Setting up your Business in Canada
Issues to consider

Canada is a premier location for investment in business. Canada not only has a wealth of natural resources but also has a stable political climate, a well-educated workforce, a sound financial system and a first-rate infrastructure. Canada is known for supporting innovation in a wide range of sectors via generous research and development incentives. Low corporate tax rates as well as easy access to major US markets make Canada a domicile of choice for businesses looking to gain a foothold in North America.

There are a number of issues which you must consider when contemplating doing business in Canada. This document addresses some of the common questions and provides practical information concerning the primary issues which should be considered.

What type of Business Structure should we use?

There are advantages and disadvantages to each of the available structures. There is no one correct answer as the most advantageous structure will be dependent on each enterprise's specific business circumstances and needs. A brief overview of the main structures is below. The considerations do not include the application of treaty benefits that may be in effect due to a tax convention between Canada and the applicable non-resident jurisdiction:

Branch:

- Not a separate legal entity but an extension of the overseas parent company.
- No limited liability in respect of the Canadian operations.
- Payments made to a Canadian branch of a foreign entity in respect of services provided in Canada are subject to federal withholding tax.
- If the Branch has a Permanent Establishment ("PE") in Canada then profits from this PE are liable for Canadian federal corporate income tax and Branch tax as well as provincial corporate income tax, any withholdings remitted on the Branch's behalf can be credited against federal taxes payable.
- Federal Goods and Services Tax as well as Provincial Sales Tax (as applicable) should be considered in all cases.

Corporation:

- Provides limited liability to Canadian operations.
- Corporate income tax to be paid on company profits.
- T2, *Corporation Income Tax Return* as well as the applicable Provincial returns must be filed within 6 months of the year end, taxes are payable within two months each year and monthly tax instalments are due federally and provincially.
- Withholding Tax to be paid on any distributions to non-resident shareholders.
- Thin capitalization rules apply to debt / equity financing by non-resident shareholders.
- Federal Goods and Services Tax as well as Provincial Sales Tax (as applicable) should be considered in all cases.

Limited Partnership:

- Members (partners) have limited liability, with the exception of the general partner (normally a corporation with no other assets).
- Payments made to a non-resident partnership in respect of services provided in Canada are subject to withholding tax.
- Taxable income is allocated to the members of the partnership who then pay Canadian income tax on these profits. Non-resident members may be entitled to foreign tax credits in their home country as a result of the payment of Canadian Income tax.
- If the partnership has a Permanent Establishment in Canada then profits from this PE are liable for Canadian federal income tax as well as provincial income tax, amounts remitted in respect of withholding taxes are also allocated and credited against tax otherwise payable, corporate members are also subject to the Branch tax as noted previously.
- Federal Goods and Services Tax as well as Provincial Sales Tax (as applicable) should be considered in all cases.

How much Corporation Tax will the business pay?

Current combined federal and provincial Corporation Tax rates applicable to active business income in Canada by province are:

2016 Combined Federal and Provincial Tax rates	%
Newfoundland and Labrador	30.0
Prince Edward Island	31
Nova Scotia	31
New Brunswick	27
Quebec	26.9
Ontario	26.5
Manitoba	27
Saskatchewan	27
Alberta	27
British Columbia	26
Northwest Territories	26.5
Nunavut	27
Yukon	30
Non-resident federal	25

(NB: includes all rate changes announced up to June 30, 2016)

A general withholding tax rate of 25 per cent applies to the gross amounts of certain payments made by a resident of Canada to a non-resident. This includes management fees, dividends, rents and royalties. This rate may often be reduced to a lower rate as stipulated in the applicable tax treaty.

Other considerations include the potential availability of investment tax credits made available by the Federal and Provincial governments. These include but are not limited to programs such as the Film or Video Production tax credits, the Scientific Research and Experimental Development ("SRED") investment tax credits, and the Apprenticeship Job Creation Tax Credit.

What if we make cross-border transactions between group companies?

Transfer prices are the prices at which services, tangible property, and intangible property are traded across international borders between related parties. Canadian legislation follows internationally accepted principles, and in particular the Organization for Economic Co-operation and Development ("OECD") transfer pricing guidelines.

Canada's Transfer Pricing ("TP") legislation embodies the arm's length principle; and requires that, for tax purposes, the terms and conditions agreed to between non-arm's length parties in their commercial or financial relations be those that one would have expected had the parties been dealing with each other at arm's length.

The arm's length principle treats a group of parties not dealing at arm's length as if they operate as separate entities rather than as inseparable parts of a single unified business. It is generally based on a comparison of prices or margins between non-arm's length parties on cross-border transactions with prices or margins on similar transactions between arm's length parties.

Typical transactions between affiliated entities that are covered by TP regulations are:

- Sale and purchase of goods;
- Provision of management services;
- Property rental charges;
- Transfer of intangible assets e.g. trademarks, patents;
- Sharing of knowledge, expertise, business contacts etc.; and
- Provision of financial support e.g. inter-group loans and charging a "market" interest on loans (although the department is more likely to use the specific provisions of the Canadian income tax act relating to loans and other indebtedness to or from non-residents before applying the transfer pricing rules).

A business will need to prepare a Transfer Pricing Report proving the arm's length basis of transactions. The report will include a functional and risk analysis, analysis of the adopted pricing model and benchmarking of the arm's length basis. Taxpayers are required to make or obtain records or documents on or before the filing date for the tax year and to provide those records and document to the Canada Revenue Agency within 3 months of the receipt of a written request to do so.

Where a taxpayer is found to not have used reasonable efforts to determine and use arm's length prices or allocations a penalty can apply.

What Employment Taxes and Social Security will need to be paid?

Under Canada's personal income tax system your personal income tax obligations depend on your residency status for tax purposes. Residency is established at the point when an individual has significant residential ties to Canada. To determine residency status for tax purposes all the relevant facts in each particular case must be considered including the individual's residency ties with Canada, as well as the length of time, object, intent and continuity with respect to stays in Canada or abroad.

As the rules in this area are complex and are not a bright line test we would advise any new entrant to Canada or person who spends time working in Canada to seek professional advice to determine whether or not they will be considered to be a resident of Canada for income tax purposes.

The amount of personal income tax payable will depend upon the province of residence of the individual as at December 31 of each year. A summary of the rates currently in effect is presented in Appendix 1.

Employers and employees are also required to pay both Canada Pension Plan ("CPP") and Employment Insurance ("EI") contributions.

2016 CPP and EI contributions are:

		Maximum annual earnings	Basic Exemption	Contribution rate	Maximum annual contribution
Employee	CPP	$54,900	$3,500	4.95%	$2,544.30
	EI	$50,800		1.88%	$955.04
Employer	CPP	$54,900	$3,500	4.95%	$2,544.30
	EI	$50,800		2.632%	$1,337.06

(NB: the province of Quebec administers an EI program for residents of that province. The applicable rate will differ for business with employees resident in Quebec.

Includes all rate changes announced up to June 30, 2016)

It is the employers' legal responsibility to withhold and remit an employee's income tax, Canada Pension Plan and Employment Insurance source deductions to the Canada Revenue Agency.

What is Goods and Services Tax ("GST") and / or Harmonized Sales Tax ("HST") and should the business be registered?

A non-resident that carries on business in Canada may be required to register for GST/HST purposes and may be liable to pay, collect or remit either the GST or the HST or both, as in some cases whether GST or HST must be charged on sales will depend on the province in which the customer is located, rather than the location from where the non-resident operates.

If a non-resident is required to register but does not have a permanent establishment in Canada they are required to post a recoverable security with the Canada Revenue Agency.

The GST/HST applies to most supplies of property and services made in Canada and the GST applies to the importation of most goods into Canada. The GST rate is 5 per cent and the HST rate varies from between 13 to 15 percent depending on the province in which the supplies are deemed to have been made.

As the intention is that GST/HST is a consumption tax it is not intended to be borne by businesses. It is therefore recoverable if the business is registered for GST/HST purposes and makes GST/HST taxable supplies. Certain supplies are considered to be exempt from GST/HST such as the provision of financial services, residential real property and health care or educational services.

HST stands for "Harmonized Sales Tax" and will apply where a province has agreed to harmonize its provincial sales tax with the GST charged by the federal government and to allow the federal government to collect a provincial amount in addition to the basic GST, on behalf of the province. Certain provinces, namely British Columbia, Saskatchewan, Manitoba and Quebec each impose their own form of provincial sales tax, separate from and in addition to the federal GST. There is a degree of connection to each province required in order for a seller to register to charge and collect PST / QST for that province. The degree required depends on the province in question. The Quebec sales tax ("QST") is structured similarly to the GST/HST but is administrated by a separate tax authority. PST levied by the other three provinces is more akin to state sales-and-use taxes in the U.S.

Can we provide Share option plans to our staff?

Many companies see Share Option plans as being an important way of attracting, motivating and retaining key staff.

Canada has a number of "approved" share option plans which give tax benefits to employees and employers alike and it is often possible to adapt an overseas stock option plan to fit into one of these "approved" plans.

However this is a very technically complex area and careful planning needs to be undertaken as soon as share option plans are being considered for implementation in Canada.

How else can we compensate our employees?

Canada has a very comprehensive range of compensation and benefit options available for companies to offer their employees. Although Canada has a robust government funded medical system there are certain services which are not fully covered such as prescriptions and dental care. As such private health funding, providing full or partial additional coverage, is quite common amongst Canadian businesses.

In addition life and disability coverage are popular benefit options. However, there are a number of tax rules in this area that should be observed.

Pensions are commonplace benefits provided by many Canada businesses to their workforce. Registered programs such as the Registered Pension Plan ("RPP") have widespread popularity as a method of providing a tax efficient pension plan to employees of Canadian businesses.

Flexible benefit packages are also growing in popularity, giving employees options on how they wish to "spend" their benefits allowance; which can range from "purchasing" additional holiday entitlement to obtaining full family medical coverage.

To discuss your requirements please contact the International Office on +44 (0) 1245 449266 or email us directly.

Kreston International

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The information in this document was prepared as at August 9, 2016

Appendix 1

	Tax Rates	Tax Bracket
Federal	15.00%	Up to $45,282
	20.50%	$45,283 - $90,563
	26.00%	$90,564 - $140,388
	29.00%	$140,389 - $200,000
	33.00%	$200,001 and over
British Columbia	5.06%	Up to $38,210
	7.70%	$38,211 - $76,421
	10.50%	$76,422 - $87,741
	12.29%	$87,742 - $106,543
	14.70%	$106,544 and over
Alberta	10.00%	Up to $125,000
	12.00%	$125,001 - $150,000
	13.00%	$150,001 - $200,000
	14.00%	$200,001 - $300,000
	15.00%	$300,001 and over
Saskatchewan	11.00%	Up to $44,601
	13.00%	$44,602 - $127,430
	15.00%	$127,431 and over
Manitoba	10.80%	Up to $31,000
	12.75%	$31,001 - $67,000
	17.40%	$67,001 and over
Ontario[1]	5.05%	Up to $41,536
	9.15%	$41,537 - $83,075
	11.16%	$83,076 - $150,000
	12.16%	$150,001 - $220,000
	13.16%	$220,001 and over
Quebec	16.00%	Up to $42,390
	20.00%	$42,391 - $84,780
	24.00%	$84,781 - $103,150
	25.75%	$103,151 and over
New Brunswick	9.68%	Up to $40,492
	14.82%	$40,493 - $80,985
	16.52%	$80,986 - $131,664
	17.84%	$131,665 - $150,000
	20.30%	$150,001 and over
Nova Scotia	8.79%	Up to $29,590
	14.95%	$29,591 - $59,180
	16.67%	$59,181 - $93,000
	17.50%	$93,001 - $150,000
	21.00%	$150,001 and over

[1] Note there is a 20% and 30% surtax applicable on taxable income in excess of $4,418 and $5,654 respectively.

Prince Edward Island[2]	9.80% 13.80% 16.70%	Up to $31,984 $31,985 - $63,969 $63,970 and over
Newfoundland and Labrador	7.70% 12.50% 13.30% 14.30% 15.30%	Up to $35,148 $35,149 - $70,295 $70,296 - $125,000 $125,001- $175,000 $175,001 and over
Yukon	6.40% 9.00% 10.90% 12.80% 15.00%	Up to $45,282 $45,283 - $90,563 $90,564 - $140,388 $140,389 - $500,000 $500,001 and over
Northwest Territories	5.90% 8.60% 12.20% 14.05%	Up to $41,011 $41,012 - $82,024 $82,025 - $133,353 $133,354 and over
Nunavut	4.00% 7.00% 9.00% 11.50%	Up to $43,176 $43,177 - $86,351 $86,352 - $140,388 $140,389 and over

[2] Note there is a 10% surtax applicable to income over $12,500