Doing Business in Canada

This document describes some of the key commercial and taxation factors that are relevant on setting up a business in Canada.

Prepared by Taylor Leibow LLP

dfk.com
+44 (0)20 7436 6722

Background

Country overview

Founded in 1867, Canada is celebrating its 150th Anniversary in 2017. Canada is a land of vast distances and rich natural resources. Canada bolsters a stable independent government and is known as an excellent country to live in as it provides for a high standard of living. Furthermore, Canada is great country to do business with due to its well-developed trade network, sound financial system, and developed infrastructure.

Canada maintains a parliamentary democracy, a federation, and a constitutional monarchy with ties with the British crown.

Canada has an elected, parliamentary system of government, divided among a federal government, ten provincial governments, and three territorial governments. Legislative authority is divided between various levels of government, including the Parliament of Canada, the legislatures of Canada's provinces and territories, and various local governments or municipalities.

Canada's legal system in most provincial jurisdictions is based on the English common law system except for the province of Quebec, which is based on the French Napoleonic code.

Canada has approximately 36,000,000 inhabitants, 18 million sof whom are in the workforce. The two official languages are English and French, with English being the predominately used language outside the province of Quebec.

Economic overview

Canada is a high tech industrial society with a market-oriented economic system and high living standards. While previously a rural country, since World War II Canada's manufacturing, mining and service industries have grown giving it a primarily industrial and urban economy. The 1989 US-Canada Free Trade Agreement (FTA) and the 1994 North American Free Trade Agreement (NAFTA) (which includes Mexico) enabled an increase in trade and economic integration with the US, its main trading partner. Thanks to Alberta's oil sands and offshore oil reserves in Newfoundland, Canada now has the third largest proven oil reserves in the world, and is the world's fifth-largest oil producer.

Canada's abundant natural resources, highly skilled and educated labour force, and modern capital plants have facilitated economic growth such that it became the world's tenth largest economy (by GDP, 2016), and GDP per capita is estimated at $43,000 USD. Canada is a member of the Organization for Economic Co-operation and Development (OECD) and the Group of Eight (G8), and is one of the world's top ten trading nations, with a highly globalized economy. Canada uses its own independent currency, the Canadian dollar.

Choice of Legal Form

One of the key initial considerations for establishing a business in Canada is whether the entity will undertake the business directly, as a branch of the foreign entity, or whether to create a separate Canadian subsidiary to carry on the business either via a corporation, a proprietorship, partnership, or joint venture.

The use of a Canadian subsidiary generally limits the liability of the foreign parent corporation to its capital investment in the Canadian subsidiary. In conducting business through a branch, the foreign parent corporation exposes itself directly to all the liabilities of the Canadian operation.

Sole proprietorship

The simplest form of business organization, a proprietorship, exists when an individual carries on business as the sole owner without incorporating. There is therefore no distinction between the proprietorship and the owner as the proprietorship's income is the owner's income and the proprietorship's liabilities are the owner's personal liabilities.

Corporation

The most common form of legal entity for businesses is a corporation. Most foreign businesses operating in Canada use a corporation. A corporation is a legal entity that is separate and distinct from the shareholders.

Corporations may be created in Canada under either federal or provincial legislation. Although federal and provincial business corporation statutes are quite similar in most respects, there are some differences that can affect the decision of whether to incorporate federally or provincially. Corporations established under federal or provincial legislation may carry on business anywhere in Canada, but are required to comply with provincial requirements.

Some provinces require that corporations incorporated in their jurisdiction have the majority of director's resident in Canada, while other provinces have no resident director requirements.

Alberta, British Columbia, and Nova Scotia unlimited liability companies

An unlimited liability company (a "ULC") is a form of corporation where the shareholders of the ULC can be liable for the obligations of the ULC. In this respect, a ULC is similar to a general partnership and is different from the common form of corporation where the corporation's shareholders are not, in general, liable for the liabilities of the corporation.

For U.S. tax purposes, a ULC can be treated as a flow-through entity. A ULC is a hybrid entity, a corporation for Canadian tax purposes and a flow-through entity for U.S. tax purposes.

Partnership

A partnership generally exists when two or more individuals or entities carry on business together with a view to making profit without incorporating. In an ordinary partnership, the partnership is not a separate legal entity and all the liabilities of the partnership are the personal liabilities of the partners.

Limited partnership

A limited partnership is something of a legal hybrid, providing some of the benefits of a limited liability company along with many of the tax benefits of a partnership. Generally, there must be one or more general partners who are liable for all the partnership's debts. There may also be any number of limited partners whose liability is limited to the amount they agree to contribute. Generally, a limited partner is not permitted to take any part in the management or control of the partnership's business. However, a limited partner may participate in certain fundamental decisions, such as the admission of new general partners or its expansion into new businesses. A limited partner may have restrictions on the amount of losses that can be deducted for income tax purposes.

Joint venture

A joint venture is similar to a partnership in that it involves an arrangement where two or more people contribute goods, services or capital to a common commercial enterprise. The main difference of a joint venture vs a partnership is that a joint venture is often considered to be more informal and temporary. The co-venturers in a joint venture do not act as agents for each other. They each receive a share of gross profits but they share only in the expenses related to the specific project. Joint ventures also have different tax rules to partnerships.

Branch office

A foreign corporation may conduct business within Canada through a branch office after obtaining a license or registering in the province where it carries on business. Since a branch office is not legally distinct from the parent company, the parent will be exposed to the debts, liabilities and obligations of the Canadian operation.

Audit Requirements

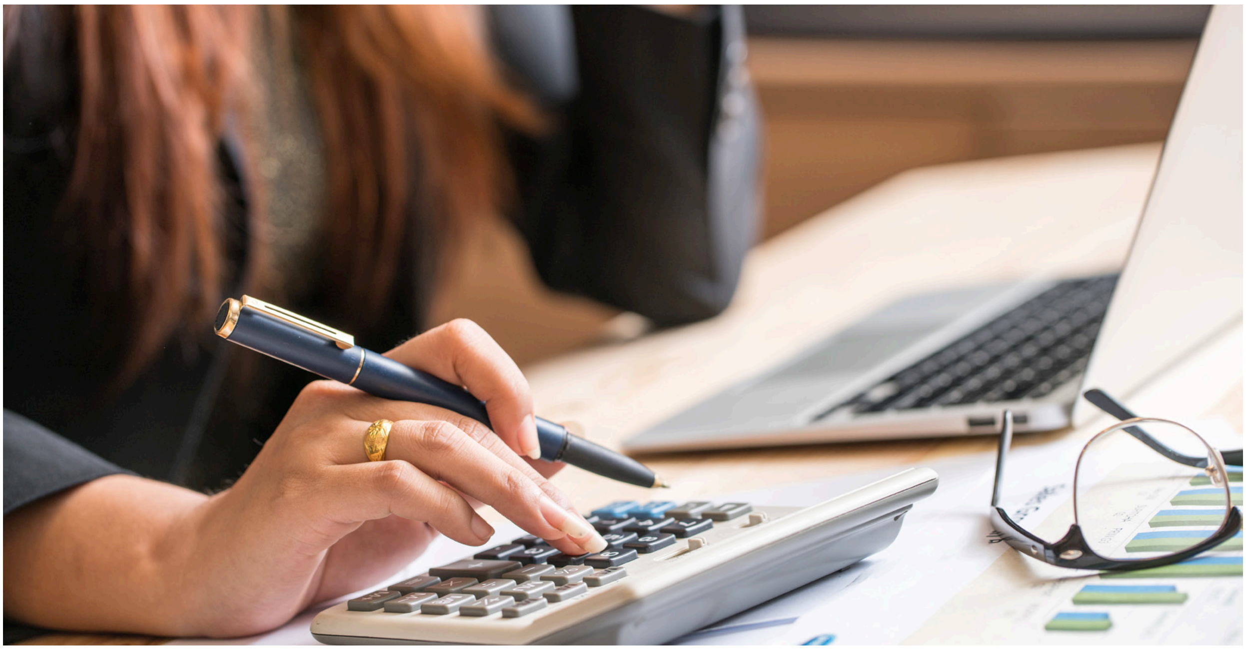
There is no requirement for a corporation to have an audit performed in Canada, unless the corporation is a publicly traded corporation. However, often where there is third party financing, the lender will require the corporation to have an audit performed as a condition of the financing.

Tax return filing requirements

The Canadian tax system is based on self-assessment, also known as voluntary compliance. In general, every corporation is required to file a tax return. Once the tax return is processed, the tax authorities will issue a Notice of Assessment.
When a return is assessed, the statute of limitations for the tax authorities to reassess (adjust) the tax return is normally between 3 to 4 years.

Routine audits are conducted by the Canada Revenue Agency to ensure tax compliance. Taxpayer's are required to comply throughout the audit process. Taxpayers are required to keep adequate books and records to substantiate their financial records.

Taxation



In Canada, there are various types of taxes that are levied, particularly income taxes and sales taxes, which are imposed both at the federal and provincial level.

Individuals that are residents of Canada are taxed on their worldwide income, whereas non-residents are subject to Canadian taxation on the following sources of income; the sale of taxable Canadian property; carrying on a business in Canada; and through employment in Canada.

Under Canada's tax treaties, business profits are generally only taxable in Canada to the extent that the non -resident has a "permanent establishment" in Canada. A permanent establishment generally means a fixed place of business in Canada through which the business of the entity is wholly or partly carried on. A Corporation operating in Canada without a permanent establishment may be required to file a treaty based corporate tax return.

Although each province has also enacted provincial income tax legislation, only Alberta and Quebec administer their own corporate income taxes. Moreover, only Quebec administers its own individual income taxes. All the other provinces rely upon the federal government to collect taxes on their behalf.

Corporate income tax

Corporate income taxes are imposed both by the federal government and the provinces. Active business income by a corporation is taxed at a rate of 15% at the federal level. The provinces then levy taxes and the rates range from as low as 11% in British Columbia to as high 16% in Nova Scotia and Prince Edward Island.

Preferential tax rates are given to qualifying small business corporations, which are “Canadian Controlled Private Corporations” that earn active business income on their first $500,000 of profits. Canadian controlled private corporations are corporations which are privately held and controlled (50% or more) by Canadian residents. Taxes are imposed at a rate of 11% federally and range from 0% to 8% throughout the provinces.

Investment income earned by a Canadian Controlled Private Corporation is taxed at 34.7% at the federal level and ranges from 11% to 16% at the provincial level. A portion of the federal tax is refundable to the corporation when a dividend is paid to the shareholders.

Investment income earned by any other corporation is taxed at a 15% federal rate and 11% to 16% provincial rate.

Dividend payments

Generally, dividends received by Canadian individual residents from corporation’s resident in Canada are subject to preferential tax rates apart from other sources of income. This is a result of the “integration” principle to provide for close parity between income earned directly by an individual and income earned by an individual shareholder through a corporation.

Dividends received by a corporation resident in Canada from another corporation resident in Canada are included in, and then fully deductible from, the recipient’s income. Dividends paid between two Canadian resident corporations are generally tax-free subject to certain exceptions. Dividends received by corporation’s resident in Canada from corporations not resident in Canada are fully included in the recipient’s income without a corresponding deduction, unless such dividends are paid out of the active business income of a non-resident corporation that is a “foreign affiliate” of the Canadian resident corporation that is resident in a specified treaty jurisdiction.

Dividends paid to non-residents shareholders are subject to income tax withholdings (see ‘Withholding Taxes’ section).

Branch tax

A non-resident corporation that carries on business in Canada through a branch must pay Canadian income tax on income earned in Canada. Generally, however, Canada’s tax treaties provide that a corporation’s business profits will only be subject to Canadian income tax to the extent that they are attributable to a Canadian permanent establishment.

In addition to Canadian federal and provincial income tax, a non-resident corporation carrying on business in Canada through a Canadian branch is subject to a branch tax. The branch tax is 25 per cent of after-tax income that is not reinvested in Canada. Where the rate of withholding tax on dividends is reduced by a tax treaty, the rate of the branch tax is often reduced to the same rate. In addition, a tax treaty may exempt the first $500,000 of a non-resident corporation’s income from branch tax.

Personal income tax

Personal income taxes are based on progressive tax rates and brackets. The federal income tax rates range from 15% to 33%. For 2017, the highest marginal tax bracket applies when income exceeds $200,000.

Provincial tax rates and brackets vary from one province to another. The top marginal rates for federal and provincial taxes combined range from 44.5% in Nunavut to 54.0% in Nova Scotia.

There also exists what is known as the "basic personal exemption", where the first $11,474 of income is not subject to taxation at the federal level.The amounts of the basic exemption differ throughout the provinces.

Capital gains tax

The gains resulting from the sale of capital property is subject to taxation at 50%. In other words, only 50% of the gain is included in computing a taxpayer's income.

In similar fashion, one half of capital losses are deductible. Capital losses may only be deducted against capital gains.

Property tax

Property taxes on real property are an important source of revenue in Canada, particularly for municipalities. Many provinces also levy transfer taxes on the purchase of land and impose various other taxes on mines, timber property and similar properties.

Value added tax ("VAT")

Canada imposes a goods and services tax ("GST") on the consumption of goods and services in Canada. Some of Canada's provinces have chosen to harmonize their sales taxes with the federal GST (referred to as Harmonized Sales Tax -HST). While GST or HST is collected by all registered businesses at each stage in the production or marketing of goods and services, the burden of the tax is ultimately borne by the consumer.

Businesses collect tax on their sales and claim a credit, referred to as an input tax credit, for any tax paid on their purchases. While most sales of goods and services are subject to GST, some goods and services are exempt or zero-rated.

The federal GST rate is 5 percent. In provinces which have harmonized their taxes, the combined HST tax rate varies from 13 percent to 15 percent. Other provinces that have not harmonized their sales taxes, such as Quebec, levy an additional 9.975 percent sales tax in addition to the GST.

GST also applies to imports of goods and is usually paid by the importer. The GST is payable on the duty-paid value of goods, meaning the value for customs purposes, plus applicable customs duty.

Non-resident corporations with a permanent establishment in Canada are considered to be resident in Canada for GST/HST purposes, and may be required to register for and collect GST/HST on all taxable supplies of property and services made through the permanent establishment.

Tax treaties

Canada has entered into over 80 tax treaties with countries throughout the world. The treaties are in place to eliminate the double taxation of income that may arise. The tax treaties generally provide that business profits of a non-resident of Canada are not subject to tax in Canada, except to the extent that profits are attributable to a permanent establishment of the non-resident in Canada. The tax treaties usually reduce both the withholding tax rates imposed under Canadian law and the branch-profits tax rate.

Transfer pricing rules

Canada generally follows the OECD transfer pricing guidelines. Canadian taxpayers are taxed on their transactions with non-arm's-length non-residents based on terms similar to those that would have applied had the parties been dealing at arm's length. Canadian taxpayers that transact with non-arm's-length non-residents are also required to prepare and retain certain documentation. Failure to do so may result in significant penalties if the terms of their transactions are ultimately held not to be arm's-length terms. These rules apply to related persons and to parties who, as a matter of fact, do not deal with each other at arm's length.

Allowances

Depreciation

With respect to depreciation, taxpayers may claim depreciation expense (known as "capital cost allowance") in accordance with prescribed government rates. Categories of assets are placed in a class and are then depreciated at the prescribed rates. For example, buildings are generally amortized at a 4% annual declining balance rate. Assets with a shorter useful life will have higher depreciation rates.

Tax credits

There is a myriad of federal and provincial tax credits available to corporations with the spirit of fostering economic growth and development, in a certain sector or region. Tax credits range from promoting IT and E-commerce business, the mining industry, the film and television industry, the financial industry, manufacturing and processing business, and to conducting research and development.

The research and development tax credit is one of the more prominent and generous incentive programs available which provides tax deductions and credits available to taxpayers for expenditures incurred for scientific research and experimental development (SR&ED) related to business carried on in Canada by the taxpayer.

Employment

Payroll taxes

Employers, including non-resident employers are also required to pay and remit certain payroll taxes with respect to the Canada Pension Plan (CPP) or Quebec Pension Plan (QPP), Employment Insurance, a workers' compensation program and, in certain provinces, health or education taxes. The CPP contribution rate for 2017 applicable to both employers and employees is 4.95%. The maximum pensionable earnings for 2017 are $55,300 with a maximum contribution by each of the employers and the employee of $2,564.10. The Employment Insurance contribution rate for 2017 applicable to employers is 2.282%, and the contribution rate applicable to employees is 1.63%. The maximum insurable earnings for 2017 is $51,300, resulting in a maximum contribution by employers of $1,170.67 and a maximum contribution by employees of $836.19.

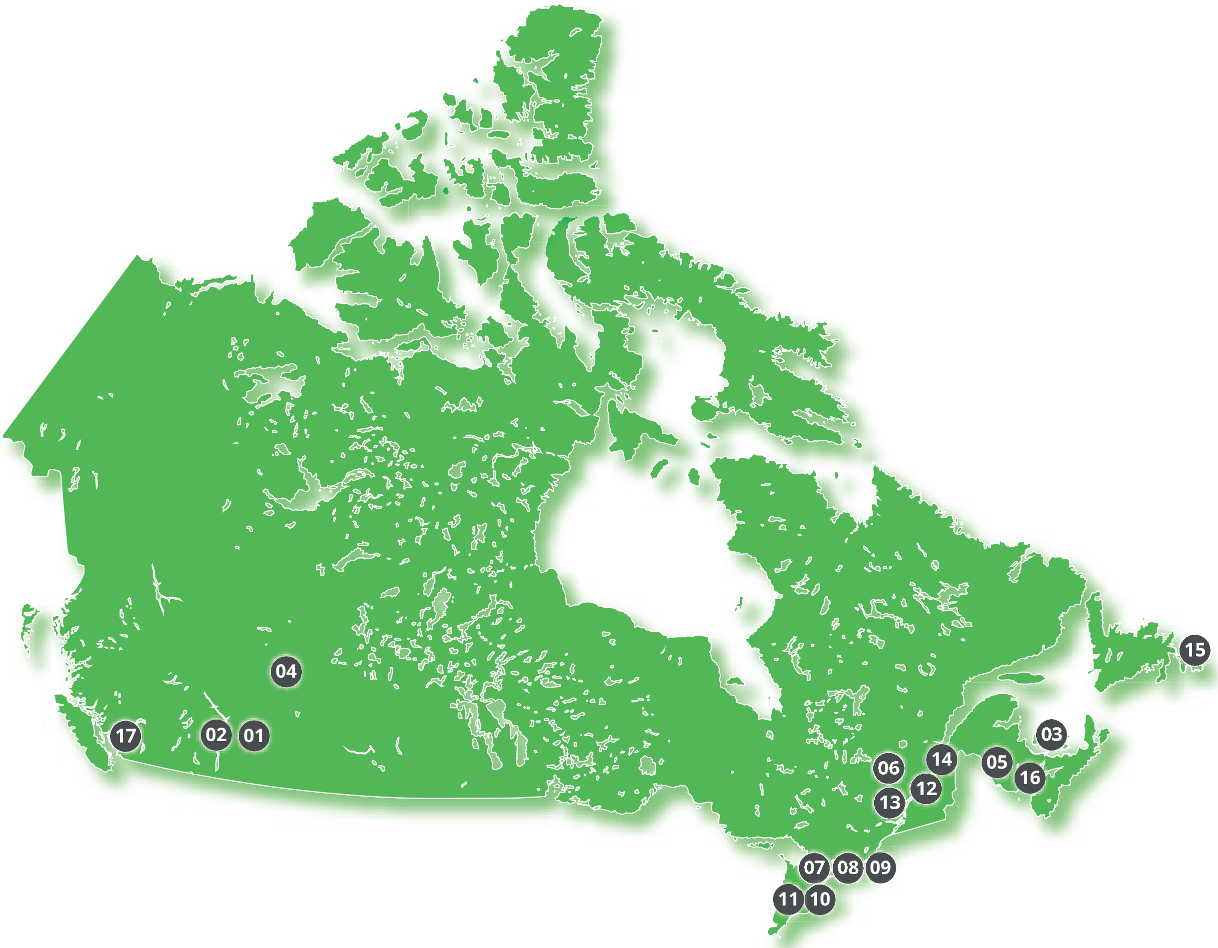
Withholding Taxes

Generally, amounts paid or credited to non-residents with regards to most forms of passive income (interest, rents, royalties, and dividend) will be subject to a withholding tax up to a maximum of 25%. The withholding rates often may be reduced or eliminated pursuant to a tax treaty.

DFK Canada National Group

DFK Canada Inc.

Lynn Morrovat
lynn@dfk.ca
+1 (0)4164 912886
www.dfk.ca



This document is provided by Taylor Leibow LLP as a general overview of matters to be considered when setting up an overseas business in Canada. It is essential to take advice on specific issues. No liability can be accepted for any action taken or not taken arising from the information provided in this publication.

If you are setting up a business in Canada, the members of DFK International can help you to achieve this efficiently. You will receive practical advice on business issues, tailored to meet your objectives, from experienced business advisers.

For further information on the services available from the DFK member firms in Canada please contact:

Calgary 01

Kenway Mack Slusarchuk Stewart LLP
Bryce Eidsness
beidsness@kmss.ca
+1 (0)4032 337750
www.kmss.ca

Canmore 02

Kenway Mack Slusarchuk Stewart LLP
David W. Somerville
dsomerville@kmss.ca
+1 (0)4036 751010
www.kmss.ca

Charlottetown 03

MRSB Chartered Accountants
Shaun MacIsaac
shaun.macisaac@mrsbgroup.com
+1 (0)9023 6826431
www.mrsbgroup.com

Edmonton 04

Kingston Ross Pasnak LLP
Chad Knippel
cknippel@krpgroup.com
+1 (0)7804 243000
www.krpgroup.com

Fredericton 05

Teed Saunders Doyle & Co.
Kenneth Kyle
kenneth.kyle@tsdca.com
+1 (0)5064 588727
www.teedsaundersdoyle.ca

Gatineau 06

Ginsberg, Gingras & Associates Inc.
Chantal Gingras
chantalgingras@ginsberg-gingras.com
+1 (0)8197 760283
www.ginsberg-gingras.com

Greater Toronto Area 07

Davis Martindale LLP
Paul Panabaker
ppanabaker@davismartindale.com
+1 (0)4168 408050
www.davismartindale.com

Greater Toronto Area 08

Taylor Leibow LLP
Nigel Jacobs
njacobs@taylorleibow.com
+1 (0)9056 379959
www.taylorleibow.com

Greater Toronto Area	09

Williams & Partners LLP
Enzo Morini
enzo.morini@wpllp.com
+1 (0)8558 889913
www.williamsandpartners.com

Hamilton	10

Taylor Leibow LLP
Nigel Jacobs
njacobs@taylorleibow.com
+1 (0)9055 230000
www.taylorleibow.com

London	11

Davis Martindale LLP
Paul Panabaker
ppanabaker@davismartindale.com
+1 (0)5196 733141
www.davismartindale.com

Montreal	12

Levy Pilotte LLP
Joseph Khouri
jkhouri@levypilotte.com
+1 (0)5144 871566
www.levypilotte.com

Ottawa	13

Ginsberg Gluzman Fage & Levitz LLP
Josh Engel
jee.ggfl.ca
+1 (0)6137 285831
www.ggfl.ca

Québec City	14

Dallaire Forest Kirouac Comptables professionnels agréés, S.E.N.C.R.L.
Josée O'Leary
joleary@dfk.qc.ca
+1 (0)4186 502266
www.dfk.qc.ca

St John's	15

Noseworthy Chapman
David Howe
davidhowe@noseworthychapman.ca
+1 (0)7093 645600
www.noseworthychapman.ca

Saint John	16

Teed Saunders Doyle & Co.
Andrew Logan
andrew.logan@tsdca.com
+1 (0)5066 369220
www.teedsaundersdoyle.ca

Vancouver	17

Williams & Partners Forensic Accountants Inc
Nick Angellotti
nick.angellotti@wpfa.ca
+1 (0)6046 889100
www.wpforensicaccountants.com

Last updated October 2017