Canada

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1.0 OVERVIEW

Canada imposes corporate and personal income tax on its residents (including Canadian subsidiaries of foreign entities) in respect of income and capital gains earned anywhere in the world. Federal income tax is imposed under the Income Tax Act (ITA). Non-residents who carry on business in Canada, are employed in Canada or sell certain types of properties are also subject to Canadian income tax.

All of the provinces of Canada impose provincial income taxes on corporations and individuals residing or carrying on business within the province. Generally, taxable income for provincial income tax purposes is computed in the same manner as under the ITA. However, each of the provinces provides for certain modifications in the calculation of tax liability, including the provision of specified tax incentives.

The ITA also imposes a 25% withholding tax on non-residents who receive dividends, certain interest payments, rents, royalties or management fees from Canada. The Canadian payer of any such amounts is liable for withholding and remitting this tax on behalf of the non-resident recipient. Canada has an extensive double-tax treaty network which will reduce or eliminate the 25% withholding tax rate on such types of income. For example, the Canada-United States Tax Convention of 1980 eliminates withholding tax on most cross-border interest payments and reduces the rate on dividends to 15% or 5% depending on the circumstances.

Canada is a signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) and has agreed to adopt the minimum standards (principal purpose test and dispute resolution) as well as certain optional provisions. The ratification process has not yet been completed.

In addition to income tax, a consumption tax is levied at each of the federal and provincial levels, except in Alberta where no consumption tax is imposed by the province. Moreover, the governments of the Canadian territories (Northwest Territories, Nunavut and Yukon) do not levy a consumption tax. Some provinces have combined their respective provincial sales taxes with the federal tax to create a harmonized sales tax that is administered centrally by the government of Canada. In addition, most provinces levy a tax when land is transferred.

2.0 LEGAL SYSTEM

Canada and its provinces and territories (other than the province of Quebec) operate under a common law legal system. Quebec utilizes a civil law system for private law that is based on the Civil Code of Quebec. While the ability to make certain laws are in the exclusive domain of the federal government, others are within the scope of provincial authority. In some cases, the federal and provincial governments exercise concurrent jurisdiction. For example, while the federal government has the authority to regulate trade and commerce, the provinces have the right to regulate (i) the incorporation of companies with provincial objects and (ii) property and civil rights in the province.

3.0 TAXATION AUTHORITIES

The federal tax system in Canada is administered by the Canada Revenue Agency (CRA). The CRA also administers provincial income tax and/or sales tax for a number of provinces. For example, in Ontario, the CRA collects both provincial income tax and sales tax, while in British Columbia only income tax is administered by the CRA on behalf of the provincial government. In Quebec, Revenu Québec is responsible for collecting provincial income tax as well as both the federal and Quebec sales tax.

4.0 BUSINESS VEHICLES

A non-resident may either establish a Canadian business vehicle to carry on business in Canada or operate directly through a foreign entity (with or without a Canadian permanent establishment). Canadian business vehicles are corporations (limited liability or unlimited liability) and partnerships (general or limited). While it is also possible to use a trust to carry on business in Canada, due to a number of complexities a trust is rarely utilized for these purposes. However, it is common for trusts (including family trusts and mutual fund trusts) to hold investments, such as shares of corporations.

4.1 Partnerships

A partnership (whether general or limited) is generally treated as fiscally transparent for Canadian income tax purposes. While certain partnerships are required to file annual information returns, it is the partners of the partnership, rather than the partnership itself, that are subject to income tax under the ITA. However, the ability of a limited partner to deduct losses incurred by a limited partnership may be restricted to the extent the losses exceed the limited partner's "at-risk amount." A partnership will be considered to be a non-resident of Canada for withholding purposes unless it qualifies as a "Canadian partnership" under the ITA. To be a Canadian partnership, all of the partners of the Canadian partnership must be Canadian residents. There is no requirement for the partnership to be formed under Canadian law in order for it to qualify as a Canadian partnership. Conversely, a partnership formed under Canadian law that has one or more non-resident partners (directly or indirectly through other partnerships) will not qualify as a Canadian partnership.

4.2 Corporations

Corporations where shareholders are not liable for the corporation's debts can be incorporated quickly (often same day) either federally or in any of the provinces or territories. The jurisdiction of incorporation does not impact on the corporation's income tax liability. Often the choice of jurisdiction is based on the residence requirements for corporate directors. For example, corporations incorporated under federal, Ontario or Alberta law require that at least 25% of the directors of the corporation be Canadian residents, while no such requirement exists for British Columbia, Quebec, New Brunswick or Nova Scotia corporations.

The establishment of a corporation does not require any capital to have been received by the corporation. However, in order to issue shares, a nominal amount of capital must be received by the corporation. Most provinces do not allow a person to issue a promissory note as payment for shares of a company.

4.3 Unlimited Liability Corporations

The provinces of Nova Scotia, Alberta and British Columbia permit the incorporation of an unlimited liability company (ULC). As with other corporations, a ULC can be incorporated

quickly. However, unlike a regular corporation, a ULC does not provide shareholder protection from the liabilities of the company in the event that the company is insolvent or wound up. Therefore the direct shareholder of a ULC is generally a liability-blocking entity (such as a holding company with no assets other than the shares of the ULC).

While a ULC does not provide any Canadian tax advantages, it does qualify to be treated as fiscally transparent for United States tax purposes, thereby providing certain tax advantages to US shareholders. Use of a ULC does create certain complexities under the Canada-United States Tax Convention.

4.4 Foreign corporation (with or without a Canadian branch)

A foreign corporation that carries on business in Canada is subject to tax under the ITA in respect of such income. The determination of whether a corporation is carrying on business is Canada is generally made in accordance with common law principles. In addition, the ITA deems certain activities conducted by a non-resident to constitute carrying on business in Canada.

Where the foreign corporation is resident in a country with which Canada has a double-tax treaty pursuant to which the corporation may claim treaty benefits, the corporation will generally be exempt from Canadian taxation on its business profits except to the extent that the profits were earned through a permanent establishment situated in Canada.

A corporation that operates through a Canadian permanent establishment (such as a branch) will be subject to Canadian income tax as well as branch tax (see details below).

The ITA imposes a withholding tax of 15% on all payments made to non-residents in respect of services rendered in Canada. For services rendered in Quebec, an additional 9% provincial withholding tax applies. These withholding taxes also apply to payments made to a Canadian branch of a foreign corporation. While the amounts withheld may be refunded in whole, or in part, upon the filing of a non-resident income tax return, the withholding obligation imposes a cash flow burden on the non-resident and an administrative burden on its customers. Accordingly, it is generally impractical for a foreign corporation to operate a Canadian services business either directly or through a Canadian branch. Non-residents planning to operate a services business in Canada will generally incorporate a Canadian subsidiary.

5.0 FINANCING A CORPORATE SUBSIDIARY

5.1 Equity financing

5.1.1 Contributions for shares

Where an equity investment is made into a Canadian corporation in exchange for shares, the amount of the investment is added to the corporation's "stated capital" account. Subject to certain adjustments, a corporation's stated capital is generally the same as its paid-up capital for tax purposes..

5.1.2 Contributions without taking additional shares

Where an equity contribution is made by a shareholder to a federally incorporated company and to most provincially incorporated companies without the issuance the issuance of additional shares, the amount is added to the "contributed surplus" account of the corporation and not stated capital. However, in certain circumstances, the contributed surplus can be transferred to stated capital without incurring negative tax consequences.

5.1.3 Distributions of paid-up capital

A corporation (other than a public corporation) is permitted to make distributions of its paid-up capital to a non-resident shareholder without incurring Canadian withholding tax. In contrast, the ITA does not permit the tax-free distribution of contributed surplus that has not been converted into stated capital. While ordinary course reductions of capital made by a public corporation are deemed to be dividends, a public corporation may return capital on a redemption, acquisition or cancellation of any of its shares or in the course of a winding-up, discontinuance or reorganization of its business.

5.2 Debt financing

5.2.1 Withholding tax implications

Canadian corporations are permitted to borrow funds from related or third parties without tax implications. Furthermore, there are no Canadian tax implications on the repayment of the principal amount of such debt. Interest payments (other than participating interest) made by a Canadian resident corporation to a non¬resident with which it deals at arm's length are generally exempt from withholding tax. However, the ITA imposes a withholding tax of 25% on interest payments made to non– arm's length parties. As previously mentioned, the withholding tax rate can be reduced or eliminated under an applicable double-tax treaty. For example, the Canada-United States Tax Convention eliminates withholding tax on cross-border, non–arm's length interest payments (other than participating interest).

5.2.2 Thin capitalization

If the Canadian subsidiary is to be financed with debt, it may be subject to the thin capitalization rules contained in the ITA. These rules restrict the deductibility of interest paid or payable by a corporation resident in Canada to certain non-resident shareholders where the ratio of interest-bearing debt to equity exceeds 1.5 to 1. To the extent that debt exceeds this ratio, there will be a proportionate denial of the interest deduction and any payment of interest that is subject to restriction under these rules is deemed to be a payment of a dividend for the purpose of withholding tax obligations.

5.3 Stamp tax

Canada does not impose a stamp tax in respect of debt or equity financing.

6.0 CORPORATE INCOME TAX

6.1 Income tax rate

For 2018, the combined federal and provincial corporate tax rate on general active business income ranges between 26% and 31%, depending on the province or territory.

A corporation that qualifies as a "Canadian-controlled private corporation" is entitled to certain tax incentives and is also subject to additional refundable taxes on investment income.

6.2 Capital gains

A Canadian resident corporation, including a Canadian subsidiary of a foreign corporation must include 50% of all capital gains (referred to as "taxable capital gains") in its taxable income. Taxable capital gains are taxed in the same manner as ordinary income; 50% of capital losses (referred to as "allowable capital losses") can be used to offset taxable capital gains in the year. To the extent that allowable capital losses exceed taxable capital gains in a year, the excess may generally be carried back three years or forward indefinitely to be applied against taxable capital gains in those other years. The ITA contains restrictions on the use of losses by a corporation following an acquisition of control of the corporation.

A non-resident is only taxable on gains arising from the disposition of "taxable Canadian property," other than gains exempted under an applicable double-tax treaty. Taxable Canadian property includes all of the following:

i. Real or immovable property situated in Canada

ii. Property (including goodwill) used or held by a taxpayer in a business carried in Canada

iii. Inventory forming part of a business carried in Canada

iv. Shares of a corporation (other than shares listed on a designated stock exchange), partnership units or interests in a trust (other than a mutual fund trust) if, at any time during the 60-month period preceding the disposition, they derived more than 50% of their fair market value from Canadian real property, Canadian resource property or timber resource property (including options, interests or rights therein).

For shares listed on a designated stock exchange and mutual fund trusts, in addition to the foregoing test, the non-resident (together with certain non–arm's length parties) must own 25% or more of the issued shares of any class of the corporation or units of the mutual fund trust, as the case may be. Other rules apply to non-resident insurance companies.

6.3 Branch tax

The ITA imposes a tax equal to 25% of Canadian after-tax profits earned by a branch of a non-resident corporation that are not reinvested in Canada. The branch tax is roughly equivalent to the withholding tax that would apply on dividends paid by a Canadian subsidiary to a foreign parent. The branch tax may be reduced or eliminated under an applicable double-tax treaty. For example, under the Canada-United States Tax Convention, the first CA$500,000 of after-tax profits not reinvested in Canada is exempt from branch tax and the tax rate is reduced to 5%.

6.4 Computation of taxable income

6.4.1 Taxable base

A taxpayer is subject to tax on its profits from carrying on its business. Profit is generally considered to be its revenues less its deductible expenditures.

6.4.2 Deductions

A taxpayer is generally permitted to deduct its current expenses in computing business income. As a general rule, capital expenses are not deductible. However, the ITA provides for specific exceptions to that rule. This includes interest incurred for the purpose of earning income from a business or property (subject to the thin capitalization rules discussed above) and depreciation expense (referred to as capital cost allowance).

6.5 Income tax reporting

Canadian resident corporations and non-resident corporations that carry on business in Canada or that dispose of taxable Canadian property are required to file an annual corporate income tax return. Corporate tax returns must be filed within six months of the fiscal year-end of the corporation in order to avoid late filing penalties. Installment payments are required in respect of current-year taxes, and interest on any unpaid tax balance will start accruing two months after the year-end of the corporation.

A provincial tax return must also be filed for each province in which the corporation has a permanent establishment. In all provinces other than Alberta and Quebec, the provincial tax return forms part of the federal return.

7.0 CROSS-BORDER PAYMENTS

7.1 Transfer pricing

Canada's transfer pricing regime generally conforms to the arm's length principle of the Organisation for Economic Co-operation and Development (OECD). The ITA permits the CRA to impose a transfer pricing adjustment in respect of a transaction that is not made on arm's length terms or conditions. A transfer pricing adjustment can also be made in respect of a transaction that would not have been entered into at all by arm's length parties if it can reasonably be considered that the transaction was not entered into primarily for non-tax purposes. Canadian taxpayers are also required to maintain contemporaneous documentation in respect of transactions subject to the transfer pricing rules.

7.2 Withholding tax on passive income

Payments made by a resident of Canada to a non-resident (including a partnership that does not qualify as a "Canadian partnership") in respect of certain types of interest payments, rents, royalties, dividends, management or administration fees and trust income distributions are subject to tax under Part XIII of the ITA at the rate of 25%. However, the rate may be reduced under an applicable double-tax treaty.

7.3 Withholding tax on services fees

Where any person make a payment to a non-resident of Canada in respect of services performed in Canada, the payer must deduct and withhold 15% of the gross payment on account of federal income tax. Where the services are performed in Quebec, the payer must deduct an additional 9% on account of provincial income tax. The payment is considered to be made on account of income taxes owing by the recipient of the payment and may be recovered in whole or in part upon the filing of an income tax return. In particular, a non-resident may be able to claim an exemption from Canadian income tax on such business profits if the non-resident is a resident of a country with which Canada has entered into a double-tax treaty and does not maintain a permanent establishment in Canada.

8.0 PAYROLL TAXES

8.1 Canada pension plan

Employers paying remuneration to employees are liable to make contributions under the Canada Pension Plan (CPP). The employer's contribution on account of CPP premiums is capped at a maximum of CA$2,593.80 per employee for 2018. Employees are also liable to make matching CPP contributions. The employer is responsible for withholding the employees' CPP contributions at source and remitting this amount to the CRA.

8.2 Employment insurance

Employers are also required to pay premiums under the federal Employment Insurance Act. The employer's contribution on account of employment insurance is capped at a maximum of CA$1,201.51 per employee for 2018. Employees are also liable to make employment insurance contributions to a maximum of CA$858.22 in 2018. The employer is responsible for withholding the employees' employment insurance contributions at source and remitting this amount to the CRA.

8.3 Provincial payroll taxes

Some provinces also impose various payroll taxes. For example, Quebec requires contributions be made for the Quebec Pension Plan and for Quebec employment insurance. Ontario imposes an employer health tax on total remuneration paid by an employer in a year exceeding CA$490,000.

9.0 INDIRECT TAXES

9.1 Goods and services tax

The federal goods and services tax (GST) is a value-added tax imposed on the final domestic consumption of most goods and services supplied in Canada. Specific rules with respect to the place of supply exist to determine whether a supply is deemed to be made in Canada.

The current GST rate is 5%, but GST is not imposed on all supplies. The rate for "zero-rated" supplies (e.g., exported goods and services, prescription drugs, medical devices and basic groceries) is zero percent and the "exempt" supplies (e.g., health care services, educational services and most financial services) are not subject to the GST at all.

Entities and individuals (including non-residents) that are involved in making taxable supplies in Canada in the course of a commercial activity are required to register for and charge, collect and remit GST on such supplies. As the GST is intended to be a consumption tax, which is ultimately borne by the final consumer, each registrant that makes taxable supplies (including zero-rated supplies), is generally entitled to recover any GST paid on its inputs by means of the input tax credit (ITC) mechanism.

9.2 Harmonized sales tax

The harmonized sales tax (HST) combines the 5% GST with a provincial sales tax component. The HST is federally administrated and has the same basic operating rules as the GST, with certain exceptions. However, each participating province to the HST regime (referred to as "participating provinces") has the ability to decrease or increase the provincial component of the tax. The current list of participating provinces includes Ontario, Nova Scotia, Newfoundland and Labrador, New Brunswick and Prince Edward Island.

9.3 Quebec sales tax

Quebec sales tax (QST), like the GST, is a value-added tax. Most of the concepts existing under the GST legislation have been adopted by the government of Quebec with respect to the QST. The QST rate is currently 9.975% on both goods and services supplied in Quebec.

9.4 Provincial sales tax

Provincial sales tax (PST), which is a single-incidence sales tax imposed on end-users or consumers of tangible personal property as well as certain services in the province, is imposed in Saskatchewan (6%), Manitoba (7% as of July 1, 2019) and British Columbia (7%). Relief from these taxes is available in certain circumstances.

9.5 Land transfer tax

A transfer tax is payable in most provinces on any acquisition of real property. In certain provinces, such as Ontario, the transfer tax is payable regardless of whether the acquisition is in respect of a legal or a beneficial interest in real property, subject to specified exceptions. The city of Toronto also imposes a land transfer tax. While there is no such tax in Alberta, Saskatchewan, Newfoundland and Labrador, or any of the territories, each of these jurisdictions does levy some form of registration fee on the transfer of real property.