



DOING BUSINESS IN CANADA



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This document describes some of the key commercial and taxation factors which are relevant on setting up business in Canada. It is a brief overview of Canadian law, business conditions and taxation of companies and individuals. It is not intended to be advice on any particular matter and, therefore, you must seek appropriate professional advice when considering a specific transaction.

1. BACKGROUND

1.1 Canada has many positive attributes that make it an attractive place to do business. A vast country, it boasts an ethnically-diverse population of some 33 million people concentrated primarily on its border with the United States. Canada has 10 provinces, three territories and two official languages, English (widely spoken throughout the country) and French (primarily spoken in Quebec). It has a stable democratically-elected parliamentary-style government which is conducive to positive business conditions.

1.2 Canada's economy has been relatively strong over the last decade, characterized by steady growth, low inflation and strong exports. Canada's currency is the Canadian dollar which tends to be relatively stable against major world currencies. Canada's most significant trading partner is the United States, and the two countries' economies are closely intertwined.

1.3 Canada's transportation infrastructure is well developed and supportive of most business activities.

2. CHOICE OF LEGAL FORM

2.1 LIMITED LIABILITY COMPANY

Canadian companies can generally be incorporated under either federal legislation (Canada Business Corporations Act) or provincial legislation. Each province's legislation will be slightly different but these differences are typically not significant and the jurisdiction of incorporation generally has no income tax impact. Most incorporations are provincial where the business will operate from a fixed base in only one province and federal where there will be fixed bases in more than one province. Common requirements regardless of jurisdiction of incorporation include:

- no minimum or maximum capital
- board of directors is required
- share capital can be issued for cash, as a contribution in kind, in exchange for services or by way of dividends

- requirement for audited financial statements may be waived by the board of directors
- annual reports must be filed to maintain good standing

2.2 UNLIMITED LIABILITY COMPANY

In the provinces of Nova Scotia and Alberta, companies can be incorporated as Unlimited Liability Companies (ULCs). The shareholders of ULC's are liable for unpaid debts of the company on dissolution. ULCs are treated in the same way as Limited Liability Companies for purposes of Canadian taxation, however, some foreign jurisdictions (notably the United States) treat ULCs as "flow through" entities which make them useful to a foreign investor who may wish to offset Canadian business losses against income in the foreign jurisdiction. Although incorporated in Nova Scotia and/or Alberta, ULCs may carry on business in any province and need not have any presence in Nova Scotia or Alberta.

2.3 PARTNERSHIPS

Partnerships are organized under provincial legislation which may differ from province to province. For Canadian income tax purposes, partnerships are viewed as "flow through" entities; although income is computed at the partnership level, it is the partners who are taxed on that income rather than the partnership. This is the case regardless of whether or not the partnership is a general partnership or a limited partnership.

Where a limited partnership exists, the liability of the limited partners is typically limited to their investment as long as they do not engage in the business of the partnership on an active basis.

Information returns must be filed with Canada Revenue Agency for partnerships having more than five partners.

2.4 BRANCH

A Canadian branch of a foreign corporation is subject to Canadian taxation on the income of the branch. It also will be subject to "branch tax" which is a substitute for the withholding tax on dividends that will apply to a Canadian subsidiary of a foreign corporation.

3. AUDIT REQUIREMENT

Canadian companies which are publicly traded on a recognized stock exchange generally have a yearly audit requirement.

Most privately-owned Canadian companies do not have a legislated audit requirement, although audits may be required as a condition of bank financing.

4. TAXATION

4.1 CORPORATE TAXES

The nature of the income earned in a corporation and the corporation's ownership and control must be analyzed before the appropriate tax rate can be determined. This is due to the fact that various sources and levels of income are taxed differently. Public and private corporations are taxed differently. As well, the percentage of Canadian ownership can affect tax payable.

Active business income less than the small business threshold, earned in a Canadian Controlled Private Company ("CCPC") is taxed federally at a rate of 13.12%. Income not eligible for the small business threshold (including income earned by foreign and public companies as well as non CCPC's) is taxed federally at a rate of 22.12%. Proposed rate changes are scheduled to reduce these rates by 2 to 3% by 2010. The small business threshold for 2007 is \$400,000.

Property income of a CCPC is taxed federally in a corporation at a rate of 35.79%. Of this tax, 6.67% is refundable to the company subject to the payment of taxable dividends to shareholders.

In addition to these federal rates, each province then levies their own corporate income tax. Provincial rates on income eligible for the small business deduction range from 1% to 8% and rates on other sources of income range from 10% to 16%.

4.2 BRANCH PROFITS TAX

Non-resident corporations carrying on business in Canada through a branch will be subject to branch tax. This tax is in addition to the corporate income tax discussed above. Branch tax is imposed at a rate of 25% unless a treaty reduces the rate.

4.3 TRANSFER PRICING

Transactions between associated entities and between significant shareholders and controlled entities must be according to the arm's length principle. The typical test of control is direct or indirect ownership of more than 50% of the voting shares. Penalties exist for significant misstatements of transfer pricing in international transactions.

4.4 THIN CAPITALIZATION

Thin capitalization rules apply to resident companies having a debt to "specified non-residents". Specified non-residents are non-residents or non-resident-owned investment corporations which alone or together with non-

arm's length persons own either 25% or more of the voting shares or shares having a fair market value of 25% or more of the fair market value of all the issued and outstanding shares of the corporation.

Under these rules, interest paid to specified non-resident related companies on outstanding debts is not deductible to the extent that the average amount of outstanding debt to specified non-residents at any time in the year exceeds twice the company's equity.

4.5 LARGE CORPORATIONS TAX (LCT)

A federal LCT of .0625% is applied on capital employed in Canada in excess of \$50 million. The rate is scheduled to reduce to 0% in 2008. Manitoba, New Brunswick, Nova Scotia, Ontario, Quebec and Saskatchewan also impose capital taxes with rates varying between 0.3% and 5%. Provincial capital tax exemptions apply to smaller companies.

4.6 PERSONAL INCOME TAX

An actual or deemed resident of Canada is taxed on worldwide income.

In general, a person is a resident of Canada if they live permanently in Canada. If they do not maintain a Canadian home but continue to maintain significant residential ties, such as a spouse or dependant, or secondary residential ties here, such as bank accounts or a drivers license, they may still be considered a resident of Canada.

In addition, if a person sojourns in Canada (visits in Canada) for periods totaling 183 days or more in a year, they are deemed to be resident in Canada for the whole year.

Rules relating to residency in Canada may be affected by Canada's international tax treaties.

Taxable individuals are liable to pay federal and provincial taxes. Tax rates increase as the individual's level of income increases. For 2007, the four marginal federal tax brackets are as follows:

Taxable income (approximately)	Tax rate
\$ 37,178 or less	15.5%
In excess of	
\$ 37,178	\$ 5,763 + 22% on next \$ 37,179
\$ 74,357	\$ 13,942 + 26% on next \$ 46,530
\$ 120,887	\$ 26,040 + 29% on remainder

Each province also applies provincial tax rates to similar brackets of income. Rates begin at approximately 6% and increase to a high of approximately 19%. Therefore, the highest combined (federal and provincial) personal tax rate in Canada is approximately 48%.

One half of capital gains are taxable in Canada. One half of capital losses may be applied against taxable capital gains realized in the current year, future or three preceding taxation years.

Husbands and wives are taxed separately. However, certain personal, medical and donation credits available to one spouse may be transferred to the other spouse.

A non-resident of Canada is taxed only on taxable income from Canadian sources.

4.7 GOODS AND SERVICES TAX (GST)

Canada's GST is similar to the value-added (VAT) system in place in the European Union. Generally if a business reaches a level of \$30,000 of sales of taxable supplies they must register for GST.

GST is assessed at a rate of 6% on taxable goods and services. However, the provinces of New Brunswick, Newfoundland and Labrador and Nova Scotia have harmonized their provincial tax systems with the GST and now impose a single sales tax rate of 14%. Other provinces maintain their own sales tax regimes except Alberta, which imposes no sales tax.

5. ALLOWANCES

5.1 DEPRECIATION (CAPITAL COST ALLOWANCE)

Most tangible property, with the exception of land, acquired for the purpose of earning income is depreciable for tax purposes.

For most classes of assets, capital cost allowance is calculated on the diminishing balance basis. In addition, generally one-half of the normal allowance may be claimed in the year of acquisition and if the taxation year is less than 12 months, the capital cost allowance must be prorated by the number of days in the taxation year divided by 365 days.

Buildings are depreciable on an annual rate of 4%; general machinery and equipment – 20%; machinery and equipment used in manufacturing and processing – 30%; computer software – 100%.

Three-quarters of the cost of acquired intangible property, such as rights, franchises and licenses of an indefinite duration may be amortized on a declining balance rate of 7% per annum.

5.2 LOSSES

Non-capital business losses may be carried forward for 20 years or carried back 3 years. Capital losses may only be used to offset capital gains realized in the current, future or three prior taxation years.

Capital losses expire upon a change of control of a corporation. Non-capital business losses can only survive a change of control if the new owners carry on the same or similar business.

6. EMPLOYMENT

6.1 SOCIAL SECURITY CONTRIBUTIONS

Individuals employed in Canada and their employers must each make government pension plan contributions. In addition, employment insurance premiums must be paid.

In 2007, the maximum amount of earnings subject to pension plan contributions is \$43,700 with a basic exemption of \$3,500. At a rate of 4.95%, this results in a maximum annual contribution for both employees and employers of \$1,989.90. Self-employed individuals must pay both portions for a maximum annual contribution of \$3,979.80.

In 2007, an employee's required employment insurance premiums are calculated at a rate of 1.80% on the maximum amount of insurable annual earnings of \$40,000 (maximum annual premium of \$720.00). Employers contribute 1.4 times the employee's premiums up to a maximum of \$1,008.00.

6.2 EMPLOYMENT OF FOREIGN PERSONNEL

Foreign personnel must have a valid work permit to work in Canada. An employer wishing to employ foreign personnel must apply to Human Resources and Skills Development Canada ("HRSDC") who will examine factors such as whether a Canadian could fill the job and whether the hiring of the foreign worker will create job opportunities or benefits for Canadians. (Some types of work are exempt from this process.) After HRSDC confirms that a foreign national may fill the job, application for a work permit may be made.

6.3 MEDICAL

Canada has a government sponsored health care system which is administered by the various provincial governments. Nominal insurance premiums may be charged after which access to many types of health care

(dental care and prescription drugs being notable exceptions) is free on a first-come-first-served basis. Many employers offer extended health insurance benefits to offset costs not covered by the various provincial health care plans.

6.4 PAY AS YOU EARN

Employers are obliged to withhold tax from all employees. Depending on the dollar value of average monthly remittances, employers may be required to remit source deductions monthly, twice monthly or four times a month.

7. WITHHOLDING TAXES ON PAYMENTS TO NON-RESIDENTS

Where no treaty is in force, Canada generally imposes a 25% withholding tax rate. This rate may be reduced where a treaty exists with the country where the recipient is resident and may vary according to the nature of the payment. For instance dividends, interest and royalties may have different treaty withholding rates.

This document is provided 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.

Prepared by: P. Vivian
KNV, Chartered Accountants
White Rock, BC Canada
Tel: 604-536-7614
email: pvivian@knv.com