



Lang Michener Tax Tips – Withholding on Payments to Non-Resident Service Providers

September 10, 2009

The recent *Stora Enso Beteiligungen* (SEB) case highlights the importance of the requirement under section 105 of the *Income Tax Regulations* for a payer to withhold 15% of the gross amount of payments of fees to non-residents of Canada in respect of services rendered in Canada.

SEB was a German-resident company with an affiliate in Canada. SEB retained the services of a Swedish company (McKinsey) to perform services in Canada at the premises of SEB's Canadian affiliate (Canco). SEB paid McKinsey but neglected to withhold 15%. SEB was then reimbursed by Canco, which subsequently remitted 15% of the amount of McKinsey's invoice to the Canada Revenue Agency (CRA). The CRA then assessed SEB for failing to withhold 15% on its payment to McKinsey, even though the CRA had received the 15% remitted by Canco. SEB appealed to the Tax Court of Canada. The Court acknowledged that the rules required SEB to withhold and remit in respect of its payment to McKinsey. The Court also acknowledged the possibility for "cascading" withholding obligations when an initial contract is further subcontracted out to one or more non-residents. However, the Court concluded that it was inappropriate for the CRA to seek to impose multiple withholding obligations in respect of the same payment for the same services.

The "Regulation 105" withholding is on account of the non-resident's Canadian tax liability and may be recovered if the non-resident is determined not to be subject to Canadian income tax. However, the withholding can impose an undesired administrative burden on the clients of a non-resident service provider and may detrimentally impact the service provider's cash flow. Further, the potential for "cascading" withholding obligations, the impact of gross-up payments, the ability to apply for a waiver, as well as the risks of disguising fees as expense reimbursements, need to be understood.

Please click on the link below to contact the members of the Lang Michener Tax Team:

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