When does an employee have personal U.S. tax liability?

Access US - August 2016 | Carolyn Powell, Invest Buffalo Niagara Business Development Manager

We often talk about corporate tax liability and how selling products in the U.S. or setting up a U.S. location can affect a Canadian company. But how does this affect your Canadian employees that come down to the U.S. to assist at this new facility? At what point to they open themselves up to US tax filings?

Factors Effecting When a Canadian Resident Working in the US is Tax Exempt:

The Canada-U.S. Income Tax Treaty provides special rules for Canadian employees who are residents of Canada but work in the United States. Provided the employee is not a U.S. citizen or resident, they will be exempt from U.S. taxation on employment income earned in the United States if:

- the employee's U.S. employment income does not exceed US $10,000
- the employee is not physically present in the U.S. for 183 or more days in the 12-month period; and
- the income is not paid by, or on behalf of, a Company that is a resident of the U.S. or has a permanent establishment in the U.S.

Steps to Consider When a Canadian Resident Working the U.S. Must Pay Income Tax:

If the Canadian employee does not meet either of the above tests, they must pay U.S. federal and, if applicable, state income tax in the United States on their U.S- source wages (income is sourced to the jurisdiction where the services are performed, not where they're paid from) as a non-resident alien. They will also have to report this income on their Canadian tax return. To avoid double taxation, they will generally be allowed to claim a foreign tax credit on their Canadian return for any tax they pay to the United States. As discussed above, the individual US states are not bound by the treaty. Therefore, even though the employee may be subject to an exemption from U.S. federal tax under the treaty, there is no guarantee that they will not be subject to a state's income tax.

"U.S. Day" - the Substantial Presence Test:

Generally, if an individual spends less than 183 days in the United States during the calendar year, has a tax home in another country, and has closer connections to a foreign country, the individual is not considered a resident of the United States. Otherwise, all individuals, other than U.S. citizens, must apply the substantial presence test under U.S. federal domestic law to determinate residency. The tests provided are mechanical and are based on the number of days present in the United States. Typically, a "U.S. day" is any day the individual is physically present in the United States. A partial day is counted as one day. The substantial presence test treats an individual as a resident of the United States if that person is present in the United States on at least 31 days during the calendar year and for a total of 183 days during the current year and two preceding calendar years. For purposes of the 183-day requirement, each day present in the United States in the current year counts as a full day; each day in the first preceding year counts as a third of a day; and, each day in the second preceding year counts as one sixth of a day.

If the Canadian employee meets the substantial presence test, they will be required to pay U.S. federal and, if applicable, state income tax in the United States on their U.S- source wages as a U.S. resident alien.

Because of the complexity of the rules discussed above it is very important that a Canadian company consult with a qualified professional before engaging in business in the U.S.