

# The Payroll Pooh-Bah: Why the Province of Employment Rules Don't Work & How They Should Be Changed



It's time to recognize once and for all that the province of employment (POE) rules need fixing. I've written about these rules before but always to explain how they work. (See HR Insider, " How to Determine an Employee's Province of Employment ") Now I'd like to express my opinion on why they actually *don't* work.

## 4 Problems with the POE

**Rule:** When employees file their T1 or TP-1 returns in April, they owe provincial income tax based on their province of residence as of the prior December 31. One of the primary problems with the POE is the difficulty in explaining to employees the reasons why their employment income is taxed by one province when they live in another.

**Problem 1:** There are many situations in which employees who are resident in one province may have source deductions and T4s prepared on the basis of another province entirely. The classic scenario is the employee who lives in Gatineau, Quebec but crosses the Ottawa River each day to physically report for work in Kanata, Ontario.

**Problem 2:** Another problem is the many different variants on these rules. These variations lack an intuitive quality and are therefore neither generally well explained nor understood.

**Example:** The issue of where an employee reports to work or is paid from applies only to employment income as reported in Box 14 on the T4. By contrast, other forms of taxable income, including retiring allowances and company pension benefits, are taxed based on where recipients *reside* at the time of payment. Thus, what might have been the correct POE for salary and wages may be the wrong POE for these other types of income. Similarly, the employee's POE also determines whether CPP or QPP applies if the employer is non-resident in Canada.

Since employment income doesn't lose its character just because employment ends, the POE for taxable benefits may not be the same as a former employee's province of residence. Thus, when an employee drives across the Ottawa River each day to physically report for work in Kanata, Ontario is the POE. Yet, if the employee

receives a company pension plan, Quebec source deductions apply. The POE for taxable benefits provided during retirement is based on where employers process the related payrolls. For example, if an employer's head office is in Victoria, BC would have jurisdiction over any taxable benefits for source deduction purposes since former employees no longer physically report for work to any employer establishment.

**Problem 3:** The current POE rules generally don't expressly describe what happens when an employee reports to work in multiple jurisdictions within a single pay period. This creates problems for the many employees who travel frequently across Canada, reporting to employer establishments in multiple jurisdictions. The rules in the *Income Tax Regulations* for POE don't expressly provide guidance in such situations. By contrast, for certain (but not all) source deductions, Quebec does have explicit rules about when it claims jurisdiction over employment that spans several jurisdictions within a single pay period.

Another variant is the basis on which Ontario and Quebec levy sales taxes—not GST, HST or the equivalent QST, but 8 or 9% provincial sales tax on group benefits. These rules are not very well known. And based on my experience, none of the major Canadian insurance carriers are compliant with all aspects of the rules. One of the resulting peculiarities is that employees and employers may not owe sales tax to the same jurisdiction—thus while Quebec sales tax may apply to employer contributions, the employee may be liable in Ontario.

**Problem 4:** The final issue I have with the POE rules is the definition of permanent establishment. If an employee physically reports to work at an employer establishment, that location determines the POE. While there's no explicit definition of 'establishment' in the *Income Tax Act* or *Regulations*, most people reference the definition of 'permanent establishment' in section 400 of the *Regulations*.

The most problematic part of section 400, for our purposes, is the reference to the use of "substantial machinery or equipment". I once heard an Ontario Employer Health Tax representative explain that EHT applies where an employee makes substantial use of a pencil in performing his employment duties. For Quebec source deduction purposes, similar language is found in interpretation bulletin IMP. 12-2/R3. The point is that both these provinces would like to understand this part of the definition as if it read "substantial use of machinery or equipment". Unfortunately, that's not quite what the words say. It's clear that "substantial" refers to the physical attributes of the "machinery or equipment" in question, and not how important that use is to the employment duties performed.

Courts have interpreted "substantial" as referring to the physical attributes of "machinery or equipment." One of the most recent cases comes from Ontario and involves the Toronto Blue Jays baseball team (2004 CanLII 14428 (ON SC)). The Ontario court cited a Supreme Court of Canada decision holding that "the adjective 'substantial' is intended to mean substantial in size." According to the Court, this term should be applied only to the heavy machinery, e.g., construction equipment.

## **Moving Beyond the Current POE Rules**

Okay, now that I've vented my spleen on the POE rules, I'd like to consider the available alternatives. I would argue using the province where employees reside

on the last day of each period for aligning payroll source deductions and reporting with an employee's ultimate T1 or TP-1 tax liability. The province of residence rule would be much simpler to administer and would eliminate all of the anomalies described above.

Example: Consider the case of employers without an establishment in Quebec but who do have employees in the province. Under current rules, the POE is either wrongly set to Quebec or there's difficulty remitting CSST premiums since a CSST-only payroll remittance account is an infrequent exception for Revenue Quebec. In this situation, why couldn't the employer remit any Quebec source deductions owing, including CSST premiums, through its CRA payroll accounts (BN numbers ending in RPxxxx), with the CRA passing on the relevant amounts to Revenue Quebec? The CRA has no trouble with the RQ collecting GST in Quebec on the CRA's behalf. So why couldn't the CRA collect Quebec source deductions on RQ's behalf from employers who are non-resident in that province? The non-resident employer could prepare RL-1s for Quebec resident but file them with the CRA.