Social Security website at www.socialsecurity.gov/international/agreements_overview.html.

2012 CR 35 Footnote-46 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

46 Part II, article V.2 of the Agreement Between the Government of Canada and the Government of the United States of America with Respect to Social Security, signed at Ottawa on March 11, 1981, as amended by the supplementary agreements signed on May 10, 1983 and October 1, 1997.

2012 CR 35 Footnote-47 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

47 Ibid., at part I, article II.1.

48 Pursuant to section 7 of the Employment Insurance Regulations, SOR/96-332, as amended.

49 See the definition of "excepted employment" in section 6(2)(k) of the Canada Pension Plan, RSC 1985, c. C-8, as amended, and regulation 23 of the Canada Pension Plan Regulations, CRC, c. 385. The CRA has confirmed this when any directors' meetings are held outside Canada: see CRA guide T4001, supra note 35.

50 See the definition of "insurable employment" in section 5(1) of the Employment Insurance Act, SC 1996, c. 23, as amended. This is confirmed by the CRA in guide T4001, supra note 35.

51 While there are two basic types of equalization programs for assignees (tax protection and tax equalization programs), the discussion in this paper focuses on tax equalization, the more common program, which is intended to ensure that an individual is in the same after-tax position that she would be in if she had not left her home country. In other words, if a US citizen is assigned to Canada, the company assumes the burden of the additional taxes. Under a tax equalization policy, a US citizen who is transferred to a low-tax regime does not reap any tax benefit from the assignment. In contrast, a tax protection policy permits the employee to benefit from the lower taxes following a transfer but ensures that she does not pay higher taxes. These programs are relatively rare.

52 However, as with every other aspect of their businesses, employers are concerned about the costs of tax equalization, and thus there is a trend not to reimburse employees for tax differences.

53 For US purposes, Rev. rul. 78-139, 1978-1 CB 23, and Rev. rul. 78-374, 1978-2 CB 67, support this position. In Rev. rul. 78-139, the Internal Revenue Service (IRS) ruled that an employee accepted a reduction in salary as a condition of employment: "the amount of compensation . . . that is to be included in the taxpayer's gross income . . . is limited to the amount of reduced compensation received." In Rev. rul. 78-374, an employee had a staff assessment withheld by the employer at source, effectively reducing the salary that the employee received each payday. The IRS ruled that an amount "withheld from the salary . . . that is nether available to, or received by, the employee nor part of a deferred compensation, pension, or disability plan is not includable in the employee's gross income" (headnote). To our knowledge, no rulings have been issued in Canada on the hypothetical tax reduction. However, the logic that the amount is neither received nor receivable should apply to exclude it from taxation. Constructive receipt should not apply as long as the reduction is agreed to before the services are rendered in Canada.

54 *Gernhart v. The Queen*, 98 DTC 6026 (FCA), remains the leading case on the treatment of tax equalization payments; the court concluded that the reasoning set out in *Ransom v. MNR*, 67 DTC 5235 (Ex. Ct.), was not applicable and the taxpayer had received a benefit as a result of the receipt of the equalization payment.

55 Code section 911. In the United States, a qualifying taxpayer transferred "offshore" could exclude US$95,100 of the foreign-source income from US taxation in 2012. There are usually also foreign housing cost exclusions that can be applied to reduce the income.

56 US alternative minimum tax (AMT) is designed to ensure that individuals with substantial income cannot avoid US taxation through the application of otherwise permissible deductions, exemptions, or tax credits. In the event that a transferred employee earns income in excess of the foreign-source exclusion income limit and uses foreign tax credits to eliminate US taxation, AMT may apply. However, foreign tax credits can be claimed in

determining US AMT. Also, to the extent that an individual's AMT arises as a result of the exclusion, the AMT amount paid cannot be carried forward to reduce federal taxes in future years. See Code section 55.

2012 CR 35 Footnote-57 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

57 Future filing may be required when significant taxable income is generated in the state. Further, taxation laws differ from state to state, and thus the employer must consider whether a detailed review of individual situations is necessary.

2012 CR 35 Footnote-58 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

58 The Canadian corporation needs to ensure that all relevant provincial payroll-based taxes, such as the Ontario employer health tax, are paid.

2012 CR 35 Footnote-59 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

59 See section 67 of the Financial Administration Act, RSC 1985, c. F-11, as amended, which provides that a Crown debt is not assignable.

2012 CR 35 Footnote-60 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

60 For example, if an executive filed her own US tax return claiming the foreign-source income exclusion, and a waiver of Canadian tax remittances had been obtained on the basis that all Canadian-source employment income would be subject to US taxation, additional Canadian taxes would be assessed, and the employer could be subject to penalty taxes. Further, it could be difficult for the executive to obtain future Canadian tax waivers.

2012 CR 35 Footnote-61 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

61 Code section 83.

2012 CR 35 Footnote-62 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

62 Section 7.

2012 CR 35 Footnote-63 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

63 There is a weak argument that there is no "acquisition" for the purposes of section 7 because the employee may not have the right to receive dividends. However, the better view is that the right to vote is sufficient to constitute an acquisition for the purposes of section 7. The appropriateness of a discount in the value of shares to reflect the impairment caused by transfer restrictions is a valuation issue, and the CRA has provided little guidance on the subject.

2012 CR 35 Footnote-64 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

64 *Interpretation Bulletin* IT-113R4, "Benefits to Employees—Stock Options," August 7, 1996, at paragraph 9; Robert J.L. Read, "Technical Matters," in *Report of Proceedings of the Thirty-Fifth Tax Conference*, 1983 Conference Report (Canadian Tax Foundation, 1984), 783-95, at 794; and CRA document nos. AC59264, March 27, 1990; 2008-0279251E5, February 2, 2009; and 2005-0112901E5, April 25, 2005.

2012 CR 35 Footnote-65 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

65 For some interesting examples of this timing issue, see Wynn Vo, "Foreign Tax Credits: Problems with Timing of Income Recognition" (2012) 2:3 *Canadian Tax Focus* 6.

2012 CR 35 Footnote-66 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

66 The arrangement can also be structured so that Parentco makes contributions to the trust to acquire shares from treasury or on the open market. For a discussion of the Canadian income tax implications of a trust that acquires shares on the open market, see Anu Nijhawan, "Employee Stock Purchase Trusts: An Alternative to Restricted Stock Plans" (2005) 17:4 *Taxation of Executive Compensation and Retirement* 614-16.

2012 CR 35 Footnote-67 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

67 Subject to a deferral under subsection 7(1.1) " " ", which is not available in our example.

2012 CR 35 Footnote-68 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

68 Because of the distinction drawn in various provisions of the Act between trusts governed by subsection 7(2) and trusts governed by employee benefit plans (EBPs), some commentators have argued that, once subsection

7(2) applies, the trust can no longer be considered to be an EBP: see, for example, Ian Macdonald, "Trusts Holding Employee Shares—After the Initial Transfer" (2012) 23:10 *Taxation of Executive Compensation and Retirement* 1415-17. The CRA has also taken certain positions to the effect that once an arrangement is subject to section 7, it cannot also be an EBP: see, for example, CRA document no. 2005-0124261E5, May 3, 2005. On the basis of the reasoning in *MNR v. Chrysler Canada Ltd. et al.*, 92 DTC 6346 (FCTD), however, the better view is that a trust can be governed by both section 7 and the EBP rules, but, in the event of a conflict, the section 7 rules prevail.

2012 CR 35 Footnote-69 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

69 Provided that the trust constitutes an EBP, subsection 75(2) " " " should not apply to the trust, pursuant to the exemption in paragraph 75(3)(a) " " ". See the discussion supra note 68.

2012 CR 35 Footnote-70 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

70 Subsections 104(2) " " " and 122(1) " " ".

2012 CR 35 Footnote-71 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

71 Subparagraph 6(1)(g)(ii) " " ". On the basis that the trust is an EBP, subsection 104(13) does not apply to cause an income inclusion for employees as a result of the exclusion in paragraph 104(13)(a) " " ". As a consequence, the designation for taxable dividends under subsection 104(19) " " " is not available.

2012 CR 35 Footnote-72 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

72 Where the RSUs can be settled only in shares issued from treasury, the stock option rules in section 7 should prevent SDA characterization, with the result that a vesting period exceeding three years can be contemplated.

2012 CR 35 Footnote-73 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

73 Subparagraph 128.1(10)(a)(vii) " " ".

2012 CR 35 Footnote-74 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

74 See, for example, CRA document no. 2001-0071485, September 18, 2001; and CRA document no. 2005-0114501R3, 2005.

2012 CR 35 Footnote-75 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

75 The deferral previously permitted under subsection 7(8) was eliminated by the 2010 Canadian federal budget: SC 2010, c. 25, section 3(8).

2012 CR 35 Footnote-76 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

76 Code section 422. This section sets out other criteria that must be satisfied before an option can be classified as an ISO. Further, the ISO benefit is included for the US AMT calculation in the year that the option is exercised.

2012 CR 35 Footnote-77 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

77 For US tax purposes, only ISO benefits where the employee benefits from preferential taxation are non-deductible.

2012 CR 35 Footnote-78 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

78 Paragraph 7(3)(b) " " ". See CRA document no. 9910975, August 6, 1999. While the court in *Transalta Corporation v. The Queen*, 2012 TCC 86, found that the employer could claim a deduction for shares issued to employees under a stock ownership plan, the particular circumstances of the plan are unlikely to apply to many stock option programs.

2012 CR 35 Footnote-79 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

79 Before establishing a partial surrender program, the accounting implications should be carefully reviewed.

2012 CR 35 Footnote-80 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

80 In our example, however, there is the risk that the assignees may also be shareholders, in which case the application of section 15 must be considered.

2012 CR 35 Footnote-81 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

81 Internal Revenue Service, Technical Advice Memorandum 200040004, June 12, 2000.

2012 CR 35 Footnote-82 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

82 Pursuant to section 62, moving expenses associated with an "eligible relocation" are deductible in determining the employee's income. The definition of "eligible relocation" set out in subsection 248(1) requires that both the previous residence and the new residence be located in Canada. However, individuals who are absent from Canada but taxable in Canada as residents throughout the year may deduct moving expenses to or from Canada as a result of the reference in the definition of "eligible relocation" to section 62.

2012 CR 35 Footnote-83 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

83 Subsection 62(1) " " "; *Interpretation Bulletin* IT-178R3 " " " (Consolidated), "Moving Expenses"; and *Interpretation Bulletin* IT-470R " " " (Consolidated), "Employees' Fringe Benefits." The rationale is the same as the primary advantage approach espoused in *AG of Canada v. Hoefele et al.; Krull v. AG of Canada*, 95 DTC 5602 (FCA). See also *Splane v. The Queen*, 90 DTC 6442 (FCTD); aff'd. 91 DTC 5130 (FCA); and *Ransom*, supra note 54.

2012 CR 35 Footnote-84 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

84 See Internal Revenue Service, *Publication* 521, "Moving Expenses" (2012).

2012 CR 35 Footnote-85 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

85 Code section 217.

2012 CR 35 Footnote-86 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

86 Subsection 6(6) " " ".

2012 CR 35 Footnote-87 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

87 The Canadian tax determination of whether a work assignment is temporary does not depend on a statutory test. Rather, the Canadian tax authorities have adopted an administrative position that an assignment exceeding two years is not generally temporary, although this remains a question of fact.

2012 CR 35 Footnote-88 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

88 See, for example, *Rozumiak v. The Queen*, 2005 TCC 811.

2012 CR 35 Footnote-89 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

89 *Bourget v. The Queen*, 2009 TCC 533.

2012 CR 35 Footnote-90 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

90 While the general administrative position of the CRA is that employment at a special job site is temporary when the assignment does not extend beyond two years, longer assignments are accepted as temporary in appropriate situations. See CRA document no. 2011-0399091E5, May 31, 2011. In Pauline's employment contract, it would be advisable to specify the date when her assignment ends and to state that thereafter she can be assigned to another position in Canada or the United States.

2012 CR 35 Footnote-91 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

91 Code section 119; and Treas. reg. section 1.119-1.

2012 CR 35 Footnote-92 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

92 See Internal Revenue Service, "Taxable Fringe Benefits Guide" (January 2012), which states: "Reimbursements received by an employee who travels on business outside of the area of his/her tax home may be excludable from wages. . . . Qualifying expenses for travel are excludable if they are incurred for temporary travel on business away from the general area of the employee's tax home." In determining whether an individual has a new tax home as a result of the duration of an assignment, the US tax authorities look to the employee's regular place of business rather than the location of the family home (see Rev. rul. 73-529, 1973-1 CB 37; Rev. rul. 93-86, 1993-2 CB 71; and Rev. rul. 99-7, 1999-5 IRB 4). The employer must determine at the commencement of the assignment whether it is reasonable to expect that the assignment will last less than one year. If the temporary assignment is extended part way through, the exemption does not apply to future benefits.

2012 CR 35 Footnote-93 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

93 Code section 119; and Treas. reg. section 1.119-1.

2012 CR 35 Footnote-94 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

94 A US citizen may claim the exclusion if she establishes herself as a bona fide foreign resident for an uninterrupted period that includes an entire calendar year or if she is physically present in one or more foreign countries for 330 full days in any consecutive 12-month period. She must also establish a foreign tax home. She is not considered to have established a foreign tax home if she retains an abode in the United States.

2012 CR 35 Footnote-95 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

95 See Code section 132(f)(5)(C). For 2012, the maximum non-taxable benefit was US$240 per month. See Internal Revenue Service, "In 2012, Many Tax Benefits Increase Due to Inflation Adjustments," *News Release* IR-2011-104, October 20, 2011.

2012 CR 35 Footnote-96 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

96 Paragraph 6(1)(a) " " " of the Act, and Code sections 105 and 106.

2012 CR 35 Footnote-97 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

97 Code section 105(h).

2012 CR 35 Footnote-98 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

98 *Cutmore et al. v. MNR*, 86 DTC 1146 (TCC).

2012 CR 35 Footnote-99 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

99 An exception is made if the employer reasonably believed that the amount would be excludable from the employee's wages as a result of Code section911. See Code section 3401(a)(8)(A)(i).

2012 CR 35 Footnote-100 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

100 See Code section 79.

2012 CR 35 Footnote-101 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

101 See Internal Revenue Service, *Publication* 15-B, "Employer's Tax Guide to Fringe Benefits" (2013).

2012 CR 35 Footnote-102 Cross-Border Employment Issues (Nijhawan, A. & A. Montgomery)

102 Ibid., at 13, table 2-2 or Treas. reg. section 1.79-3(d)(2), table 1.

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