Detailed feedback from the Performing Arts Tax Working Group on the Simplified Regulation 105

July 9, 2018

Introduction

The following thoughts, observations and suggestions were developed to supplement and to replace the initial feedback provided by the Performing Arts Tax Working Group on May 29, 2018. We are submitting this feedback brief to the CRA with the intent to contribute to the evaluation of the simplified Regulation 105 and to continue the dialogue on non-resident taxation in the performing arts.

1. Training and assistance

While the R105-S provides a certain administrative relief, it creates another layer of complexity on an otherwise intricate set of regulations and guidelines. Members of the Performing Arts Tax Working Group have consequently identified a need for support for two stakeholder groups.

Canadian payers and non-resident artists will need some form of training from CRA to understand in which cases R105-S applies and to what extent. This training can be delivered at live events, but it should also be made available via webinars. The Performing Arts Tax Working Group is willing to assist the CRA in the promotion and delivery of these training sessions.

In addition, a few questions raised in this feedback brief require clarification. We would recommend that the CRA provide answers in a public fashion, in the form of a Questions and Answer page or as amendments to the current guidelines.

We are thankful that CRA responded to our recommendation for providing an info line service for answering questions on R105-S in a prompt manner.

2. Second-level taxation

The R105-S instructions do not currently indicate whether the simplified waiver will be made available to non-resident companies when they act as a payer to their non-resident contract personnel. Although this is implicit within the current instructions, we believe it should be explicitly included (or excluded) within the instructions, and possibly accompanied with an example.

A) Second-level taxation for United States residents

If the R105-S is indeed made available to non-resident payers, this could make a significant difference for companies in the United States (the only country for which Treaty-Based Waiver R105-S is available). This could enable smaller touring companies to file R105-S forms with each of their contract performers, and to avoid having to withhold Canadian income tax, which their contract workers are exempt by virtue of the Canada-U.S. tax convention.

The United States company/payer would still have to get a Business Number and to issue a T4A-NR summary, but their contract workers would not have to file a T1 tax return, which is a significant administrative relief.

The scope of the potential use of R105-S for 2nd-level withholding is however very limited. R105-S would only be an option for 2nd-level withholding if:

A. The United States payer is not already filing a R105-R application for itself; and,
B. None of its contract performers are earning more than $15,000.

We therefore anticipate that the R105-S would be used by relatively few United States companies. But the benefit would nonetheless be significant for those who do smaller tours and are willing to take the 15% withholding in order to avoid the regular R105 process.

Consequently, **we recommend that the CRA specifically extend the simplified taxation process to non-resident payers for the purpose of reducing the burden associated with secondary-level withholding**.

B) Second-level taxation for residents of other countries

Because of the higher withholding rate and the fact that eligible expense don't happen at the secondary level (see below), we do not anticipate that the R105-S would provide any meaningful benefit for the purpose of secondary-level withholding by non-resident companies in countries other than the United States. Expanding R105-S to secondary withholding would, in the Working Group's view, not present any significant risk for CRA in countries other than the United States.

A note on the Business Number

In the Working Group's experience, the application for a BN is daunting and confusing to non-residents. Consequently, this requirement may be sufficient to deter non-resident companies from using the simplified taxation process for second-level withholding. This being said, confusion is even greater when non-resident corporations start to receive automated payroll notifications. These automated notifications are a mystery to both the Canadian presenters and the non-resident companies. Further clarity would be appreciated as to how these automated payroll notifications are triggered, and how such notifications could be written

and issued in such a manner as to minimize the confusion they create with non-resident companies.

3. Unincorporated groups

Although the simplified process appears to apply to artists who tour as unincorporated groups, the form is ill-adapted for this business practice.

Typically, when artists tour as an unincorporated group, one performer will act as the band leader and will receive the full payment from the payer on behalf of the group. Then, the group's fee is distributed by the band leader to the other performers, but the exact amount received by each performer isn't known by the payer.

However, in the simplified Regulation 105 policy does not address this reality.

- The guidelines do not specify if each performer have to file the R105-S or if a single R105-S is to be filled only by the band leader. This should be clarified.

- Box 11 of R105-S form simply asks for "Total gross revenues to be paid as per the current contract for this individual's services". In the case of an unincorporated group, is the CRA expecting this box to feature the unique fee paid to the band leader or the final revenues received by each group member? If it is the fee paid to the band leader, we could easily run into situations where the total fees paid to a given group could exceed $15,000 but none of the individual performers would receive gross revenues exceeding $15,000. Would such a group be eligible to R105-S? Again, this requires clarification.

4. Non-performing personnel

Almost any group or company that tours internationally sends out support personnel on the road along with their performers: a tour manager/coordinator, a technical director, a sound technician, a stage manager, etc. These various support workers are all tax exempt under the business profit provision of the Canada-United States convention. However, there is no place for them in the Simplified Regulation 105 guidelines and form. Consequently, as soon as an incorporated group brings in a single support worker with their performer, they can no longer use the Simplified Regulation 105. This is a serious oversight.

Both the guidelines and the form should be amended to extend eligibility to non-performing support personnel, provided that they are tax exempt under a business profit exemption.

5. Eligible expenses for Income and Expense Waiver

A) Agent and Management Fees

The new guidelines for establishing reasonable expense amounts will go a long way towards simplifying the income and expense waiver application. However, we feel that the range of eligible expenses is too limited to arrive at an accurate estimation of the anticipated net income. Although we wouldn't want the R105-S to become as elaborate as the R105-R income and expense waiver, we feel one more reasonable expense should be considered for integration in the R105-S.

It is extremely common for touring artists to be under contract with agents and managers who assist them with market development and securing engagements, negotiating contracts, providing tour coordination services and/or providing financial management services. Almost all artists who tour internationally will be procuring one or several of these professional services.

According to the Working Group's collective experience:

- Touring agent fees are incurred in 90-95% of instances of non-resident tours to Canada.
    - The industry standard for touring agent fees is 10%.
- Management fees are incurred in roughly 75-85% of instances of non-resident tours to Canada.
    - There is no set industry standard for management fees. The rates vary between 10 and 25%. They sometimes apply to the gross revenues, sometimes to the net revenues.

An old R105 income and expense form used to allow a 10% agent fee and a 10% manager fee as reasonable expenses (as per a version of the form last revised in 1991). We believe introducing something along these lines would significantly improve the estimation of the anticipated net income under R105-S.

B) Expenses and 2nd-level withholding

Since this feedback brief calls for clarity about the application of R105-S on instances of second-level withholding by non-resident payers, it should be noted that eligible expenses are almost exclusively incurred at the primary level. Whenever a tour involves more than one performer, travel expenses and accommodation expenses will usually be managed in a centralized fashion so that individual performers and other support personnel have as few as possible out-of-pocket expenses to incur. Therefore, at the secondary-level, only meal expenses would normally be incurred by individuals.

As we mentioned above, the application of R105-S at the secondary level would probably only be of interest to U.S. companies (for whom deduction of expenses aren't allowed in the policy).

Therefore, we do not anticipate that many (if any) non-resident payer would have to be concerned with expenses at the second-level.

This observation is provided only for information purposes, in order to allow the CRA to better understand the business practices in the touring sector and to properly assess risk associated with 2nd-level taxation.

6. Amortizing of travel expenses over multiple waiver forms

Most of the time, non-resident artists touring in Canada will have multiple engagements. In the draft R105-S form this will require the non-resident artist to amortize one-time travel expenses, such as a flight from and to the country of origin or a vehicle rental, across several engagements – and on multiple R105-S income and expense waiver forms. Because such a situation is highly probable and predictable, the R105-S instructions should include some guidance in this regard.

With or without guidance, this amortizing of travel expenses adds complexity to the R105-S income and waiver process, and will contribute to making this process less attractive and efficient.

7. Thoughts on the impact of R105-S

Based on the Performing Arts Tax Working Group's assessment, the R105-S provides some level of improvement with the following recommendations of the Working Group:

3 – Streamline and Simplify the Individual Tax Number (ITN) Process
This is where we are seeing the most significant improvement. The full impact of this improvement will however only be provided only to artists based in the United States. The Working Group would like to inform the CRA that up to 80% of performances coming from the U.S. are touring as a corporation or LLC and that the relief on primary-level withholding may consequently not be as significant as we had hoped.

5 – Increase and Index the De Minimis Threshold for Waivers
From the perspective of non-resident artists, the benefit provided by the increase of the waiver threshold from $5,000 to $15,000 is outweighed by the increase of the withholding rate from 15% to 23%. At the primary level, R105-S does allow for deduction of reasonable expenses, but the range of eligible expenses is too narrow to deliver an accurate estimation of the anticipated net income. At the secondary level (when a non-resident company becomes the payer for its contract personnel), those eligible expenses are usually paid for by the non-resident company on behalf of its contract performers. Consequently, contract performers would be withheld the full 23% on their income. Under these circumstances, the R105-S will likely not be seen as a

significant improvement by non-resident companies/LLC for the purpose of secondary-level withholding.

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

As mentioned above, only U.S. companies will benefit from an exemption to the withholding requirement (pending on the clarification regarding 2nd level taxation) and, logically, should also be exempted from the information return requirement (as in the Non-Resident Employer Certification program). However, R105-S instruction state that: "The payer must also complete and file a T4A-NR summary and slip with the CRA and provide the non-resident individual with his/her copy of the T4A-NR slip before the end of February of the following year." Does this note refer only to income and expense waivers or to both waiver types?

The potential relief with regard to the information return obligation could be significant for U.S. companies, and we look forward to having CRA's answer on this question.

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, and

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

Although compliance efforts at CRA have to our knowledge not been placed on the T1 return obligation, the Performing Arts Tax Working Group is truly appreciative of the CRA's introduction of a formal *de minimis*-type exemption on the T1 obligation. We see this as a step in the right direction and we look forward to entertaining further discussions with CRA and Finance Canada about our recommendation for *de minimis* exemption on the T2 obligation.

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

The R105-S does nothing with regards to the Working Group's recommendation on tax treaties, but we did develop over the process an understanding that most of the administrative burden related to non-resident taxation originates from Canada's tax treaty. We regret that the CRA has not been able to bring Finance Canada into the dialogue and we understand that part of the responsibility for engaging with Finance Canada rests with the Working Group.

8. Exempting deposits - a missed opportunity

Because of its limited scope, the simplified taxation process does very little to alleviate business difficulties arising from the obligation to withhold tax on security deposits. As the Performing Arts Tax Working Group highlighted time and again (see recommendation 2 from the Recommendations by the Performing Arts Tax Working Group, dated December 6, 2016) , these deposits usually never 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. Consequently, the exemption of the withholding tax obligation on security deposits

does not represent any risk whatsoever for the Canada Revenue Agency. And it remains, in the opinion of the Performing Arts Tax Working Group, the simplest and most effective administrative relief that the CRA could offer.

The opportunity to remove the withholding obligation on security may however not be entirely missed.

To our knowledge, the obligation to withhold tax on deposits is specifically mentioned only in information circular IC75-6R2 - *Required Withholding from Amounts Paid to Non-Residents Providing Services in Canada*, dated May 2005. Paragraphe 12 of IC75-6R2 stipulates: "Regulation 105 withholding is applicable to advance payments made in respect of services to be performed in Canada by a non-resident."

IC75-6R2 is however rendered obsolete by the introduction of R105-S, and it will eventually need to be replaced by a new information circular. We believe this is an ideal opportunity to provide relief on the obligation to withhold tax on deposits.

The Performing Arts Tax Working Group therefore recommends that Paragraph 12 of IC75-6R2 be amended to exclude "advance payments and other forms of security deposits not exceeding 50% of the total anticipated payment or guaranteed fee" from the withholding tax obligation.

By specifying a cap of 50%, the information circular:

A. Would eliminate any risk that the final payment might not be sufficient to withhold the entire 15% withholding tax; and,
B. Would mirror industry practices.

Moreover, we believe that the introduction of alternative specific terminology such as "security deposits" would provide needed clarity and would reduce risks of the policy being challenged for not specifically including security deposits.

9. Further steps

The Performing Arts Tax Working Group will soon be sending a letter to the Minister of Finance in order seek international taxation changes at the treaty level. Any assistance from the CRA in terms of liaising with Finance Canada will be welcomed.

Prepared on behalf of the Performing Arts Tax Working group by:

Frédéric Julien
Director of Research and Development
CAPACOA

July 9, 2018