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DOING BUSINESS IN CANADA



COMPANY FORMATION IN CANADA

Canada is a common law jurisdiction, with the exception of Quebec which is a civil code jurisdiction. Common business structures in Canada are Partnerships and Corporations, with Corporations being the most popular form. In Canada, a corporation is a legal entity distinct from its shareholders. It can own property, carry on business, borrow, lend, sue or be sued. Generally, shareholders are not personally responsible for the liabilities of the corporation. Corporations offer limited liability, ease of transfer of assets and perpetual existence.

A corporation may be created under either federal or provincial law. The decision as to the jurisdiction of incorporation will depend on where the company plans to transact its business. In addition, particular local nuances in the provincial statutes may result in a foreign investor favoring certain jurisdictions.

In Canada, a corporation is composed of officers, directors and shareholders. The officers are responsible for the daily management of the corporation's affairs. The directors appoint the officers and the shareholders elect the directors. The board of directors is charged with oversight over the officers and management. There are certain liabilities attached to the office of director but insurance may be purchased to shield directors from such liability.

The federal statute requires that at least 25% of directors (or at least 1 director where there are fewer than 4) be resident in Canada. Provincial statutes have different residency requirements, some do not require any directors to be resident in Canada.

In Canada, income tax is levied by both the federal and provincial governments, and a variety of other taxes, including federal and provincial value added and sales taxes, are also imposed. A corporation incorporated outside Canada can be resident in Canada if its central management and control is located in Canada and there is no treaty provision deeming it to be resident where organized.

Canadian resident corporations are taxable on their worldwide income from every source. Income is classified as business income if a certain degree of commercial activity exists. Property income is derived from more passive sources, and may include interest, dividends, rents and royalties. There may be different tax rates on each source of income.

A Canadian-controlled private corporation (CCPC) receives preferential tax treatment, including reduced tax rates on a specified amount of its active business income. Special tax planning is required if a non-resident wishes to carry on business in Canada through a CCPC.

In addition, the Income Tax Act of Canada imposes withholding tax on the gross amount of certain payments made by a Canadian resident to a non-resident, including management fees, related party interest, dividends, rents and royalties. These rates may be reduced or eliminated pursuant to an applicable Tax Treaty.

The books and records of the corporation must be maintained at a Canadian place of business, or otherwise made available in the event of an audit by the Canada Revenue Agency.

PERMANENT ESTABLISHMENT IN CANADA: BRANCH OR SUBSIDIARY?

Whether a Canadian permanent establishment exists depends on the facts. Generally, a permanent establishment is a fixed place of business through which the business of the non-resident is wholly or partly carried on. Tax treaties generally provide that a permanent establishment includes a place of management, a branch, an office, a factory or a workshop. As such, depending on the nature of its activities, a branch operation in Canada will often have a permanent establishment in Canada.

A permanent establishment can arise in many other circumstances as well. For example, having a server that connects to the Internet may be considered to be tangible property having a physical location that may constitute a place of business of a non-resident person. Agents and employees in Canada may constitute a permanent establishment in some circumstances. Having sales representatives in Canada might not constitute having a permanent establishment, provided the representatives do not have or habitually exercise authority to conclude contracts in the name of the non-resident.

A subsidiary is a separate corporation established in Canada and taxed as a Canadian resident on its worldwide income. A branch refers to the Canadian business activity of a foreign corporation. A Canadian branch which is only subject to Canadian tax on certain Canadian source income.

A number of issues should be considered in choosing whether to operate as a branch or a subsidiary. If the Canadian operation is expected to incur significant losses in its early years of operation, the foreign entity may wish to carry on business in Canada directly through a branch, in order to deduct these losses for foreign tax purposes, if possible. However, because a branch office is not a legally distinct entity from the parent company, the parent will be exposed to the debts, liabilities and obligations of the Canadian operation. For this reason, many foreign investors prefer to carry on business in Canada through a Canadian subsidiary. The use of a Canadian subsidiary is also more convenient for administrative purposes.

A foreign corporation may conduct business within Canada through a branch operation after obtaining a license or registering in the province(s) where it carries on business. A corporation may be found to be carrying on business in Canada if it has a resident agent, representative, warehouse, office or place where it carries on its business in a province or if it holds an interest in real property located in a province other than by way of security.

When setting up a subsidiary corporation, care must be taken to ensure proper capitalisation to avoid the tax effect of Canada's thin-capitalisation rules. As well, attention must be paid to ensure the international corporate structure does not offend other tax legislation designed to avoid erosion of the Canadian tax base.

The two important concepts on which Canada's tax laws are based are residency and source. In Canada, income earned by Canadian residents and income earned by non-residents sourced in Canada are subject to Canadian income tax. Under the Income Tax Act, Canadian residents are taxed on their world-wide income, whereas non-residents are taxed on Canadian source income which generally includes income that arises from employment in Canada, a business carried on in Canada, or the disposition of "taxable Canadian property". Generally, however, Canada's tax treaties provide that a corporation's business profits will only be subject to Canadian income tax to the extent that they are attributable to a Canadian permanent establishment. Furthermore, non-residents may also be subject to Canadian withholding tax on certain types of passive income, including interest, dividends, rents, and royalties paid to them.

In addition to Canadian federal and provincial income tax, a non-resident corporation carrying on business in Canada through a Canadian branch operation is subject to a branch tax (to replace dividend withholding taxes

that would be paid by a subsidiary on repatriation of earnings). Where the rate of withholding tax on dividends is reduced by tax treaty, the rate of the branch tax is often reduced to the same rate.

The ITA generally provides that branch tax is levied on the after-tax Canadian earnings of the business carried on in Canada less any amounts that are reinvested in the Canadian business. A tax treaty may modify the method of calculating the earnings for branch tax purposes. In addition, some tax treaties may provide for an exemption on the first \$500,000 of a non-resident corporation's income from branch tax.

Whether operating through a branch or a subsidiary, the business is required to maintain books and records in Canada and to file corporate tax returns within six months of the fiscal year end. The balance of tax, if any, is due to be paid 2 months after the fiscal year end. The corporate tax rate is the same for a branch as for a foreign-controlled corporation.

Non-resident corporations exempt from tax in Canada, under treaty, must file a corporate tax return claiming the treaty exemption within six months of their year-end, or will be subject to penalties.



HOW TO HIRE MY FIRST EMPLOYEE IN CANADA

Employment in Canada is a heavily regulated area, governed by either federal or provincial legislation. The majority of employers are covered by provincial legislation, with the exception of “federal works or undertakings,” which include businesses involved in banking, shipping, railways, pipelines, airlines and airports, inter-provincial transportation, broadcasting and telecommunications.

The types of employment-related legislation with which employers operating in Canada should be familiar include: employment standards legislation; labour relations legislation; human rights legislation; occupational health and safety legislation; federal and provincial privacy legislation; and employment benefits, including pension, employment insurance and workers’ compensation.

All jurisdictions in Canada have enacted legislation that governs minimum employment standards. Generally, employment standards acts (ESAs) are broad and apply to employment contracts, whether oral or written. Although standards vary across jurisdictions, many topics covered are common to all ESAs, including minimum wages, maximum hours of work, overtime hours and wages, rest and meal periods, statutory holidays, vacation periods and vacation pay, termination and severance pay and leaves of absence. The leaves of absence protected by ESAs vary across provinces, but may include sick leave, bereavement leave, maternity/parental/adoption leave, reservist leave, compassionate care/family medical leave, organ donor leave, personal emergency leave and family responsibility leave.

The Canada Revenue Agency (CRA) will generally consider a company to be an employer if it pays salaries, wages (including advances), bonuses, vacation pay, or tips to individuals; or provides them with certain taxable benefits or allowances, such as board and lodging. An employer will need a registered Business Number with a payroll deductions account before the employee starts work.

It is recommended that the terms for employment be outlined in a letter or contract. New employees should sign the letter, confirming that they understand and accept these terms and conditions. The employment agreement should include position title, scope of responsibility, identity of manager or supervisor, compensation details (salary, bonuses and incentives, stock options), vacation entitlement, description of benefits (eg. health plans, life insurance, pension plan) and any other relevant points.

It is important to determine whether a worker is an employee or a self-employed individual. The facts of the working relationship as a whole determine the employment status. If the worker is an employee (employer-employee relationship), the payer is considered an employer. Employers are responsible for deducting Canada Pension Plan (CPP) contributions, (Employment Insurance) EI premiums, and income tax from remuneration or other amounts they pay to their employees. They have to remit these deductions along with their share of CPP contributions and EI premiums to the Canada Revenue Agency. An employer who fails to deduct the required CPP contributions or EI premiums has to pay both the employer’s share and the employee’s share of any contributions and premiums owing, plus penalties and interest. The intentions of the parties and the signed contract can affect whether it is an employee or non-employee relationship but will not override the factual arrangements.

If a worker or payer is not sure of the worker’s employment status, either party can request a ruling to have the status determined. A ruling determines whether a worker is an employee or is self-employed, and whether that worker’s employment is pensionable or insurable.

SENDING NON-RESIDENT EMPLOYEES TO WORK IN CANADA

The ITA requires applicable payroll source deduction withholdings from compensation paid to an employee or director that is related to services physically rendered in Canada, regardless of the employee's/director's residency status in Canada. This requires all employers, resident in Canada or not, to maintain a Canadian payroll system and withhold prescribed federal and provincial income taxes when paying Canadian source employment income. Deductions at source are required to be remitted to CRA regularly and an information return is required to be filed annually with CRA reporting details of the payroll. A wage slip is also required to be issued to the employee.

Generally, a tax treaty may exempt a non-resident employee from Canadian income tax on Canadian source employment income if the remuneration is paid by a non-resident person/employer, is not deducted from the Canadian profits of a payer, and the employee was present in Canada for no more than 183 days in any 12 month period beginning or ending in the fiscal year concerned. In addition, the Canada – U.S. tax treaty exempts up to \$10,000 of income from taxation in Canada.

The requirement for employers to withhold and remit Canadian income tax on salaries and wages paid in respect of employment applies regardless of whether a treaty shields Canadian source employment income from taxation in Canada. However, if a treaty exemption is available a waiver from the applicable source deductions could be applied for. Despite obtaining a waiver, an employer must still report the Canadian wages paid to a non-resident employee by filing an information return and issuing the employee a wage slip.

Obtaining a regulation 102 waiver for each non-resident employee can be burdensome for non-resident employers with multiple non-resident employees working in Canada. Alternatively, recent legislation allows non-resident employers that are resident in a treaty country to apply for certification that acts somewhat as a blanket waiver provided certain conditions are met.

If granted, the certification exempts the employer from source deduction requirements on payments to a non-resident employee exempt from tax under treaty, who works in Canada for less than 45 days in the calendar year and is present in Canada for less than 90 days in any 12-month period that includes the time of the payment. Furthermore, if the income attributable to Canadian workdays is \$10,000 or less, the employer is not required to file an information return reporting the payroll details with the CRA, or issue the employee a wage slip.

In circumstances where a waiver is not obtained for exempt employment income under treaty, the employee would be required to file a personal tax return claiming the treaty exemption to recover the withheld taxes as a refund.

International bilateral social security agreements with other countries may relinquish CPP contribution requirements for a non-resident employee within a certain time-span of Canadian employment (commonly 5 or 3 years depending on country). Similarly, if premiums are payable on Canadian employment income under unemployment insurance laws of the non-resident employee's home jurisdiction, Canadian EI premiums are not required.

USING NON-RESIDENT SELF-EMPLOYED INDIVIDUALS TO RENDER SERVICES IN CANADA

Under Canadian tax legislation, every payer (including a non-resident), must withhold 15% of any payment made to a non-resident of Canada for services provided in Canada, and is required to remit the withholdings on account with CRA by the 15th of the month following the payment. All payer's must also report the payments to the CRA by filing an information return, and providing the employee with a slip reporting certain details of the payment and withholdings.

The withholding requirement does not apply to payments issued to non-residents in exchange for the delivery of goods, or for services provided outside of Canada.

In instances where a treaty exempts the income from Canadian taxation, an application can be filed with CRA requesting a waiver from the withholding requirement. While CRA's criteria for granting waivers is similar to general treaty exempting provisions, the guidelines CRA uses to determine if to grant a waiver do not mirror exactly the provisions of every treaty. As a result it is possible to have an instance where exempt income under treaty may not be granted a waiver. The waiver must be obtained prior to the payment is made in order to absolve the payer's withholding obligation.

Though cumbersome to obtain, waivers can provide necessary relief from problematic cash flow timing issues that arise in instances where a payment for a single service requires multiple levels of withholding since the payment filters through a chain of multiple levels of non-resident subcontractor service providers.

CANADA: FINANCIAL STATEMENTS AND ACCOUNTING STANDARDS

Chartered Professional Accountants of Canada (CPA Canada) is the national organization established to support a unified Canadian accounting profession. CPA Canada supports its members by conducting research into current and emerging business issues and supports the setting of accounting, auditing and assurance standards for businesses, not-for-profit organizations and government. The Accounting Standards Board determines the contents of the CPA Canada Handbook – Accounting. The following accounting standards apply:

1. Publicly accountable enterprises apply the International Financial Reporting Standards (IFRS).
2. Private enterprises apply either Accounting Standards for Private Enterprises (ASPE) or IFRS.
3. Not-For-Profit Organizations apply either Accounting Standards for Not-For-Profit Organizations or IFRS.
4. Pension plans, and benefit plans that characteristics similar to pension plans and provide benefits other than pensions, apply Accounting Standards for Pension Plans.

The Canadian Auditing and Assurance Standards Board determines the contents of the CPA Canada Handbook – Assurance.

The Canadian Professional Engagement Manual 2015 (CPEM) specifies the following types of engagements and reports on financial statements:

1. **Audit:** The auditor expresses an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with CASs and relevant ethical requirements enables the auditor to form that opinion.
2. **Review:** Review engagements are designed for entities that do not require an audit opinion to meet their needs but that want some level of assurance, as opposed to compilation engagements that provide no assurance. A review engagement provides a limited level of assurance on the subject matter (usually annual financial statements), prepared in accordance with an applicable financial reporting framework.
3. **Compilation (Notice to Reader):** Compilations are the lowest rung on the ladder with regard to a public accountant's involvement with information. Compilations offer no assurance other than the involvement by the accountant in the preparation of the information.

In Canada, financial statements are comprised of the following components:

- **Audits and Review Engagements:** Balance Sheet, Statement of Earnings, Statement of Retained Earnings, Statement of Cash Flows, Notes to the Financial Statements (ASPE); or Statement of Financial Position, Statement of Earnings and Comprehensive Earnings and Statement of Changes in Equity (IFRS).
- **Compilation Engagements:** Balance Sheet, Statement of Earnings, Statement of Retained Earnings
- **Not-For-Profit Organizations Terminology:** Statement of Financial Position, Statement of Revenues and Expenditures, Statement of Changes in Net Assets, Statement of Cash Flows

The attached schedule outlines sample asset, liability, equity, revenue and expense categories that may be found in Canadian financial statements. Please note that this is not a finite list, entities may add disclosures as they deem appropriate.

CPA Canada offers a series of Model Financial Statements for sale at the following link:

<https://www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/accounting-standards-for-private-enterprises-aspe/publications/Model-Financial-Statements-Series>

BALANCE SHEET

ASSETS

CURRENT ASSETS

Cash and cash equivalents
Short term investments
Accounts receivable
Income taxes receivable
Inventories
Work in progress
Prepaid expenses
Loans receivable - related parties
Loans receivable - others
Other receivables
Sundry assets
Future income taxes

LONG TERM ASSETS

Property, plant and equipment
(net of accumulated amortization)
Investments
Interest in joint ventures
Subsidiaries
Goodwill and intangible assets
Loans receivable
Related party loans receivable
Future income taxes (non-current)

LIABILITIES

CURRENT LIABILITIES

Bank indebtedness
Accounts payable and accrued liabilities
Income taxes payable
Current portion of long term debt
Loans payable
Related party loans payable
Deferred income

LONG TERM LIABILITIES

Bank loans
Capital lease obligations
Loans payable - related parties
Loans payable - others
Employee future benefits
Asset retirement obligations

EQUITY

Share capital
- Common shares
- Preferred shares
Contributed surplus
Retained earnings

STATEMENT OF EARNINGS

REVENUE	Sales of goods Fees and services
COST OF SALES	(If applicable to a sales business)
GROSS PROFIT	Sales less Cost of Sales (if applicable to a sales business)
OTHER INCOME	Investment income Share of income from joint ventures Income from the sale of assets Other income
EXPENSES	General and administrative expenses Selling expenses (Categories based on the significant amounts)
EARNINGS BEFORE INCOME TAXES	Revenues less expenses
PROVISION FOR INCOME TAXES	
NET EARNINGS	Revenues less expenses, less provision for income taxes

STATEMENT OF RETAINED EARNINGS

BALANCE, BEGINNING OF YEAR

ADD: NET EARNINGS

LESS: DIVIDENDS PAID

LESS: PREMIUM ON REDEMPTION OF SHARES

BALANCE, END OF YEAR

STATEMENT OF CASH FLOWS

CASH WAS PROVIDED BY (USED IN)

OPERATING ACTIVITIES

Net earnings

Items not affecting cash

(eg. Amortization, unrealized gains and losses)

Change in non-cash operating working capital items

(eg. changes in operating current assets and liabilities)

FINANCING ACTIVITIES

Change in liabilities related to financing the company

INVESTING ACTIVITIES

Change in asset balances related to assets

CHANGE IN CASH POSITION

Total of the above 3 categories (Operating, Financing, Investing)

CASH, BEGINNING OF YEAR

CASH, END OF YEAR