Doing Business In Canada

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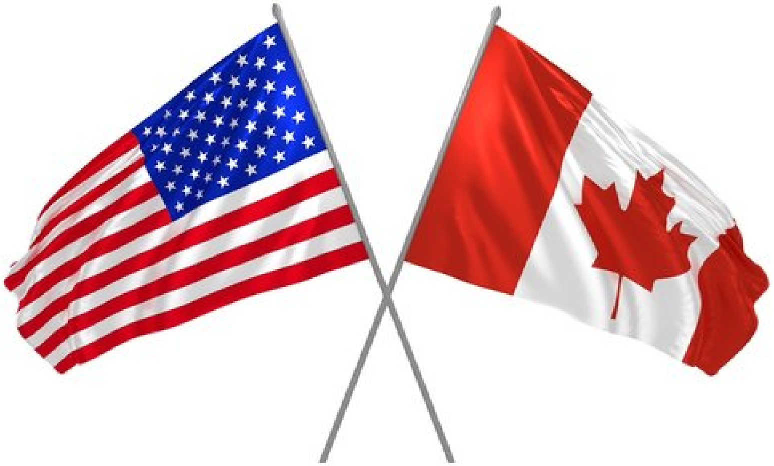

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Doing Business in Canada

- Introduction
- Why Canada?
- Regulatory Considerations
  - System of Gov't – Federation
  - Legal System – Common Law & Civil Code (Quebec)
  - Workplace & Employment Law
  - Accounting & Financial Reporting
- Forms of Business Entities
- Expansion of Business into Canada
- Structural Planning Considerations
- Taxation in Canada
  - Income Tax, Sales Tax, Payroll Tax, Non-Resident tax

Introduction

- Historical Background
  - Gained independence from colonial England through gradual legislative progress
  - Constitution Act – 1867
- National Languages
  - English & French
- 10 Provinces & 3 Territories
  - Jurisdiction over natural res, education, social welfare and health care
  - Authority over direct taxation

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Major Financial Centers

- Toronto, Vancouver, and Montreal

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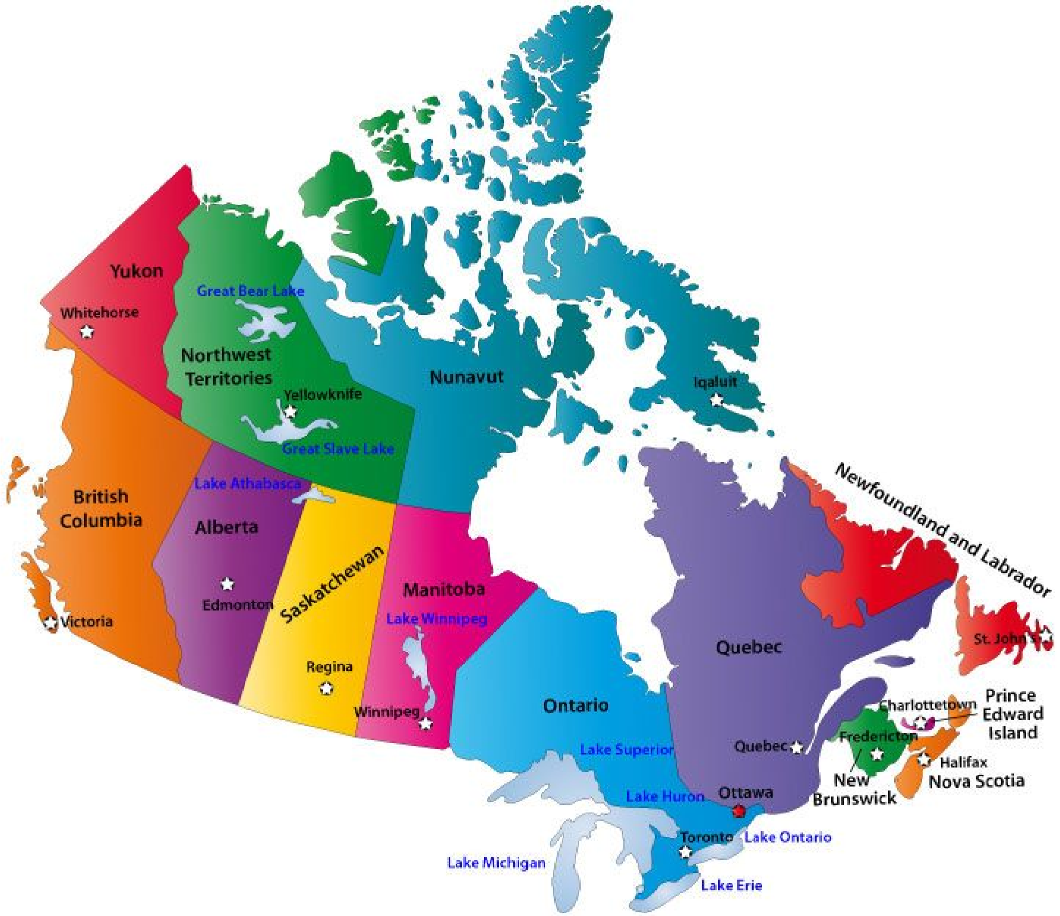
Why Canada?

- Growing diverse population
- Well educated/highly skilled work force
- Pop. (2020) = 37.7M
- Industries:
  - Natural resources/Energy
  - Agriculture
  - Technology and R&D
  - Financial services/Banking
  - Manufacturing
- 5,525 mi. (8,900 km) total land borders shared with U.S.
- Progressive international trade policies/agreements (USMCA)



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Regulatory Considerations

- Parliamentary System of Gov't – Federation
  - Federal Legislative Body - Members of Parliament ("MP's") elected to House of Commons (appointed/unelected Senate)
  - Leader of Party with most MP's = Prime Minister
  - Provincial – Legislature of elected MLA's – Leader = Premier
- Legal System
  - English Common Law (all of Canada except Quebec)
    - Court judgements set precedent/law
    - Statutes/Regulations/By-Laws
  - Civil Code (Quebec only)
    - Based on Napoleonic Code
    - Written rules that govern
- *Constitution Act*
  - Amended in 1982 – *The Charter of Rights & Freedoms*
- *Competition Act*
  - Federal legislation governing CDN competition laws

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Regulatory Considerations

- Workplace & Employment Law
  - Legislated Provincially
    - Minimum Wage laws
    - Vacation Pay/OT/Holidays/Pay Equity/Termination laws
    - Human Rights/Parental Rights
    - Worker's Compensation/Workplace Safety & Insurance

- Accounting & Financial Reporting (CDN GAAP)
  - IFRS – Int'l Financial Reporting Standards
  - ASPE – Accounting Standards for Private Enterprises
    - Review Engagements – assurance below full F/S audit

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Forms of Business Entities

- Individual/Unincorporated Sole Proprietor
- Corporations – Federal & Provincial Charters
  - Limited Liability Corporation (“Inc. or Ltd.”)
  - Unlimited Liability Corporation (“ULC”) (Only B.C., Alberta & N.S.)
    - Disregarded Entity for U.S. Tax Purposes
- Partnerships
  - Limited Partnership – limited liability
  - General Partnership – unlimited liability
- Joint Venture
- Trust
- Co-operatives/Not-for-profit Associations
- Branch of Non-resident Corporation or Partnership
  - Extra-Provincial License/Registration

Expansion of Business into Canada

- <u>Start-Up/New Expansion</u>

  - Non-resident Permanent Establishment ("PE") in Canada?
    - CDN branch/office/place of business/location of employees
    - Only profits of CDN branch PE subject to CDN income tax

  - Branch vs Subsidiary – Incorporation of CDN Entity?
    - Non-resident operating through branch of U.S. parent corp; OR
    - Incorporate separate CDN subsidiary – CDN resident for CDN tax

  - Branch – consider extra-provincial corp registration if operating PE through U.S. entity.

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Expansion of Business into Canada

- Start-Up/New Expansion (cont'd)
  - CDN Bank Account
    - Reduce foreign exchange exposure/timing conversion
    - Streamline collections/payment options for CDN customers
    - Simplify recordkeeping/paper-trail/electronic transfers
  - Register with Canada Revenue Agency ("CRA")
    - Federal Business Number
      - Corp Income Tax/Sales Tax (GST/HST)/Payroll Tax/Imported Goods
  - Register with relevant Provincial Gov'ts
    - Provincial Corp Income Tax – Alberta & Quebec filed separate
    - Provincial Sales Tax – varies by province
    - Provincial Employer Health Tax – varies by province w/ payroll

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Expansion of Business into Canada

- <u>Merger/Acquisition – Existing CDN Business</u>
  - Target existing CDN business to merge/acquire
    - Assets vs Shares – tax results can vary considerably
      - Purchaser typically favours asset deal for liability issues and tax basis bumps
      - Vendor typically favours share deal for simplicity/tax benefits (lower rates)
  - CDN Legal Advice on Purchase
    - Incorporating new CDN entities/acquisition corp?
    - Potential differences in property & secured debt; employment laws
  - Due Diligence – financial/tax/legal

Expansion of Business into Canada

- <u>Merger/Acquisition – Existing CDN Business (cont'd)</u>

  - Planning – Structure
    - Acquisition Corp? Maximize Paid-Up Capital ("PUC") on Shares
    - Blocker Corp? Tax Treaty Eligibility

  - Tax Elections
    - Bump in cost basis?
    - Sales tax exemptions?

  - Change of Control for Tax Purposes
    - Deemed tax year-end of CDN target corp immediately before
    - Change in status (CCPC)
    - Tax loss cfwd restrictions/expiry

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Structural Planning Considerations

- <u>Structural Considerations</u>
  - Acquisition of CDN target business
    - Use of CDN acquisition corp for financing target/tax efficiency?
      - Capitalize CDN acq corp and maximize PUC for tax-free distribution
  - How is CDN acquisition to be financed?
    - If using related debt, consider thin cap interest deduction rules
    - Limited to 1.5:1 debt-equity thin cap ratio
    - Denied interest deduction becomes deemed dividend subject to non-resident withholding tax
  - U.S. LLC recognized as ordinary taxable corporation for Canadian tax purposes, despite pass-through treatment for U.S. tax
    - Can be problematic achieving Treaty Protection in some cases

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Structural Planning Considerations

- Structural Considerations (cont'd)
  - ULC Corporations – B.C., Alberta, Nova Scotia
    - Popular choice with U.S. in-bound investment due to disregarded entity/flow-thru nature for U.S. tax
      - Effective strategy for U.S. C-corps, S-corps or partnerships
    - Taxed as regular CDN corp for CDN tax – FTC for U.S. parent taxes
    - Two-step process needed for Tax Treaty WHT rate on dividends
    - **CAUTION** – do not hold ULC directly with U.S. LLC parent
      - Potential double taxation without Tax Treaty relief
      - Consider blocker C-corp to hold ULC shares for U.S. LLC

Taxation In Canada

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General Overview

- Three main CDN taxes to consider when a client is doing business in Canada:
  - Income taxes
  - Sales tax
  - Payroll

- Canada-US Tax Treaty often provides relief from CDN income taxes and payroll, but often still require a tax filing to get the exemption

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Taxation of Different Structures

- If using a US entity to carry on business in Canada, the Treaty can provide relief from CDN income taxes if there is *no permanent establishment* in Canada
  - US entity would still be required to file a treaty-based return to claim treaty relief; late-filing penalties ($2,500) can apply if not filed
  - If Reg. 105 withholding taxes were paid, it can be refunded through the tax return filing

- If the US entity *has a permanent establishment* in Canada (i.e. branch), it will be subject to CDN income taxes on its CDN-based profits.
  - Branch tax applies on after-tax CDN profits of non-resident corporations that are not reinvested in Canada; branch tax rate is reduced to 5% under Treaty (with the first $500,000 of cumulative branch profits being exempt)

- If there is a Canadian subsidiary conducting the CDN operations, it will be subject to CDN income taxes on all of its profits.

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Income Tax Rates and Filings

- Combined federal and provincial rates: 23% - 31% for non-Canadian owned corporations
  - Branch tax can apply to US entities operating as a branch in Canada
- All provinces except Alberta and Quebec synchronize income tax filings federally with Canada Revenue Agency (“CRA”)
  - i.e. AB and QC require their own income tax filings
- Foreign reporting obligations can apply for Canadian entity if they have transactions with non-arm’s length non-residents

Income Tax Deadlines

- Income tax returns required annually for all structure types
- Filing due dates:
  - T2 (Corporation) – 6 months after year-end
  - T5013 (Partnership) – 3 or 5 months (shorter if any individual partners)
  - T1 (Personal) – April 30 or June 15
  - T3 (Trust) – 90 days after year-end
  - Corporate tax payments – generally 2 or 3 months after year-end to avoid interest charges
- Unlike the US, no filing extensions available in Canada (with 2020 year being exception due to COVID-19)

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Reg. 105 Withholding Tax

- Regulation 105 requires a 15% CDN withholding tax to be remitted on services rendered in Canada by a non-resident
  - E.g. US engineer travels to Vancouver to provide engineering services on-site; CDN customer obligated to withhold taxes on engineering fees

- Withholding obligation is often missed as the CDN customer may not be aware they are dealing with a US vendor or may not be aware of the cross-border tax issue
  - Withholding obligation resides with CDN customer

- T4A-NR filing required by CDN customer to report amounts

- Reg. 105 waiver application can be filed with CRA to avoid the upfront withholding tax if Treaty exemption applies; needs to be filed and approved prior to rendering services

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Repatriation of CDN Profits

- CDN withholding tax applies on any dividends paid by a CDN subsidiary entity to its US parent entity

- Domestic tax rate of 25% on dividends but reduced by Treaty:
    - 5% - if the beneficial owner is a US company which owns at least 10% of voting stock;
    - 15% - in all other cases.

- NR4 filing required by CDN subsidiary to report dividend amounts

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Rental Properties in Canada

- Seeing more US residents with CDN real estate
- CDN withholding tax applies on any rental income received from CDN-based real estate
- Domestic tax rate of 25% applies on the *gross* rents; can be reduced by filing NR6 form with CRA which calculates the 25% withholding tax on a net basis
- Tax return can be filed to deduct rental expenses against income, and pay tax on net rental income. Often more favorable tax rate for individuals.
- Additional CDN tax compliance and withholdings are required when CDN real estate is sold (similar to US FIRPTA rules); short time frame for compliance requirements

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Sales Tax

- GST – 5% (Federal)
  - Similar to a VAT
  - Allows registrants to recover the GST paid; typically only end customer is subject to the GST
- PST – Between 6-7% (Provincial)
  - Provinces (incl. Quebec) have separate PST return filings
- Some provinces have combined the GST and PST rates to one blended rate: HST
- Reporting and payments required monthly, quarterly or annually depending on amount of sales

GST – “Carrying on a business in Canada”

- Generally, a US entity is only required to register for a GST/HST account if it is “carrying on business in Canada”. If it is not, no requirement to register or collect GST on its CDN sales

- Fact based test - generally looks at how much presence the US entity has in Canada (e.g. presence of office, employees, equipment in Canada)

- Relevant for GST and income tax purposes

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GST Registration

- If uncertain about GST obligations, it is often recommended to register for GST account and collect GST from CDN customers as a protective measure. Voluntary registration is permitted.

- CDN customers that are GST registrants can often recover the GST paid to the US entity and so the CDN customer may not even be out of pocket

- If client is shipping goods to Canada, they will often be subject to GST on importation. Being a GST registrant will allow the client to recover this GST rather than having to absorb this cost

- Generally, the obligation to collect and remit GST resides with the vendor

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Payroll Tax

- Required when employment services are physically performed in Canada by an individual
  - E.g. US employee moves to Vancouver and continues to be employed by US entity

- Treaty can provide relief from CDN payroll for US individuals working in Canada for short periods
  - Treaty relief: <183 day test or <$10k remuneration
  - Even if Treaty provides relief, waivers are required to obtain this relief. Reg. 102 waiver is done for *each* employee
  - CRA audits can occur if CDN payroll is ignored

- US employers can now apply for company-wide waiver to avoid doing individual waivers for each employee working in Canada

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CRA Audits and Non-Compliance

- US entities doing business in Canada can be subject to CRA audits due to non-compliance in income tax, GST or payroll
  - The treaty-based tax return *discloses* CDN revenues, payroll and subcontractor information, and this can often trigger an audit. Therefore, need to ensure *all* CDN taxes are considered
- CRA has Voluntary Disclosure Program to allow taxpayers to fix tax filings without being subject to penalties; partial relief available for interest