PKF International Limited

Doing Business in Canada

LOCAL KNOWLEDGE, GLOBAL EXPERTISE

Contents

Foreword

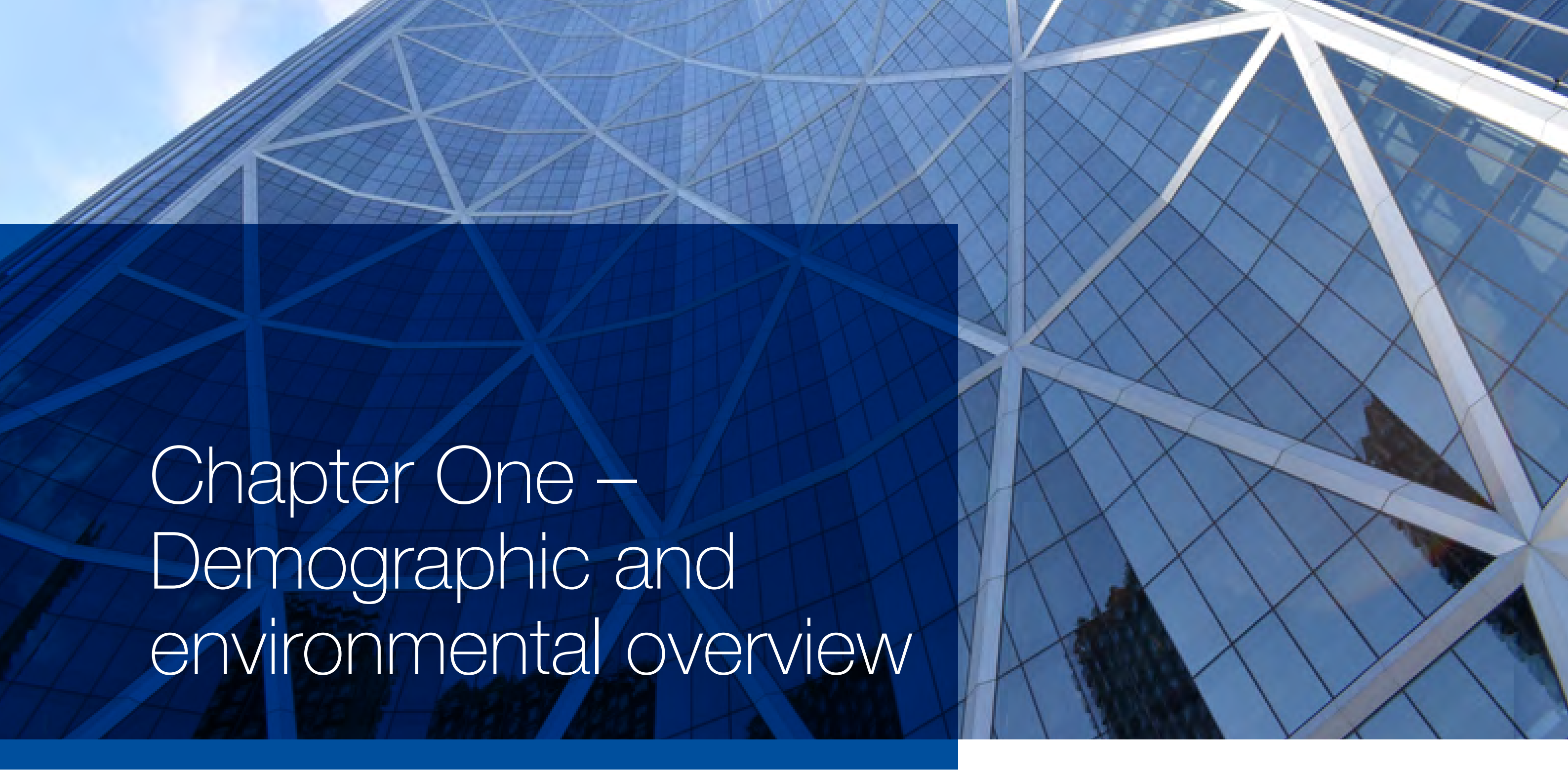
This guide is produced as a service to the readers of the member firms of PKF North American Network and PKF International Limited, and as an introduction to the fiscal and commercial environment of Canada for those who are considering doing business within its jurisdiction. The contents provide a guide for understanding the business processes, not a complete description of everything a business or entity needs to know. This guide should not be used as the basis for any decision in the areas of Canadian commercial and tax law. Because the laws of Canada are constantly being modified – both legislatively and judicially – readers are advised to seek specific professional advice from any PKF North American Network or PKF International member firm before proceeding with any activities involving Canada.

Doing Business in Canada

This guide has been designed to provide an overview of the business climate in Canada. The discussion is a survey of the many varied considerations involved in establishing a business enterprise in this country. While every effort has been made to keep content current and concise, the rapidity of change and the complexity of our interrelated world mean that consultation with professional advisors is indispensable. The highly skilled and dedicated people at PKF North American Network and PKF International look forward to working with you to implement your business plans.

Although the greatest possible care was observed in creating this publication, the possibility always exists that certain information may, in time, become outdated. PKF North American Network and PKF International Limited, therefore, accept no liability for the consequences resulting from activities undertaken on the basis of this publication. Consultation about your business opportunity with a professional advisor remains necessary at all times.

Our offices in Canada and the many locations around the world are committed to responsiveness and dedicated to excellence.



Chapter One – Demographic and environmental overview

Geography and population

Canada is the second largest nation in the world in geographic size after Russia. It covers more than half the distance between the North Pole and the Equator, more than 5,000 kilometers (3,106 miles) from north to south and 8,000 kilometers (4,970 miles) from east to west. Its climate runs from temperate in the southern and coastal regions to sub-arctic or arctic in the far north. It has a population of approximately 37.6 million people, 90 percent of whom live within 200 kilometers (124 miles) of the U.S. border.

Canada has a comprehensive system of internal and external communications. This system is a mixture of public and private ownership. A complete transportation network by land, water and air provides access for goods and services to all parts of the country.

Canada has two official languages, English and French. The federal government offers all of its services in both languages, as does the Province of New Brunswick. The Province of Quebec uses French in virtually all of its material and has specific legislative requirements governing the use of French in signs, education, etc. The rest of the country uses predominantly English.

Political and legal environment

Canada is a self-governing federal constitutional monarchy made up of 10 provinces and three territories. The basic forms of government are those of a parliamentary democracy. At the national level, the head of the political party with the most seats in the lower house of Parliament, the House of Commons, is asked by the Queen's representative, the Governor General, to form a government and act as Prime Minister for as long as he or she retains the support of the House of Commons. There is an appointed upper house, the Senate, which, though theoretically equal in power to the House of Commons, usually acts as a review body on legislation initiated in the lower house, and as a house of "sober second thought."

Each province has an elected legislature similar to the House of Commons. No province has an upper house. The leader of the governing political party becomes the Head of Government in the province and is generally given the title of "**Premier**."

The legal system is overseen by an independent judiciary. The judiciary members are appointed by the Governor General upon recommendation of the federal Cabinet. The administration of justice, including the establishment of the court system, is the responsibility of the provincial governments.

The federal government, however, has the sole responsibility for the establishment of criminal law for the entire country. Appeals from the provincial courts may be made to the Supreme Court of Canada. In federal tax matters, appeals must be taken through the federal court system.

The legal system of Canada derives its origins from the English system of common law with precedents from England often acting as *stare decisis*. In the Province of Quebec, however, the Civil Code, based upon the Code Napoleon, is in force for all civil matters. Pursuant to the Constitution Act, jurisdiction over various matters is divided between federal and provincial jurisdictions.

Economy

Canada has traditionally had a free-market economy overlaid with a substantial amount of government-controlled enterprise in the area of public service. In this way, its economy more closely parallels those in western Europe than that of the United States. Government enterprises, generally called Crown Corporations, operate in several fields including electrical energy generation and distribution, broadcasting, transportation, postal services and telecommunications.

The size of the Canadian economy has greatly increased in recent years so that the gross domestic product is estimated to be $1,600 billion.

The Canadian economy is significantly intertwined with that of the United States. On January 1, 1989, a Free Trade Agreement came into effect that reduced the tariffs on most of each country's domestically produced goods to zero.

On January 1, 1994, the North American Free Trade Agreement (NAFTA) took effect. NAFTA provides for free trade between Canada, the United States and Mexico. The Agreement provides access to the Mexican market and enhances the benefits available under the Canada - United States Free Trade Agreement.

The Comprehensive Economic and Trade Agreement, or CETA, is a trade agreement between the EU and Canada entered into force on April 1, 2021. CETA will benefit European companies by getting rid of 99% of the duties (taxes) they must pay at Canadian customs. The same will apply to Canadian businesses exporting to the EU.

Canada is also a member of the following economic and trade organizations:

- Asia-Pacific Economic Cooperation
- Commonwealth
- Group of Eight (G8)
- International Monetary Fund
- Organization for Economic Co-operation and Development
- Organization of American States
- United Nations
- World Bank
- World Trade Organization

Securities and foreign currency controls

The major financial center of the country is Toronto. Montreal and Vancouver have special status as international finance centers with favorable tax status available for certain international banking and finance arrangements. Calgary, Winnipeg, and Halifax exist as major regional financial centers. Canada has no foreign currency or exchange controls. Securities laws and regulations are under provincial jurisdiction, although national securities policies exist to facilitate national distribution of securities. The system is regulated by ten provincial securities commissions and trading is facilitated by the Montreal Stock Exchange, Toronto Stock Exchange (TSX), TSX Venture Exchange (TSX-V) and Canadian Stock Exchange (CSE).

Financial services

The Canadian financial sector is dominated by the chartered banks, which are federally regulated and chartered pursuant to the Bank Act. There are 21 Schedule I domestic banks. Schedule II banks are foreign bank subsidiaries authorized under the *Bank Act* to accept deposits, which may be eligible for deposit insurance provided by the Canada Deposit and Insurance Corporation. Foreign bank subsidiaries are controlled by eligible foreign institutions. Schedule III banks are foreign bank branches of foreign institutions that have been authorized under the *Bank Act* to do banking business in Canada. These branches have certain restrictions. There are 23 Schedule II banks and 22 Schedule III banks in Canada. All of these banks are licensed and regulated by the federal Superintendent of Financial Institutions. They can operate freely in all parts of the country.

In addition to the banks, there are federally and provincially regulated trust companies, credit unions and caisses populaire. There are 56 trust companies, 10 are now bank, 8 are life insurance company, 11 are Credit Unions and 27 are owned or controlled by corporations.

The various banks are the most important suppliers of funds to businesses. Short-term financing is usually arranged as a line of credit limited by standard margining of operating assets. Medium-term financing, generally five to seven years, is often used by foreign investors to begin operations in Canada. As a condition of a loan, banks usually require execution of a note and a formal loan agreement that restricts the borrower’s decision-making powers through special covenants. Investment bankers, commonly known in Canada as brokerage houses, are often used to arrange financing through the issuance of shares, debt obligations, or commercial paper.

Grants and Incentives

All levels of government in Canada offer various levels of grants in order to assist investors in making business investments, mainly in depressed areas, clean tech, start-ups and indigenous communities. These incentives take many forms, from investment tax credits to direct cash grants. In certain arrangements with specific foreign governments, businesses from those countries have been given the same status as Canadian businesses in terms of dealing with the Canadian government.

Income tax legislation gives favorable treatment to certain activities or industries. Scientific research and experimental development activities undertaken in Canada receive significant tax incentives including a 20 percent investment tax credit on qualified expenditures, as well as a 100 percent write-off of current and capital costs associated therewith. Certain private corporations are eligible for a 35 percent refundable investment tax credit on qualified expenditures, depending on their size and ownership status. Specialized industries such as those engaged in natural resource activities are offered generous write-offs for tax purposes for exploration and development activities. While several provinces offer incentive programs, Quebec offers significant additional incentives to a number of businesses including those involved in scientific research and experimental development.

When Canada negotiates tax treaties, it generally agrees to reduce withholding taxes on dividends, interest, royalties and certain other income. In addition, there are exemptions from withholding tax on interest on government securities and certain long-term corporate debt.

Chapter Two – Regulatory Environment

The business environment of Canada is a combination of open competition and consumer protection. The responsibility for regulation is split between the federal and provincial levels of government based upon the scope of the concern. The federal government has an overriding authority to provide for the "peace, order and good government" of the country. It has used this in the past to ensure uniform application of regulations that were either under provincial jurisdiction or shared authority. There have been on-going attempts to minimize the intrusion of the governmental regulators in the lives and businesses of Canadians.

Acquisitions and Mergers

The federal laws governing acquisitions and mergers are administered by the Bureau of Competition Policy and the Competition Tribunal. These boards administer the Competition Act and ensure that acquisitions or mergers do not unduly affect the marketplace or restrain open and free trading. For certain large transactions, advance notice must be given to the authorities.

There is a review procedure for foreign entities investing in Canada. In accordance with the Investments Canada Act, direct investments in excess of $5 million and indirect investments in excess of $50 million are subject to review and approval.

Indirect acquisitions by investors resident in WTO member countries are not reviewable but are nonetheless subject to notification. In four key policy sectors – uranium, financial services, transportation services and cultural businesses – the $5 million and $50 million review thresholds apply for all investors, including residents of WTO countries.

Securities

Securities laws are under the jurisdiction of the provinces. As such, they vary from province to province. The Securities Act of Ontario has become the standard for the securities regulatory system because of the dominance of Toronto in the Canadian financial sector. The purpose of the legislation is to assure full, true and plain disclosure of all material facts with respect to securities being distributed in the respective provincial jurisdictions on a continual basis.

A foreign investor who wishes to acquire a Canadian corporation may pay for it in cash or may issue its own securities in exchange for the shares of the Canadian corporation. If this acquisition is done through a takeover bid for the shares, or if the acquisition is for 5 percent or more of the shares of a corporation that offers its shares to the public, the foreign investor is required to file certain information within a twelve-month period.

Usually, information contained in a takeover bid circular is contemporaneously filed with the pertinent provincial securities commissions and the stock exchange on which the shares are listed, if applicable, as well as being sent to the shareholders to solicit their shares.

There are specific continuous disclosure reporting requirements for all corporations that offer their shares to the public. These requirements vary from province to province. Additional reporting requirements may also be imposed by any stock exchange on which the shares are listed, particularly with respect to material changes in the affairs of the issuer.

Consumer protection and special industries

There are a number of consumer protection laws that are enforced by a variety of federal and provincial agencies, as this is an area of shared jurisdiction. The federal departments of Industry Canada, Environment Canada, Health Canada, and Human Resources and Social Development Canada are the leading federal agencies in the consumer protection field.

In addition, certain industries are subject to regulation because of the nature of their activities. The Superintendent of Financial Institutions regulates all federally incorporated financial institutions, including all banks and insurance companies. The Canadian Radio-Television and Telecommunications Commission has authority over all forms of electronic media, including telephone companies and local cable TV companies as well as the radio and television industries. Transport Canada regulates air, marine, rail and road transportation.

Legal protection for intangibles and intellectual property

Canada offers extensive protection for intellectual property. Owners of intangible property have the following protection.

Patents	20 years
Trademarks	15 years, renewable without limitation
Industrial design	10 years
Integrated circuits	10 years
Plant breeders	18 years
Trade secrets	No legislative protection
Copyright	The life of the author and 50 years following his or her death. Citizens or subjects of a Commonwealth or Berne Convention country are automatically granted copyright protection as are United States citizens who first publish the work in the US. Copyright protection also applies to computer programs, choreographic works, and certain artistic works.

Employee welfare

The federal and provincial governments have shared jurisdiction over standards of employment and employee benefits. They are generally the same across the country, but it is important to check the jurisdiction involved to ensure compliance with the appropriate standards. The rules in general affect:

- Minimum wage and maximum hours of work
- Non-discrimination in employment practices
- Pay equity between various jobs
- Pension standards
- Collective bargaining rights
- Termination notice protection
- Health and safety requirements
- Successor employer obligations

Basic medical and hospital costs are covered by provincially run health insurance plans. Residents of a province or territory are required to participate in these plans.

Immigration to Canada

There are essentially three types of status available for a person coming to Canada: visitor, work permit, or landed immigrant. Entry to Canada as a visitor from many countries does not require a visa. The list of countries of origin for which Canada does not require a visa is constantly changing. Up-to-date information may be obtained from the nearest Canadian Embassy, Consulate or High Commission. For an online resource follow this link **https://www.canada.ca/en/services/immigration-citizenship.html**. Visitor status does not permit a person to work in Canada under any circumstances.

To obtain a work permit, or landed immigrant status, application must be made with Immigration officers at a Canadian Embassy, Consulate or High Commission. Online application cannot be made inside Canada. A work permit allows a person to engage in a specified type of work for a specified employer. Landed immigrant status grants virtually all of the rights and responsibilities of Canadian citizenship except the right to vote.

The income tax implications of immigration to Canada are discussed under a separate heading in chapter eight.

Chapter Three – Forms of business organisations

Canadian corporations

From a Canadian domestic perspective, a Canadian corporation is a separate legal entity created under the laws of the federal government or under the laws of one of the provinces or territories. Each of these jurisdictions has enacted its own laws regarding the formation and operation of corporations. Many of these rules are similar but there are sufficient differences to warrant close assessment in choosing the jurisdiction of incorporation. Many corporations that operate in more than one province would be incorporated federally or need to be registered separately if provincially incorporated. In Canada, lawyers are normally retained to incorporate a company. The documents necessary to create a corporation may be obtained from the Industry Canada office in Ottawa or from the corporate administrator in the appropriate provincial capital. After incorporation, some jurisdictions have annual information reports that must be filed, usually with a small annual filing fee. A corporation conducting business outside its jurisdiction of incorporation may find it necessary to register to do business in those other jurisdictions.

A Canadian domestic entity that has corporate status under its jurisdiction of incorporation is treated as a corporation for income tax purposes. There is no separate definition of “corporation” in the *Income Tax Act*.

Alberta, British Columbia and Nova Scotia corporation statutes have a special type of corporation called an Unlimited Liability Corporation (ULC). ULCs essentially provide no liability protection to shareholders. The advice of legal counsel should be obtained in analyzing the legal differences between Alberta, British Columbia and Nova Scotia ULCs. ULCs are often used by U.S. investors due to tax advantages available to flow-through entities under U.S. domestic tax legislation. ULCs are treated as a corporation for Canadian tax purposes and are subject to the normal corporate tax rules.

There is a more detailed discussion of the Canadian tax regime later in this guide, but a brief overview of the taxation of Canadian corporations may be useful. As a general rule, a Canadian corporation is subject to Canadian tax on its worldwide income regardless of where it is earned. The earnings of a Canadian corporation are subject to tax first at the corporate level and then again at the personal level when they are received in the form of dividends. This double taxation is largely mitigated because of a tax credit given to Canadian resident individuals receiving the dividend. Prior to 2006, an individual’s dividend tax credit did not, however, give sufficient credit for the corporate tax except in the case of a Canadian-controlled private corporation’s investment income and active business income bearing a tax-favored rate. Dividend tax credits are not available to corporations or non-resident individuals.

Certain favorable rules apply on dividends paid between “connected” Canadian corporations. A connected corporation is essentially a corporation that is controlled by the recipient or a member of the same controlled group, or it is a corporation in which the recipient owns at least 10 percent of the issued shares (measured by votes and value).

A distribution by a Canadian corporation to its foreign parent will only be treated as a dividend when an actual dividend is declared and paid or if the distribution exceeds the paid-up capital of the corporation’s issued capital stock when its stock is being redeemed or otherwise acquired by the Canadian corporation. Dividends are not deductible by the payer. Dividends paid to non-residents of Canada are subject to a 25 percent withholding tax unless reduced by a tax treaty.

A Canadian-controlled private corporation (CCPC) is a private corporation that is given a favorable status under the Income Tax Act. A CCPC is essentially a private corporation not controlled by non-residents, public corporations or any combination thereof. A CCPC, its shareholders and its employees have the potential to benefit from a number of tax incentives and other measures available under the Income Tax Act. Often, these benefits are reduced or eliminated based on the size or profitability of the CCPC.

Branches of foreign corporations

A branch is a part of a foreign enterprise and is not a separate legal entity in Canada. A foreign corporation may establish a Canadian branch and commence business at any time. Advice should be sought from legal counsel regarding the requirements of registering to do business in provinces in which the branch intends to operate and the possibility of obtaining limited legal liability.

As noted above for Canadian corporations, there is no separate definition of “corporation” in the income tax law. The Canada Revenue Agency (CRA) has a published administrative position on the characterization of many foreign entities and can be consulted on whether or not other foreign entities will be considered corporations for Canadian income tax purposes.

As a general rule, the Canadian branch of a foreign corporation is subject to regular Canadian income tax on its taxable income attributable to a permanent establishment in Canada. In addition to the regular corporate income tax, Canada also has a 25 percent Branch Tax that is imposed on notional distributions of profits to the foreign head office. This tax rate may be reduced by treaty.

If there is not a governing treaty limiting Canada’s taxation authority, a foreign enterprise carrying on business in Canada will be subject to tax in Canada regardless of whether or not it has a fixed place of business or permanent establishment in Canada.

Partnerships

For legal purposes, a partnership is defined as the relationship that exists between persons carrying on business in common with a view to profit. There is no separate definition for income tax purposes. The two broad types of partnerships in Canada are general partnerships and limited partnerships. Certain provinces also offer limited liability partnerships, which are generally used by professional services partnerships. Limited partnerships have become increasingly popular as they combine the tax advantages of a partnership with the limited liability protection offered by corporate status. In order to preserve limited liability protection, limited partners may not take part in the management of the partnership. Each province and territory have its own laws governing the formation and operation of partnerships.

Partnerships are treated as conduits for Canadian tax purposes. Each partner recognizes a proportionate share of income, loss and credits, whether or not distributed to the partners. There is no withholding tax on the normal business earnings allocated to any partner, whether or not resident in Canada. Non-resident partners will be required to file a Canadian income tax return and, if applicable, a provincial tax return.

A partnership that has one or more non-resident partners is deemed to be a non-resident of Canada for the purposes of the 25 percent withholding tax on non-business income payments.

Joint ventures

Joint ventures are enterprises where two or more entities enter into a specified project with an achievable objective or a set time frame. Joint venture parties typically agree to share investments and resources as well as income and expenses in a specified manner.

Unlike partnerships, joint ventures are not recognized as an entity under Canadian income tax legislation. Rather, each joint venture party treats its share of investment, income and expenses as being directly earned or incurred by the co-venturer.

Sole proprietorships

A business may be conducted directly by an individual and the results of operations reflected on financial statements reported on the owner's individual income tax return. This approach has the advantages of informality and direct control over the enterprise, but it is accompanied by the potentially significant disadvantage of unlimited personal liability.

Chapter Four – Principles of business taxation

Overview of Canadian taxation

There are a number of tax regimes in Canada, the provinces and the territories. The federal government imposes income taxes on corporations, individuals, estates and trusts. There are no estate or gift taxes. There are a number of sales and excise taxes. The major sales tax imposed by the federal government is known as the Goods and Services Tax (GST). The provinces and territories also impose a number of taxes. These include income, resource, capital, sales and payroll taxes. Municipalities are normally limited to imposing property taxes. The focus of this guide is on income taxes and their effect on conducting business in Canada. Where broadly applicable, other tax matters are mentioned.

The Canadian tax system is a self-assessing system that requires withholding of tax from salaries and wages of employees and on certain other payments. In addition, individuals with income from sources on which tax is not withheld are required to make quarterly instalment payments during the year. Corporations must generally pay monthly tax instalments. When a taxpayer is required to withhold taxes on payments to another person, the taxpayer has a fiduciary relationship and must remit the withheld amounts to the government. Failure to withhold or failure to remit will generally subject the taxpayer to liability for the taxes as well as penalties and interest.

For each taxation year, a taxpayer must file a tax return that reports all taxable income and allowable deductions. The tax is computed on the net taxable income amount and is then reduced by the total taxes that the taxpayer either had withheld from wages or paid as estimated instalments of tax. The net result is a final payment by, or a refund to, the taxpayer. There are penalties for failure to file a return, late filing of a return and tax instalment deficiencies.

The CRA is a separate agency under the Minister of National Revenue responsible for the administration of the income tax law. Its mission includes interpreting tax laws, auditing tax returns and collecting revenues. In the absence of fraud or misrepresentation, the period during which the CRA may adjust a return is either three or four years from the date on the Notice of Assessment for the year depending upon the taxpayer's status. The reassessment period is extended a further three years in the case of:

- a transaction with a non-arm's length non-resident; or
- a non-resident who carries on business in Canada where the issue pertains to an allocation of revenues or expenses to the Canadian business or to certain notional transactions.

Transfer pricing

The Income Tax Act requires Canadian taxpayers to report transactions conducted with related non-residents as though the resident taxpayer and the related non-resident were dealing at arm's length with each other during the year. The intent is to ensure that cross-border transactions do not result in a redirection of income from Canada to other jurisdictions.

The Income Tax Act imposes stringent requirements relating to transfer pricing. The CRA may adjust the cost of a capital property or the income relating to a transaction with a related non-resident, and it may assess a penalty if reasonable efforts to determine arm's length prices or allocations have not been made. A taxpayer is considered to have made reasonable efforts if such specified matters as the property or services to which the transaction relates, the terms and conditions of the transaction, the identity and relationship of the parties, the functions performed, the risks assumed, the data and methods considered, and the analysis performed to determine transfer prices or allocations are documented before the filing due date for the tax return.

It is possible to negotiate with the CRA to establish an acceptable transfer pricing mechanism in advance. The decision to enter into such negotiations should be approached with care as the process can be time-consuming, expensive and may result in a transfer pricing policy that can cause tax difficulties in foreign jurisdictions.

Tax treaties

Canada has an extensive network of tax treaties with other countries for the primary purpose of eliminating double taxation. The OECD Model Convention, with Canada's specific reservations has been the basis for all recent treaty negotiations. Treaties in Canada override domestic law regardless of when the law or the treaty came into effect. Treaties usually do not affect transactions that occurred prior to the implementation date of the treaty. Treaties in Canada generally come into effect after enabling legislation has been passed by Parliament and ratification by the correspondent country. Canada has a policy of establishing a wide network of income tax treaties and is constantly negotiating new treaties and renegotiating existing treaties.

It should be noted that U.S. LLCs that are treated in the United States as flow-through entities and not subject to U.S. corporate tax are not recognized by the CRA as being eligible for benefits under the Canada-U.S. treaty. U.S. LLCs should obtain cross-border tax advice prior to carrying on business in Canada or entering into transactions with Canadians that will subject them to Canadian withholding tax.

Chapter Five – Taxation of corporate income

Taxation of business operations

A corporation is resident in Canada if its mind and management is located in Canada or if control is exercised in Canada. In addition to this common law test of residency, there is a statutory expansion of the rule so that all corporations incorporated in Canada after April 26, 1965 are deemed to be resident in Canada. A resident corporation is taxed by Canada on its worldwide income, including capital gains, without regard to the source of income. The corporate tax rates are constantly changing. At the time of publication, general corporate tax rates (combined federal and provincial) range from 25 percent to 31 percent. Lower rates apply to the first $500,000 of active business income earned by a CCPC or an associated group of CCPCs and to income earned from manufacturing and processing operations in certain provinces and territories. CCPCs pay a higher rate of tax on investment income (including the taxable 50 percent of capital gains). This special tax ranges from 46.7 percent to 54.7 percent depending upon the province, but 30.67 percent of taxable investment income is added to the CCPCs "refundable dividend tax on hand." When a CCPC pays taxable dividends, it receives $1 of refund for every $3 of dividends paid to the extent of its refundable dividend tax on hand (RDTOH).

A Canadian corporation is required to file an income tax return for each taxation year, which is generally twelve months. The return is due six months after the corporation's year-end. Payments of tax are made monthly with the final balance of tax (corporate and sales tax) due two or three months after the corporation's year-end, depending on the corporation's tax status. Interest and penalties are imposed for failure to make adequate monthly instalments and on final balances overdue. Certain transactions, such as amalgamations and those resulting in an acquisition of control or a change in CCPC status, cause a deemed year-end with the requirement to file a tax return for that period.

There is no provision for consolidated tax returns. Each member of the corporate group files a separate tax return.

Provincial income taxes are paid on the basis of an allocation of taxable income between the provinces where the corporation has a permanent establishment. The average weighting of revenues and salaries and wages between the permanent establishments is the basis for the allocation of business income. Alberta and Quebec each has its own corporate tax administrations and require the separate filing of provincial corporate tax returns. The CRA administers the collection of income taxes for the other provinces and territories through the filing of a combined federal and provincial tax return.

Losses

Canadian tax laws distinguish between non-capital losses and net capital losses. A non-capital loss is a loss arising from business or property, and it may be carried back three years and forward 20 years. The allowable 50 percent of capital losses arising on the disposition of capital assets may only be used to offset the taxable 50 percent of capital gains in the year (Net capital loss). To the extent not used in the current taxation year net capital loss may be carried back three years and forward indefinitely to offset the taxable portion of capital gains.

There are restrictions on the use of non-capital losses if control of a corporation changes. Net capital losses expire on an acquisition of control. In addition to triggering a deemed taxation year-end, the acquisition of control of a corporation results in the deemed disposition and re-acquisition of certain assets if the asset's cost, or undepreciated cost for depreciable assets, for tax purposes exceeds its fair market value. These rules are intended to crystallize an unrealized loss when control changes, making the loss subject to restriction or expiry. It is possible to elect to recognize unrealized capital gains on other eligible assets to offset the restricted or expiring loss and increase the cost base of one or more depreciable or non-depreciable capital assets.

Computation of taxable income

The starting point in the computation of taxable income is the net income of the corporation based on generally accepted accounting principles. This amount is then adjusted for various specific items outlined in the Income Tax Act in computing taxable income.

There are three basic limitations on the deduction of expenses by a taxpayer. First, expenses are deductible only to the extent that they are incurred for the purposes of earning income from a business or property. Second, expenditures on account of capital assets are not deductible on a current basis. There is, however, a system of capital cost allowances similar to depreciation, which is discussed below. Thirdly, there is a restriction against deducting any expenses that are of a personal nature. Overriding the three basic limitations, there is a further limitation that will allow a deduction only if the outlay or expense is "reasonable in the circumstances."

Dividends paid to shareholders are generally not deductible by the paying corporation. On the other hand, dividends received from other taxable Canadian corporations and from certain foreign affiliates are usually deductible in the computation of the taxable income of the receiving corporation. If the dividends are from a Canadian corporation that is not part of the same control group and in which the recipient corporation's shareholding (based on votes and value) is less than 10 percent, a special refundable tax of 33.3 percent of the dividend received may be imposed on the recipient corporation. This tax is refundable upon the payment of dividends by the recipient corporation.

Thin capitalization rules

The fact that interest expense is deductible while dividends paid are not deductible places a high premium on the appropriate classification of capital infusions when establishing the capital structure of a Canadian corporation. There are thin capitalization rules that govern the deductibility of interest paid to a non-resident who (together with persons not dealing at arm's length) owns 25 percent or more of the shares (measured by value) or to a non-resident not dealing at arm's length with that non-resident shareholder.

Essentially, these rules prevent the deduction of interest paid to these non-residents on debt outstanding that exceeds two times the aggregate of:

- Retained earnings at the beginning of the year;
- Average monthly contributed surplus contributed by the non-resident; and
- Average monthly paid-up capital of shares owned by the non-resident.

These rules are intended to encourage the financing of a corporation through domestic Canadian sources or through equity.

Depreciation and amortization

To override the general limitation against the deduction of any amount on account of capital or depreciation, the Income Tax Act provides a comprehensive system of tax depreciation called the Capital Cost Allowance (CCA) system. This system segregates capital assets into classes and stipulates the maximum deduction that may be claimed in a year with respect to assets of that class. With certain exceptions, the CCA claims are generally computed on a pool basis, not on an individual asset basis. The basic system generally permits a percentage of the undeducted balance in the class to be deducted each year. Some examples of the deduction rates are as follows:

Assets	Percent
Buildings	4
Office equipment	20
Computer equipment	55
Automobiles	30
Manufacturing equipment	30

Some classes of depreciable assets, such as leasehold interests, are amortized on a straight-line basis.

Most CCA classes are restricted to a claim of one-half the prescribed percentage on asset acquired in the year. When property is sold, the class is credited with the lesser of the proceeds of sale or the original cost of the asset. If this produces a negative balance in the class, that negative amount is included in income as recaptured CCA. Alternatively, if all the assets in the class have been disposed of and there is a positive balance in the class, the balance may be deducted as a terminal loss.

Some capital expenditures are not covered under the CCA system. Instead, they are handled through special statutory rules. Such expenditures as organization costs, scientific research and experimental development outlays, and natural resource exploration and development expenses are subject to various special rules.

Foreign source income rules and foreign tax credits

A corporation resident in Canada is taxed on its worldwide income. In addition, investment and other passive income of a controlled foreign affiliate may be imputed to the Canadian corporation under the Foreign Accrual Property Income (FAPI) rules. To provide relief from double taxation, there is a series of deductions available relating to the foreign taxes paid both at the foreign affiliate level and at the withholding tax level when taxable dividends are actually remitted to Canada by a foreign affiliate. Dividends received from a foreign affiliate of a Canadian corporation out of active business income earned in a country with which Canada has a tax treaty are not taxable to the receiving Canadian corporation as long as the foreign corporation retains its status as a "foreign affiliate."

For foreign income earned directly by a Canadian corporation, a complex system of foreign tax credits is available in order to prevent double taxation. Foreign taxes imposed upon non-business income such as portfolio dividends or interest must be used in the current year's credit computation or they are lost. Foreign taxes imposed on business income may be carried back three years or forward 10 years if they cannot be used in the foreign tax credit computation for the current year.

Capital gains and losses

The disposition of capital assets gives rise either to capital gains or to capital losses. These gains and losses are subject to special rules. Only 50 percent of the capital gains in excess of capital losses is included in taxable income. This amount is then subject to general income tax rates unless the corporation is a CCPC, in which case the additional refundable tax on investment income is applicable. Capital losses on depreciable property are deemed to be nil and the economic loss is recognized through the CCA system as a terminal loss. Net capital losses, the amount by which the allowable 50 percent of capital losses exceeds the taxable 50 percent of capital gains for any year, may be carried back three years or forward indefinitely to offset the taxable 50 percent of capital gains realized in those other years. Net capital loss carry-forwards are extinguished on a corporate change of control.

Refundable income taxes

As previously mentioned, a special refundable tax is levied on dividends received by certain corporations. This tax is added to the corporation's "refundable dividend tax on hand" (RDTOH) account. In addition, CCPCs pay a higher rate of tax on investment income (including the taxable 50 percent of capital gains), but 30.67 percent of taxable investment income is added to the corporation's RDTOH. When a corporation with a balance of refundable dividend tax on hand pays taxable dividends, it receives $1 of refund for every $3 of dividends paid.

Chapter Six – Taxation of non-resident corporations

A non-resident corporation is any corporation that, under the common law, the statutory rules or operation of treaty, is not resident in Canada. The income of a non-resident corporation may generally be taxed by Canada in two different ways.

First, business income from Canadian sources and 50 percent of the capital gains from the disposition of certain specified Canadian assets are taxed at the normal Canadian corporate tax rates. This tax is referred to as "Part I tax." The business income and capital gains components are discussed below under separate headings.

Second, certain types of Canadian source income that would generally be regarded as passive income (e.g., interest, dividends, rents, royalties, management fees, estate or trust income, alimony, pension benefits and annuities) are taxed at a rate of 25 percent of gross income, unless a lower treaty rate applies. This second type of tax, referred to as "Part XIII tax," is generally withheld at source by the payor. The CRA has an administrative procedure to process applications for waivers of this 25 percent tax where the income pertains to a business carried on through a permanent establishment in Canada.

Permanent establishment rules and business income

Under Canadian domestic tax law, a non-resident who carries on business in Canada is liable for tax on taxable income earned in Canada. Whether or not a business is carried on in Canada is a question of fact. The Courts have considered the following to be significant factors, amongst others:

- The place where the contract is made;
- The location of operations from which profits arise;
- The place from which payments are made; and
- The place of delivery.

Additionally, the Income Tax Act deems the non-resident to be carrying on business in Canada if the non-resident:

- produces, grows, mines, creates, manufactures, fabricates, improves, packs, preserves or constructs, in whole or in part, anything in Canada;
- solicits orders or offers anything for sale in Canada; or
- disposes of certain timber resource property; Canadian real property that is not capital property; or in certain circumstances, Canadian resource property.

Where a tax treaty exists between Canada and the country of the non-resident, a non-resident corporation carrying on business in Canada will generally be subject to Canadian income tax on its Canadian business income only if it has a permanent establishment in Canada and only to the extent such income is attributable to the permanent establishment. The term “permanent establishment” is usually defined in the tax treaty. Under most treaties, an agent’s office is not considered a permanent establishment unless the agent regularly exercises power to negotiate and conclude contracts. Furthermore, the utilization of the services of an independent agent engaged in his or her own business will not result in a permanent establishment. The particular treaty may provide special rules for such activities as construction and installation projects, international shipping, offshore resource exploration, etc.

A non-resident corporation’s income from carrying on business in Canada attributable to a permanent establishment in Canada is taxed using the same rules as a resident Canadian corporation. A non-resident corporation may claim all normal business expenses incurred for the purpose of earning that income, including an appropriate allocation of head office expenses. Relative to the taxation of distributions of branch profits, refer to the Branch Tax discussion below.

Income Tax Regulation 105 requires that every person paying a non-resident a fee, commission or other amount in respect of services rendered in Canada, of any nature whatever, is required to withhold 15 percent of the payment as an instalment of Part I tax. This 15 percent withholding does not apply to payments to employees. The Regulation 105 withholding is applied on the federal income tax return and will be refunded to the extent it exceeds the actual tax payable on Canadian-source business income. The CRA has an administrative program with detailed guidelines to process applications for waivers of this Regulation 105 withholding, particularly where the non-resident does not have a permanent establishment and would be treaty-exempt on the Canadian business income. Non-residents paying non-resident sub-contractors for services performed in Canada should obtain advice about their withholding responsibilities under Regulation 105. Quebec has a similar 9 percent withholding for services rendered in Quebec.

A non-resident corporation that carries on business in Canada but does not have a permanent establishment in Canada and is exempt from Canadian tax on its business profits by virtue of a treaty must file a treaty-based tax return and related information forms within six months of its year-end.

Disposition of taxable Canadian property

Canada requires that non-residents include in their income reportable in Canada 50 percent of the capital gains on the disposition of taxable Canadian property, which essentially includes:

- real property located in Canada;
- most capital property used in a business being carried on in Canada;

- shares of the capital stock of any corporation resident in Canada, except for public corporations;
- shares of a public corporation resident in Canada or units of a unit mutual fund if the non-resident owned 25 percent or more of the shares or units in the past 5 years;
- interests in partnerships whose assets are primarily taxable Canadian property;
- interests in non-resident trusts whose assets are primarily taxable Canadian property;
- certain interests in resident Canadian trusts;
- shares of a non-resident corporations that is not a public corporation, which essentially have more than 50 percent of their value derived from taxable Canadian property, Canadian resource property, timber resource property or options to acquire such property; and

As referred to in the context of this list, a “public corporation” is a corporation which has the particular class of shares listed on a prescribed stock exchange.

There is a pre-disposition clearance certificate procedure in place that usually requires withholding tax to be paid on the closing of a transaction involving a disposition of taxable Canadian property. Where advance notification procedures are followed, withholding is limited to 25 percent of the net gain on disposition (without regard to selling costs). Otherwise, 25 percent of gross proceeds must be withheld by the purchaser. There is a 50 percent withholding in respect of life insurance policies, resource properties, real property (other than capital property), timber resource property, and depreciable property that is taxable Canadian property. The amount of withholding may be reduced where a tax treaty applies to the transaction. Quebec imposes a similar requirement for property situated in Quebec.

The withholding is on account of the final tax liability for the year. If the amount withheld exceeds the actual tax liability, a refund will be issued upon filing of the federal tax return (or Quebec tax return) for the year.

Non-business income

Certain types of non-business income paid or credited to non-residents of Canada are taxed at a flat rate of 25 percent. This rate is usually reduced by treaty. The items subject to this rate include interest, dividends, rents, royalties, management fees, estate or trust income, alimony, pension benefits and annuities. Various exemptions and deeming rules are applicable. Professional advice should be sought with respect to cross-border payments.

Branch operations and the branch tax

Income from the operation of a corporate branch carrying on business in Canada is generally taxed at normal Canadian corporate rates. However, an additional Branch Tax of 25 percent may apply to the branch’s income not reinvested in Canada. The rate may be reduced by treaty to the treaty rate applicable to dividends. Some treaties also provide for a threshold amount that must be exceeded before the Branch Tax will apply to a corporation from that country.

Chapter Seven – Other taxes

Sales tax

The GST is a federal value-added tax. GST is charged on the sales price of goods and services sold by registered suppliers in Canada unless those supplies are "zero-rated," "exempt" or outside the scope of GST (see definitions below). GST is also charged on the transfer, lease or disposition of property. A person who makes taxable supplies in the course of business is required to register for GST if taxable sales exceed certain limits. The term "person" includes individuals, partnerships, associations, corporations, clubs and charities.

The tax is eventually borne by the ultimate non-registrant consumer of the goods and services. In effect, registrant suppliers only act as collectors of GST. Registrant suppliers remit the GST charged to customers to the government and receive a refund or credit referred to as an "input tax credit" for the GST they have paid to their suppliers in respect of purchased supplies. Input tax credits may be claimed for capital costs as well as current expenditures.

There are three categories of transactions:

- Supplies subject to the normal rate of tax (currently 5 percent), referred to as "taxable supplies";
- Supplies subject to a zero rate of tax, referred to as "zero-rated supplies"; and
- Exempt supplies.

A registrant business engaged in providing zero-rated supplies or services is able to claim a refund of all GST paid on its purchases. By contrast, a person who provides exempt supplies does not charge GST on supplies it makes and is not entitled to a refund of GST paid on its purchases.

There is also the potential problem where some supplies are exempt, and others are zero or standard-rated. In these circumstances, input tax credits on GST paid on the related expenses incurred must be allocated using some reasonable method.

Examples of zero-rated and exempt supplies and services are:

Zero-rated Supplies	Exempt Supplies
Agricultural and fish products	Day care services
Basic groceries	Educational services
Exports	Financial services
Medical devices	Health care services
Prescription drugs	Residential rentals
Sale of used residences	

Prompt registration for GST is an important requirement of carrying on business in Canada.

The federal government has committed to integrating the GST with the provincial sales tax regimes. Quebec commenced the harmonization of its provincial sales tax program in 1992. The provinces of Newfoundland and Labrador, Nova Scotia, New Brunswick, Prince Edward Island and Ontario have completely harmonized their sales tax systems with the GST.

The GST rate is 5 percent of the selling price of all goods and services consumed domestically except those classified as zero-rated or exempt. In the harmonized sales tax regimes of Newfoundland and Labrador, Nova Scotia, New Brunswick, and Prince Edward Island the rate is 15 percent, in Ontario – 13 percent. In Quebec, the sales tax rate is 9.975 percent, which is levied on the selling price, including GST, resulting in a combined rate of 14.975 percent.

Other provinces, with the exception of Alberta, which has no sales tax, charge provincial sales tax on the retail price of most goods at rates that range between 7 percent and 10 percent.

Duties

Canada has a complex system of duties imposed on the importation of goods into Canada. The rate of duty, if any, varies depending on the nature of the goods and their country of origin.

Canada, Mexico and the United States are co-signatories of NAFTA, which provides free trade among the countries.

Canada and European Union co-signatories of CETA, which removes 98% of the preexisting tariffs between these countries.

Chapter Eight – Personal taxation

Individual taxation

Individuals are divided into two classifications for Canadian income tax purposes: residents and non-residents. Physical presence in Canada for 183 days in one taxation year deems the individual to be a resident of Canada for that year. Aside from this and certain other deeming rules, there is no exhaustive definition in the *Income Tax Act* of who is and who is not a resident of Canada, and there has been much jurisprudence on this issue over the years. The courts have looked at the following factors to determine if an individual is resident in Canada:

- the amount of time spent by the individual in Canada during the taxation year in question and preceding years;
- the motives or reasons for being present in Canada or absent from Canada during the year;
- whether the individual maintains a dwelling or establishment in Canada;
- the individual's roots and background;
- the individual's general mode or routine of life; and
- other connections that the person has in Canada, such as ownership of property, membership in clubs, presence of spouse and children, etc.

The determination of Canadian tax residency is normally based on consideration of this information. In a case where Canadian law determines that a person is resident in Canada, and another country with which Canada has a tax treaty determines that the person is resident there as well, the related treaty usually has procedures and criteria for determining that person's tax status.

Residents

An individual resident is required to report and pay tax on his or her worldwide income. There is a foreign tax credit system to provide relief from double taxation on non-Canadian income. The system usually results in the person paying the higher of the Canadian or foreign tax on that income.

Individuals who are residents of Canada for part of the year only report worldwide income and deductions relating to that part of the year. For the part of the year, they are non-resident, they will also have to report Canadian employment income, Canadian business income and gains from the disposition of taxable Canadian property.

Every individual files a separate return reporting his or her own income. There are no joint returns or filings for spouses or families. Personal income tax returns are generally due to be filed by April 30 with no extensions permitted. Individuals earning business income as a proprietor or partner and their spouses are required to file their returns by June 15. Income taxes owing on income earned in the calendar year are due by April 30 of the following year, regardless of when the return must be filed.

All provinces and territories impose a personal income tax. The CRA administers the collection of the income taxes for all provinces and territories except Quebec. Quebec administers its own personal income tax system. Persons subject to Quebec taxation must file separate federal and Quebec tax returns.

At the time of publication, the maximum personal tax rates ranged from 44.5 percent to 54 percent depending on the province or territory a taxpayer resided in on December 31. Lower rates apply to dividend income from Canadian corporations.

Non-residents

A non-resident individual is usually subject to Canadian income tax only on Canadian source income. A non-resident is subject to normal Canadian personal income tax rates on the total of the salaries and wages earned in Canada, the income from a business carried on in Canada and the gains from the disposition of taxable Canadian property, as described more fully in the taxation overview section. Income from Canadian sources such as dividends, interest, rents, royalties and pensions are not subject to normal Canadian tax; rather, they are subject to a 25 percent withholding tax, which may be reduced by a tax treaty. If the non-resident individual is required to file a Canadian income tax return, this return is normally due on April 30 following the calendar year the income was received. An alternative method is available to recipients of rental, pension and certain employment benefits that can result in a reduction of taxes payable.

Immigration and emigration

When an individual becomes a resident of Canada, his or her world income is taxable for the remaining part of the taxation year. Most property is deemed to be acquired at fair market value at the time of immigration. As a result, Canada will only tax the economic gain that accrues during Canadian residency. The Income Tax Act provides an immigrant with the opportunity to transfer non-Canadian investment assets into a foreign trust exempt from Canadian tax for up to five years. Professional advice should be sought prior to immigration.

When a resident individual becomes a non-resident of Canada and a resident of another jurisdiction, there is a deemed disposition of most of his or her assets, at fair market value immediately prior to departure with 50 percent of the resultant capital gain or loss being included in income for the year of departure. Assets subject to the deemed disposition include virtually everything except Canadian real property, property used in a Canadian business, certain pension entitlements, certain stock options and certain interests in Canadian trusts. Where an individual resided in Canada for no more than five of the 10 years preceding departure, any assets owned at the time of entry and property inherited while in Canada will be excluded from the deemed disposition rules.

Taxes payable as a result of the deemed dispositions are due in the year of departure. If acceptable security is provided to the CRA, payment of tax may be deferred until the actual disposition or the death of the individual. No security is required for the first $100,000 of capital gains. Interest is not payable on the taxes deferred up to the actual disposition or death.

Death

There are no estate taxes or succession duties, as such, imposed in Canada. At death, a person is deemed to have disposed of his or her property at its fair market value immediately prior to death. Thus, on the deceased person’s final income tax return, the accrued capital gains and losses are recognized for tax purposes. There are rules to provide a tax-free rollover of the property that is transferred to, or made available for the exclusive use of, a surviving spouse. Upon the death of the surviving spouse, the underlying capital gains and losses will be realized and any resulting taxes become due. These deemed realization rules also apply to non-residents with property in Canada at the time of their death.

Chapter Nine – Accounting

Accounting and financial reporting

Under the Canadian Charter of Rights and Freedoms, the regulation of commerce is the responsibility of the provinces. Accordingly, many of the requirements for the maintenance of accounting records are contained within the provincial statutes and regulations. However, various federal statutes and regulations contain requirements for accounting records.

The accounting requirements for corporations are generally to maintain books and records to enable full and fair disclosure of the financial condition of a business in compliance with applicable accounting principles, laws, rules and regulations.

Private businesses are not required to publicly disclose the results of their financial operations. Based on their own requirements, banks and other lending institutions may require these businesses to issue annual, or more frequent, financial statements. Corporations that are publicly listed need to comply with the requirements of the applicable provincial securities commissions and stock exchanges, which include the requirement for an annual audit of financial statements and unaudited quarterly statements. The fundamental guidelines for maintaining accounting records include these points:

- Accounting records are kept in accordance with the laws of each province;
- Accounting records fairly and accurately reflect the transactions or events to which they relate;
- Accounting records fairly and accurately reflect the corporation’s assets, liabilities, revenues and expenses;
- All transactions are supported by accurate documentation in reasonable detail; and
- Corporate financial reports are prepared in accordance with generally accepted accounting principles (GAAP).

Accounting principles

The Canadian Institute of Chartered Accountants (CICA) is recognized as an authority for rules and guidelines for accounting principles. The Accounting Standards Oversight Council was established by the CICA to serve the public interest by overseeing and providing input to the activities of the Accounting Standards Board (AcSB). The AcSB is responsible for establishing standards of accounting and reporting by Canadian corporations and not-for-profit organizations, except public sector (municipalities and government entities).

The Public Sector Accounting Standards Board (PSAB) establishes accounting standards for entities that are part of the public sector.

The AcSB adopted IFRS® Standards as the accounting standards used by publicly accountable enterprises. Private enterprises and not-for-profit organizations can choose to use Accounting Standard for Private Enterprises (ASPE) or Accounting Standard for NPO, respectively. or IFRS Standards. Separate accounting standards exist for pension plans.

The table below summarizes the different types of Canadian entities and the corresponding financial reporting framework for each type of entity.

Type of entity	Financial Reporting Framework	Handbook Reference
Publicly accountable enterprises	IFRS	CPA Canada Handbook Part I
Private enterprises[1]	Accounting Standards for Private Enterprises (ASPE)	CPA Canada Handbook Part II
Not-for-profit organizations[2]	Accounting Standards for Not-for-profit organizations (NFPOs)	CPA Canada Handbook Part III
Pension plans	CPA Canada Handbook Section 4600, Pension Plans	CPA Canada Handbook Part IV
Publicly accountable enterprises subject to a deferred IFRS adoption date	Pre-changeover accounting standards	CPA Canada Handbook Part V
Public Sector entities	Public Sector Accounting Standards (PSAS)	Public Sector Accounting Handbook

1 Private enterprises may also elect to apply Part I of the Handbook (IFRS).

2 Not-for-profit organizations may elect to apply Part I of the Handbook (IFRS)

Financial reporting

Financial statements must follow the appropriate guidelines and, if necessary, regulatory requirements of various agencies. Every Canadian corporation is required to have an audit, unless the shareholders consent to waive an audit of the corporation.

At a minimum, the corporation needs to compile financial statements for income tax purposes. Corporations that desire a level of assurance on financial statements may opt for the differential reporting options available to private corporations (see previous section).

Publicly-traded corporations are required to have an audit performed by an independent Chartered Accountant. In order to audit publicly-traded corporations, a public accounting firm must be registered with the Canadian Public Accountability Board (CPAB). Audits are conducted in accordance with generally accepted auditing standards (GAAS) that are issued and supported by the CICA. Canadian GAAS is currently being integrated with International Auditing and Assurance Standards.

More information on accounting and financial reporting can be found on the CICA website at www.cica.ca.

Glossary

AcSB – Accounting Standards Board

CCPC – Canadian-controlled private corporation

CICA – Canadian Institute of Chartered Accountants

CPAB – Canadian Public Accountability Board

CRA – Canadian Revenue Agency

FAPI – Foreign Accrual Property Income

GAAP – Generally accepted accounting principles

GAAS – Generally accepted auditing standards

GST – Goods and Services Tax

NAFTA – North American Free Trade Agreement

ULC – Unlimited Liability Corporation

WTO – World Trade Organization

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