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Income Tax Folio S4-F3-C2, Provincial Income Allocation

Series 4: Business

Folio 3: General Principles of Business Income Calculation

Chapter 2: Provincial Income Allocation

Summary

A corporation may operate in more than one province or territory and therefore may be liable for income tax in more than one jurisdiction.

Provincial Income Allocation is the term that describes the legislative scheme that allocates a corporation's taxable income to each province or territory in order to determine a corporation's provincial or territorial income tax liability.

A corporate taxpayer is required to allocate taxable income among all provinces and territories in which the corporation has a permanent establishment. The allocation not only impacts provincial income tax liability but also various federal and provincial taxes in a number of ways.

This Chapter explains the rules for determining and allocating a corporation's taxable income earned in a province or territory in which the corporation has a permanent establishment. In particular, this Chapter discusses:

- the meaning of gross revenue for provincial income allocation purposes, and the legislative scheme to attribute gross revenue;
- determining salaries and wages for provincial income allocation purposes and how to attribute salary and wages; and
- applying these rules in the context of a partnership, joint venture, and central paymaster.

This Chapter does not discuss in detail the factors that are relevant for the determination of whether a permanent establishment exists in a particular province or territory. Information about the permanent establishment of a corporation is provided in [Interpretation Bulletin, IT-177R2 Permanent Establishment of a Corporation in a Province](#).

The Canada Revenue Agency (CRA) issues income tax folios to provide a summary of technical interpretations and positions regarding certain provisions contained in income tax law. Due to their technical nature, folios are used primarily by tax specialists and other individuals who have an interest in tax matters. While each paragraph in a chapter of a folio may relate to provisions of the law in force at the time it was written (see the [Application](#) section), the information provided is not a substitute for the law. The reader should, therefore, consider the chapter's information in light of the relevant provisions of the law in force for the particular tax year being considered.

The CRA may have published additional guidance and detailed filing instructions on matters discussed in this Chapter. See the CRA's [Forms and publications](#) web page for this information and other topics that may be of interest.

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Discussion and interpretation

General overview of provincial income allocation

2.1 Under the Canadian tax system a taxpayer, which includes a corporation, is generally required to compute and pay federal and provincial or territorial income tax. In order to determine the income tax liability for each province or territory, a corporation's taxable income is allocated to any province or territory in which it carries on a business through a permanent establishment.

Definition of a province

2.2 Subsection 35(1) of the Interpretation Act defines **province** to mean a province of Canada, and includes Yukon, Northwest Territories, and Nunavut. Subsection 124(4) of the Income Tax Act further defines a province, for the purposes of section 124 (that is, federal tax abatement) and the regulations prescribed for this purpose, to include the Newfoundland offshore area and the Nova Scotia offshore area.

2.3 Under subsection 248(1), these offshore areas are defined respectively in the Canada-Newfoundland and Labrador Atlantic Accord Implementation Act, S.C. 1987, c.3., and the Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act, S.C. 1988, c.28.

2.4 As a result, each of the Newfoundland offshore area and the Nova Scotia offshore area is considered to be a province for provincial income allocation purposes. Accordingly, the term **province** will include the jurisdictions identified in this paragraph for the remainder of this Chapter.

Permanent establishment

2.5 A **permanent establishment** in respect of a corporation is defined in subsection 400(2) of the Income Tax Regulations to mean a fixed place of business of the corporation, including an office, a branch, a mine, an oil well, a farm, a timberland, a factory, a workshop, or a warehouse.

2.6 Where a corporation does not have any fixed place of business (in or outside Canada), a permanent establishment means the principal place in which the corporation's business is conducted.

2.7 Whether a corporation has a permanent establishment in a particular province depends on whether the corporation meets any of the criteria in subsection 400(2) of the Regulations. Such a determination involves questions of fact which must be answered by the circumstances of each case. An establishment in a province is not a permanent establishment unless a business is connected with it.

2.8 Further information regarding the permanent establishment of a corporation in a province is available in [Interpretation Bulletin, IT-177R2 Permanent Establishment of a Corporation in a Province](#).

Taxable income earned in the year in a province

2.9 Under subsection 124(1), a corporation may deduct from tax otherwise payable under Part I for a tax year, an amount equal to 10 percent of the corporation's taxable income earned in the year in a province. This deduction is commonly referred to as the federal tax abatement.

2.10 Subsection 124(4) defines the expression **taxable income earned in the year in a province** as the amount determined under rules prescribed for the purpose by regulations. In applying the definition of this expression for a corporation's tax year, paragraph 400(1)(a) of the Regulations provides that the prescribed rules referred to in that definition are the rules in Part IV of the Regulations. In addition, paragraph 400(1)(b) of the Regulations provides that the amount determined under those prescribed rules means the aggregate of the corporation's **taxable income earned in the tax year in a particular province** as determined under that Part.

2.11 Section 401 of the Regulations provides that Part IV of the Regulations applies to determine the amount of taxable income of a corporation earned in a tax year in a particular province.

2.12 Under paragraph 413(1)(b) of the Regulations, **taxable income** of a corporation not resident in Canada is deemed to refer to the corporation's taxable income earned in Canada. A corporation that does not have taxable income earned in Canada is not eligible for the federal tax abatement.

General rules for allocation of taxable income

2.13 Under subsection 402(1) of the Regulations, where in a tax year, a corporation had a permanent establishment in a particular province and no permanent establishment outside that province, all of its taxable income for the year shall be deemed to have been earned in that particular province and as a result will be allocated to that province.

2.14 Subsection 402(2) of the Regulations provides that where, in a tax year, a corporation had no permanent establishment in a particular province, no part of its taxable income for the year shall be deemed to have been earned in that particular province. Similarly, if a corporation has a permanent establishment outside of Canada, no portion of its taxable income earned outside Canada may be attributable to any province. Accordingly, in such circumstances, the corporation would not be eligible for the federal tax abatement on the taxable income earned outside Canada.

Allocating taxable income to a province - multiple permanent establishments

2.15 Except where certain industry specific rules apply (see ¶2.19), where, in a tax year, a corporation had a permanent establishment in a province and a permanent establishment outside that province, the corporation's taxable income that is deemed to have been earned in the year in the province is determined pursuant to subsection 402(3) of the Regulations. Under paragraph 402(3)(a) (see also ¶2.17 and ¶2.18), the corporation's taxable income earned in the year in a province equals 1/2 the total of:

- the proportion of the corporation's taxable income for the year that the gross revenue for the year reasonably attributable to the permanent establishment in the province is of its total gross revenue for the year, and
- the proportion of the corporation's taxable income for the year that the total salaries and wages paid in the year by the corporation to employees of the permanent establishment in the province is of the total salaries and wages paid in the year by the corporation.

2.16 The allocation of a corporation's taxable income attributable to a province for a tax year can be illustrated by the following formula:

$$TI \times [\frac{1}{2} \times (A/B + C/D)]$$

Where:

TI – is the corporation's taxable income for the year;

A – is the corporation's gross revenue for the year that is reasonably attributable to the permanent establishment in the province;

B – is the corporation's total gross revenue for the year;

C – is the salaries and wages paid in the year by the corporation to employees of the permanent establishment in the province; and

D – is the total salaries and wages paid in the year by the corporation.

Example 1

ACo is a Canadian corporation with permanent establishments in more than one province. It has the following amounts for a particular tax year:

TI – Taxable income for the year: \$100,000

B – Total gross revenue for the year: \$500,000

D – Total salaries and wages paid in the year: \$250,000

ACo has the following amounts attributable to one particular province for the tax year:

A – Gross revenue for the year reasonably attributable to the permanent establishment in the province: \$250,000

C – Salaries and wages paid in the year to employees of the permanent establishment in the province: \$150,000

ACo's **taxable income allocated to the particular province** is computed as follows:

$$TI \times [\frac{1}{2} \times (A/B + C/D)]$$

$$= \$100,000 \times [\frac{1}{2} \times (\$250,000/\$500,000 + \$150,000/\$250,000)]$$

$$= \$55,000$$

Therefore, ACo's taxable income allocated to the particular province is \$55,000.

2.17 When a corporation with a permanent establishment in a particular province and a permanent establishment outside that province has gross revenue of nil for a tax year, paragraph 402(3)(b) of the Regulations applies to calculate the taxable income attributable to that province. It is deemed to be the proportion of the taxable income for the year that the salaries and wages paid in the year by the corporation to employees of the permanent establishment in the province is of the total of all salaries and wages paid in the year by the corporation.

2.18 When a corporation with a permanent establishment in a particular province and a permanent establishment outside that province has total salaries and wages paid by the corporation in a tax year of nil, paragraph 402(3)(c) of the Regulations applies to calculate taxable income attributable to that province. It is deemed to be the proportion of the taxable income for the year that the gross revenue for the year reasonably attributable to the permanent establishment in the province is of the total gross revenue for the year.

2.19 The allocation rules described above apply to all corporations except those to which industry-specific regulations apply. The industry-specific regulations are listed as follows:

- Insurance corporations, section 403;
- Banks, section 404;
- Federal credit unions, section 404.1;
- Trust and loan corporations, section 405;
- Railway corporations, section 406;
- Airline corporations, section 407;
- Grain elevator operators, section 408;
- Bus and truck operators, section 409;
- Ship operators, section 410;
- Pipeline operators, section 411; and
- Divided business, section 412.

The industry-specific rules described in these provisions are not discussed in this Chapter. Readers should refer to the industry-specific regulations.

Gross revenue

2.20 Gross revenue of a taxpayer for a tax year is defined in subsection 248(1) of the Income Tax Act as: "the total of:

- a. all amounts received in the year or receivable in the year (depending on the method regularly followed by the taxpayer in computing the taxpayer's income) otherwise than as or on account of capital, and
- b. all amounts (other than amounts referred to in paragraph (a)) included in computing the taxpayer's income from a business or property for the year because of subsection 12(3) or (4) or section 12.2 of this Act or subsection 12(8) of the Income Tax Act, chapter 148 of the Revised Statutes of Canada, 1952."

By virtue of section 16 of the Interpretation Act, this definition of gross revenue also applies for purposes of the Regulations.

2.21 For purposes of Part IV of the Regulations, gross revenue includes all amounts received or receivable by a taxpayer, other than on account of capital. In addition, any amounts that are included in income pursuant to paragraphs 12(1)(a) or (b) would also be considered gross revenue for purposes of Part IV of the Regulations. Gross revenue of a corporation would typically include amounts received by the corporation from its principal business operations as well as other amounts received or receivable that a corporation considers incidental to its business operations. The CRA recognizes that revenue reported on financial statements in accordance with generally accepted accounting principles may not, at times, coincide with gross revenue as defined in the Act for purposes of Part IV of the Regulations.

2.22 Examples of amounts that would normally be included in determining gross revenue of a corporation for purposes of Part IV of the Regulations are:

- Sales of goods or merchandise by a corporation. Similarly, revenue for services rendered by a corporation.
- Interest earned on bank accounts and trade receivables.
- Foreign exchange gains, where the gains are on income account.
- Proceeds received on the disposition of property that was included in the inventory of a business upon the disposition of or ceasing to carry on the business.

However, an amount received or receivable on account of capital generally represents, in whole or in part, the proceeds of disposition in respect of the disposition of a capital property. Accordingly, an amount received or receivable as proceeds of disposition of a capital property and any consequential income inclusions under sections 13 or 38 on the disposition is excluded from gross revenue.

Amounts excluded from gross revenue

2.23 Subsection 402(5) of the Regulations provides that for purposes of subsection 402(3), gross revenue of a corporation does not include interest on bonds, debentures or mortgages, dividends on shares of capital stock, or rentals or royalties from property that is not used in connection with the principal business operations.

2.24 In Provincial Income Allocation Newsletter No. 1 the CRA confirmed that a broad interpretation of the excluded amounts is appropriate for the purposes of Part IV of the Regulations. Under such a broad interpretation, interest on promissory and other notes, bankers' acceptances, intercompany loans, certificates, guaranteed investment certificates, and any unsecured debt instruments or other similar obligations would also be excluded from the gross revenue of a corporation.

2.25 In addition, the reference in subsection 402(5) to “that is not used in connection with the principal business operations of the corporation” refers only to “rentals or royalties from property” and not to the other items enumerated in that subsection.

2.26 Examples of amounts that would normally be excluded in determining gross revenue of a corporation for purposes of Part IV of the Regulations include the following:

- Amounts received or receivable in respect of expenditures incurred by the corporation.
- Amounts received or receivable as volume rebates as these amounts would normally relate to expenditures incurred instead of receipts in respect of income-earning activities.
- Financial assistance received by the corporation from a government in respect of expenditures incurred or to be incurred by the taxpayer.

Attribution of gross revenue to a permanent establishment

2.27 The rules described in subsection 402(4) of the Regulations apply for the purpose of determining a corporation’s gross revenue for a tax year reasonably attributable to a permanent establishment in a province or country other than Canada, within the meaning of subsection 402(3). In general terms, these rules allocate gross revenue where the revenue is derived from the sale of merchandise, the provision of services, the sale of standing timber or the right to cut standing timber, and the leasing of land.

2.28 To the extent that the rules discussed in ¶2.29 to 2.54 do not apply to a particular situation, the gross revenue attributable to a permanent establishment in a province or country other than Canada may be determined on a reasonable basis pursuant to subparagraph 402(3)(a)(i).

Merchandise shipped to a customer

2.29 Where a corporation makes a sale of merchandise to a customer and ships the merchandise directly to the customer, one of paragraphs 402(4)(a), (b), or (c) of the Regulations will apply provided the conditions specified are met. The term **merchandise** means any tangible personal property or corporeal movable property, and can include both goods manufactured by the corporation and goods the corporation purchased from a third party.

2.30 Subsection 402(4) makes several references to the location of “the destination of a shipment of merchandise”, which is a question of fact. For the purposes of paragraphs 402(4)(a), (b) and (c), a vendor of a product should allocate gross revenue to a jurisdiction that is a particular province or country other than Canada if the vendor has a permanent establishment in that jurisdiction and the vendor has reasonable knowledge at the time of sale that the customer will consume or resell the goods in that jurisdiction. Whether a vendor had such reasonable knowledge can only be determined by reviewing all of the relevant facts and documentation of a particular situation.

2.31 Under paragraph 402(4)(a) of the Regulations, where the destination of the shipment of merchandise is in a province or country other than Canada where the corporation has a permanent establishment, the gross revenue from the merchandise sale is attributable to the permanent establishment in that province or country.

2.32 However, where the circumstances described in subsection 402(4.1) are met (see ¶2.43), paragraph 402(4)(a) does not apply. Instead, gross revenue derived from the merchandise sale is attributed to a province where the corporation has a permanent establishment as described in (a) or (b) in ¶2.35, and modified such that no gross revenue derived from the merchandise sale would be attributed to the country outside Canada.

2.33 Paragraph 402(4)(b) of the Regulations applies where the destination of the shipment of merchandise to a customer to whom the merchandise is sold is in a province or country other than Canada in which the corporation does not have a permanent establishment. In this situation, the gross revenue from the merchandise sale is attributed to the permanent establishment where the person negotiating the sale for the corporation may reasonably be regarded as being attached.

2.34 Paragraph 402(4)(b) does not apply where paragraph 402(4)(c) applies (See ¶2.35).

2.35 Paragraph 402(4)(c) of the Regulations describes an exception to the attribution of gross revenue under paragraph 402(4)(b). Under paragraph 402(4)(c), where the destination of the shipment of merchandise to a customer to whom the merchandise is sold is in a country other than Canada in which the corporation has no permanent establishment, the gross revenue reasonably attributable to a province is determined in one of the following two ways:

- a. if the merchandise was produced or manufactured (or produced and manufactured) by the corporation entirely in a particular province the gross revenue derived from the merchandise sale is attributable to the permanent establishment in that province.
- b. if the merchandise was produced or manufactured (or produced and manufactured) by the corporation partly in a particular province and partly in another place, the gross revenue from the merchandise sale that is attributable to the permanent establishment in the particular province is computed on a prorated basis. This proration is made by reference to the proportionate share of the salaries and wages paid in the tax year to the employees of the permanent establishment in the province where the merchandise was partly produced or manufactured, or partly produced and manufactured that is of the total salaries and wages paid in the year to employees of all permanent establishments where the merchandise was produced or manufactured (or produced and manufactured).

2.36 The gross revenue derived from the sale of merchandise attributable to the permanent establishment in a particular province described in ¶2.35(b) can be illustrated by the following formula:

$$\text{GRP} = \text{GR} \times (\text{A/B})$$

Where:

GRP – is gross revenue derived from the sale of merchandise attributable to the permanent establishment in a particular province;

GR – is the corporation's total gross revenue for the year from the sale of merchandise produced or manufactured (or produced and manufactured) partly in the particular province and partly in another place;

A – is the salaries and wages paid in the year by the corporation to employees of the permanent establishment in the province where the merchandise was partly produced or manufactured (or partly produced and manufactured); and

B – is the total salaries and wages paid in the year to employees of all permanent establishments where the merchandise was produced or manufactured (or produced and manufactured).

Example 2

B Co, a Canadian corporation with two permanent establishments, one in Ontario and one in Manitoba, produced and manufactured merchandise partly in Ontario and partly in Manitoba with the following amounts for the particular tax year:

GR – Total gross revenue for the year from the sale of merchandise produced and manufactured partly in Ontario and partly in Manitoba: \$200,000

A – Total salaries and wages paid in the year to Ontario employees: \$20,000

B – Total salaries and wages paid in the year to employees of both permanent establishments (Ontario and Manitoba): \$40,000

BCo's gross revenue reasonably allocated to the permanent establishment in Ontario (GRP) would be determined as follows:

$$\begin{aligned}\text{GRP} &= \text{GR} \times (\text{A/B}) \\ &= \$200,000 \times (\$20,000/\$40,000) \\ &= \$100,000\end{aligned}$$

BCo's gross revenue for the year reasonably allocated to the permanent establishment in Ontario is therefore \$100,000.

Merchandise shipped to a person other than the customer

2.37 Where a corporation makes a sale of merchandise to a customer who instructs the shipment to be sent to a person other than the customer, one of paragraphs 402(4)(d), (e), or (f) of the Regulations will apply provided the conditions specified are met.

2.38 Under paragraph 402(4)(d), where the customer instructs that the merchandise sold be shipped to some other person and the customer's office with which the sale was negotiated is located in a particular province or country in which the corporation has a permanent establishment, the gross revenue from the merchandise sale is attributable to the permanent establishment in that province or country.

2.39 However, where the circumstances described in subsection 402(4.1) are met (see ¶2.43), paragraph 402(4)(d) does not apply. Instead, gross revenue derived from the merchandise sale is attributed to a province where the corporation has a permanent establishment as described in (a) or (b) in ¶2.41 and modified such that no gross revenue derived from the merchandise sale would be attributed to the country outside Canada.

2.40 Paragraph 402(4)(e) of the Regulations applies where the customer instructs that the merchandise sold be shipped to some other person and the customer's office with which the sale was negotiated is located in a province or country other than Canada in which the taxpayer has no permanent establishment. In this situation, the gross revenue from the merchandise sale is attributed to the permanent establishment where the person negotiating the sale for the corporation may reasonably be regarded as being attached. This paragraph does not apply where paragraph 402(4)(f) applies (see ¶2.41).

2.41 Paragraph 402(4)(f) of the Regulations describes an exception to paragraph 402(4)(e). Paragraph 402(4)(f) applies where the customer instructs that the merchandise sold be shipped to some other person and the customer's office with which the sale was negotiated is located in a country other than Canada in which the taxpayer has no permanent establishment. In this case, the gross revenue derived from the sale shall be attributable to a permanent establishment in the following manner:

- a. If the merchandise was produced or manufactured, or produced and manufactured, by the corporation entirely in a particular province, the gross revenue from the merchandise sale is attributable to the permanent establishment in that province.
- b. If the merchandise was produced or manufactured, or produced and manufactured, by the corporation partly in a particular province and partly in another place, the gross revenue from the merchandise sale that is attributable to the permanent establishment in the particular province is computed on a prorated basis. This proration is made by reference to the proportionate share of the salaries and wages paid in the tax year to the employees of the permanent establishment in the province where the merchandise was partly produced or manufactured, or partly produced and manufactured that is of the total salaries and wages paid in the year to employees of all permanent establishments where the merchandise was produced or manufactured (or produced and manufactured).

2.42 The gross revenue derived from the sale of merchandise attributable to a permanent establishment in a particular province as described in ¶2.41(b) can be illustrated as follows:

$$\text{GRP} = \text{GR} \times (\text{A/B})$$

Where:

GRP – is gross revenue derived from the sale of merchandise attributable to the permanent establishment in a particular province;

GR – is the corporation's total gross revenue for the year from the sale of the merchandise produced or manufactured, or produced and manufactured, partly in the particular province and partly in another place;

A – is the salaries and wages paid in the year by the corporation to employees of the permanent establishment in the province where the merchandise was partly produced or manufactured (or partly produced and manufactured); and

B – is the total salaries and wages paid in the year to employees of all permanent establishments where the merchandise was partly produced or manufactured (or partly produced and manufactured).

Attribution of gross revenue where the sale of merchandise is outside Canada

2.43 A corporation's gross revenue from the sale of merchandise for a tax year (described in ¶2.29 to 2.42) that is reasonably attributable to a province or a country other than Canada is modified per subsection 402(4.1) of the Regulations where:

- a. either
 - i. the destination of the shipment of merchandise to a customer is in a country other than Canada; or
 - ii. the customer to whom merchandise is sold by a corporation instructs that the shipment of merchandise be made by the corporation to another person and the customer's office with which the sale was negotiated is located in a country other than Canada;
- b. the corporation has a permanent establishment in the other country; and
- c. the corporation is not subject to tax on its income under the laws of the other country, or the corporation's gross revenue from the sale is not included in computing the income or profit or other base for income or profits taxation by the other country because of:
 - i. the provisions of any taxing statute of the other country, or
 - ii. the operation of any tax treaty or convention between Canada and the other country.

2.44 The rules in subsection 402(4.1) do not apply to services.

2.45 For the purposes of calculating a corporation's provincial income allocation, where subsection 402(4.1) applies, the salaries and wages paid in the year to employees of any permanent establishment located in the foreign country are deemed to be nil.

2.46 The rules outlined in ¶2.29 to 2.42, as modified by subsection 402(4.1) also apply to attribute the sale to the jurisdiction where the merchandise was manufactured or produced. If the modifications in subsection 402(4.1) result in subsection 402(4) being not applicable, the allocation of the gross revenue on this sale should be made on the basis of where it is reasonably attributable as required by subparagraph 402(3)(a)(i) (see ¶2.28).

Attribution of gross revenue from services

2.47 Under paragraph 402(4)(g) of the Regulations, where a corporation's gross revenue is derived from services rendered in a particular province or country other than Canada, the gross revenue is attributable to the permanent establishment in the province or country.

2.48 In allocating gross revenue from services, a corporation must determine the place where those services were performed. Where a corporation renders services from permanent establishments in more than one jurisdiction, the gross revenue from the services is attributed to each jurisdiction and should recognize the value of any ancillary services rendered by the permanent establishment.

2.49 Paragraph 402(4)(h) of the Regulations applies where gross revenue is derived from services rendered in a province or a country other than Canada in which the corporation does not have a permanent establishment. In such a situation, the gross revenue from the services is attributed to the permanent establishment of the corporation to which the person negotiating the service contract may reasonably be regarded as being attached.

Attribution of gross revenue from standing timber or the right to cut timber

2.50 Paragraph 402(4)(i) of the Regulations applies to determine the attribution of the gross revenue from the sale of standing timber or the right to cut standing timber. Such gross revenue is attributable to the permanent establishment of the corporation in the province or country other than Canada where the timber limit on which the timber is standing is located.

Attribution of gross revenue from leases

2.51 Under paragraph 402(4)(j) of the Regulations, gross revenue from leasing land owned by a corporation in a province and which is included in computing the corporation's income under Part I of the Act, is attributable to the permanent establishment, if any, of the corporation in the province where the land is situated.

2.52 However, where the land is not used in connection with the corporation's principal business operations, subsection 402(5) of the Regulations excludes the rental revenue from property from the corporation's gross revenue.

2.53 Gross revenue of a corporation from non-financial leases (generally, these are operating leases) should be allocated in the following manner:

- a. Gross revenue should be attributed to the permanent establishment in the province in which the leased property is being used, where the corporation has reasonable knowledge of such information.
- b. If the corporation does not have reasonable knowledge of where the property is being used, or the corporation does

not have a permanent establishment in the jurisdiction described in ¶2.53(a), the gross revenue should be allocated to the permanent establishment to which the person negotiating the lease may reasonably be regarded as being attached.

2.54 Regarding reasonable knowledge, the corporation may have knowledge of the location where the leased property is being used simply by virtue of the relationship with the client. This alone is not necessarily the prerequisite for reasonable knowledge. Gross revenue should be allocated to the jurisdiction where the leased property is being used only if the corporation needs to have this information because of the commercial or business relationship with the client, and only if the corporation has a permanent establishment in that jurisdiction. See [Provincial Income Allocation Newsletter No. 3](#).

Salaries and wages

2.55 As noted in ¶2.15, subsection 402(3) of the Regulations provides the attribution rule for situations where a corporation has a permanent establishment in a province and a permanent establishment outside that province. One of the relevant factors in the attribution of taxable income of the corporation is the salaries and wages paid in the year to the employees by the corporation.

Salaries and wages defined

2.56 The expression **salaries and wages** has the same meaning as the definition of “salary or wages” in subsection 248(1) of the Act. Furthermore, “salaries and wages” should be read in conjunction with the phrase “paid in the year by the corporation”.

2.57 The phrase **salaries and wages paid in the year by the corporation** incorporates all remuneration that is calculated under subdivision a of Division B of Part I of the Act. Such salaries and wages paid refers to the income inclusions of an employee under sections 5, 6, and 7. Deductions available to an employee under section 8 are not taken into account.

2.58 Furthermore, salaries and wages paid in the year by a corporation to employees of a permanent establishment in a province includes salaries and wages paid to non-resident employees who report for work at that permanent establishment.

2.59 For the purposes of the allocation of taxable income, the following list describes some of the amounts that are **not** included in the calculation of salaries and wages paid in the year by the corporation to employees:

- Employer’s Canada Pension Plan contributions and Employment Insurance premiums
- Employer contributions to the Quebec Pension Plan, and the Quebec Parental Insurance Plan
- Payments of superannuation and pensions benefits
- Retiring allowances as defined under subsection 248(1) of the Act, which includes amount in respect of a loss of an office or employment
- Unpaid bonuses
- Provincial worker’s compensation benefits
- Deductions available to the employee under section 8

Salaries and wages attributable to a permanent establishment

2.60 Whether an individual is considered an employee of a permanent establishment in a particular province is a question of fact that can only be determined after a review of the circumstances. The fact that the employment responsibilities of a particular employee of a permanent establishment in one province would also benefit permanent establishments of other provinces does not in and of itself result in the employee also being an employee of the other establishments. Other factors that are relevant in determining whether an individual is an employee of a permanent establishment of any particular province include the following:

- whether the individual is also considered to be an employee of that establishment for provincial government related filing requirements (for example, income tax deduction, medical premium deduction, etc.);
- whether the employee maintains an office or other connections in that establishment; and
- whether the employee normally reports to or receives instructions from that establishment.

2.61 Under paragraph 413(1)(a) of the Regulations, where a corporation is not resident in Canada, “salaries and wages paid in a year” does not include salaries and wages paid to employees of a permanent establishment outside Canada. In addition, the taxable income of the corporation is deemed to refer to the corporation's taxable income earned in Canada.

Fees paid to service providers

2.62 Subsection 402(7) of the Regulations deems certain amounts paid to third parties to be salaries and wages paid to employees of the corporation. Under subsection 402(7), where a corporation pays a fee to another person (the **service provider**) under an agreement by which the service provider or service provider's employees perform services for the corporation that would normally be performed by the corporation's employees the following rules apply:

- the fee paid to the service provider is deemed to be salary paid in the year by the corporation; and
- the part of the fee paid to the service provider that may reasonably be regarded as payment in respect of services rendered at a particular permanent establishment of the corporation is deemed to be salary paid to an employee of that permanent establishment.

2.63 The term **normally** is not defined for the purposes of subsection 402(7) of the Regulations. It is the CRA's view that the term “normally” in subsection 402(7) has two conditions:

- The service or function performed by the service provider must be one that is already performed by an employee of the corporation. Subsection 402(7) will not apply in situations where the corporation does not have any employees.
- The need for the individual service provider to perform a particular service or function is short-term.

For example, where a corporation's employees usually perform a certain service for the corporation but for some reason, such as short-term economic conditions or labour problems, the corporation entered into an agreement with a service provider to perform such service, the fee paid to the service provider would be deemed to be salary paid in the year by the corporation. In addition, the portion of the fee paid that may reasonably be regarded as a payment in respect of services rendered at a particular permanent establishment of the corporation is deemed to be salary paid to an employee of that establishment.

Commissions

2.64 Under subsection 402(8) of the Regulations, for the purposes of subsection 402(7), a fee does not include a commission paid to a person who is not an employee of the corporation. The word **commission** in the context of subsection 402(7) has been defined by the courts to mean a fee determined as a percentage of some given amount.

Central paymaster

2.65 It may happen that an individual who is an employee (**Employee**) of a service provider (**Employer**) performs a service in a particular province for the benefit of or on behalf of a corporation who is not the Employer (that is, the corporation has contracted with the Employer for the Employee's services). In these circumstances, subsection 402.1(1) of the Regulations deems an amount that may reasonably be regarded as salary and wages earned by the Employee for the service performed to be salary paid by the corporation to an employee of the corporation in the corporation's tax year in which the particular salary is paid. This will be the case if all of the following conditions are met:

- a. at the time the service is performed, (i) the corporation and Employer do not deal at arm's length, and (ii) the corporation has a permanent establishment in the particular province;
- b. the service is performed (i) by the Employee in the normal course of the Employee's employment by the Employer, and (ii) for the benefit of or on behalf of the corporation in the ordinary course of a business carried on by the corporation;
- c. the service is of a type that could reasonably be expected to be performed by employees of the corporation in the ordinary course of the business, referred to in ¶2.65(b); and
- d. the amount is not otherwise included in the total of the salaries and wages paid by the corporation for purposes of Part IV of the Regulations.

2.66 Generally, the central paymaster rules would not apply in a situation where the services in question are shared administrative (that is, non-operational) services. For the purposes of section 400 of the Regulations, the salaries and wages of a parent corporation's employees providing shared administrative services will be part of the parent's salaries and wages paid in the year if:

- those employees report to a PE of the parent;
- those employees receive direction from the parent's corporate structure; and
- all or substantially all of the economic activity of those employees (in this case, providing services to a subsidiary) is for the benefit of the parent.

2.67 Where applicable, the central paymaster rules will attribute salary and wages as follows. Under paragraph 402.1(2)(a) of the Regulations, if the service was performed at one or more permanent establishments of the corporation in a particular province, the amount deemed by subsection 402.1(1) (see ¶2.65) to be salary paid by the corporation to an employee of the corporation for the service performed in the province is deemed to have been paid to an employee of the permanent establishment or establishments.

2.68 If paragraph 402.1(2)(a) of the Regulations (see ¶2.67) does not apply, paragraph 402.1(2)(b) provides that the amount deemed in subsection 402.1(1) (see ¶2.65) to be salary paid by the corporation to an employee of the corporation for the service performed in a province is deemed to have been paid to an employee of any other permanent establishment (as is reasonably determined in the circumstances) of the corporation in the particular province.

2.69 Under subsection 402.1(3) of the Regulations, the salaries and wages paid by the Employer in the year are reduced by the salaries and wages that are deemed by subsection 402.1(1) to be paid by the corporation.

Example 3 – Central paymaster rules

Corporation A provides services to its subsidiary companies. Corporation B, a subsidiary of Corporation A, is a recipient of such services. The services are of a type that could reasonably be expected to be performed by employees of the Corporation B in the ordinary course of its business. In this regard, Employees of Corporation A report to a permanent establishment of Corporation B, receive direction from Corporation B's corporate structure, and all or substantially all of the Employees' economic activity is for the benefit of Corporation B. The salaries and wages of these Employees are not otherwise included in the salaries and wages of Corporation B.

For the purposes of Part IV of the Regulations the salaries and wages of Corporation A's Employees would be attributed to Corporation B's salaries and wages paid in the year. Corporation A's salaries and wages would be reduced by a corresponding amount.

2.70 The central paymaster rules in section 402.1 of the Regulations normally apply to a corporation and an Employer that do not deal at arm's length. However, under subsection 402.1(4), the rules may also apply to a corporation and an Employer that deal at arm's length. This will be the case if the Minister of National Revenue determines that the corporation and Employer have entered into an arrangement for the provision of services in a particular province by the Employer for the benefit of the corporation the purpose of which is to reduce the corporation's income tax in the province.

Partnerships and members

2.71 Each member of a partnership is considered to have a permanent establishment in the province(s) in which the partnership has a permanent establishment. When a corporation conducts all or part of its operations in partnership with one or more other persons, subsection 402(6) of the Regulations provides that for the purposes of subsection 402(3) (see ¶2.15, 2.17 and 2.18), the corporation must include in its gross revenue for the tax year and in its salaries and wages paid in the tax year its proportionate share of the gross revenue of the partnership and the salaries and wages paid by the partnership. The corporation's proportionate share of these amounts from the partnership's fiscal period ending in (or coinciding with) the corporation's tax year is based on the corporation's share of the partnership's income or loss for the fiscal period of the partnership.

Example 4

XCo is a member of a partnership. The partnership has the following amounts for its fiscal period ending in XCo's tax year:

Gross revenue: \$10,000

Salaries and wages: \$4,000

Under the terms of the partnership, XCo's share of the partnership income is 10%.

Therefore, XCo would include the same proportionate share of gross revenue and salaries and wages as follows:

Gross revenue: \$1,000 (10% of \$10,000)

Salaries and wages: \$400 (10% of \$4,000)

2.72 Where a corporation is a member of a partnership that has more than one fiscal period ending in (or coinciding with) the corporation's tax year, the corporation would include its proportionate share of the gross revenue of the partnership and its proportionate share of the salaries and wages paid by the partnership for each fiscal period of the partnership that ends in (or coincides with) the corporation's tax year.

2.73 For the purposes of the central paymaster rules subsection 402.1(5) deems a partnership to be a corporation and deems the corporation's tax year to be the partnership's fiscal period.

Joint ventures and participants

2.74 Where a corporation is a participant in a joint venture, the determination of salaries and wages paid by the corporation from the joint venture activities will generally depend on the terms of the joint venture agreement. For example, where, pursuant to the joint venture agreement, the participants agree to share legal responsibility for the salaries and wages of the employees of the joint venture, the participants would include their proportionate share of the salaries and wages of the joint venture for purposes of determining salaries and wages paid by the corporation as set out in subparagraph 402(3)(a)(ii) of the Regulations.

2.75 Where a corporation uses its own employees in the joint venture activity, for purposes of determining salaries and wages paid by the corporation as set out in subparagraph 402(3)(a)(ii), the corporation would include its share of the salaries and wages of the joint venture employees that are directly paid by the corporation to the employees of the permanent establishment in a province.

2.76 Where there is a nominee corporation paying the employees of a joint venture and the legal responsibility is not shared among the joint venturers, the central paymaster rules in section 402.1 may apply to attribute the salary and wages to the joint venturers.

Application

This Chapter, which may be referenced as S4-F3-C2, is effective January 30, 2024.

Except as otherwise noted, all statutory references herein are references to the provisions of the Income Tax Act, R.S.C., 1985, c.1 (5th Supp.), as amended and all references to a Regulation are to the Income Tax Regulations, C.R.C., c. 945, as amended.

Links to jurisprudence are provided through CanLII.

Income tax folios are available in electronic format only.

Reference

Sections 400, 401, 402, 402.1, and 413 of the Regulations.

Section 124 of the Income Tax Act.

Section 35 of the Interpretation Act.

Date modified:

2024-01-30