



TaxNewsFlash

Canada

CRA Extends Relief for Reg. 105 Subcontracting

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Taxpayers who reimburse non-residents for services rendered in Canada through subcontracting arrangements now have additional time before they have to make withholding tax payments on these reimbursements. The CRA recently extended its Regulation 105 administrative relief policy so that taxpayers will not be required to remit withholding tax (or related interest and penalties) under these rules until June 30, 2026 (from September 30, 2024). The CRA previously announced this limited relief after it revised its position on Regulation 105 and found that these reimbursements are technically subject to withholding tax.

The CRA's administrative relief extension is welcome news for many taxpayers, especially since a proposed new Regulation 105 waiver rule for eligible non-residents is not yet law. This waiver rule, which allows the CRA to waive the withholding requirement in certain circumstances, was originally announced in the 2024 federal budget. KPMG can help you determine how your business is affected by the CRA's revised position on the Regulation 105 rules, including to consider whether service agreements should be revised, and to understand your withholding tax obligations in light of this new change. We can also assist with preparing refund requests for any withholding tax payments made on or after October 1, 2024 and before CRA's administrative relief extension was announced.

Background

Taxpayers who pay fees, commissions or other amounts to non-residents for services rendered in Canada are generally subject to a 15% withholding tax obligation under Regulation 105. This rule is intended to ensure that the CRA collects income taxes that may be owed by non-residents.

However, non-residents, including self-employed individuals, corporations, partnerships, joint ventures or hybrid entities, may be apply with the CRA for a waiver to have the 15% withholding tax waved or reduced. For example, eligible non-residents may apply for a treaty-based waiver where the non-resident resides in a country that has a treaty with Canada. In addition, non-residents may be eligible to apply for an “income and expense waiver” where they estimate their expenses against their Canadian source income and determine that their estimated tax payable is lower that the withholding tax rate. However, before the CRA will waive or reduce the withholding for either type of waiver, the non-resident must demonstrate that the withholding amount would cause them undue hardship.

Earlier in 2024, the CRA revised its position on the Regulation 105 rules and stated that, where a Canadian resident reimburses a non-resident person for subcontractor fees related to services performed in Canada, these reimbursed amounts are now subject to Canadian withholding tax, effective for reimbursements made after June 30, 2024. However, the CRA also indicated at that time that it would provide administrative transitional relief for taxpayers on withholding tax, penalties and interest from July 1, 2024 to September 30, 2024. Previously, the CRA’s position was these reimbursements were not subject to withholding tax.

KPMG observations

The tax community has raised issues with Regulation 105 on many occasions. Generally, the Regulation 105 regime is considered to be a barrier to cross-border service providers because it is overly broad, rigid in application and administratively burdensome. As a result, the rules could deter non-residents from entering into service agreements where services need to be rendered in Canada on the basis that these rules are too costly and burdensome. The waiver process, while effective, can also be cumbersome and time consuming.

Note that Finance released draft legislation on August 12, 2024 that includes a measure that generally allows the CRA to exercise its discretion to waive the Regulation 105 withholding requirement. Under this proposal, the CRA may waive the requirement for a taxpayer who pays a non-resident for services provided in Canada, over a specified period, as long as the payments are exempt from Canadian income tax under a tax treaty, or they relate to providing services where the income is exempt (i.e., income from international shipping or from operating an aircraft in international traffic). This proposed measure, which does not require the CRA to find that the withholding tax would cause the non-resident undue hardship (among other things), was originally announced in the 2024 federal budget but has not yet been included in a bill.

We can help

Your KPMG adviser can help you assess the effect of these new developments. For more details, contact your KPMG adviser.

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