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Transferring Employees to Canada

A Glimpse Beyond Income Tax Considerations: Social Security Benefits

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The globalization of markets is now, more than ever, a driving factor for the international transfer of employees. In order to take advantage of their skills and expertise in a specific field, American companies are assigning a growing number of employees to work in Canada.

The transfer of an employee to Canada, even on a temporary basis, will necessarily have a significant impact on that employee, particularly on a personal level. Certainly, the financial compensation that forms part of the transfer will be a significant deciding factor. In this regard, so as to properly evaluate the economic impact of a transfer, in addition to the income tax burden to be borne by the employee, one should consider social security contributions and whether or not the employee will still be able to contribute to the employer's pension fund or to avail himself of the social security coverage of his country of origin.

Transfers to Canada

An American resident who is assigned to Canada, particularly to Quebec, in order to work in the facilities of a Canadian company and who stays in Canada for more than 183 days will be taxed in Canada on his income earned during the year from all sources.

In addition to being subject to federal and provincial income tax, the employee will have to contribute to the Quebec Pension Plan and to the Employment Insurance Program. In general, given the temporary nature of his stay in Canada, the employee may nevertheless decide to maintain his social security coverage in the United States. In such a case, he will be in a situation of dual social security taxation.

In order to avoid this problem of dual social security taxation, Canada and certain provinces, including Quebec, have entered into agreements with the United States regarding social security. The purpose of these agreements is to allow an employee who has been transferred temporarily to a country which is a party to the agreement to continue to participate in the social security system of his country of origin and to be exempt from all social security contributions in the country in which he is working. In Quebec, the social security contributions covered by these agreements are the contributions to the Quebec Pension Plan and to the Employment Insurance Program.

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Under these agreements, an American citizen who is transferred temporarily to Canada (i.e. less than 60 months) may maintain his social security coverage in the United States if all of the facts show that the employee has kept his employment relationship with the American employer. The American tax authorities have published a list of criteria to determine whether or not an employer-employee relationship exists.

The expression "American employer" also includes foreign subsidiaries of an American employer if the company enters into an agreement—commonly designated as a 3121(L)—with the American tax authorities pursuant to which it undertakes to pay the social security costs for American citizens who work for its foreign subsidiaries. Thus, if the employment relationship with the American company is not maintained but is instead transferred to the Canadian subsidiary, the employee can benefit from the provisions of the social security agreement if the Canadian company is a subsidiary of the American company. A Canadian company is deemed to be a subsidiary of an American company if at least ten percent (10%) of its fully-voting shares are held by the American company.

Certificate of Coverage

If, pursuant to American tax legislation, it has been established that an employee has maintained his employment relationship with an American employer or that a 3121(L) agreement has been entered into with the American tax authorities, then if the employee wishes to be exempt from contributing to the Employment Insurance Program and the Quebec Pension Plan, he

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must obtain a certificate from the *U.S. Social Security Administration* confirming that he is subject to social security contributions in the United States. A copy of the certificate must be provided to the appropriate federal and provincial authorities in Canada so that the American company can be exempted from making contributions and deductions at the source with respect to the Quebec Pension Plan and the Employment Insurance Program.

The decision not to keep a transferred employee on the payroll of the American company for tax reasons may affect the social security contributions payable by the employee and his continued coverage in his country of origin. For example, if, for tax reasons—such as the tax holiday for foreign experts available in Quebec—an employee is transferred to the payroll of a Canadian company which is not a subsidiary of the American company, the American tax authorities will consider that the employer-employee relationship has not been maintained. In such a case, the employee will not be able to maintain his social security coverage in the United States and, during his entire stay in Quebec, he will have to contribute to the Quebec Pension Plan and to the Employment Insurance Program. Therefore, it is important when negotiating compensation agreements prior to the transfer of an employee, whether American or Canadian, to look beyond the income tax implications and to also consider the social security benefits granted under the laws of both countries in order to arrive at a combination which is advantageous to the employee overall.

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