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Recommendations by the Performing Arts Tax Working Group

Background information

Major performing arts organizations in Canada regularly contract for the services of non-resident artists and companies, in addition to engaging a large number of artists residing in Canada. Since 2013, however, increases in standards for compliance have rendered the taxation of non-resident entertainers cumbersome to the point of impeding the regular business of Canadian performing arts organizations: a large number of waivers are being denied for failing to meet the increased standards, waiver processing times have increased, and a growing number of non-resident companies are assessed penalties for not filing information or tax returns. The burden of compliance with non-resident taxation is currently causing hardship to both Canadian engagers and to non-resident artists and companies.

Recommendations

These recommendations were defined by members of the Performing Arts Working Group in a series of meeting held since March 2014. They were first published in March 2015, revised in December 2015, and further revised in December 2016 following a series of meetings with representatives from the Canada Revenue Agency.

The intent behind these recommendations is to achieve both greater efficiency and better risk management in the administration of taxation of non-residents, including R105 and R102 Withholding, information return requirements and tax return requirements. As general guidelines, the working group sought to ensure that efforts to protect the fisc are commensurate with the actual risks of foregoing taxation, that they do not unnecessarily impede the productivity of performing arts organization, and do not interfere with the principles of openness and balance of the UNESCO *Convention on the Protection and Promotion of the Diversity of Cultural Expressions*.

The list order does not reflect a sense of priority; the recommendations are ordered so as to follow the workflow of the non-resident performance taxation process:

- recommendations 1-5 address pre-performance activities (the waiver process);
- recommendations 6-8 address post-performance activities (information return and tax return processes); and,
- recommendation 9 offers overarching considerations at the treaty level.

1 – Develop Performing Arts Specific Guidelines

Many performing arts organizations and non-resident artists and companies are finding it difficult to access information on how to successfully apply for a Regulation 105 or Regulation 102 Waiver, and/or an Individual Tax Number (T1261) and/or a Business Number (RC1), all of which are required as part of the waiver application process. Similarly, CRA officers could benefit from having a better knowledge of the specificities of performing arts business practices. We therefore recommend the joint development, by the CRA and the industry, of performing arts guidelines recognizing industry practices, addressing both risks and processes, and intended for both CRA officers and applicants. We believe this could go a long way in increasing the success rates of R105, R102, T1261, and RC1 applications, thereby enhancing the efficiency of the process as well as the service standards.

It should be noted that similar industry-specific guidelines and approaches exist at Citizenship and Immigration Canada, in regards to work permits requirements for foreign performing artists (R186(g) of the *Immigration and Refugee Protection Regulations*), and also at the CRA, for the Film Industry, specifically in regards to the administration of R105.

2 – Exempt Deposits from Withholding

It is a common practice in the live performance industry for the agent representing the contracted artist or company to require that a deposit be given at the time of signing the engagement contract. Such deposits are a security for the performance of the contract rather than a payment for actual services rendered in Canada. These security deposits are held in trust by the receiving party and remain in the dominion of the depositing party. They are a liability for the receiving party until the services have been rendered and the payment has been made.

In the performing arts sector, it is not uncommon for a deposit to be given a year before the actual services are rendered. This creates situations where a non-resident artist or company may be required to file a Canadian tax return in a fiscal year where no services have been rendered in Canada. Requiring withholding on such deposits effectively deprives the non-resident artist or company of the opportunity to apply a waiver, since the deposit is to be paid before a waiver can even be filed. Finally, these deposits usually do not exceed 50% of the total fees to be paid. This makes it possible for Canadian payers to withhold the full 15% on the actual payment at the time that the services are rendered. We consequently believe that withholding on performing arts deposits is unnecessary and that deposits should be exempted from withholding, information returns and tax return requirements.

3 – Streamline and Simplify the Individual Tax Number Process

One of the biggest stumbling block in the waiver process is the requirement for Individual Tax Numbers (ITN). Although the ITN can be applied for at the same time as the waiver, the collection of signatures and of properly certified passport copies is time consuming and is the cause of many incomplete or late waiver applications. In the music industry in particular, while

the lead performers are known a long time ahead of the performance, it may take a certain amount of time for the producer to hire every single performer, back vocal singer and supporting staff for a tour. This hiring of all performers and tour crew is the first step in a long critical path to obtaining ITNs. Then certified passport copies must be mailed by each performer to whomever is applying for the waiver. While it is relatively easy to do in a country like Canada, it can be much more of an ordeal in certain parts of the world. Only when the entire waiver application is assembled can it be mailed to the CRA, at which point is once again forwarded by mail from a waiver Centre of Expertise to the unit that assigns the ITN. This makes for a very long critical path.

In order to speed up the ITN (and waiver) process for both the clients and the CRA, the Working Group proposes that ITNs no longer be required for individuals whose fees and/or salary are lower than a given allowance: either the $10,000 allowance in the expanded certification program recommended below (see recommendation 6) or the administrative allowance or threshold in the waiver guidelines (which we are proposing to increase under recommendation 5). Considering that non-resident employee revenues under $10,000 were deemed insignificant enough to remove the withholding, remitting, and reporting obligations under the new non-resident employer certification program, the same logic should apply to the attribution of ITNs.

4 – Streamline and Centralize the Application Process by Using Electronic Means of Submission and Communication

In its 2015 Pre-budget Report, the Standing Committee on Finance recommended: "In addition to its focus on reducing regulation, the government should direct efforts to modernization, such as reducing the use of paper and utilizing the benefits of technology and digital solutions." Yet, at the present time, R105, R102, T1261, and RC1 forms and support documentation must be filed in paper form. Moreover, applicants do not receive any acknowledgement of receipt and they consequently do not have any reference number with which they can track the progress of their application. We believe that a single-window online service for electronic submission of all forms and supporting documentation, including scanned documents in place of certified documents, would resolve all of these issues. Moreover, it would also expedite the reception, treatment and response processes – resulting in much faster turnaround. At a time when the 30-day service standard is becoming the exception rather than the norm, this would be a welcomed change.

5 – Increase and Index the *De Minimis* Threshold for Waivers

Under the current CRA waiver guidelines, if an individual performing artist (from a treaty country other than the United States) earns less than CAN$5,000 in one calendar year including hotel and per diem expenses paid on his/her behalf, then a waiver will be granted on earnings for services rendered. It serves as a test for granting both primary waivers to individual artists and unincorporated group, as well as secondary-level waivers, that is for non-resident performers hired or employed by a non-resident corporation. This administrative threshold

was introduced 30 years ago as a *de minimis* (low risk) exclusion in order to reduce the administrative burden for all parties involved in the withholding and waiver processes. It has never been revised for inflation. Consequently, the majority of non-resident artists who do any touring in Canada find themselves in situations where their earnings may easily exceed $5,000. Moreover, second-level withholding, once very rare, is becoming quite frequent. One could argue that such a low threshold now represents much higher administrative expenses for the CRA than potential lost tax revenues.

This is why we recommend that this administrative exemption threshold be significantly increased and that it then be indexed on a regular basis to account for inflation. Under the Tax Legislative Proposals announced by the Department of Finance on July 31, 2015, revenues under $10,000 are deemed insignificant enough to waive the T4-type filing requirements. We consequently believe that, at the very least, the same logic should apply to the administrative threshold for waivers. We moreover believe that an increase to $15,000 is entirely justifiable since:

a) it would match the tax exemption currently in place for performing artists in the Canada-United States Convention; and,
b) it would be more in line with the limit proposed in the Commentary on Article 17 of the 2014 OECD Model Tax Convention (see Recommendation 7)

6 – Introduce an Information Return Exemption Program Modeled on the Non-Resident Employer Certification Program

Second-level withholding, remittance and return obligations have become a major irritant for non-residents doing business in Canada. The waiver application process generates a payroll account, which in turns triggers automated notifications. This can be quite unsettling for a non-resident company who is under the impression that all tax matters were dealt with at the waiver level. Failing to understand the logic behind these notifications or to obtain clarification from the CRA, their reflex is to disregard them. However, if these notifications are disregarded, penalties are automatically assessed – regardless whether a full waiver was granted or not – and non-resident artists and companies can no longer come back to Canada until these penalties are paid.

The Non-Resident Employer Certification program was introduced by the Government of Canada in 2016 to alleviate these issues. It removes the second-level withholding, remittance and return (T4-NR slip and T4-NR summary) obligations when "the qualifying non-resident employer has no reason to believe that the qualifying non-resident employee's total taxable income earned in Canada in the calendar year during which the salary was paid is more than CAN $10,000."

However, as we expressed in our comments to the Legislative proposals for the certification program (as part of consultations held in September 2015), non-resident performing artists cannot qualify to the program in the vast majority of instances. Obstacles reside in the fact that

artists are not tax exempt under all tax treaties (except the U.S.) and that they are usually hired under contract rather than as regular employees.

For these reasons, we recommend:

1. That the government extends of the employer certification program so as to specifically include non-resident performers, regardless of there existing a *de minimis* exemption in article 17 (or 16) of their treaties;

2. That certification be automatically provided to non-profit making and similar publicly-funded entities (as per paragraph 14 of the Commentary on Article 17 OECD Model Tax Convention), who benefit from a tax treatment similar to Canadian not-for-profit and charitable organizations;

3. That this expanded certification program be administered and executed at the time of applying for a waiver (in other words, if second-level waiver is granted, information return requirements are also waived altogether); and,

4. That this expanded certification program covers for both salaries (T4-NR) and fees (T4A-NR) paid to performers.

Considering the timelines imposed by such a legislative change, we urge Finance and the Canada Revenue Agency to undertake the design of a legislative proposal as soon as possible, so the new legislation can be adopted before the tenth anniversary of the Advisory Panel on Canada's System of International Taxation, in 2018.

7 – Adopt a Phased-In Approach in the Enforcement of Penalties for late filing of T4A-NR, T4-NR, T1, and T2 Returns of Non-Residents

While the information returns (T4A-NR, T4-NR) and tax returns (T1, T2) requirements for non-residents have been in place for decades, they have historically not been enforced systematically by the CRA. These requirements were therefore little known to Canadian contractors, and even less so to non-resident artists. In fact, the waiver determination letters do not provide any clear instructions to the non-residents regarding their tax return obligation. As a consequence, many non-resident artists, especially those who were granted withholding waivers, have failed to comply with these requirements.

Since 2014, however, we have observed a growing number of cases where non-resident performing artists were assessed penalties for late filing of information and/or tax returns. In most cases, these performing artists had no tax liability, and in one instance, the CRA even owed a refund to the company.

In 2015, the enforcement of these penalties took a quite a dramatic turn: the CRA began tracking non-compliant non-resident artists and has attempted to seize their fees when they come back to perform in Canada. This has led to much confusion among both the non-resident performing artists (who were often unaware that they had been assessed a penalty, because of

a change of address, a change of corporate entity or simply a lack of capacity to interpret an assessment sent by a foreign country) and the Canadian engagers (who had no responsibility whatsoever in the non-resident's liability and who didn't know how to interpret the collection phone calls from the CRA). One Canadian engager reported that this collection procedure led to the cancellation of a performance by a non-resident artist, which resulted in financial losses much greater than the $2,500 penalty owed by the artist.

At this point we consider the need for education to be greater and more relevant than the need for enforcement. Consequently, we propose the following changes to late-filing penalty assessments for non-residents:

- Waive all penalties for late filing of information returns for payments made in 2015 and earlier (in keeping with the Legislative Proposals discussed in recommendation 5);
- Waive all penalties for late filing of tax returns for 2015 and earlier; and,
- No penalty for first time offense, including where multiple information and/or tax returns are required to restore compliance.

8 – Introduce a De Minimis Exemption to the Tax Return Obligation

A very simple way to reduce the incidence of automated penalty assessments to non-filers is to exempt them from the obligation to file when the risk level is insignificant.

Currently, non-residents who are provided a treaty-based waiver are not required to file a T1 return, unless they self assess that they have a tax liability. The Non-Resident Certification Program was established under the same principles and provides exemptions to the information return obligations for qualifying non-resident employees earning less than CAN$10,000.

No such an exemption exists for the T2 return obligation.

For a vast majority of non-resident performers, the 15% withholding tax levied directly on their performances fees by Canadian engagers exceed their actual tax liability pursuant to the *Income Tax Act of Canada*. For those performers who are taxable in Canada pursuant to a tax treaty and who submit a waiver application based on their income and expenses, many expense categories are not considered in the waiver process such that the CRA's preliminary assessment of such an artist's tax liability remains higher than their actual tax liability.

It is therefore a reality that for most artists operating through a corporate entity, the requirement to file a T2 return does nothing to improve the CRA's assessment of payable tax amounts, and in fact will often result in a refund given the withholding measures and waiver processing policies mentioned above.

We consequently recommend the introduction of an exception to the T2 filing requirement, under the following conditions and safeguards:

- Made available to corporation or hybrid entities earning less than CAN$15,000 in given a calendar year;
- Made available only when full or partial withholding tax was levied and remitted;
- Based on a self-assessment that the non-resident corporation's tax liability for a given calendar year is lower than the withholding tax paid throughout that year;
- Subject to occasional audit when the non-resident corporation comes back to Canada for additional performances in subsequent calendar years.

9 – Integrate Exclusions from the Commentary on Article 17 of the 2014 OECD Model Tax Convention into Canada's Tax Treaties

Ultimately, the administrative exclusion described in recommendation 4 is only necessary in the absence of much broader exclusions in Canada's tax treaties.

Article 17 of the OECD Model Tax Convention was introduced and in the 1960s and integrated in the OECD model in 1977 to create an exceptional rule for performing artistes (and sportspersons). Article 17 states that entertainers and sportspersons need to pay income tax in the country of performance, regardless of the general rules for companies, self-employed persons or employees. The main reason for this special treatment is that top artists and athletes are very mobile, and they can easily move their residency to a tax haven in order to avoid taxation.

The original Article 17 was a "one-size-fits-all" and a number of issues have arisen over the years. As a result, OECD-member countries have agreed to introduce several options for the restriction of the scope of Article 17. The 2014 OECD Model Tax Convention includes several such options, including the following which we deem worthy of inclusion in Canada's tax treaties:

- **Deduction of expenses**
  Paragraph 10 of the Commentary on Article 17 refers to the determination of taxable income. It proposes the deduction of expenses from gross income and taxation of net income under the normal rules of each country. Currently, the guidelines for the administration for R105 do the exact opposite. Waiver applicants are asked to report expenses reimbursable expenses or expenses paid on their behalf by the payer. These expenses are then "grossed up" on top of the artist fee to determine the eligibility to a waiver. This provision in the R105 guidelines is imposed by the Canada-U.S. Tax Convention, and it should be brought up with U.S. authorities when the convention comes up for renewal.
- ***De minimis* rule**
  Paragraphs 10.1 to 10.4 of the Commentary recognize that it would be inappropriate to apply Article 17 to a non-resident artist who would not be taxable in the performance state or who, during a given taxation year, derives only low amounts of income in that state. In order to exclude such low-risks situations, the paragraphs propose a minimum amount 15,000 IMF Special Drawing Rights (the equivalent of CAN$27,000 of

US$20,000 at December 2016 conversion rates), under which artists fees are exempt from tax in the performance state. The existing $15,000 exclusion in the Canada-United States is an example of a *de minimis* rule. However, the practice of "grossing up" revenues (see previous point) when assessing whether a non-resident qualifies for a *de minimis* exclusion isn't desirable, because it adds a significant layer of complexity to the preparation and the assessment of a waiver application.

- **Public funds**
  Paragraphs 14 of the Commentary provides an option to exclude from Article 17 events supported from public funds. Canada's tax treaties with France and the United Kingdom include an exemption along these lines. While the option in paragraph 14 may grant an exclusion to non-profit-organizations receiving public funds, the option has not yet been extended so as to specifically include not-for-profit organizations. We however consider that not-for-profit organizations should benefit from this exclusion since they are tax-exempt under the *Income Tax Act*, and they are unlikely to tour Canada on a regular basis or for long durations.

Over the coming years, trade agreements such as the Comprehensive Economic and Trade Agreement may create opportunities Canada to reopen several bilateral treaties. We urge the government of Canada to take advantage of these renegotiations to integrate exclusions on Article 17 into Canada's tax treaties.

About the Performing Arts Tax Working Group

The Performing Arts Tax Working Group is a collective of twenty performing arts organizations and associations representing more than 1,000 Canadian stakeholders. It was formed in 2014 to examine ways to achieve greater efficiency and better risk management in the administration of taxation of non-resident entertainers. CAPACOA was designated by Working Group members to be the facilitator for the group. The Working Group is comprised of the following organizations:

Arts Commons
Canadian Dance Assembly
Canadian Independent Music Association
CanDance Network
Cusson Management
CAPACOA
Danse Danse
East Coast Music Association
Eponymous
Festival International de Jazz de Montréal
Festivals and Major Events Canada
Festival Transamériques
Les Grands Ballets Canadiens de Montréal
Lula Music and Arts Centre
National Arts Centre
North American Performing Arts Managers and Agents

Music Canada Live
Regroupement des événements majeurs internationaux
Small World Music Society
Sunny Artist Management

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