# Canadian Overview
# Q2, 2023

A quarterly Canadian newsletter produced by the Canadian member firms of Moore North America for the purpose of inspiring conversation and collaboration throughout Canada and beyond.

# Permanent Establishment (PE)

Written by: Segal GCSE Tax Team

To determine the Canadian tax implications of activities undertaken in Canada, a non-resident should first determine whether their activities represent “carrying on business in Canada” under domestic law. The determination of whether a non-resident corporation is carrying on business in Canada is based on legislative authority as well as an analysis of the common law. This analysis requires consideration of all the relevant facts concerning the activities undertaken in Canada as well as relevant legislation, case law, and administrative positions of the CRA. The threshold for “carrying on business in Canada” is generally low. Generally, providing services in Canada in exchange for a fee would be considered “carrying on business in Canada” along with “soliciting orders or offering anything for sale in Canada.”

Generally, Canada's tax treaties provide that the business profits of a non-resident corporation are not subject to Canadian tax unless the non-resident corporation carries on business in Canada through a PE situated in Canada and the business profits are attributed to that PE. Canada’s extensive treaty network and the treaties are largely based on the OECD Model Tax Convention, with some variances depending on the relevant treaty. Where a tax treaty is applicable, we would generally expect Canada to follow OECD guidelines, but it should be verified with each treaty as the treatment may ultimately differ.

Canada’s tax treaties may also restrict the imposition of branch tax to situations where the non-resident corporation carries on business in Canada through a PE situated in Canada and/or limit the applicable branch tax rate. While the wording of tax treaties varies, a PE generally is defined as:

- A fixed place of business through which the business of the non-resident corporation is wholly or partly carried on.
- A place of management, a branch, an office, a factory, and a workshop; a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources; a building site, construction, or assembly project that exists for a specified period.

- A dependent agent or employee who has and habitually exercises authority to concludecontracts in the name of the non-resident corporation.
- In some circumstances, a Canadian PE may also arise where services are rendered in Canada and certain requirements (e.g., relating to the duration of the services) are met.

The Canadian domestic definition of PE (federal and provincial/territorial) generally mirrors the above.

Where a PE is established/constituted in Canada, income attributable to the PE shall be taxable at 26.5% on a net income basis (i.e., after deduction of expenses incurred by the PE, subject to compliance with withholding tax obligations by a foreign entity). An additional branch tax applies to non-residents' after-tax profits not invested in qualifying property in Canada. It is intended to replicate the withholding tax that would have been due had a Canadian subsidiary paid its profits to its non-resident parent in the form of a dividend. This may be reduced under the applicable tax treaties. An undertaking of profit attribution study should be conducted to determine the profits which can be said to be attributable to the PE in Canada.

Where there are non-resident employees physically located in Canada, regardless of whether the non-resident has a PE or not, and it is expected that their Canadian source compensation will constitute remuneration, the employee may be subject to personal income tax in Canada. Canada's domestic law in this area applies from the first day a non-resident employee earns income from conducting employment duties in Canada.

<u>Written by: Segal GCSE Tax Team</u>

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# Cloud Accounting: Elevate Your Numbers

Written by: Amy Duncan, CPA, CGA

As accountants, we're used to working in the past. We operate under the principle that reporting on historical information, whether it be financial statements or tax returns, is highly relevant to our clients due to its use in critical instances like bank financing and creating benchmarks on operations. That being said, if you're a business owner or decision maker, you also want real-time information that empowers you to make informed financial decisions—anytime and anywhere.

Enter cloud accounting. In the past decade or so, cloud-based accounting software has made a sizeable impact on the accounting industry, empowering us to provide clients with up-to-the-minute data whenever and wherever they need it. If you're thinking this sounds like something you and your business could benefit from, here's a few more reasons why you should consider moving your accounting services to the cloud.

### Document Management and Organization

Cloud-based software solutions are like Swiss Army knives for your business; they do so much more than simply storing information off-site. Take audits, for example. Cloud accounting neatly packages all the documents required for a successful audit, organizing them in a more accessible format that makes your auditors' lives much easier. And for small businesses, forget about stuffing your office with piles of paperwork—cloud storage saves space and keeps your records safe and sound for a reasonable fee.

### Data Protection

Most cloud-based platforms offer comprehensive security features that can be a literal lifesaver for your business. These systems give you the ability to manage user access and permissions, ensuring only authorized individuals can access sensitive financial information. They also offer built-in disaster recovery plans, storing your data on secure, remote servers that are often situated in multiple locations. This ensures your financial data is safe from natural or digital disasters like fires, floods or power surges, and can be quickly restored from the cloud in an emergency.

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It also goes without saying that modern, reputable cloud accounting platforms invest heavily in their product's cybersecurity. In addition to using state-of-the-art encryption and firewalls, these companies employ monitoring teams that will flag potential issues and raise alarms at the first sign of suspicious activity or attempts to access your data.

## Systems Integration

Integration is the name of the game when it comes to cloud accounting. These platforms are designed to seamlessly connect with various other business tools and systems, maximizing the automation and accuracy of your financial processes. One significant integration feature is the ability to link your bank account directly to the software. This integration enables automatic import of transactions, eliminating the tedious task of manual data entry and making bank reconciliations a breeze.

Cloud accounting platforms also recognize your need for flexibility, especially when making payments to vendors or invoicing customers. As such, they offer the ability to incorporate electronic billing capabilities directly into your systems. From one platform, you can send out invoices via email, take online payments, complete payroll and even issue payments to vendors. Regular software updates mean these platforms are pulling in the most recent tax rates and information, keeping your payments accurate and your operations compliant without the need for purchasing annual updates.

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## AI Integration

But the magic doesn't stop there. Cloud accounting software is leveraging the power of AI to revolutionize bookkeeping practices. With AI algorithms, these platforms can predict and suggest the appropriate transaction coding, making your bookkeeping tasks more efficient than ever before. By learning from patterns and historical data, the software becomes increasingly accurate in coding transactions, reducing the need for manual intervention and speeding up the reconciliation process.

An experienced cloud accounting team can support you through implementing and rolling out cloud-based software, assist with reconciliations, and even be your off-site virtual cloud accountants. If you think cloud accounting is a good fit for you and your business, you can contact your CPA advisor to see how you can get started.

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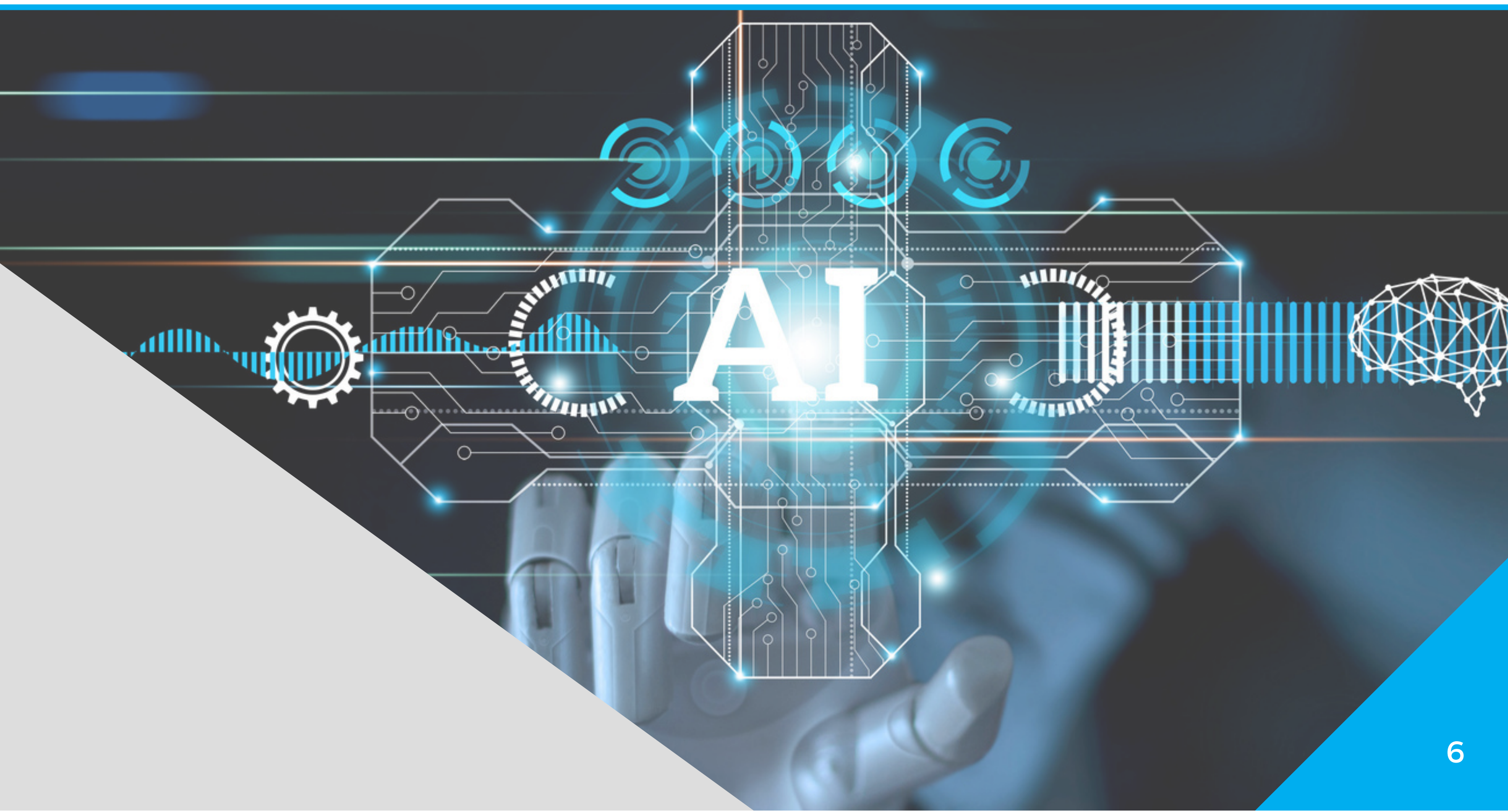

# Financial experts…how can they help?

Written by: Scott Nabozniak CPA, CA

In business, as in life, we run into common situations and problems that can hold us back from reaching our full potential. As a small to medium-sized business owner, can you relate to any of these situations and wonder what you can do about them? If so, see how adding financial expertise to your team can help…

Communication – or rather, a lack thereof. Keeping everyone on the same page is difficult. You often have to repeat yourself, and it can seem frustrating to keep delivering the same message. But communicating expectations, building routines (or “good habits”), and checking progress are important and healthy. It may seem obvious to you where the business is going and how you’re going to get there, but things can get off track if you’re not measuring them and communicating them.

For example, pilots making a transcontinental flight don’t just set the autopilot and forget about it; getting off track even to a small degree over such a long distance can drastically change where the plane ends up. That’s why pilots constantly check their vectors and make course corrections along the way. The same applies to your business, you know your destination is somewhere out there in the distant horizon, but it’s not always easy to see. Don’t let turbulence change where you end up. Pay attention and make course corrections to stay on track.

Communicate the vital financial and operational information with those helping you pilot to ensure everyone knows where the company needs to go and what they need to do to get it there. Make sure you have a financial expert on your team. They can help develop a reporting package that is accurate, timely, and summarizes what everyone needs to know, and then help interpret it and identify red flags.

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**Accountability** – have you ever started a new diet or exercise regimen? Is it easier to stick to it on your own or with a partner to encourage you and hold you accountable? When you're a business owner and you're at the top of your organizational chart, you may feel isolated. It's not always easy or even possible to talk to your employees about the problems you or your business are facing.

Getting honest feedback about what you're doing right and, more importantly, what you're doing wrong, is valuable to help you grow. Start to build that accountability into your business by building an executive team that gives you honest feedback. Do you have senior employees whom you trust and who have the right mix of expertise? If not, look for consultants that can provide that as needed.

Do you have a group of peers that provides oversight? If not, think about joining a professional peer group, hiring a board of directors or (less formally) an advisory board. Look for a group that could add insight where you might have blind spots or lack expertise.

Use that accountability to help you set goals, put up guardrails to stay focused, and ensure that you're making progress. Make sure there is someone on your team that can give you an experienced financial perspective.

**Growth** – most business owners want growth. At first, it can seem like a pathway to the realization of your dreams, but if it's not managed, it can turn into a nightmare. Even if you aren't looking for it, it can happen anyway.

Maybe there are market forces pushing you, and you need to grow your business to take advantage of that demand. Perhaps there are forces pulling you as a business moves from one generation of ownership to the next; the previous generation only had two owners, but now it has eight. To divide the same income amongst more people means that the business' output is shrinking even if the income stays the same. In fact, staying the same size might not even be optional.

Growth can be painful, especially if it's uncontrolled. If you don't invest enough, you overstretch your resources and start to fail to meet customer expectations. If you invest too much (especially with today's cost of capital), cash inflows won't support outflows. Either situation can damage or even destroy a business.

Do you have a plan? Do you have a budget? Have you built financial and operational forecasts to see where and when you can expect these pitfalls and to come up with ideas for how you're going to deal with them? Developing and keeping this reporting current and relevant takes financial understanding and skill. Make sure you have the right expertise on your team.

**Optimization** – are you getting the most out of your business? Of all that you sell, do you know what makes the most money? Do you know what makes the least? Who are your best, most profitable customers? Who are your worst? What are your best markets? Have you estimated your business' capacity? Is your business performing under capacity, or over it? How does your business compare to others like it? Do you have systems that capture data but don't summarize it into something useful?

Analyzing and planning help you gain an in-depth understanding of your business and helps you optimize its operations by setting targets and benchmarks. Once you figure out what you should be doing, you can make plans for what you will be doing. This understanding can help you build a strategy and discover where you best fit in your market. A financial expert can help you with this analysis and help build a strategy to develop the best path forward for your business.

Do you see the benefits of adding a higher level of financial expertise, but your business is at a stage where adding it is cost prohibitive? Consider alternatives to full-time employees like part-time consultants or Fractional CFOs ("Chief Financial Officers"). These are experts who spread their time between several clients and can tailor their services to what you need either on an ad hoc basis or for regularly scheduled terms. Discover how adding big business expertise to your small business can help!

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# Canada Releases Consultation on Transfer Pricing Rules

Written by: Avinash S. Tukrel, Principal & Transfer Pricing Leader

The Department of Finance Canada, on June 6, 2023, released the much-awaited transfer pricing public consultation paper Consultation on Reforming and Modernizing Canada's Transfer Pricing Rules. The Federal Budget 2021 previously announced the Government's intention to consult on Canada's transfer pricing rules to protect the tax system's integrity while preserving Canada's attractiveness as a destination for new investment and business activity. The consultation paper includes proposed draft revisions to Section 247 of the Canada Income Tax Act ("the Act") and potential changes to administrative measures.

The catalyst for these changes and consultation is the view that Canada's existing transfer pricing legislation does not provide clear guidance on applying the arm's length principle[1], and the rules have not been revised since their introduction in 1997. In comparison, other countries have updated their transfer pricing rules to align with international tax reform and related developments with detailed guidance and provisions.

A broad consensus exists that the limited guidance on Canada's application of the arm's length principle was evidenced in the Federal Court of Appeal's decision in The Queen v. Cameco Corporation, 2020, FCA 112.

The fundamental change pertains to possible amendments to the transfer pricing adjustment provisions in Section 247 of the Act to clarify the application of the arm's length principle in Canada and align local legislation with international consensus and best practices. Appendix A of the consultation paper includes proposed draft legislative measures such as:

- To provide a new definition for economically relevant characteristics in line with the Organisation for Economic Cooperation and Development ("OECD") 2022 Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD 2022 TP Guidelines").

- The objective of this proposed rule is to delineate the conduct (i.e., substance) of the parties to a transaction and not limit conclusions to just the contractual terms (i.e., form), therefore, placing a significant emphasis on the function, asset, and risk (FAR) analysis of the related parties in the context of a related party transaction or series of transactions.
- The Canada Revenue Agency ("CRA") will be able to disregard the transaction(s) in exceptional circumstances.

- Define comparable circumstances to reduce hypothetical comparisons for delineated transactions compared to what independent third parties dealing at arm's length would have agreed to.

- Requirement that controlled transactions or a series of transactions will be compared to those of independent third parties in comparable circumstances. It is vital to note that the proposed conditions will be interpreted broadly and rely on any relevant financial and commercial information in the transaction(s) context.

    - Application of the arm's length principle will require assessing the conditions that would have been included in comparable transactions entered into by third parties in the context of the delineated controlled transaction(s) in comparable circumstances.

    - Where such information is unavailable, the CRA will be able to assess whether the controlled transaction(s) was conducted on an arm's length basis using a hypothetical basis.

- Include legislative provisions to align Canada's Transfer Pricing legislative framework with the OECD 2022 TP Guidelines. The proposed changes also indicate that any future changes to the OECD 2022 TP Guidelines will not automatically change the interpretation of the transfer pricing rules in Canada, which provides certainty to taxpayers, but potentially create an inconsistency with evolving guidance on international tax reform and consensus.


Additionally, the consultation process invites key stakeholders to provide input on transfer pricing administrative measures such as documentation, penalty provisions, and adopting a simplified approach to specific business circumstances and transactions. The proposed administrative measures include, but are not limited to:

- Changes to compliance requirements through annual reporting schedules, potentially relieving the existing compliance burden for certain taxpayers. Introduction of minimum thresholds and exemptions for certain taxpayers based on size and types of transactions.
- Adoption of the OECD BEPS[2] Action 13 Master File and Local File approach for transfer pricing documentation for Canadian taxpayers.
- Changes to transfer pricing penalty thresholds to encourage taxpayers to maintain contemporaneous transfer pricing documentation and reduce non-compliance.
- Safe harbour provisions or acceptable arm's length returns for:
  - Interest rates
  - Low value-adding intra-group services
  - Routine distribution functions.

Segal GCSE will continue to review the consultation paper and monitor related developments in the coming months to provide inputs on what is likely to be a key milestone in Canada's transfer pricing legislative reform at a crucial time for taxpayers in an ever-evolving complex international tax landscape.

This consultation process allows key stakeholders to actively participate and shape a transfer pricing framework that is robust and sustainable for the future. Comments and responses are invited to 23 questions from various stakeholders by July 28, 2023.

For more information and to provide your perspective as a business on the impact of the proposed changes, please get in touch with our Principal & Transfer Pricing Leader, Avinash S. Tukrel.

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[1] The arm's length principle requires that related party / intercompany transactions are comparable to conditions applied by independent third parties in a comparable, commercial context.
[2] OECD Base Erosion Profit Shifting (BEPS) Project, Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting

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