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Mobility Matters

US and Canada Cross-Border Commuter Impact: From Compliance to Change Management

May 2024 | by John Denworth and Kyle Christensen, KPMG LLP (U.S.), Detroit (KPMG LLP in the United States is a KPMG International member firm)

There are several border crossing points in the United States, but few with as notable a commuting population as the crossing between Michigan and Ontario. Daily, it is estimated that there are over 20,000 individuals (about the seating capacity of Little Caesars Arena in Detroit) that commute in either direction across the border.[1] While it is more common for Ontario residents to commute daily into Detroit, there are many Michigan residents who commute to Windsor every day.

Commuting between United States and Canada has been common for decades, though it was the COVID-19 pandemic that shined a light on the tax and payroll implications for a commuter workforce. With the closure of the border during the pandemic, and as a result, typical commuters working from home rather than at their usual cross-border workplace, employers were suddenly required to consider the payroll implications of the commuters' home office being their new work location.

In this article, we focus on the technical rules on both sides of the border, how remote and hybrid work policies have spotlighted the risks of compliance, and how change management is critical to a creating a positive experience for all stakeholders involved.

Tax and Payroll Implications

Overall, the rules and regulations have not changed since prior to COVID-19. In the case of Canadian commuters living in Canada and commuting to the United States daily, the tax and payroll requirements have been straightforward. If they were working five days a week in the U.S., and were paid by a U.S. employer, they would typically receive a Form W-2 that reported their full wages. Assuming they are not U.S. citizens or green card holders, and are considered U.S. nonresidents, they are only taxable on employment income related to U.S. workdays and would file the U.S. Nonresident Alien Income Tax Return (Form 1040NR) to report the W-2 income and reconcile their withholdings.

In a fact pattern such as this, there have been differing approaches on the Canadian side, however. As Canadian resident, such individuals would be required to restate their U.S. earnings on their Canadian tax return and claim a foreign tax credit (FTC) for the U.S. taxes paid, which will help to offset much (if not all) of the Canadian tax liability.

A rule that has always been on the books, but not widely known previously, requires the U.S. employer to also issue a Form T4 (Canadian equivalent of the W-2) for a Canadian tax resident, and actively run a Canadian payroll for any anticipated Canadian taxes that may not be covered by the FTCs.

The following summary of 2024 tax rates in each location indicates that the Canadian taxes are generally higher than those in the United States, especially at upper income levels, and may require additional tax payments in Canada.

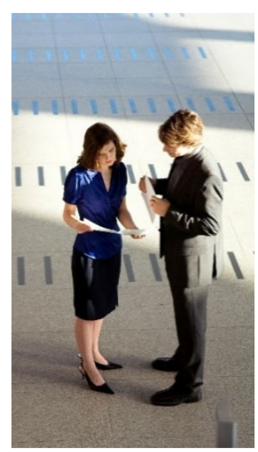
US and Mchigan		Canada and Ontario (in USD)	
Rate	**Income**	**Rate**	**Income**
14.25%	$0 to $11,600	20.05%	$0 to $38,070
16.25%	$11,600 to $47,150	24.15%	$38,070 to $41,341
26.25%	$47,150 to $100,525	29.65%	$41,341 to $67,043
28.25%	$100,525 to $191,950	31.48%	$67,043 to $76,141
36.25%	$191,950 to $243,725	33.89%	$76,141 to $78,981
39.25%	$243,725 to $609,350	37.91%	$78,981 to $82,682
41.25%	$609,350 or more	43.41%	$82,682 to $111,000
		44.97%	$111,000 to $128,172
		48.29%	$128,172 to $162,800
		49.85%	$162,800 to $182,597
		53.53%	Over $182,597

Source: KPMG LLP (U.S.)

Historically, many companies did not follow these rules. Many viewed the risk of non-compliance as low because commuters were crossing daily and primarily generating U.S.-sourced employment income. However, with the onset of working remotely during the pandemic and most companies allowing for more flexibility since then, commuters who are working from home are earning Canadian-sourced income on those telecommuting days instead of U.S.-sourced income. As a result, the FTCs that would have previously been claimed are no longer to offset Canadian income tax on Canadian-sourced income. If the U.S. company does not run a Canadian payroll and remit the necessary amounts, this could lead to unpaid Canadian taxes. Running dual payrolls would also reduce the amount of U.S. taxes to be paid in U.S. payroll.

Social Security Implications

Social security is another key consideration. The United States and Canada have a totalization agreement that coordinates the two countries' social security programs, helping to eliminate dual social security coverage and taxes. Generally, an employee will only be subject to social security taxes in the country where he or she works. However, the totalization agreement includes exceptions that in many cases allow a cross-border commuter to pay social security tax only in the primary country of employment, even if some days are worked in the other country.



In terms of thinking forward to the individual’s retirement, for many workers the U.S. Social Security system may provide a greater benefit at retirement, and thus is typically preferred by the individual.[2] It has been observed that companies take differing views on the approach to funding U.S. Social Security and Canada Pension Plan, so employers should carefully review the applicable rules to help ensure the most suitable scenario for the company and the employee.

Corporate Tax Implications

In addition to the individual tax implications mentioned above, there are also significant corporate tax concerns relating to executives working remotely. If a company has employees working in another country, it could be considered to have a "permanent establishment" in that country, subjecting the company to corporate income tax there on the profits attributable to the permanent establishment. In the U.S.-Canada cross-border work context, this is commonly encountered when a representative of the U.S. company is working from home in Canada but conducting business on behalf of the U.S. company. It is important to review the population of (potential) telecommuters with this fact pattern and work with the company's corporate tax team and advisers to make sure they have carefully considered all implications.

Change Management Considerations

After an employer has reviewed the exposure raised by its work-from-home arrangements, it may conclude that adjustments to policies and procedures are necessary. Implementing a new policy on cross-border commuters requires careful change management. Clear and consistent communication is crucial, explaining why the policy is being implemented, what changes will occur, and how they will affect employees.

Training sessions may be warranted to educate employees on the new policy, and it is important to involve all stakeholders in the change process. Implementing a system for collecting feedback on the new policy can help identify any issues or concerns early.

Pilot testing the policy on a small scale first can help identify potential challenges before a company-wide rollout. Of course, making sure the policy complies with all relevant laws and regulations in both the United States and Canada is essential.

Conclusion

Many people commute across the United States–Canada international border every day. HR departments and global mobility professionals working at companies in this border area have their hands full. Managing a cross-border workforce between the United States and Canada requires a deep understanding of the tax, payroll, and corporate tax implications in both countries, as well as a thoughtful change management approach. To manage effectively, it is important to fully understand the cross-border travel patterns and the location of each commuter, as well as ascertain their visa status, and to track their travel actively. As an individual's travel patterns change, so too will his or her employer's payroll requirements in each location.

We know several companies have already implemented a commuter strategy, but as companies formally establish (and stick to) new in-office policies, and tax authorities turn their attention to remote workers, telecommuters, and hybrid work, now is an appropriate time to review the company's telecommuter population and revisit strategy and approach with a long-term view, as there is no expectation that the above-mentioned requirements will change anytime soon.

Footnotes:

[1] Figures gleaned from statistics available from the following sources: https://www.dwtunnel.com/history/, https://en.wikipedia.org/wiki/Blue_Water_Bridge, and https://en.wikipedia.org/wiki/Ambassador_Bridge . *By clicking on these links, you are leaving the KPMG website for external sites (non-KPMG, non-governmental), that KPMG is not affiliated with nor does KPMG endorse their content. Use of the external sites and their content may be subject to the terms of use and/or privacy policies of their owner or operator.*

[2] Readers may learn more about the benefits paid under U.S. Social Security by visiting "What is the maximum Social Security retirement benefit payable?" and under the CPP by visiting "CPP Retirement pension: How much you could receive."

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