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DOING BUSINESS IN CANADA

FORM OF BUSINESS ORGANIZATION

Branch

Business can be carried on in Canada as a branch of a foreign corporation. The corporation must register in each province in which it does business by obtaining an extra-provincial licence. A local agent for service must be appointed and the name must not conflict with any currently registered name, but otherwise, the process is relatively straightforward. Any liability of the branch will be the responsibility of the corporation.

Subsidiary

A Canadian subsidiary can be formed under any of the provincial statutes or under the federal act. There are differences between the various statutes and they should be reviewed to select the appropriate jurisdiction. Although Canadian corporations generally do not have to obtain an extra-provincial registration in each jurisdiction, they do have to register in each province in which they carry on business.

Each of the corporate statutes contains residency requirements for the board of directors. At least 25% of the directors of a federal corporation must be resident Canadians. The Ontario statute requires that a majority of directors (one out of two) be resident Canadians.

Partnership or Joint Venture

If the tax result is more favourable, business can be carried on in partnership or a joint venture. Partnerships are generally formed for the sharing of profits of a long-term business relationship. Joint ventures are generally used for one off transactions; typically real estate investments. A partnership is registered under the relevant provincial statute and often involve detailed agreements that set out the nature of the relationship between the partners and rules governing the sale of their interest or dissolution of the partnership. Most provincial statutes allow for limited partnerships that allow for the limitation of exposure by the partners to claims against the partnership, provided the limited partners do not take part in the management of the partnership.

TAXATION OF BUSINESS ORGANIZATIONS

Liability for tax

“Persons”, including individuals, corporations and other entities are liable for Canadian income tax if they are resident in Canada. Non-residents are liable for Canadian income tax if they carry on business through a permanent establishment in Canada. Provincial income taxes parallel this structure. Tax treaties will establish rates of withholding tax payable on dividends, interest and other forms of payments and will also provide tie breaking rules that govern which jurisdiction may tax certain income.

Taxation of a Branch

A branch that becomes subject to Canadian income tax must pay “branch profits tax” on its taxable income generated in Canada. Typically, non-resident corporations will favour a branch if start-up losses are anticipated. Income is calculated on Canadian tax rules, which may be different than the rules that apply in the local jurisdiction of the corporation. It is generally possible to transfer the branch operation to a Canadian subsidiary in the future on a tax deferred basis.

Taxation of Corporations

A subsidiary is taxed as a separate entity. Consolidation of corporate entities is not allowed under Canadian tax laws. A Canadian controlled private corporation (one that is not controlled, either directly or indirectly by non-residents or by a public corporation) is granted favorable tax treatment on the first \$400,000 of taxable income. Transfer pricing rules provide that related organizations must use inter-corporate pricing that is equivalent to pricing that arm’s length entities would use.

Income paid by a subsidiary to its foreign parent is subject to withholding tax at rates set out in the relevant tax treaty. In addition, Canada disallows a deduction for interest paid to a non-arm’s length entity, if the debt/equity ratio exceeds 2:1.

Capital Tax

Most provinces levy a capital tax of between 0.3% and 0.6% of paid-up capital (share capital plus retained earnings and contributed surplus) allocated to the permanent establishment of the corporation in that province.

The federal government levies a “large corporation tax” of 0.2% of capital in excess of \$50 million.

Goods and Services Tax

GST is payable on goods and services provided in Canada at the rate of 5%. Imported goods are taxable at the same rate. Business entities that are registered for GST are generally treated as a flow through so that an input tax credit is allowed as a credit against tax payable. Certain goods and services such as financial services and instruments and most health care services are exempt from GST.

Non-resident businesses must comply with the GST legislation if are engaged in a commercial activity in Canada or if they have a permanent establishment (branch) in Canada.

Provincial Sales Taxes

A business may be required to collect and remit provincial sales taxes. Different provinces have different rates and rules regarding sales taxes. In some provinces, sales taxes have been harmonized with federal GST.

GENERAL

This is a general summary of some of the considerations in establishing a business in Canada. Please contact us to provide more specific advice.