Doing Business In Canada

By Larry Rotstein C.A., TEP

Rich Rotstein LLP
CHARTERED ACCOUNTANTS

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Topics Covered

- General Considerations
- Permanent Establishment Rules
- Forms of Business Organizations
- Branch vs. Incorporation
- Specific details to consider for all business setups/structures
- Taxation of Profits

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General Considerations

- Foreign investment by non Canadians reviewed by Investment Canada (ICA).
- Includes new investment in Canada or acquiring control of existing Canadian business.
- Foreign investors must file notification with Industry Canada (unless exempt under ICA).
- Should obtain appropriate Canadian professional advice to set up business operations in Canada.

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General Considerations

- Business immigration regulations are established for investors, entrepreneurs and self employed persons
  - Investors require qualified experience, $800,000 net worth
  - Entrepreneurs require qualified experience, $300,000 net worth
  - Self employed include artists, cultural, athletes, farmers only.
  - Seek proper professional advice.

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General Considerations

- Immigrant investor program to attract experienced business persons, minimum net worth $800,000 and required passive investment in Canada - $400,000
- **NOTICE: There is currently a moratorium on new applications under the Federal Immigrant Investor Program until Autumn 2010, at which time the minimum net worth will be raised to CAD$1.6 million and the investment to CAD$800,000, with a financing option.**

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General Considerations

- Entrepreneur program attracts experienced business persons to own and manage businesses in Canada & create jobs.
- Minimum net worth $300,000
- Subsequent monitoring by Citizenship and immigration Canada to ensure conditions maintained.

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General Considerations

- Self employed program create own employment and make significant contribution to cultural, artistic or athletic life in Canada.
- Can also purchase and manage a farm in Canada.

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General Considerations

- Foreign investment in real estate permitted through various structures including corporations, partnerships, personally, trusts.
- With-holding taxes usually apply at 25% or a lower treaty rate on gross rents
- With-holding taxes can be applied on net rental income if file in advance form NR6 & undertake to file Canadian tax return on rental income only (section 216 election).

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General Considerations

- If non-resident sells Canadian real estate will be subject to with-holding taxes unless a clearance certificate is obtained in advance of sale from Canadian tax department.
- Obligated to file tax return in Canada if you are employed in Canada, operate a business in Canada or sell taxable Canadian property like real estate situated in Canada.
- A fee or commission earned by a non resident for services rendered in Canada, not employment, is subject to 15% with-holding tax at source (form T4A nr used)

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Permanent Establishment Rules

- May be operating a business in Canada subject to taxation without realizing it.
- Many jurisdictions have similar rules regarding a permanent establishment (P/E).
- Province of Ontario rules:
  - Incorporated in Ontario
  - Corporation has branch, mine, oil well, farm, timberland, factory, workshop, office.

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Permanent Establishment Rules

- Corporation has substantial machinery and equipment used in Ontario at any time in a taxation year.
- Corporation has employee or agent in Ontario who has general authority to contract for the corporation or who regularly fill orders from a stock of merchandise owned by the corporation located in Ontario.

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Permanent Establishment Rules

- The corporation has no fixed place of business but conducts its business principally in Ont.
- The corporation has a permanent establishment elsewhere in Canada and owns land in Ont.
- A non-resident corporation produces, grows, mines, creates, manufactures, fabricates, improves, packages, preserves, or constructs anything in Ontario.

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Permanent Establishment Rules

- In addition to statutory criteria, Ontario Finance have issued comments that a showroom where orders are normally taken or an office of the corporation in a salesmen's residence would create a permanent establishment.
- Being a member of a partnership with a P/E in Ont. will give any partner a P/E in Ontario.

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Forms of Business Organizations

- Once it is established you are operating a business in Canada, what structure is most appropriate?

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Forms of Business Organizations

- Carrying on business in Canada can be accomplished through different structures
  - Corporation
  - Branch
  - Co-operative corporation
  - Joint venture
  - Limited partnership
  - General partnership
  - Franchise or licensing arrangement

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Forms of Business Organizations

- Corporation and branch setup, the most common, will be discussed shortly.
- Co-operative corporation are organized on co-op principles with earnings distributed as a patronage dividend to its members (ie customers, suppliers). The patronage dividend is a deduction from earnings.

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Forms of Business Organizations

- Joint ventures ("J/V") are co-ownerships by 2 or more entities to undertake a business activity.
- A non resident can hold an interest in a joint venture through a Canadian corporation or directly. If held directly this constitutes a branch operation.
- Profits and losses flow to the joint venture participants for tax purposes.
- J/V not a separate legal entity like a partnership.

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Forms of Business Organizations

- Partnerships are popular in service businesses like accounting and law.
- If a non resident holds the partnership interest directly, this constitutes a branch operation.
- Can have negative tax implications with non resident partners such as no tax free rollover on windup.
- Profits and losses flow through to partners for tax purposes. Limited partners restricted on losses to amount invested ("at risk amount").

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Forms of Business Organizations

- Non residents can use a licensing or franchise arrangement.
- Contractual arrangement between non resident and a Canadian entity.
- Typical arrangements
  - Licenses to exploit intellectual property such as patents, designs, trade-marks
  - Agency or distribution agreement with Canadian companies to sell products in Canada.
  - Franchising agreements to provide a product or service in Canada.

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Branch vs. Incorporation

- Of all the structures available, the 2 most common are a branch operation vs incorporation.
- The other structures mentioned are usually utilized in special circumstances.
- A branch or corporate setup tend to be more general purpose.

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Branch Setup

- Need extra-provincial license for entities created under the laws of a different province/country to operate a business in a province in Canada.
- In Ontario, a foreign entity must obtain permission from Ministry of Consumer & Business services, as well as an extra-provincial license to carry on business or own real estate in Ontario.
- If license not obtained – penalties. Also unlicensed business cannot sue in Ontario courts.
- Lawyers usually consulted for extra-provincial license needs.

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Branch Setup

- Filing requirements included for Branch
  - Name search report
  - Certificate of status setting out name of the extra-provincial corporation, when it was incorporated and the jurisdiction incorporated and that it is a valid corporation.
  - An appointment of an agent to handle legal proceedings in Ontario.

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Branch Setup

- Lower cost of setup than incorporation typically.
- Usually the branch is owned by a foreign subsidiary, with little assets, of a foreign parent company to limit liability issues of the branch.
- Branch is liable for taxes in Canada and files a corporation tax return as if it was incorporated in Canada.
- If a non resident individual owns the branch in Canada, the non resident is liable to file a Canadian personal income tax return on that income.

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Branch Setup

- In addition, there is a branch tax imposed comparable to the with-holding tax that a Canadian subsidiary would pay on dividends paid to its foreign parent.
- Most treaties reduce the branch tax rate and some treaties, like the Canada-US tax treaty exempt the first $500,000 of accumulated profits from branch tax.

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Incorporation

- Lot more decisions and choices.
- Incorporation can be federal or provincial
- Most Canadian jurisdictions require at least one Canadian resident director.
- New Brunswick allows incorporations with no Canadian directors.
- Nova Scotia, Alberta and British Columbia allow the incorporation of unlimited liability corps (U.L.C.)

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Incorporation

- All U.L.C.s are treated as corporations in Canada but under U.S. tax law the U.L.C. is treated as a flow-through allowing a U.S. Parent company to consolidate the U.L.C. operations for tax purposes.
- A Nova Scotia and British Columbia U.L.C. do not require any Canadian directors.
- Each U.L.C. has its own differences regarding shareholder liability and other issues which should be investigated prior to setup.

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Incorporation

- Regular incorporation can cost $1,200 and upwards depending on the complexity.
- Private companies in Canada are designated as Canadian Controlled (“CCPC”) or other private (“OP”).
- There are income tax differences between a CCPC and OP which I will discuss later.

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Incorporation

- Corporations require share capital to be issued which can be a number of different classes of shares with varying rights to votes, dividends, etc.
- A minimum of 1 director is required unless the corporation is public.
- Limited liability for shareholders (unless the corporation is a U.L.C. discussed earlier.)

Branch vs. Incorporation

- Both a branch setup and incorporation have advantages and disadvantages.
- From a tax point of view, a branch is a flow through entity allowing profits and losses to flow to the parent company.
- A corporation, other than a U.L.C. mentioned previously traps the profits and losses inside the corporation. Profits are distributed as dividends, which if paid to non-residents are subject to with-holding taxes per the applicable tax treaty.

Branch vs. Incorporation

- Time and space does not permit me to go through an exhaustive list of pros and cons of each structure.
- Consult with an advisor.
- The last 2 Canadian setups I assisted with for a U.K. company and U.S. company opening operations in Toronto were branch setups.

Specific details to consider for all business setups/structures

- Any business setup requires various registrations with government agencies, some specific to the type of business being operated.
- The following are registrations required for virtually all businesses. Some businesses will require special registrations for their business with specific government agencies(ie. liquor license for restaurant).
- Initial registration should be for a business number with the Canada Revenue Agency on form RC1.

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Specific details to consider for all business setups/structures

- Obtaining a business number allows the business to setup an income tax account, a GST/HST account, a payroll account, an import/export account.
- Both Ontario and British Columbia merged their respective sales tax systems with the Federal tax department GST system on July 1, 2010 which is now called HST (harmonized sales tax) in these provinces.

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Specific details to consider for all business setups/structures

- In Ontario, the major difference between the old GST (5%) and PST (provincial sales tax) (8%) systems and the new HST (13%) system is that services provided in Ontario like legal and accounting services are now subject to the 13% HST whereas before they were only subject to the 5% GST (services were generally exempt from the 8% PST).

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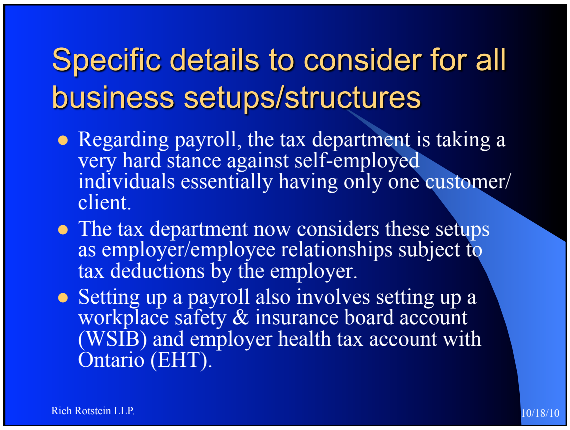
Specific details to consider for all business setups/structures
Regarding payroll, the tax department is taking a very hard stance against self-employed individuals essentially having only one customer/ client.
The tax department now considers these setups as employer/employee relationships subject to tax deductions by the employer.
Setting up a payroll also involves setting up a workplace safety & insurance board account (WSIB) and employer health tax account with Ontario (EHT).
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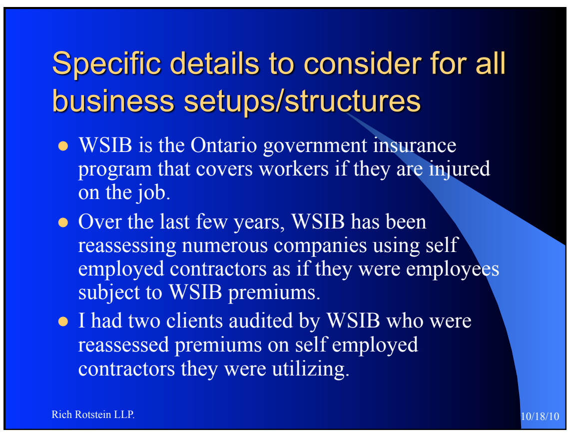
Specific details to consider for all business setups/structures
WSIB is the Ontario government insurance program that covers workers if they are injured on the job.
Over the last few years, WSIB has been reassessing numerous companies using self employed contractors as if they were employees subject to WSIB premiums.
I had two clients audited by WSIB who were reassessed premiums on self employed contractors they were utilizing.
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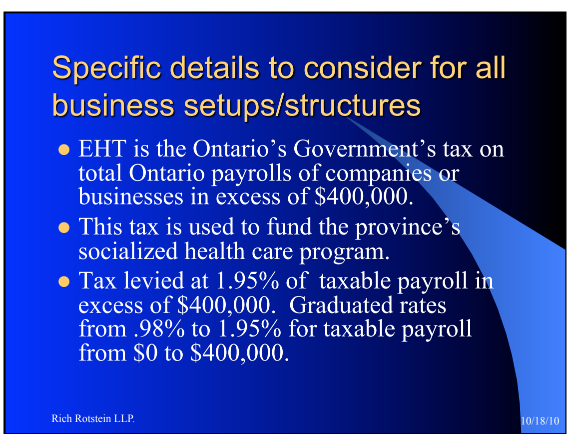
Specific details to consider for all business setups/structures
EHT is the Ontario's Government's tax on total Ontario payrolls of companies or businesses in excess of $400,000.
This tax is used to fund the province's socialized health care program.
Tax levied at 1.95% of taxable payroll in excess of $400,000. Graduated rates from .98% to 1.95% for taxable payroll from $0 to $400,000.
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Taxation of Profits

- If a non resident corporation operates in Canada through either a branch or subsidiary corporation, the Canadian corporation tax rates will apply.
- If Canadian residents own 50% or more of a private Canadian corporation, it will be considered a Canadian controlled private corporation (CCPC).
- Otherwise it is considered an other private corporation.

Taxation of Profits

- Following table highlights non CCPC effective combined federal and provincial tax rates in the larger provinces effective Jan. 1, 2010
- Further lowering of corporate tax rates in 2011 and beyond.

	General M&P Income	General Active Business Income	Investment Income
	%	%	%
British Columbia	28.5	28.5	28.5
Alberta	28	28	28
Saskatchewan	28	30	30
Manitoba	30	30	30
Ontario	29	31	31
Quebec	29.9	29.9	29.9
New Brunswick	29.5	29.5	29.5
Nova Scotia	34	34	34
Prince Edward Island	34	34	34
Newfoundland	23	32	32
Yukon	20.5	33	33
Northwest Territories	29.5	29.5	29.5
Nunavut	30	30	30

Taxation of Profits

- Investment income includes interest and capital gains income (capital gains taxed at ½ the amount of the gain.
- Dividends from taxable Canadian corporations and foreign affiliates attract 33.33% tax. Tax refunded to company when dividends paid to shareholders.
- Dividends from non Canadian companies taxed like interest income.

Taxation of Profits

- Following table compares the previous table to the corporate tax rates for a CCPC.
- The rates for active income and M&P income apply to the 1st $500,000 of net income. Above that income the Non-CCPC rates start.
- Investment income tax rates apply to all interest and capital gains income (capital gains are only ½ taxable).
- Dividends attract 33.33% tax rate which is refunded when paid out to shareholders who are taxed on the dividends.

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Taxation of Profits

- CCPC tax rates
- Approximately ½ investment income tax refunded to corp. when dividends paid to shareholders.
- Only applies to CCPC not to other private companies.

	General M&P Income	General Active Business Income	Investment Income
	%	%	%
British Columbia	13.5	13.5	45.17
Alberta	14	14	44.67
Saskatchewan	15.5	15.5	46.67
Manitoba	11.92	11.92	46.67
Ontario	16	16	47.66
Quebec	19	19	46.57
New Brunswick	16	16	46.16
Nova Scotia	16	16	50.67
Prince Edward Island	12.27	12.27	50.67
Newfoundland	16	16	48.67
Yukon	15	15	49.67
Northwest Territories	15	15	46.17
Nunavut	15	15	46.67

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Taxation of Profits

- If a non resident individual has the following types of income earned in Canada, he/she is liable to file a Canadian personal income tax return for the income.
  - Employment in Canada
  - Carrying on business in Canada (similar to a branch operation)
  - Dispositions of certain property located in Canada (ie. real estate in Canada).

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Taxation of Profits

- Top personal tax rates by province on various income types.

income > $126,264	ordinary income & interest %	capital gains %	canadian dividends eligible %	canadian dividends ineligible %
British Columbia	43.70	21.85	19.92	32.71
Alberta	39.00	19.50	14.55	27.71
Saskatchewan	44.00	22.00	20.35	30.83
Manitoba	46.40	23.20	23.83	38.21
Ontario	46.41	23.21	23.06	31.34
Quebec	48.22	24.11	29.69	36.35
New Brunswick	46.00	23.00	21.80	34.21
Nova Scotia	48.25	24.13	28.35	33.06
Prince Edward Island	47.37	23.69	24.44	38.15
Newfoundland	44.50	22.25	22.89	32.71
Yukon	42.40	21.20	17.23	30.49
Northwest Territories	43.05	21.53	18.25	29.65
Nunavut	40.50	20.25	22.24	28.96
non-resident	42.92	21.46	21.53	28.98

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Taxation of Profits

- Personal tax brackets for Ontario residents

Ontario only	ordinary income & interest %	capital gains %	canadian dividends eligible %	canadian dividends ineligible %
$0 – $10,320	0	0	0	0
$10,320 – $40,726	21 – 24.15	10.5 – 12.08	0–2.54	3.23 – 7.11
$40,726 – $81,452	31–39	15.5 – 19.5	6.94 – 12.91	5.86 – 22.59
$81,452 – $126,264	43.41	21.705	18.71	27.59
$126,264 +	46.41	23.21	23.06	31.34

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Taxation of Profits

- Transfer pricing between Canadian companies and non residents
  - Looks at transactions between non-arm's length parties to review inter-company pricing. Should equate to prices charged by arm's length parties.
  - Examples: purchase and sale of inventory and services, management fees, royalties on intellectual property, interest on inter-company loans and inter-company administrative fees.

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Taxation of Profits

- Thin capitalization rules
  - Disallow deduction of interest expense on debts owed to by companies to specified non residents.
  - Interest expense disallowed where debt to equity ratio of non residents exceeds 2:1.
  - Specified non residents include ones who own 25% or more of votes or value of issued stock of Canadian company.
  - Only includes debts of non residents
  - Equity includes stock and retained earnings.

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Taxation of Profits

- Scientific Research and Experimental Development (SR&ED) Tax Incentive
  - Incentive program to encourage research and development (R&D) in Canada.
  - Tax credits provided reduce cost of R&D in Canada
  - Expenditures include wages, materials, machinery cost, equipment cost, overheads
  - Work to advance new science or technology such as create new materials, products, devices.
  - Credit = 35% of qualified expenditures for CCPC, 20% for non CCPC companies.

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Taxation of Profits

- With-holding tax rates with selective countries on various income types
- Canada has over 50 tax treaties with various countries

Country	Interest	Dividends % of ownership	Dividends Regular	Royalties	Pension & Annuity	From Trust
United States	0.00%	5.00%	15.00%	10.00%	15.00%	15.00%
United Kingdom	10.00%	5.00%	15.00%	10.00%	10.00%	15.00%
Germany	10.00%	5.00%	15.00%	10.00%	0.00%	0.00%
Australia	10.00%	5.00%	15.00%	10.00%	15.00%	15.00%
Norway	10.00%	5.00%	15.00%	10.00%	15.00%	15.00%

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Taxation of Profits

- Review individual tax treaty for discussion on with-holding taxes with specific country.
- Dividends with-holding taxes reduced in many cases where 10% or more ownership in Canadian company
- Many countries reduce or eliminate with-holding taxes on alimony and child support payments
- Remember that in most cases the income received from Canada may be taxed in receiving country with tax credit for taxes with-held by Canada.

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Larry W Rich FCA, TEP

Senior partner

45 years experience

Acted as mediator in business disputes

Accounting and audit assignments

Negotiations with Canada Revenue Agency

Estate planning

Family Law dispute resolution and valuations

Voluntary disclosure representations with tax department

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Larry S. Rotstein CA, TEP

Partner for 23 years

Estate planning

Personal and corporate tax planning

Matrimonial dispute valuations

Negotiations with Canada Revenue Agency

Accounting and auditing practice

Assisted in implementation of two reverse takeovers taking a private company public.

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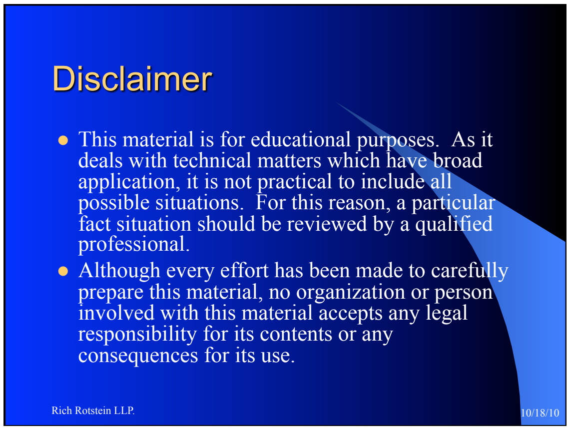
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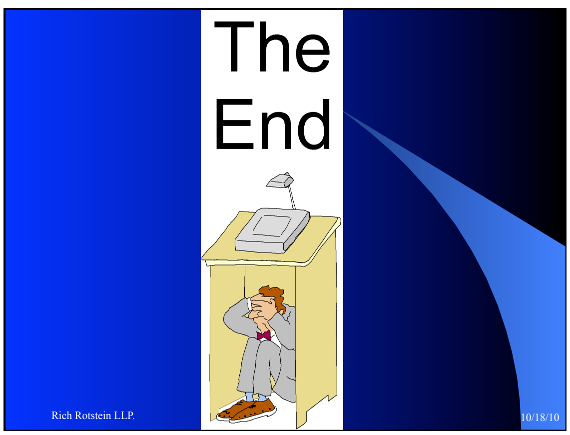
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