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A: Finding the meaning of nexus for taxes – past, present and future

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Branch reporters
Kim Maguire[1]
Ivan Ozai[2]

Summary and conclusions

The definition of nexus in Canada primarily relies on the combination of statutory and case law. Canadian courts explicitly refer to the economic allegiance theory and, therefore, apply several substantive tests to define tax residence on the basis of economic and social affiliation.

Canada's *Income Tax Act* stipulates that residents are taxed on their worldwide income, with residency determined in some instances using a facts-and-circumstances approach based on factors that indicate a socio-economic connection between Canada and the particular individual or entity, and in other cases based on a bright-line approach such as the physical presence of an individual in Canada for over half the year or the incorporation of a corporation in Canada after 26 April 1965.

Beyond the personality-based jurisdiction, Canada also taxes non-residents on a territoriality (source) basis, namely on employment income derived from services performed in the country, business income from businesses carried on in the country, and capital gains from the disposition of real or immovable property situated in Canada (or property deriving significant value from such property). Consistent with the international norm, Canada also levies withholding taxes on non-residents receiving payments of dividends, interest, rent, and royalties from Canadian residents. The presumption of territoriality is predicated upon the non-residents accruing returns from their investments within Canada.

The Canadian value-added and sales tax system presents unique features because Canada is one of the few countries with a general sales tax that is raised both at the federal and provincial levels. Some provinces have chosen to harmonize their provincial sales to the federal goods and services tax ("GST" and when harmonized "GST/HST"). In contrast, other provinces have distinct sales taxes, and one province has entirely forgone the implementation of any sales tax.

The definition of nexus for Canada's federal GST generally relies on a personality basis that considers the place of consumption, technically defined as the recipient's location. A supply will be taxed in Canada if the place of a supply to a Canadian resident is deemed to have been made in Canada or if there is an importation of goods or services. The supply is deemed to have been made in Canada if, in the case of the sale of tangible personal property, the goods are delivered or made available in Canada to the recipient of the supply; in the case of a supply of intangible personal property, the property may be used in whole or in part in Canada, or the property relates to real or tangible personal property, or a service to be performed, in Canada; in the case of a supply of real property, or of a service in relation to

[1] Osler, Hoskin & Harcourt LLP.
[2] Osgoode Hall Law School.

real property, the property is situated in Canada; and in the case of the supply of a service, the service is to be performed in whole or in part in Canada.

The emergence of online platforms and services has challenged the traditional principles and nexus definitions in Canadian GST legislation. Prior to 2021, many online foreign vendors were not required to register for GST. Consequently, while consumers theoretically owed the tax on their purchases, it was not collected by the vendor or the Canada Revenue Agency ("CRA"). This scenario was prevalent in online transactions involving intangible properties and services to Canadian consumers. As a result, certain non-resident entities with significant sales in Canada were not obligated to register, effectively exempting their supplies from GST/HST. Canadian consumers were technically supposed to self-assess and remit the GST/HST to the CRA, but this was rare in practice. Thus, for all practical purposes, supplies made to the Canadian market by foreign online sellers were essentially non-taxable.

To address these disparities, a 2021 amendment changed registration rules to subject all sales to Canadians facilitated by non-resident vendors or digital platform operators using Canadian fulfillment warehouses to GST/HST. The revised rules maintain the concept of nexus as it is adopted in Canada. However, they enhance tax enforceability and significantly impact the effectiveness of the nexus when the vendor resides outside the country. These rules require vendors and digital platform operators with sales exceeding $30,000 over 12 months to register under the regular GST/HST regime. Consequently, they must collect and remit GST/HST on sales of goods in Canadian fulfillment warehouses to Canadian consumers.

Additionally, fulfillment warehouses are required to keep detailed records and inform the CRA about their non-resident clients and any goods stored on their behalf. The amended rules also create specific requirements for non-resident digital platforms facilitating short-term accommodation, like Airbnb and Vrbo. Under these rules, GST/HST will be applied to all short-term rental accommodations in Canada provided through platforms by both Canadian and foreign property owners. Property owners registered for GST/HST are required to collect and remit the tax on their short-term rentals. In cases where the property owner is not registered, the accommodation platform operator is deemed the supplier and thus bears the responsibility for tax collection and remittance.

1. Introduction: Brief overview of Canada

Canada has a highly developed mixed market economy and often ranks within the top ten largest economies in the world in terms of gross domestic product. While Canada receives a significant amount of foreign direct investment, on a net basis, Canada is a capital-exporting nation.

Canada has a parliamentary system within the context of a constitutional monarchy. Canada is a member of the British Commonwealth, and its Head of State is currently King Charles III. While the government acts in the name of the Crown, it derives its authority from the Canadian people.

Canada's parliamentary system stems from the British, or "Westminster", tradition. Parliament consists of the Crown, the Senate, and the House of Commons, and laws are enacted once they are agreed to by all three parties. Since Canada is a federal state, lawmaking is shared among one federal, ten provincial and three territorial governments.

The judiciary is tasked with interpreting and applying the law and the Constitution, as well as delivering impartial judgments. Furthermore, each province and territory has its own executive, legislative, and judicial branches.

In Canada, income is generally taxed at the federal and provincial levels. The federal statute for taxing income is the *Income Tax Act* (Canada) ("ITA"), and each of the provinces has its own income tax legislation, which is generally consistent with the ITA. The federal GST is imposed by the *Excise Tax Act* (Canada), and most provinces either have their own sales tax legislation or have harmonized their sales tax with the federal GST. Additionally, the federal government is nearing the enactment of a digital services tax, along with two principal elements of the Organisation for Economic Co-operation and Development's ("OECD") Pillar Two global minimum tax in Canada—the income inclusion rule and the domestic minimum top-up tax. Canada is a party to over ninety tax treaties, over twenty tax information and exchange agreements and the Multilateral Instrument.

Canada adheres to a dualist approach to international law, wherein a treaty or any other instrument of international law, once signed and ratified by the executive branch, requires incorporation through domestic law to be enforceable at the national level.

2. Income Tax

2.1. General characteristics

Canada follows a blended schedular/global approach grounded in the source doctrine derived from the United Kingdom's historical tax system. Section 3 of the ITA identifies five enumerated sources of income: (1) office, (2) employment, (3) business, (4) property and (5) capital gains (but only 50% of capital gains net of capital losses included in income). The sources of income are not exhaustive, and income can arise from any other unnamed source; however, Canadian courts have generally interpreted section 3 restrictively and shied away from identifying other sources.[3] A somewhat schedular approach is used for capital gains and losses.

The computation of income from each source is generally determined in the following sequence:

a. characterize receipts as being on account of income or capital;
b. if income, classify the income by source;
c. deduct expenses applicable to each source to determine net income;
d. if capital, determine if there is a capital gain or loss, and include one half of any net capital gains in income; and
e. aggregate the various sources of net income in the sequence set out in section 3.

[3] See e.g. *Canada v Johnson*, 2012 FCA 253 (CanLII), 435 NR 361 (leave to appeal to SCC denied) at para. 25: "It is an open question whether any source of income exists that is not listed in [section 3] … it may never be necessary to determine that question because the words 'business' and 'property' are so broadly defined". Section 56 of the ITA allows for some flexibility that approximates Canada's income tax system to a global approach based on an accretion concept of income. Section 56 encompasses a multitude of income sources that extend beyond those enumerated under section 3.

Residents of Canada are taxable on their worldwide income.[4] Non-residents, on the other hand, are taxed on "taxable income earned in Canada" from being employed in Canada, carrying on business in Canada, and capital gains realized on the disposition of "taxable Canadian property".[5] The nexus between employment income and Canada is generally where the employee physically renders the services, whereas, for business, it is generally where the business activities are considered to occur. The nexus for capital gain and Canada is generally whether the gain is derived, directly or indirectly, from the value of real or immovable property situated in Canada or certain assets used in a business carried on in Canada.

2.2. Main jurisdictional bases

2.2.1. Personality basis

Jurisdiction in public international law generally follows principles derived from international courts (such as the 1927 *Lotus* decision by the Permanent Court of International Justice[6] or the 1955 *Nottebohm* decision by the International Court of Justice[7]) or customary international law. In general, in international law, the territoriality principle offers primary guidance for ascertaining prescriptive jurisdiction. Still, it is complemented by principles of extraterritorial jurisdiction recognized under international law, such as the active personality principle, the passive personality principle, the protective principle, or the universality principle.[8] These principles have had limited hold in international tax law, where principles used to ascertain tax jurisdiction developed significantly apart from, and oblivious to, how doctrines of jurisdiction have evolved in general international law. A case in point is that Canadian courts have referenced the *Lotus* and the *Nottebohm* decisions in cases involving national security law,[9] immigration law,[10] and criminal law,[11] but there is no reference to these cases in Canadian tax cases.

4 Subsection 2(1) of the ITA.
5 Subsection 2(3) of the ITA.
6 *S.S. 'Lotus', France v Turkey* (1927), Judgment No 9, PCIJ Series A No 10, ICGJ 248 (PCIJ 1927) [*Lotus*].
7 *Nottebohm, Liechtenstein v Guatemala* (1955), ICJ Rep 4, ICGJ 185 (ICJ 1955) [*Nottebohm*].
8 See Cedric Ryngaert, *Jurisdiction in International Law*, 2nd ed (Oxford: Oxford University Press, 2015) at 101–44. Our use of the term 'prescriptive jurisdiction' refers to the entitlement of states to consider income taxable under their domestic laws irrespective of their enforceability. However, there is little agreement in the literature about the adequacy of categorizing jurisdiction into two types (enforcement jurisdiction and prescriptive jurisdiction, as established in *Lotus*), or three (to also include adjudicative jurisdiction, as proposed under the Third Restatement of Foreign Relations Law of the United States), or four (to also include investigative jurisdiction, as some have put forth as a way to address the digital economy), or even none (as some have suggested given the artificial nature of the endeavour to separate prescriptive jurisdiction from its complementary dimensions). In any case, most seem to agree that, in practice, these facets of jurisdiction are intertwined. For a discussion, see Kathleen Hixson, "Extraterritorial Jurisdiction Under the Third Restatement of Foreign Relations Law of the United States" (1988) 12:1 Fordham International Law Journal 127; Roger O'Keefe, "Universal Jurisdiction: Clarifying the Basic Concept" (2004) 2:3 Journal of International Criminal Justice 735 at 741; Dan Jerker Svantesson, *Solving the Internet Jurisdiction Puzzle* (Oxford: Oxford University Press, 2017) at 159–70.
9 See, e.g., *X* (Re), 2018 FC 738 (CanLII), [2019] 1 FCR 567.
10 See, e.g., *Katkova v. Canada*, 1997 CanLII 5166 (FC).
11 See, e.g., *R. v. Cook*, 1998 CanLII 802 (SCC), [1998] 2 SCR 597.

In public international law, state jurisdiction generally derives authority from some version of the notion of political allegiance. Political connection is what ultimately justifies the legal interest of a state over a territory or a person, as well as other extraterritorial principles.[12] In contrast, international tax has developed significantly oblivious to these theoretical developments, and it primarily centred on the notion of economic allegiance rather than on political connections. The principle of economic allegiance, notably endorsed by the 1923 Report on Double Taxation commissioned by the League of Nations,[13] has had a strong hold in Canada. Canadian common law references to economic allegiance appear in various decisions by the Tax Court of Canada[14] and the Supreme Court.[15]

Tax nexus is generally considered to follow from the notion of economic allegiance: a subjective nexus, namely the *residence* of the person earning the income, which allows the residence state to tax all of the person's worldwide income regardless of where the income has been produced; and an objective nexus, namely the *source* of the income, which allows the source state to tax all income arising in its territory regardless of the where the person earning the income resides. Canadian common law has generally considered tax residence on the basis of 'economic and social affiliation' to be a strong enough basis to justify Canada's tax jurisdiction.[16]

The first substantive provision in Canada's ITA establishes that "An income tax shall be paid, as required by this Act, on the taxable income for each taxation year of every *person resident* in Canada at any time in the year."[17] This provision implies that Canada will tax a Canadian tax resident on their worldwide income sourced either within or outside the country. In Canada, two main tests determine whether a person is a resident. A person will be a Canadian resident in a taxation year if they ordinarily reside in the country (ordinary residence) or are temporarily present there for more than half of the year (deemed residence). The second test is a bright-line rule that ascertains residence on the basis of physical presence, which considers no other factors aside from a person's presence in the country.[18] For the first test, statutory law does not fully define the meaning of ordinary

[12] See Kenneth Gallant, *International Criminal Jurisdiction: Whose Law Must We Obey?* (Oxford: Oxford University Press, 2022) at 181; James Crawford, *Brownlie's Principles of Public International Law*, 9th ed. (Oxford: Oxford University Press, 2019) at 453.

[13] GWJ Bruins et al, *Report on Double Taxation: Submitted to the Financial Committee* (Geneva: League of Nations, 1923). The report was prepared by four eminent economists at the time: Gijsbert Weijer Jan Bruins from the Commercial University in Rotterdam, Luigi Einaudi from Turin University, Edwin R. A. Seligman from Columbia University, and Sir Josiah Stamp, a British industrialist and economist who later came to be the director of the Bank of England. For a historical analysis of their work, see Sunita Jogarajan, "Stamp, Seligman and the Drafting of the 1923 Experts' Report on Double Taxation" (2013) 5:3 World Tax Journal 368.

[14] See, e.g., *Husky Energy Inc. v. The King*, 2023 TCC 167; Garcia v. The Queen, 2007 TCC 548.

[15] See, e.g., *Canada v. Alta Energy Luxembourg SARL*, 2021 SCC 49, para. 151 ("The allocation of taxing powers follows the theory of 'economic allegiance', under which an economic connection between the state and the taxpayer serves as the basis of taxation").

[16] See *Garcia v. The Queen*, 2007 TCC 548, para. 15 ("The theory underlying the use of residence is that a person should owe economic allegiance to the country with which he or she is currently most closely connected in economic and social terms. Thus, the obligation to pay tax on the basis of residence derives from the principle that persons who benefit from their economic and social affiliation with a country have an obligation to contribute to its public finances. Thus, an intention to reside indefinitely in the country is not necessarily relevant to 'residence'.").

[17] Subsection 2(1) of the ITA.

[18] Para. 250(1)(a) of the ITA deems a person who sojourns in Canada for a period of 183 days in the year to be a resident in Canada throughout the taxation year.

residence, thus deferring the choice of a substantial test to case law.[19] Canadian courts have generally adopted a multifold test, determining that whether a person is a resident generally depends on the degree of that person's relationship with Canada, which relies on a multitude of factors that suggest an economic or social affiliation, such as the maintenance of a dwelling in Canada, familial relationships in the country, the reasons for the time spent in the country in the taxation year and in previous years, and other social and economic associations, such as the ownership of property, membership in clubs or professional organizations, among others.

The leading decision on the meaning of 'resident' for individual tax residence is *Thomson v. M.N.R.*[20] In this decision, Rand J. of the Supreme Court of Canada held 'residence' to be "a matter of the degree to which a person in mind and fact settles into or maintains or centralizes his ordinary mode of living with its accessories in social relations, interests and conveniences at or in the place in question." Therefore, aside from the deemed residence under paragraph 250(1)(a) of the ITA (which deems a resident any person physically present in Canada for more than 183 days in the year), Canadian case law does not adopt a bright-line test for residence. As Rand J. noted in *Thomson*, "it is quite impossible to give it a precise and inclusive definition" so that "in one case it is satisfied by certain elements, in another by others, some common, some new".[21] According to the court, the characterization of a person's residence is a matter of the degree to which the person centralizes in mind and fact their "ordinary mode of living", based on their social relations and interests in the place.[22]

Corporate residence is defined in Canada, as in many other countries, by two alternative tests: the place of incorporation (statutory rule) and the place of management (case law rule). The statutory rule deems any corporation incorporated in Canada after 26 April 1965, to be resident in Canada for tax purposes – this rule applies to all corporations incorporated in Canada after 26 April 1965, regardless of where they are managed or controlled.[23] The common law test based on the place of management requires an analysis of facts and circumstances. According to the common law test, a corporation is resident where its 'central management and control' resides.[24] The place of central management and control has historically been identified with the control that a company's board of directors has over its business and affairs, namely generally where the board meets (*de facto* control).

Trusts receive specific treatment in Canadian tax law. Although they are legally recognized as relationships rather than separate legal entities, Canadian law considers a trust an 'individual' for tax purposes.[25] The residence for trusts is determined by case law.

[19] The ITA provides no guidance to the meaning of residence. Subsection 250(3) generally states that "a reference to a person resident in Canada includes a person who was at the relevant time ordinary resident in Canada".

[20] *Thomson v. MNR*, (1946) [1946] CTC 51 (SCC), 2 DTC 812.

[21] Fn. 20.

[22] Fn. 20 .

[23] Para. 250(4)(a) of the ITA. The ITA also deems a corporation incorporated in Canada prior to 26 April 1965, to be resident in Canada in a taxation year if after that date it becomes resident in Canada at any time under the "common law" rules or carries on business in Canada (para. 250(4)(c) of the Income Tax Act).

[24] *De Beers Consolidated Mines Ltd. v. Howe,* [1906] A.C. 455 (HL) ("In applying the conception of residence to a company, we ought, I think, to proceed as nearly as we can upon the analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business. […] [A] company resides for purposes of income tax where its real business is carried on […]. I regard that as the true rule, and the real business is carried on where the central management and control actually abides.").

[25] Subsection 104(2) of the ITA. Subsection 248(1) defines an individual as "a person other than a corporation".

In the past, courts recurrently considered a trust to reside where its trustee resides.[26] This test allowed, for many years, Canadian taxpayers to avoid Canadian tax on trust income by appointing a trustee residing elsewhere. This changed after *Garron Family Trust v R*, where the Supreme Court of Canada established that "a trust resides [...] where its real business is carried on [...] which is where the central management and control of the trust actually takes place".

2.2.2. *Other jurisdictional bases*

In Canada, territoriality is the main alternative basis for income tax jurisdiction. Under the ITA, non-residents are generally subject to Canadian tax under Parts I, XIII, or XIV of the ITA. Part I, or "ordinary income tax", applies to

a. income from an office or employment derived from services performed in Canada,
b. income from a business carried on in Canada, and
c. taxable capital gains from dispositions of "taxable Canadian property", which are generally gains derived from real or immovable property situated in Canada or certain assets used in a business carried on in Canada.

Part XIII tax at a rate of 25% is withheld at source and generally applies to certain amounts paid or credited to a non-resident by a Canadian resident (e.g. dividends, royalties, interest in certain circumstances). Canada generally follows a formal approach with respect to the nexus of amounts described in Part XIII: the tax residence of the payor is decisive.

If the same income is subject to Part I and Part XIII tax, Part I tax generally overrides Part XIII either automatically or in some cases on a discretionary basis.[27]

If a Canadian resident payor fails to withhold Part XIII withholding and remit it to the CRA, the Canadian resident payor is liable to pay the full amount of such tax on behalf of the non-resident person plus interest and penalties. The primary rationale for imposing liability on the payor is to impose enforcement and collection responsibilities on the payor in Canada, thereby reducing the burden on the Canadian Revenue Agency to collect from payees outside of Canada.

Finally, Part XIV generally applies an additional 25% "branch tax" on non-residents carrying on business in Canada. Part XIV tax is intended to reduce any disparity between a non-resident carrying on business in Canada through a Canadian resident subsidiary—on account of Part XIII withholding tax on dividends paid by the subsidiary—and a non-resident carrying on business directly through a branch.

[26] *McLeod v. Min. of Customs & Excise*, [1917–27] CTC 290 (SCC), 1 DTC 85; *MNR v. Royal Trust Co.*, [1928–34] CTC 74 (SCC), 1 DTC 217; *MNR v. Holden*, [1928–34] CTC 127, 1 DTC 234; *Williams v. Singer*, [1921] 1 AC 65 (HL); *IRC v. Gull*, [1937] 4 All ER 290.

[27] Subsection 215(4) of the ITA, section 805 of the ITR and subsection 248(28) of the ITA which contains an overarching rule intending to deal with anomalous results of double taxation but is limited to preventing double inclusions or double deductions of an amount in computing a taxpayer's income, loss, taxable income, or taxable income earned in Canada, or tax payable under any Part of the ITA. One example of a discretionary basis is section 216 under which a non-resident earning rent that is income from property may elect to pay tax under Part I on a net basis, rather than Part XIII tax applying to the gross amount of rent.

2.3. Dividends

A dividend paid or credited by a corporation resident in Canada to a non-resident is subject to Part XIII withholding tax.

Many rules in the ITA deem a corporation to have paid, and a person or partnership to have received, a dividend even where there is no such dividend as a matter of corporate law. Examples include:

a. If a non-resident shareholder (or contemplated shareholder) of a Canadian resident corporation has received a benefit from the corporation, the corporation is deemed to have paid a dividend to the non-resident.
b. If a Canadian resident corporation has redeemed, repurchased or cancelled shares, the corporation is deemed to have paid a dividend equal to the amount, if any, by which the amount received on the redemption, repurchase, or cancellation exceeds the paid-up of the shares.
c. If interest payable by a Canadian corporation is not deductible under the thin capitalization rules in the ITA, the amount of the non-deductible interest is deemed to be a dividend.

Canada generally takes a formal approach with respect to the nexus of dividends by applying Part XIII withholding tax solely based on whether the dividend is paid or deemed to be paid by a corporation resident in Canada for purposes of the ITA. Other factors, such as the location of the corporation's share register or the listing of shares on a stock exchange, are irrelevant.

2.4. Interest

Part XIII withholding tax may apply to interest paid by a Canadian resident to a non-resident if the payor and payee are not dealing at arm's length or if the interest is "participating debt interest", which generally includes interest that is contingent on some other factor, for example, revenues or profits of the payor. Interest that is "fully exempt interest" is exempt from Part XIII withholding; it includes interest paid by a government in Canada. In some instances, an amount may be deemed interest for purposes of Part XIII, for example, a premium paid on the conversion of a debenture to shares may be considered "participating debt interest" and thus subject to Part XIII withholding.[28]

2.5. Royalties

Rents, royalties, and certain other payments described in paragraph 212(1)(d) of the ITA that are paid or credited to a non-resident by a resident of Canada are subject to Part XIII withholding tax. The types of payments described in paragraph 212(1)(d) may go far beyond payments typically considered royalties under Canada's tax treaties and include many types of payments computed by reference to production, use or profits related to a business or property in Canada.

[28] Subsections 214(7) and 212(3) of the ITA.

Canada takes a largely formal approach such that the tax residence of the payor is decisive in determining nexus; however, the ultimate source of the payment—i.e. whether derived from the use of or production from property in Canada—may also be relevant.

2.6. Income from the sale of goods

Canada generally follows a substantive approach to the sale of goods: income from the sale of goods will normally be included in computing a non-resident's taxable income earned in Canada under Part I if the goods are sold in the course of carrying on business in Canada.

The determination of whether a business is carried on in Canada depends on factors identified in the common law—e.g. the place where the contract is concluded—as well as whether the business is deemed to be carried on in Canada under section 253 of the ITA. In particular, section 253(b) deems a non-resident to be carrying on business in Canada if the non-resident solicits orders or offers anything for sale in Canada through an agent or employee, whether the contract or transaction is to be completed inside or outside Canada or partly in and partly outside Canada. A non-resident may be considered carrying on business in Canada even though the person may not have a permanent establishment in Canada.

2.7. Income from services (general and specific)

If a non-resident earns income from services rendered while physically present in Canada, then it is highly likely the non-resident is carrying on business in Canada, and such income must be included in computing their taxable income earned in Canada under Part I. In addition, the payor must withhold 15% from the services fees and remit to CRA,[29] unless a waiver from the tax authority is obtained. The withholding obligation applies to payors regardless of whether they reside in Canada.

If a Canadian resident pays fees to a non-resident for management or administrative services, Part XIII withholding tax of 25% generally applies. In cases where Part I and Part XIII may be applicable, Part I would generally override Part XIII.

The rationale for imposing Part I tax in these circumstances is primarily territoriality—the non-resident is carrying on business in Canada. Presumably, the rationale for Part XIII is to generally protect against base erosion, such as when a parent company is repatriating profits from its Canadian subsidiary as deductible services fees. Again, the rationale for the withholding and remittance obligations is to protect Canada's ability to enforce their tax laws and collect from non-residents who otherwise have little connection to or assets in Canada.

2.8. Pensions

Pension benefits received by a resident of Canada are generally included in their income regardless of where the payor is, or whether a private or state pension plan.

[29] An additional 9% must be withheld and remitted to the Quebec tax authority if services are rendered in Quebec.

Part XIII withholding tax applies to the gross amount of a pension benefit paid by a Canadian resident to a non-resident subject to certain exceptions.[30] A non-resident may elect to be taxed under Part I as if the non-resident were resident in Canada and subject to a lower marginal income tax rate because they had little other income.[31]

2.9. Employment income and director fees

Non-residents are generally required to include income from an office or employment in Canada in computing their taxable income earned in Canada, and for this purpose, a director is considered an employee. Nexus generally hinges on whether the duties or services are performed while physically present in Canada, regardless of whether the employer or payor of the remuneration is resident in Canada. A person who pays salaries, wages and other remuneration to an individual in respect of an office or employment in Canada is generally required to deduct amounts in respect of income tax and other payroll amounts and to remit such amounts to the appropriate tax authority[32] unless the tax authority grants a waiver (generally because the individual's income is treaty exempt) or the employer is a certified non-resident employer and the employee is working in Canada for a short term.[33] If a payor fails to deduct and remit payroll amounts, the payor may be liable for the entire amount that should have been deducted and remitted.

The rationale for subjecting remuneration earned by an employee or director to Part I tax is territoriality—the income is earned for services rendered in Canada. The rationale for imposing the remittance obligation of the payor (even if not the employer) is twofold: (i) it is consistent with the general rule in the domestic context that income and payroll amounts should be deducted from employee remuneration; and (ii) in most cases the payor has a meaningful presence in Canada that necessitated the employee's presence in Canada and therefore it will be easier for the tax authorities to collect from the payor.

2.10. Capital gains

Canada takes a substantive approach to capital gains taxation with respect to non-residents. A capital gain is included in computing a non-resident's taxable income earned in Canada if the capital gain is realized on the disposition of "taxable Canadian property".
Taxable Canadian property generally includes:

a. real or immovable property situated in Canada;
b. certain intangible property or property described in the inventory of a business carried on in Canada (subject to certain industry-specific exceptions);
c. unlisted securities, including corporate shares, partnerships interests and trust interests or units, where at any time in the preceding 60 months more than 50% of the fair market

[30] Para. 212(1)(h) of the ITA.
[31] S. 217 of the ITA.
[32] S. 102 of the ITR.
[33] Government of Canada, *Non-resident employer certification* at <https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/information-been-moved/rendering-services-canada/non-resident-employer-certification.html>.

value of the security was derived directly or indirectly from real property situated in Canada or certain Canadian mineral, oil and gas or timber property;

d. shares of a corporation or units of a trust listed on a designated stock exchange where at any time in the preceding 60 months (i) more than 50% of the fair market value of the security was derived directly or indirectly from real property situated in Canada or certain Canadian mineral, oil and gas or timber property and (ii) the non-resident alone or together with certain persons or partnerships owned more than 25% of the issued shares of a particular class of the corporation or the issued units of the trust; or
e. an option in respect of, or an interest in any property described above.[34]

Section 116 of the ITA contains rules designed to protect Canada's ability to collect tax on a capital gain realized on taxable Canadian property by non-residents. Subject to certain exceptions, section 116 requires a purchaser (regardless of residence) who is buying taxable Canadian property from a non-resident to withhold 25% to 50% of the gross purchase price unless the non-resident seller obtains a certificate of clearance from the CRA. Similar to the rules in Part XIII, if the purchaser fails to withhold and remit when required, the purchaser is liable for the amount that should have been withheld and remitted. In an arm's length transaction, the purchaser typically holds 25% to 50% of the gross purchase price in escrow until the non-resident seller obtains the certificate of clearance on the consent of the CRA in the form of a comfort letter. Upon receipt of the certificate, the purchaser pays out the withheld amount to the CRA or the non-resident seller as required by the CRA and the terms of the escrow.

There are no special concessions available to short-term residents with respect to the taxation of capital gains on taxable Canadian property. However, if a non-resident (other than a trust) becomes a resident in Canada for a period of less than 60 months, then the non-resident is generally not subject to Canadian Part I tax on capital gains that accrued on other property they owned before they became a resident in Canada.

The rationale for Canada's taxation of capital gains on taxable Canadian property is primarily territoriality because the gain is attributed to real and natural resource property situated in Canada. The rationale for the section 116 rules is to protect Canada's ability to enforce its tax rules and collect from non-residents.

2.11. Payments or transactions between foreign persons

Below, we consider how Canadian tax may apply in the following examples.

Example 1: Some countries such as Germany claim an income tax nexus based on the registration of intellectual property as sufficient to either trigger a source-based tax on payments in relation to such intellectual property rights (e.g. royalties) or require at least tax reporting about such payments.

Canada has no such registration requirement.

Example 2: Some states maintain rules according to which interest paid on money borrowed between a foreign debtor and a foreign creditor leads to source-based tax when the loan is secured by an

[34] Subsection 248(1) of the ITA.

immovable (or real) property located within that state (referred to as mortgage bonds in some countries).

Under the ITA, a non-resident would generally only be required to withhold under Part XIII in certain narrow circumstances where the payment is deductible in computing a non-resident's taxable income earned in Canada.[35]

Example 3: Some states have specific source rules according to which a capital gain realized on a foreign-to-foreign transaction (i.e. both the buyer and the seller are resident abroad) is nevertheless subject to (corporate) income taxation. This type of source rule may take different forms. For example, some countries may either interpret, or expand the legislative meaning of "real or immovable property" or "real estate" to include movable property (such as shares in companies) that derive their value, indirectly, for some or all part, from underlying property located in such a state. The underlying property can be real or immovable property such as land, or rights or privileges attaching to land or the territory of a state (e.g. mining licences, mobile phone operator licences, broadcasting licences, etc.). This type of nexus is prevalent for so-called offshore indirect share sales.

As described above, under the ITA, a non-resident must include a capital gain realized on "taxable Canadian property" in computing their taxable income earned in Canada and, subject to certain exceptions, the section 116 withholding and clearance certificate rules (as described in section 2.10. above) apply regardless of the purchaser's place of residency, subject to certain exceptions. The concept of "taxable Canadian property" is very broad and includes securities that derive their value primarily from Canadian real or immovable property. Notable exceptions to section 116 (but not to taxable Canadian property) are if the property being disposed of is a security listed on a designated stock exchange, or bond, debenture or similar debt obligation.

Example 4: Some states have CFC rules according to which income arising from transactions between foreign entities is subject to domestic corporate income taxation. If the state has implemented any source (or residence) taxation in these or similar situations, is there a particular justification for nexus?

Canada has a comprehensive set of CFC rules, referred to as the foreign affiliate rules. The foreign affiliate rules are generally concerned with taxing income earned on highly mobile capital and transactions that are perceived to erode the Canadian tax base.

Very generally, if a controlled foreign affiliate of a Canadian resident earns "foreign accrual property income" ("FAPI") such income is included in the Part I income of the Canadian resident. FAPI includes many types of income, such as: passive income from property; income from a business the principal purpose of which is to earn income from property (i.e. leasing, licencing, investment income) and does not employ more than five full-time employees; and income from services provided by the foreign affiliate but are performed by persons in Canada.

At a high level, Canada's foreign affiliate rules are generally aimed at income that may have a closer nexus to the foreign jurisdiction in a traditional sense, however in Canada's

[35] See e.g. subsection 214(9) of the ITA, which deems a non-resident to be resident in Canada for purposes of Part XIII of the ITA.

view such income could have been earned by persons resident in Canada and is not necessarily tied to the foreign jurisdiction.

3. Value Added Tax (or General Sales Tax)

Canada is one of the few countries in the world with a value-added tax system where the tax is raised at the federal and the local (provincial) levels. Canada's sales tax system includes several key components: GST, the Harmonized Sales Tax ("HST"), Provincial Sales Taxes ("PSTs"), and the Quebec Sales Tax ("QST"). The GST, a federal tax introduced in 1991, is a value-added tax applied to most goods and services sold in Canada. The HST is a combination of the GST and the provincial sales tax in certain provinces, creating a single, unified tax. The PSTs, on the other hand, are retail sales taxes imposed by individual provinces on the sale of goods and services within their jurisdictions. Each province decides its own PST rate and rules. Lastly, the QST, specific to the province of Quebec, functions similarly to the GST but is administered by the province.[36]

Due to the dual-level nature of sales taxation in Canada, ascertaining the place of supply for goods or services entails a two-step process. Initially, one must determine whether a supply occurs within Canada or, alternatively, if it constitutes an import into Canada. Only subsequent to this determination are provincial rules pertaining to the place of supply considered.

Complexities in determining the place of supply arise particularly when transactions span multiple provinces. Moreover, a supply might be rendered partly in Canada and partly outside Canada. There are also special rules governing the movement of goods and services between provinces that participate in the HST and those that do not, as well as between provinces that apply different HST rates.

Only supplies deemed to have been made in Canada are subject to GST and HST.[37] If a supply is not made in Canada, then it is deemed not to be made in a Canadian province, in which case the supply might still attract the GST or HST if it is considered an importation of goods or services. Where a supply is made in Canada, the next step is to determine whether it occurs in a participating or non-participating province. In the case of a participating province, the tax is imposed at the prevailing HST rate. Conversely, the GST rate applies if the supply occurs in a non-participating province.

Where a supply is made by a non-resident, the "non-resident override rule" applies.[38] Under this rule, all supplies of personal property or service made in Canada by a non-resident of Canada are deemed to be made outside Canada (and, therefore, outside the scope of GST/HST), except where:

a. the supply is made in the course of a business carried on in Canada (in which case, registration and tax collection on said supply is required);
b. the non-resident is a GST/HST registrant; or

[36] This chapter focuses on the concept of nexus within the frameworks of GST, HST, and QST, which have the nature of value-added taxes. Since PSTs are single-stage, cascading taxes, they are excluded from the discussion in this chapter.

[37] See subsections 165(1) and (2) of Division II of the ETA.

[38] S. 143(1) of the ETA.

c. the supply is an admission to a place of amusement, seminar, activity, or event charged by the non-resident, where the admission was not acquired by the non-resident from another person (in which case, registration and tax collection on said supply is required).

Where the conditions for applying the non-resident override rule above are not met, the supply is not automatically deemed to be made in Canada. If the non-resident override rule does not relieve a transaction from tax, the following rules must be considered in order to determine whether a supply is made inside or outside Canada for GST/HST purposes. A supply is deemed to be made in Canada in the following circumstances:

a. in the case of the sale of tangible personal property, the goods are, or are to be, delivered or made available in Canada to the recipient of the supply;[39]
b. in the case of the supply of tangible personal property otherwise than by way of sale (e.g., by lease), possession or use of the property is given or made available in Canada (see below);[40]
c. in the case of a supply of intangible personal property, the property may be used in whole or in part in Canada, or the property relates to real or tangible personal property, or a service to be performed, in Canada;[41]
d. in the case of a supply of real property, or of a service in relation to real property, the property is situated in Canada;[42] and
e. in the case of the supply of a service, the service is to be performed in whole or in part in Canada.[43]

For tangible personal property, the place of supply is typically determined by the place of legal delivery of the goods. The point of legal delivery is often based on the trade terms specified in the supply agreement, such as the Incoterms. Conversely, a supply of tangible personal property is deemed to occur outside Canada under a set of conditions reverse of the above (i.e., if the goods are delivered or made available outside Canada). However, it is important to note that a service is not deemed supplied outside Canada unless it is entirely performed outside Canadian borders. Similarly, an intangible is not treated as supplied outside Canada unless its use is restricted to outside Canada or if it is related to real property located outside Canada, tangible personal property that is ordinarily situated outside Canada, or a service to be entirely performed outside Canada.[44]

For telecommunication services, specifically those that entail providing access to telecommunications facilities to a user, the place of supply for GST purposes is determined based on the location of the facilities. If any part of these facilities is situated in Canada, the supply is deemed to be made in Canada. In cases not involving the direct provision of facilities, the supply of the service is deemed to be made in Canada if the

[39] Section 142(1)(a) of the ETA; *Toyota Tsusho America Inc. v. The Queen* (1997), 5 GTC 1178 (TCC), where the TCC upheld a penalty assessed on a US GST registrant for failure to collect GST on shipments of vehicles from the USA to Canadian customers, where the Incoterms indicated that legal delivery occurred at the Canadian location, after the customers had arranged for the clearance of the goods through customs as Importer of Record.

[40] S. 142(1)(b) of the ETA.

[41] S. 142(1)© of the ETA.

[42] S. 142(1)(d) of the ETA.

[43] S. 142(1)(g) of the ETA.

[44] S. 142(2) of the ETA.

telecommunication is both emitted and received within Canada or if either the emission or reception of the telecommunication happens in Canada coupled with the billing location being in Canada. This latter scenario is commonly referred to as the "'two-out-of-three rule".[45] For these purposes, the billing location is deemed to be in Canada if the charges for the services are billed to an account associated with a telecommunications facility that is ordinarily situated in Canada. Alternatively, the supply is also deemed to be made in Canada if the telecommunications facility used to initiate the service is located within Canadian territory.[46]

The determination of nexus for HST is contingent upon the presence of nexus for GST. When it's established that a supply is made within Canada, the next step is to ascertain whether the supply takes place in a participating province, which is a requirement for the imposition of HST on the supply. A distinct and more intricate set of place of supply rules apply for this purpose.[47] A supply is deemed to have been made in a particular province if it is first deemed to be made in Canada and then is deemed to be made in that province under the HST place of supply rules. In any other scenario, the supply is deemed to be made outside that particular province. If a supply occurring in Canada is not deemed to be made in a participating province, it is then considered to have been made in a non-participating province.[48]

Quebec operates under distinct rules for determining the place of supply. According to the QST place of supply rules, if a supply is not deemed to be made in Quebec, it is automatically deemed to have occurred outside of Quebec.[49] It's important to note that these QST place of supply rules are subject to the operation of the non-resident override rule discussed above.[50] The QST rules place greater emphasis on the recipient's location over the supplier's in determining the place of supply for services and intangibles. However, for tangible personal property and real property, the rules generally align with those of the HST to ensure consistency. This ensures that the same rules are applied in determining the place of supply across various provinces, including Quebec.

Where a service provider in Canada obtains, in the normal course of business, a specific address of the recipient, the supply is deemed to be made in the province where this address is located. Where multiple home or business addresses in Canada are obtained, the address most closely connected to the supply is considered, such as the "contracting address." Where no home or business address in Canada is obtained, the place of supply is any other Canadian address located in the province and most closely associated with the supply. Typically, the "contracting address" is the business address in Canada from which the contract is negotiated, often the head office of the purchasing organization. This is common in scenarios where a supplier signs a national contract with a client for services at various customer locations. While an office, branch, factory, workshop, or service depot may qualify as a business address for this rule, a post office box generally does not. However, a

45 S. 142.1 of the ETA. See also Arsenault and Ducharme, "Telecommunications or not Telecommunications?", Tab 4, 1999 Commodity Tax Symposium.

46 S. 142.1(1) of the ETA.

47 S. 144.1 and Schedule IX of the ETA, parts of which have been replaced by the New Harmonized Value-added Tax System Regulations.

48 S. 144.1 of the ETA.

49 S. 22.32 of the *Quebec Sales Tax Act* [*QSTA*].

50 S. 23 and 22.6 of the QSTA.

post office box could be considered as another address of the recipient in cases where no business address in Canada is obtained.[51]

Where the vendor does not acquire the recipient's home or business address in Canada, the place of supply is deemed to be in a participating province if the majority (over 50%) of the service's Canadian component is performed in those provinces. If the service is performed in two or more participating provinces, the place of supply is deemed to be the province where the largest portion of the service's Canadian element is carried out. Additionally, if this Canadian component is equally performed in multiple participating provinces, the supply is deemed to be made in the province with the highest provincial HST rate.

In cases where the Canadian element is equally performed in two or more participating provinces with identical HST rates (referred to as specified provinces), the place of supply will be the specified province where the business address of the supplier which is most closely connected with the supply is located or, if that address is not in one of the specified provinces, the nearest specified province by any reasonable measure. This last rule is commonly known as the "tie-breaker rule." In addition, where the vendor does not obtain the recipient's address, and the portion of the service performed in Canada is not primarily performed in the participating provinces, the place of supply will be deemed to be in a non-participating province.[52]

4. Real estate taxes

A non-resident earning income from real estate situated in Canada will generally be subject to Part I tax if the income is from activities that constitute carrying on business in Canada. If the non-resident is earning more passive income, such as rental income, the non-resident may elect to pay Part I tax generally on its net income,[53] or Part XIII tax on gross rent.[54]

As discussed above in section 2.10., a non-resident must include in their Part I taxable income earned in Canada any capital gain realized on the disposition of "taxable Canadian property", which generally includes an interest in or right to real property situated in Canada. A security, such as a corporate share, partnership interest or trust unit or interest, may also be taxable Canadian property if more than 50% of the fair market value of the security is derived from real property situated in Canada at any time in the 60 months preceding the disposition.

Subject to certain exceptions, the withholding and certificate rules under section 116 of the ITA (described above in section 2.10.) will apply where a non-resident disposes of taxable Canadian property regardless of whether the purchaser is a Canadian resident.

[51] S. 13(1) of the New Harmonized Value-added Tax System Regulations. See also GST/HST Technical Information Bulletin B-103, "Harmonized Sales Tax—Place of supply rules for determining whether a supply is made in a province". For further discussion on the use of the recipient's address to determine the place of supply, see Day, "More Questions than Answers", GST & Commodity Tax, Vol. XXIV, No. 3, June/July 2010 (Carswell).

[52] S. 13(2) of the *New Harmonized Value-added Tax System Regulations*.

[53] S. 216 of the ITA.

[54] Para. 212(1)(d) of the ITA.

There is a plethora of other Canadian federal, provincial and municipal taxes in respect of Canadian real estate, ranging from property tax to land transfer taxes to vacancy taxes, all of which may be imposed on, or are specifically targeted at, non-residents.

The following example illustrates how Canadian taxes may apply to the sale of property that derives its value from real estate in Canada: Assume a non-resident owns units of a non-resident global real estate fund that owns real property situated in Canada and the non-resident sells the fund units to a non-resident third party. The units are not listed on a stock exchange. In this example, if more than 50% of the fair market value of the fund units is attributable to real property situated in Canada, then the units should generally constitute taxable Canadian property regardless of whether the fund is structured as a partnership or trust. The non-resident seller should be subject to Part I of the ITA, and the parties would need to comply with the withholding and clearance certificate requirements in section 116 of the ITA. The non-resident purchaser would also need to investigate whether the acquisition of the units may be subject to provincial or municipal land transfer taxes since certain provincial rules may effectively treat the non-resident as acquiring the real property directly.

5. Natural resources and energy taxation

In general, the exploration, development or extraction of mineral, oil and gas or timber resources in Canada constitutes carrying on business in Canada,[55] therefore non-residents engaged in such activities are generally subject to Part I tax.

A non-resident may also be subject to Part I tax if they dispose of an interest in or right to a mineral, oil and gas or timber property situated in Canada that is taxable Canadian property, including a licence, an option to acquire or a royalty computed by reference to production. A security, such as a corporate share, partnership interest, or trust unit that derives more than 50% of its value from a mineral, oil and gas or timber property in Canada may also constitute taxable Canadian property. Section 116 withholding and certificate rules also generally apply to dispositions of resource properties that are taxable Canadian property.

Part XIII withholding tax may apply to amounts paid or credited to a non-resident where the amount is computed by reference to production from a resource situated in Canada.

In addition, certain provinces impose mineral or resource taxes on the value of resources extracted within their jurisdiction, minus certain prescribed expenses and allowances for capital expenditures.

[55] S. 253 of the ITA.

6. Other (indirect) taxes

6.1. Financial transfer tax

Canada does not charge a specific turnover tax in the form of a financial transfer tax, but the transfer of a financial instrument will generally trigger capital gains taxation. The supply of financial services is exempt under the GST/HST.[56]

In 2023, the federal government proposed legislation to implement a 2% tax on the annual net value of shares repurchased by public corporations. This measure is inspired by and is broadly similar to a US measure taxing share buybacks. Some have compared this Canadian tax to a stamp tax on share redemptions and repurchases.

6.2. Inheritance or wealth taxes

Upon death, a taxpayer is generally deemed to dispose of their assets for proceeds equal to the fair market value of the assets immediately before death. This deemed disposition rule generally applies to non-residents holding taxable Canadian property at the time of death.

While there is no inheritance tax in Canada, provinces may impose probate fees or estate administration taxes on the value of a deceased taxpayer's estate.

6.3. Digital services or economic activities

6.3.1. Digital Services Tax

Canada's Department of Finance announced its intention to implement a Digital Services Tax ("DST") in its 2020 Fall Economic Statement, following the lead of other OECD countries, including France, Spain, Austria, Italy and the United Kingdom. Canada's main rationale for enacting a DST is a commitment to "ending the corporate tax race to the bottom", "ensuring that multinational corporations pay their fair share of tax wherever they do business", and "putting Canadian workers and businesses on a level playing field with [...] global competitors."[57]

The Canadian government has expressed a preference for a collective international solution and is thus advancing its DST as a temporary measure, intended to be in place only until a global approach is established. While endorsing the two-pillar proposal, the Canadian government introduced a draft of the DST legislation in December 2021 for public consultation. It was understood that this proposed DST would not be enacted until at least 1 January 2024 and might never come into effect if the Pillar One measures were to be implemented by the end of 2023 as anticipated. However, if the multilateral approach failed to materialize by 2023, Canada's DST would be activated in January 2024, with its effects retroactively applied to 1 January 2022.

The deadline was based on earlier statements by the OECD-led Inclusive Framework that

[56] Schedule V, Part VII, s. 1 of the ETA.

[57] Canada, *Federal Budget 2023* (Chapter 6: Effective Government and a Fair Tax System) at <https://www.budget.canada.ca/2023/report-rapport/chap6-en.html>.

BEPS Pillar One would be implemented by 2024. After the agreement within the Inclusive Framework to a further one-year standstill into 2025,[58] Canada's Minister of Finance issued a statement. This statement reaffirmed Canada's commitment to a multilateral solution as a priority and preference but highlighted that postponing the implementation of Canada's DST would place Canada at a competitive disadvantage compared to countries already generating revenue through their existing DSTs.[59]

Canada's DST consists of a tax of 3% on revenues derived by residents and non-residents of Canada from certain digital services they provide.[60] The targeted revenues are generally those that arise in connection with the digital service providers' engagement with online users in Canada. These revenues include certain revenue relating to online marketplaces, online targeted advertising, social media platforms and the sale or licensing of user data. The tax is aimed at large businesses with annual revenues of €750,000,000 or more and Canadian digital services revenue (as defined in the legislation) of more than $20,000,000.

Canada's DST, if implemented, will be based on a demand-side source-based nexus, i.e., a user located in Canada, thus defined as "any individual [...] or an entity that interacts (directly or indirectly in any manner whatever) with a digital interface."[61] Whenever an individual is acting in the course of an entity's business, it is the entity that will be characterized as the user. Accordingly, if two or more employees of the same business interact with the digital interface in the performance of their employment activities, the business will be considered a single user.

The statutory definition of "user located in Canada" is circular ("user located in Canada, at any time, means a user in respect of which it is reasonable to conclude [...] that the user is located in Canada at that time [...]").[62] Nonetheless, the legal definition provides that the determination of the user's location will be based on the data associated with the user, including the "billing, delivery or shipping address, or the phone number area code, most recently provided by the user; global navigation satellite systems data; and Internet Protocol address data".[63] Following the broad definition of "user", a user of online advertising services will not be the person contracting the advertising services, but rather the person interacting with the online targeted advertisement.

Therefore, for the purposes of the DST, nexus is not established based on factors related to the entity generating revenue from the pertinent digital activities or the entity contracting for the services. Instead, nexus is determined by the location of the individual who is the target of or interacts with the advertisement.

[58] OECD, "Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy" (11 July 2023) at <https://www.oecd.org/tax/beps/outcome-statement-on-the-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2023.pdf>.

[59] Department of Finance Canada, *Legislative and Regulatory Proposals Relating to the Digital Services Tax Act* (12 July 2023), online <https://www.canada.ca/en/department-finance/news/2023/07/statement-by-the-deputy-prime-minister-on-international-tax-reform-negotiations.html>.

[60] See Government of Canada, *Notice of Ways and Means Motion to introduce a bill entitled An Act to implement certain provisions of the fall economic statement tabled in Parliament on November 21, 2023 and certain provisions of the budget tabled in Parliament on March 28, 2023*, online: Government of Canada < https://fin.canada.ca/drleg-apl/2023/ita-lir-0823-l-3-eng.pdf >. This considers the revised draft of the *Digital Services Tax Act*, released for public comment on 23 November 2023, along with the *Digital Services Tax Regulations*.

[61] Fn. 60.

[62] Fn. 60.

[63] Fn. 60.

6.3.2. Value Added Tax on digital goods and services

The GST/HST that is payable when a supplier sells a taxable good or service in Canada is formally imposed on the recipient when the supply is considered to be "made in Canada," although the tax is normally collected and remitted by the supplier.

The emergence of online platforms and services has posed challenges to the traditional principles and nexus definitions in Canadian GST/HST legislation. Prior to the 2021 amendments, many online foreign vendors were not required to register for GST/HST. Consequently, while consumers theoretically owed the tax on their purchases, it was not collected by the CRA. This scenario was particularly common in online transactions involving intangible properties and services to Canadian consumers. As a result, certain non-resident entities with significant sales in Canada were not obligated to register, effectively exempting their supplies from GST/HST. Canadian consumers were technically supposed to self-assess and remit the GST/HST to the CRA, but this was rare in practice. Thus, for all practical purposes, supplies by foreign online sellers to the Canadian market were essentially non-taxable.

In contrast, Canadian-based sellers, barring small suppliers with annual sales under $30,000, were generally required to register for GST/HST and charge the tax to their Canadian customers. This regulatory framework placed Canadian businesses at a competitive disadvantage. A similar pattern of non-compliance was observed among many small-scale suppliers of online short-term accommodation rentals through platforms like Airbnb. This placed traditional hotels and inns, which were required to collect and remit tax, at a disadvantage.

These competitive disparities were exacerbated by the COVID-19 pandemic, which brought a nearly 70 per cent increase in retail e-commerce sales in the first eight months of 2020. This scenario prompted the Department of Finance to introduce the 2021 amendments, which were intended to level the playing field.

The 2021 amendments generally follow the OECD's International VAT/GST Guidelines.[64] Foreign-based online vendors and digital platform operators (i.e., online marketplaces), without a physical presence in Canada and exceeding a $30,000 registration threshold, are now required to register under a new simplified regime. This involves collecting and remitting GST/HST on specific taxable sales, including digital products and services like mobile apps and streaming of music and movies to Canadian consumers.

The regulations mandate that affected non-resident vendors and digital platform operators collect GST/HST on sales to Canadian customers who are not registered for GST/HST. These foreign entities must implement systems to gather GST/HST registration details and ascertain the recipient's residence to apply the correct GST/HST rate. In this simplified regime, non-residents are not obliged to collect GST/HST from customers who are registered for GST/HST, nor can they claim input tax credits for GST/HST paid on their expenses. Non-resident vendors and platform operators subject to these rules may opt to register under the conventional GST/HST system, thereby subjecting themselves to all standard GST/HST regulations.

Similar concerns about fairness arise when Canadians purchase goods from online vendors or through digital platforms that lack a physical presence in Canada but store their goods in Canadian fulfillment warehouses. While GST/HST is applied upon importation,

[64] OECD, *International VAT/GST Guidelines* (Paris: OECD Publishing, 2017).

it isn't levied on the final sale price of these goods within Canada. This contrasts with Canadian-based online vendors operating on the same digital platforms and using identical fulfillment warehouses, who must charge GST/HST on the final sale price.

To address this disparity, the amended rules subject all sales to Canadians facilitated by non-resident vendors or digital platform operators using Canadian fulfillment warehouses to GST/HST. These rules require vendors and digital platform operators exceeding $30,000 in sales over 12 months to register under the normal GST/HST regime. Consequently, they must collect and remit GST/HST on sales of goods in Canadian fulfillment warehouses to Canadian consumers. Additionally, fulfillment warehouses are required to keep detailed records and inform the CRA about their non-resident clients and any goods stored on their behalf.

Finally, the amended rules also create specific requirements for non-resident digital platforms facilitating short-term accommodation like Airbnb. Many property owners use digital platforms to rent out their residences or other properties without charging GST/HST, either due to a lack of awareness of the rules or because their rental income falls below the $30,000 registration threshold. This situation raises fairness issues for hotels and other traditional lodging providers, exacerbated by the absence of GST/HST collection responsibilities for digital platforms facilitating these rentals.

Under the new rules, GST/HST will be applied to all short-term rental accommodations in Canada provided through platforms by both Canadian and foreign property owners. Property owners registered for GST/HST are required to collect and remit the tax on their short-term rentals. In cases where the property owner is not registered, the accommodation platform operator is deemed the supplier and thus bears the responsibility for tax collection and remittance.

Accommodation platform operators can register to collect and remit GST/HST under the simplified regime. Short-term accommodation typically refers to the rental of a residential complex or unit for less than a month at a rate exceeding $20 per day. Accommodation platform operators are required to keep detailed records and submit an information return to the CRA for each calendar year within six months following the year's end.

6.4. Shipping

Canada is surrounded by three oceans and has many international shipping ports. Canada has been a signatory to the United Nations Convention on the Law of the Sea since 1993. Also, in 1958 Canada signed but did not ratify the Geneva Convention on the High Seas.

Canada has generally applied an "anti-nexus" solution to achieve the intended goal of attracting and retaining management of international shipping groups—that is, by providing an exemption from Canadian taxation where a foreign company is managed and controlled in and from Canada in certain circumstances.

More specifically, the ITA contains the concept of an international shipping corporation[65] that effectively deems companies incorporated in foreign jurisdictions but managed in Canada (that would normally be resident in Canada) not to be tax residents in Canada where

[65] Subsection 250(6) of the ITA.

a. the company carries on international shipping[66] as its principal business directly or indirectly through certain eligible entities,
b. all or substantially all (generally 90% or more) of the company's gross revenue for the year is from international shipping earned directly or indirectly through certain eligible entities, and
c. the company is not continued to Canada.

A separate rule includes a reciprocity requirement for claiming a specific exemption for international shipping income by non-residents. In particular, Canadian-sourced income of a non-resident from international shipping is not included in computing a non-resident's taxable income earned in Canada provided that the jurisdiction in which the person is tax resident grants substantially similar relief to persons resident in Canada.[67] The CRA has historically been of the view that the reciprocity requirement is met where a foreign jurisdiction does not impose an income tax, or the income of persons resident in Canada from the operation of a ship in international traffic is exempt from tax in such foreign country by virtue of domestic legislation of such country or by tax treaty between the foreign jurisdiction and Canada.[68]

In 2023, the Canadian federal government announced proposals to align the current exemption for international shipping income in the ITA with the approach taken under Pillar Two. The Pillar Two global minimum tax generally excludes international shipping income; however, one condition for the exclusion is that the "strategic or commercial management" of the shipping operations be located in the same jurisdiction where its income is booked. Therefore, taxpayers that meet the current exemption in the ITA for foreign shipping companies—managed from Canada but income is booked to another jurisdiction—may not qualify for the exclusion under Pillar Two. The proposed amendments to the ITA and the proposed GMTA are intended to remedy this inconsistency by extending the international shipping income exemption to Canadian residents including foreign corporations managed from Canada.

6.5. Other taxes

We have not identified any material nexus issues from other taxes.

6.6. Specific issues concerning federal/regional tax systems

In Canada, the federal and provincial governments have concurrent jurisdiction to implement and regulate income and sales taxes. Consequently, there are distinct nexus rules at the national and provincial levels, reflecting their respective legislative authorities.

Yet, for both the income tax system and the value-added tax system, the characterization of national nexus is a prerequisite for establishing provincial nexus. Thus, they raise no

[66] The term "international shipping" is defined in subsection 248(1) of the ITA to include, *inter alia*, the operation of a ship owned or leased by a person or partnership that is used primarily in transporting passengers or goods in international traffic.
[67] Para. 81(1)(c) of the ITA.
[68] Technical Interpretation of 26 July 1991 (Tax Window, No. 7, p. 2, 1376).

specific issues concerning a federal and provincial mismatch of nexus. For greater detail, see sections 2 (income tax) and 3 (value-added tax).

7. (Non-tax) Legal instruments & tax nexus

We have not identified any relevant issues relating to tax nexus and non-tax legal instruments.

The primary statutory source for federal income tax in Canada is the ITA. However, a range of other legal documents also significantly contribute to the framework of Canada's tax system.

The ITA delegates many detailed income tax rules to the Income Tax Regulations ("ITR"). Unlike regular legislation, regulations in Canada are not subject to parliamentary approval. They are enacted by the Governor General in Council upon the recommendation of the Minister of Finance and are generally considered to have legal force, provided they do not contradict their parent legislation.

The ITR, established under the authority of section 221 of the ITA, encompasses a variety of provisions relevant to tax nexus. These include specific regulations on the taxation of foreign affiliates (section 5900 and following of the ITR), rules regarding deductions for payments to non-residents (section 105 of the ITR), requirements for tax information on payments to non-residents (section 202 of the ITR), stipulations for non-residents conducting business in Canada (section 805 of the ITR), and definitions applicable to non-resident corporations (section 413 of the ITR). Furthermore, the ITR lays down the legal basis for determining jurisdiction at the provincial level (section 2601 of the ITR).

The Minister of National Revenue and the Minister of Finance also possess the authority to make certain designations under the ITA through means other than regulations under the ITA. One example is the designation of notifiable transactions as per subsection 237.4(3) of the ITA (however, such designations must be made with the "concurrence" of the Department of Finance). Another example is the designation of stock exchanges by the Minister of Finance as per section 262 of the ITA. Among other things, this is relevant for determining whether a share qualifies as "taxable capital property" to determine whether a capital gain realized by a non-resident is subject to Canadian tax or whether withholding under section 116 of the ITA applies.

The CRA also issues several documents that, in principle, do not carry the force of law but can have relevant implications. These documents include information circulars, interpretation bulletins, income tax folios, and informational guides. Typically, they offer a detailed examination of specific topics in tax law and are intended to serve as references to statutory and case law. However, some of these documents have been noted to extend beyond the stipulations of the law.

For example, there is no clear statutory definition of tax residence in Canada. Case law typically hinges on factors that are highly dependent on the unique circumstances of each case. However, a CRA administrative policy document offers a specific definition of tax residence based on "significant residential ties" (such as having a dwelling place, spouse or common-law partner, and dependants in Canada) and "secondary residential ties", which include a list of factors like owning personal property in Canada, holding a

Canadian passport, and membership in Canadian unions or professional organizations.[69] These factors, although not legally binding, are often followed by taxpayers as if they were law.

Another instance where administrative policy has extended beyond statutory and case law is in defining "carrying on business in Canada", a crucial factor for establishing whether a supply was made in Canada for GST/HST purposes. The common law approach typically focuses on where contracts are signed and profit-making activities occur. However, the CRA's administrative policy adopts a broader perspective.[70] It includes various factors such as the location of agents or employees of the non-resident; the places of delivery and payment; locations where purchases are made or assets acquired; areas from which transactions are solicited; locations of assets or inventory; places where contracts are negotiated; locations of bank accounts; listings in directories; locations of branches or offices; places where services are performed; and sites of manufacturing or production. As a result, the CRA's policy has faced widespread criticism for largely deviating from established law.[71]

Another example is the Part XIII withholding tax, which section 215 of the ITA requires to be "immediately" remitted to the CRA. The CRA interprets "immediately" to mean by the 15th day of the month following the month in which the payment was made. A similar interpretation applies to payments that must be made "forthwith" under the ITA. Another instance involves the application of the CRA's cost recovery method to earnouts payable for the sale of corporate shares that may be subject to Part XIII withholding under paragraph 212(1)(d) of the ITA.

Despite not having the force of law, these CRA publications are generally followed by taxpayers. Courts have recognized that while administrative policy and interpretations are not determinative, they are given consideration and can play a crucial role in interpreting tax law.[72]

8. Outlook and current policy debates

Recent international tax developments are leading to a re-evaluation of the longstanding concept of nexus. In Canada, two significant measures have been proposed that extend beyond the conventional definitions of residence or source.

69 Canada Revenue Agency, *Income Tax Folio S5-F1-C1, Determining an Individual's Residence Status*, online: <https://www.canada.ca/en/revenue-agency/services/tax/technical-information/income-tax/income-tax-folios-index/series-5-international-residency/folio-1-residency/income-tax-folio-s5-f1-c1-determining-individual-s-residence-status.html>.

70 Canada Revenue Agency, *Policy Statement P-051R2, Carrying on Business in Canada*, online: <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/p-051r2/p-051r2-carrying-on-business-canada.html>.

71 See, e.g., Steven D'Arcy, "Attempting to Create New Law: The CRA's Draft Policy Statement on Carrying on Business", *Canadian GST Monitor* (CCH), No. 193 (October 2004), pp. 1–4; Stephen W. Bowman, "Carrying on Business in Canada—Out with the Old; In With the New?" *Corporate Finance* (Federated Press), Vol. XIII, No. 2, (2005) pp. 1318–1325; W. Jack Millar, "'Carrying on Business in Canada' and 'Permanent Establishment': GST Considerations", *Report of Proceedings of the Fifty-Eighth Tax Conference*, 2006 Conference Report, Canadian Tax Foundation, pp. 21:1–51.

72 See, e.g., *Harel v The Deputy Minister of Revenue of the Province of Quebec*, [1978] 1 SCR 851; *Nowegijick v. R.*, [1983] CTC 20 (SCC), 83 DTC 5041.

As noted in section 6.3. , although not explicitly claiming the expansion of nexus through the income tax, Canada's anticipated implementation of a DST mirrors a similar stance previously adopted by European countries regarding market jurisdictions. This approach is underscored by the Canadian government viewing the DST as a backstop if the Pillar One solution fails to yield a design deemed "acceptable" by Canada. Canada's DST is broader in scope compared to DSTs in the UK, France, and other countries. Whereas these countries' DSTs will be imposed on multinationals with €750 million in annual digital services revenue, the Canadian DST's threshold applies to €750 million in total revenues, which will likely include businesses that do not have enough digital services revenue but that have online marketplaces and earn more than €750 million in global revenue, such as Home Depot, Target, and Walmart.[73]

Another international tax initiative being adopted in Canada is the Pillar Two global minimum tax regime. Draft legislation for this was released on 4 August 2023, as the Global Minimum Tax Act ("GMTA").[74] The GMTA aligns with Pillar Two's model rules and OECD commentary and explicitly states that its provisions should be interpreted consistently with these guidelines and any subsequent OECD updates.

The GMTA introduces an Income Inclusion Rule ("IIR") and a domestic minimum top-up tax ("DMTT"). The IIR applies to Canadian entities that are the ultimate or other relevant parent entities of a multinational enterprise ("MNE") group with an effective tax rate ("ETR") below 15% in a foreign jurisdiction. The DMTT is applicable to Canadian entities of a qualifying MNE group when the group's Canadian ETR falls below 15%. If the entity subject to the IIR or DMTT is a partnership, the computed top-up tax is typically borne by the partners in proportion to their income shares from the partnership.

Part III of the GMTA is dedicated to the undertaxed profits rule ("UTPR"), but currently, it contains only a placeholder provision. The federal budget released on 28 March 2023, indicated that draft legislation for a UTPR will be forthcoming. In line with most participating countries, Canada's IIR and DMTT will take effect for fiscal years of qualifying MNE groups beginning in January 2024, while the UTPR is anticipated to apply from fiscal years starting in January 2025.

[73] See Wei Cui, "The Canadian Digital Services Tax" in Craig Elliffe, ed, *International Tax at the Crossroads* (forthcoming 2024).

[74] Government of Canada, *Legislative Proposals Relating to the Global Minimum Tax Act*, online: <https://fin.canada.ca/drleg-apl/2023/ita-lir-0823-l-4-eng.html>.

International Fiscal Association