Doing Business In Canada

This chapter is a general overview of Canadian tax principles and has been prepared by Cadesky and Associates LLP, a Canadian and International Tax Advisory firm. Comments should be regarded as a summary and should not be considered to be specific advise with respect to any issue. We therefore recommend that any reader seek professional advice with respect to any Canadian tax matters. If you have any questions or comments on the materials, please feel free to contact any member of Cadesky and Associates LLP.

The discussion will focus on U.K. companies investing, acquiring a business, or doing business in Canada. The discussion will also look at issues for U.K. Individuals working in Canada or who are considering moving to Canada. Of particular importance will be the Canada-U.K. Income Tax Convention (aka the "Treaty").

1) Doing Business in Canada

Canada imposes income tax on individuals, corporations and trusts. Income taxes are levied at the federal and provincial/territorial levels of government. Canada has 10 provinces and 3 territories. The federal government also imposes a Value Added Tax (VAT) called the "Goods and Services Tax" (GST) or "Harmonized Sales Tax (HST)", depending on the province in which the supply takes place. Those provinces which did not harmonize their provincial sales tax with the GST, still impose their own retail sales tax, except for Alberta.

Canada does not impose wealth taxes, capital taxes or stamp duties. Municipalities impose property tax (rates) on the assessed value of real property interests. Land transfer taxes are levied on the sale or transfer of real property interests, but an exemption exists in the event of death for assets passed to heirs or estates. All provinces impose probate fees.

Federal income taxation is imposed pursuant to the Canadian Income Tax Act (the "Act"). Three separate government bodies play a role in income taxation in Canada. The Department of Finance ("Finance Canada") is responsible for analyzing and developing tax policy and for implementing tax legislation. The Canada Revenue Agency ("CRA") is responsible for administering the Act and collecting taxes. The Department of Justice is involved when tax disputes go to court.

Canada has a comprehensive tax system whereby residents of Canada are subject to tax on their world wide income. Non-residents are subject to Canadian taxation on Canadian source income only, though exemptions or reductions may be permitted by virtue of a tax treaty. Non-residents will be subject to the "regular" income tax on three types of income: (1) employment income exercised in Canada; (2) profits from a business carried on in Canada; and (3) gains from the disposition of taxable Canadian property ("TCP"), for example, Canadian real property. Other types of income, for example interest, dividends, rents, royalties, etc., would be subject to a flat non-resident withholding tax. The provinces, in general, do not impose any taxes on non-business income earned by a non-resident.

Under the Act, income is sorted into one of five possible categories: employment; business; property; capital gains; and other. An item of income is not subject to tax unless it is specifically addressed in the Act. Employment, business, property, other income and one-half of a capital gain (known as the taxable capital gain) is included in the computation of taxable income and is taxed at the taxpayer's applicable tax rate.

2) Corporations

Residence

A corporation that is resident in Canada is taxed on its world wide income. A U.K. corporation doing business in Canada would be subject to Canadian tax on its Canadian source income only subject to any Treaty relief.

A Canadian corporation is deemed resident in Canada (subject to a limited exception for Canadian corporations incorporated before April 27, 1965 that never carried on business in Canada). A foreign corporation may be considered a resident under common law principles.

Common law has generally established that a company is resident in the country in which its central management and control is exercised. For most U.K. companies, the mind and management issue should not be a factor in determining its residency status in Canada. It may be an issue, however, for private U.K. companies where the owner/manager moves to Canada. As such, it is possible that a corporation may be resident in both countries. Should such a situation occur, taxpayers must refer to the Treaty to make a determination of a company's residency status for tax purposes.

Article 3(1)(d) of the Treaty defines the term "company" to mean any body corporate or any other entity which is created as a body corporate for tax purposes.

Article 4(3) of the Treaty provides the corporate tie-breaker rules. The provision states "..the competent authority of the Contracting States shall endeavor to determine by mutual agreement the State of which the person shall be deemed to be resident, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and other relevant factors." Obtaining a competent authority ruling can take a considerable amount of time and result in significant costs.

U.K. companies expanding into Canada will want to ensure that mind and management has not moved to Canada.

Business Income

Canada taxes the profits of taxpayers carrying on business. The term business implies a certain level of activity as opposed to a passive investment. The starting point in determining a corporation's taxable income is its "book" income computed in accordance with generally accepted accounting principles or generally accepted business practices. Book income is then modified by specific rules contained in the Act.

In general, expenditures are deductible in computing income if they have been incurred for the purpose of gaining or producing income and are reasonable in the circumstances. There are, however, restrictions on the ability to deduct certain expenditures such as capital outlays, accounting reserves, and expenses associated with exempt income. In addition specific expenditures, for example, those incurred for recreational facilities and club dues, are also denied.

A U.K. company which is doing business in Canada may be exempt from Canadian corporate tax, under the Treaty, on its business income if the company does not have a permanent establishment ("PE") in Canada. A company could have a PE if it has a fixed place of business, including a place of management, a branch, an office, a factory or a workshop, a mine, quarry or other place of extraction of natural resources, or a building site or construction or assembly project which exists for more than 12 months. Where the company has a PE in Canada, Canadian tax would only apply with respect to activities associated with that PE. Where a U.K. company does not have a PE in Canada, the associated Canadian source income would be exempt from Canadian corporate taxation. The company, however, would still be required to file a Canadian corporate tax return to disclose its reliance on the Treaty.

If a company is carrying on business in more than one province, through a permanent establishment in each province, the business must apportion its business income to each province. The method of apportioning is based on revenues earned and wages paid in each province.

Property Income

Dividends, interest, rents and royalty income are taxable in Canada when received. Compound interest securities are subject to accrual requirements, generally on an annual basis.

Canada employs an exemption approach to inter-corporate dividends. Dividends received from a taxable Canadian corporation will not be subject to a second level of corporate taxation. Dividends received from a foreign corporation will be excluded if the foreign entity is a foreign affiliate and the dividend is paid out of the foreign corporations "exempt surplus". In general, exempt surplus refers to the foreign corporation's tax adjusted retained earnings from active business income carried on in a country with which Canada has an international tax treaty or an information exchange agreement.

Income from a trust, royalties and similar income is taxed as received or allocated, depending on the circumstances.

Capital Cost Allowance (CCA)

Though a general deduction on capital expenditures is denied, the Act allows businesses to deduct tax depreciation under a standard set of rules known as capital cost allowance. Under this system most assets are grouped into particular classes and the entire class is depreciated at a set percentage on a declining balance method. For example, office furniture is a Class 8 asset, depreciated at the rate of 20% per year on a declining balance method. Buildings would be Class 1 assets depreciated at a 4% rate.

Some classes of assets, such as leasehold improvements or intangibles with a fixed life, are depreciated on a straight line basis over the life of the assets.

Taxpayers are not obligated to claim CCA. It is a permissive deduction but a taxpayer may not claim more than the annual computed limit. Catch up claims are not permitted. If a property is disposed of in excess of its undepreciated capital cost (UCC) it may result in recapture. If the proceeds are in excess of the property's original cost, the disposition may result in a capital gain. A terminal loss may result if there are no assets left in the class at the end of the year but there remains a positive balance in the class.

In order to encourage companies to invest in capital assets, the government has allowed for accelerated deprecation on certain classes of assets. For example, electronic data processing equipment (i.e. computer hardware) is included in Class 50 and is subject to a 55% CCA rate. Machinery and equipment, used for the manufacturing and processing in Canada of goods for sale or lease, is a class 43 asset eligible for a 30% CCA rate.

U.K. companies, that are in capital intensive industries, looking to expand into North America may consider selecting Canada to take advantage of the relatively high CCA rates.

Rates and filings

Corporations must file a corporate tax return known as Form T2, "Corporation Income Tax Return". The filing deadline is 6 months after the fiscal year end. For all provinces, other than Alberta and Quebec, a joint federal/provincial/territorial return is filed. The provinces of Alberta, Form AT1, "Alberta Corporate Income Tax Return" and Quebec, Form CO-17, "Corporation Income Tax Return", require additional separate filings.

Canada does not permit the filing of consolidated tax returns. Each corporation must file its own tax return. This requirement for independent filings means that taxpayers must plan the co-ordination of tax liabilities and loss utilization within the corporate group. A taxable loss in one corporation can not be directly used to reduce the taxable income of another corporation. Planning opportunities exist, however, to mitigate this.

The general federal corporate tax rate, for 2012, is 15%. General provincial and territorial rates vary from 10% to 16%. Provincial and territorial tax will only apply if the corporation is doing business in that province through a permanent establishment. If not, an additional 10% federal tax applies.

The current U.K. main rate of corporation tax is 24% and is scheduled to decrease to 23% for financial years starting April 1, 2013 . As such, though competitive, the Canadian corporate tax rates are slightly higher than U.K. rates. U.K. companies doing business in Canada would want to ensure that income, where possible, is taxed in the U.K. and not in Canada.

Thin Capitalization

In a global context, though corporate tax rates have been falling, Canada is still considered a relatively high tax jurisdiction. Multi-national groups, that invest in Canada, can do so by either lending funds, as debt, or acquiring shares of a Canadian entity. All things being equal, these organizations would prefer to maximize debt in the Canadian entity. The interest payments on this debt have the effect of reducing business income taxed at a relatively high rate and attracting only the lower (often treaty-reduced) non-resident withholding rate on interest paid abroad. This would result in an overall loss of tax revenue to Canada. To stop this potential abuse, Canada imposes limits on how much deductible interest can be paid to certain non-resident investors.

A non-resident is a "specified" non-resident if he owns alone, or together with other non-arm's length parties, at least 25% of the shares of any class of the capital stock of the corporation. The interest expense is limited when the debt owing to specified non-residents exceeds a 2 to 1 debt-equity ratio. The 2012 budget has proposed to: (1) reduce the debt-equity ratio to 1.5 to 1 and (2) recharacterize the disallowed interest expense as dividends, which will then be subject to the dividend non-resident withholding tax. For U.K. shareholders, the general dividend non-resident withholding tax is 15%. However, a 5% rate applies where the U.K. shareholder controls directly or indirectly at least 10% of the voting power in the Canadian company paying the dividends.

Transfer Pricing

To prevent taxpayers from artificially shifting income earned in Canada to lower taxing jurisdictions, Canada requires that taxpayers, within a related group, employ a transfer pricing methodology.

Transfer prices represent the prices at which services, tangible property, and intangible property are traded across international borders between related parties. In general, Canada follows the Organization for Economic Co-operation and Development (OECD) Guidelines set out in its 1995 document, Transfer Pricing for Multinational Enterprises and Tax Administrations. The transfer prices adopted directly affect the profits to be reported by each party in its respective country.

Canada's transfer pricing legislation embodies the arm's length principle and requires that, for tax purposes, the terms and conditions agreed to between related parties be those that one would have expected had the parties been dealing at arm's length.

Under the arm's length principle, related parties would be treated as if they are separate entities. The principle requires a comparison of prices or margins between related parties on cross-border transactions with prices or margins on similar transactions between unrelated parties. It is a factual determination as to whether a taxpayer has adhered to the arm's length principle.

Methodologies such as the comparable uncontrolled price (CUP) method; the resale price method; the cost plus method; the profit split method; and the transactional net margin method (TNMM) are examples of strategies devised to determine an arm's length transfer price.

Where the Canadian tax authorities have determined that the transfer price employed does not reflect the price that would have been charged between arm's length parties, the income for Canadian tax purposes can be adjusted accordingly. Depending on the amount of the adjustment (percentage and dollars), penalties may be imposed.

A company's transfer pricing methodology is routinely examined by the CRA. Any U.K. company operating a branch or subsidiary in Canada needs to ensure that is has in place an appropriate transfer pricing methodology and that the company has contemporaneous documentation to support its methodology. Companies may apply to the CRA for an Advance Pricing Arrangement (APA) to reduce its risk of adjustment.

Scientific Research and Experimental Development Credits (SR&ED)

The SR&ED program is intended to encourage businesses of all sizes, particularly small to medium businesses and start-up firms, to conduct research and development (R&D) that will lead to new, improved, or technologically advanced products, processes, devices, and materials. The SR&ED tax incentive is the Canadian government's largest single support program for R&D.

SR&ED expenditures are deducted as business expenses, and may also qualify for investment tax credits (ITC) that are received in the form of a reduction in income taxes payable, cash refunds, or both. Cash refunds, however, are only available to Canadian Controlled Private Corporations. In general, UK companies doing SR&ED work in Canada, through a Canadian subsidiary, would only be eligible for a reduction in income taxes payable. The current general ITC rate is 20% on qualified expenditures. The 2012 Canadian budget, however, has proposed to reduce the general ITC rate to 15% and to provide for more targeted assistance.

Qualifying expenditures may include wages, materials, equipment leases, overhead that is directly related to R&D, and eligible work by contractors. Experimental development, i.e., technological advancement, applied research, the advancement of knowledge for a practical purpose and basic research, the advancement of knowledge for its own sake, are activities that would qualify.

Eligible activities include: engineering, design, operations research, mathematical analysis, computer programming, data collection, testing and psychological research. In order to claim such expenditures, an assessment on scientific or technological eligibility of the claimed activities needs to be performed.

The Canadian SR&ED program is comparable in concept to the U.K. R&D Relief Schemes. For U.K. Small and Medium-sized Enterprises (SME), since April 1, 2011, an SME can deduct 200% of qualifying costs, Effective April 1, 2012, an SME can deduct 225% of its qualifying costs. Under the Large Company Scheme, a company may deduct 130% of qualifying costs. At a general corporate tax rate of 24%, the effective credit rate is 7.2% (30% increase in deductions x 24% corporate tax rate). As the corporate rate drops to 23%, the effective rate drops to 6.9% (30% x 23%). For SMEs, with profits eligible for the small profits rate, as of April 1, 2012 the effective credit is 25% (125% increase in deductions x 20% corporate tax rate).

For larger corporations, the proposed Canadian SR&ED rate of 15% is greater than the U.K. effective R&D rate of 6.9%. For smaller companies, however, the proposed Canadian SR&ED rate of 15% will be lower than the U.K. effective rate of 20%.

Larger U.K. companies may consider moving R&D activities to Canada to take advantage of the higher credits.

Withholding considerations when undertaking activities in Canada

Under section 105 of the Canadian Income Tax Regulations, whenever a non-resident of Canada performs services in Canada (other than in the capacity as an employee) the payor is required to withhold and remit, to the CRA, 15% of the payment. This regulation not only covers Canadian payors but also applies to non-residents paying other non-residents for services performed in

Canada. For example, assume a U.K. general contractor wins a contract in Canada and hires another U.K. company as a subcontractor. The Canadian payor would be required to withhold and remit 15% of the payment made to the U.K. general contractor. The U.K. general contractor would also be required to withhold and remit 15% of the payment made to the U.K. subcontractor.

The 15% withholding is not the final tax. The withholding is a payment on account of the non-resident's potential tax liability in Canada. The non-resident would then file a Canadian income tax return to calculate the tax liability or to get a refund of withholding amounts if no PE exists. If the non-resident taxpayer can demonstrate that they are exempt from Canadian tax, pursuant to the Treaty, they would receive a refund of the full 15%. In those cases, the 15% withholding represents a cash flow issue only.

If the facts determine that the non-resident has a PE in Canada, the 15% will be applied against the ultimate tax liability.

If a non-resident can show that the 15% withholding is more than their potential tax liability in Canada, either due to treaty protection or related expenses, they may apply for a waiver to reduce or eliminate the withholdings. The payor is not allowed to reduce the 15% withholding absent a waiver from the CRA.

Non-residents who want to ask for a waiver or reduction of withholding have to file a waiver application to the tax services office in the area where their services are to be provided. Waiver applications have to be filed no later than 30 days before the period of service begins, or 30 days before the first payment for the related services.

Payroll Taxes

Canada imposes a number of payroll taxes and withholding requirements on employers who have employees providing services in Canada. It is not necessary that the employer be located in Canada, nor the employee be a resident of Canada. Withholding may be required even though a Canadian payroll does not even exist. It is entirely possible that a U.K. based employee could be subject to Canada taxation on his Canadian source employment income and the U.K. employer be subject to Canadian withholding requirements.

In general, employment income is sourced to the physical location where the services are provided. Therefore, if the employment is exercised in Canada the income would be considered Canadian source and Canada would have the first right to tax that income, absent any Treaty relief. The allocation of the employment income should be done on a reasonable basis consistent with the facts. There is no statutory allocation methodology. In many cases, an allocation based on work days is reasonable and supportable.

An U.K. resident employee may obtain relief from Canadian taxation , on his Canadian source employment income (and vice versa), pursuant to Article 15(2) of the Treaty if " (a) the recipient is present...for a period or periods not exceeding 183 days in the calendar year concerned, and (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of that other State (Canada), and (c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State (Canada)."

In general, the provision provides that a non-resident individual has not been in Canada for more than 183 days in the year (not just work days but any days) and his associated payroll costs have not been deducted for Canadian tax purposes, then he would not be subject to Canadian taxation on his Canadian source employment earnings.

If the facts determine that an individual would not be subject to Canadian taxation the employer, however, will still be required to withhold and remit Canadian source deductions unless they obtain a waiver before the employee has been paid.

The Canadian Income Tax Regulations require that employers withhold and remit Canadian source withholdings. There is no exclusion for foreign employers. Typical federal withholdings include income tax, Canada Pension Plan ("CPP") contributions and Employment Insurance ("EI") premiums.

Individuals employed in Canada are required to contribute to the Canada Pension Plan (CPP), or the Quebec Pension Plan (QPP) if the individual is resident in Quebec. The maximum annual contribution, for 2012, is Cdn $2,306.70 based on a contribution rate of 4.95% on maximum contributory earnings of Cdn $ 46,600 (Maximum pensionable earnings of Cdn $50,100 less the basic exemption of Cdn $3,500). In Quebec, the contribution rate is 5.025% for a maximum contribution of $2,341.65. The employer is required to match the contribution. The employee contribution is partially creditable against income taxes. A U.K. employee on temporary assignment in Canada may qualify for exemption from CPP contributions under the Canada-United Kingdom Agreement on Social Security Taxes.

Individual employees must also pay a premium to the Canadian Employment Insurance Fund (EI). The maximum annual premium, for 2012, is Cdn $839.97 based on a contribution rate of 1.83% on maximum insurable earnings of $45,900. In Quebec the EI rate is 1.47% up to a maximum contribution of $674.73. Employees in Quebec also, however, have to contribute to the Quebec Parental Insurance Plan (QPIP) at a rate of .559% of earnings up to $66,000. The employer is required to pay a premium equal to 1.4 times the employee contribution. The employee premiums are partially creditable against income taxes. EI contributions are not eligible for exemption under a social security agreement.

Provinces, in general, levy two additional taxes on the employer. These are premiums for provincially or territorially run health care systems (Manitoba, Newfoundland and Labrador, Ontario, Quebec, Northwest Territories and Nunavut) and worker's compensation programs (all provinces and territories). The provinces of Alberta, British Columbia and Ontario, however, impose additional health premiums on individuals. The tax is collected through payroll withholdings.

3) Individuals

Residence

For individuals, residency is a question of fact. There is no statutory definition of residency , for individuals, contained in the Income Tax Act. Case law and jurisprudence have defined the tests used to make that determination. Each individual taxpayer must then determine his residency status based on his particular "facts and circumstances". The more ties an individual has to Canada, the stronger the argument that he is a Canadian resident. Significant ties would include a home available for his use, having immediate family in Canada, whether children are in school, etc. The CRA has issued a number of documents which address issues considered significant when determining an individual's residency status. These would include Interpretation Bulletin IT-221R3, "Determination of an Individual's Residence Status" and forms NR73, "Determination of Residency Status (Leaving Canada)" and form NR 74, "Determination of Residency Status (Entering Canada)".

Canada also has a sojourner rule, whereby if a factual non-resident spends more than 183 days (for any reason) in Canada during the calendar year, the individual will be deemed to be resident throughout the entire year. For determining the 183 day test, any part of a day counts as a full day. There are no exceptions for day of arrival or departure. As such it is possible that a U.K. individual, spending significant time in Canada, may inadvertently become a resident of Canada for Canadian tax purposes.

When an individual is considered a resident of both the United Kingdom and Canada, under each country's' respective tax law, the individual needs to consult the Treaty to determine his residence status for tax purposes. When the facts indicate that the individual is a dual resident, residency is determined under a series of "tie-breaker" rules contained in Article 4(2) of the Treaty. The provision states "...then his status shall be determined as follows:

(a) he shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him. If he has a permanent home available to him in both Contracting States, or neither, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests);

(b) if the Contracting State in which he has his centre of vital interested cannot be determined, he shall be deemed to be a resident of the Contracting State in which he has a habitual abode;

(c) if has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting of which he is a national;

(d) if he is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement."

Thus, under the Treaty an individual will be deemed to be a resident of one Contracting State and, by default, will be taxed as a non-resident in the other Contracting State. For a U.K. resident who has sojourned in Canada (and become a resident under Canadian domestic tax law) but has maintained his primary ties to the U.K., he would be considered a U.K. resident under the Treaty and a non-resident of Canada for tax purposes.

Employment income

Income from an office or employment includes all amounts received as salary, wages, commissions, director's fees, bonuses, honoria and taxable benefits. In addition to amounts received while an employee, amounts received in contemplation of or on termination of employment are also taxed as employment income.

Taxable benefits take many forms. Employer provided housing, schooling, automobiles and membership dues are examples of typical taxable benefits. Exceptions, however, exist for employer provided board and lodging where the employee is in Canada on a temporary basis and the employee has maintained his principal residence elsewhere for his continued use (i.e., he hasn't let it).

Employer provided stock options exercised, while in Canada, would be subject to Canadian taxation to the employee. If certain conditions are met, a deduction (generally equal to 1/2 of the employment benefit) may be deducted in computing the employee's taxable income. If the options were owned prior to the employee moving to Canada, the full employment benefit would be included in income but the employment benefit would need to be sourced between Canada and the United Kingdom on a reasonable basis. That portion, considered U.K. source, would eligible for a foreign tax credit in Canada for any U.K. tax paid on the income.

All remuneration received by a resident of Canada is taxed by Canada including items relating to a pre-Canadian period of employment. As such it may be prudent to ensure that all pre-assignment remuneration is received prior to commencing Canadian residence.

Items relating to a period of Canadian employment would be taxable by Canada, even if the amount is paid after the employee has left Canada.

There are no special concessions for the compensation of individuals once they become residents of Canada.

Business income

The rules for individuals carrying in business in Canada are similar to corporations carrying on business in Canada. It may be easier, however, for an individual to be considered to have a permanent establishment in Canada. Non-resident individuals carrying on business in Canada will want to ensure that they do not give the impression that the business is resident in Canada. For example, there should be no Canadian telephone number or Canadian address associated with the business.

Property income

Similar to corporations, interest, dividends, rents, royalties, etc. are taxed when received. Dividends from taxable Canadian corporations, however, are taxed at a reduced rate through a gross-up and tax credit mechanism.

Many U.K. individuals, who move to Canada on a temporary basis, maintain ownership of their U.K. principal residence but let it out to offset some of the carrying costs. As a Canadian resident, the U.K. source rental income must be reported. Tax depreciation, capital cost allowance, may be claimed to reduce net rental income but losses cannot be created or increased through the use of tax deprecation. Even though CCA may be claimed, consideration should be given to not claiming it as recapture may arise when the individual ceases Canadian residency and returns to the U.K.

Capital gains

One-half of the net capital gains ('taxable capital gains"), on the disposition of capital property, are included in the calculation of taxable income. Allowable capital losses (one-half of the net loss) can only be applied against taxable capital gains and cannot be deducted against other sources of income in the current year. These denied losses, however, may be carried back 3 years and forward indefinitely to be applied against net capital gains arising in those years.

In order to create Canadian jobs and to mitigate investment risk, the government provides incentives for Canadian residents to start Canadian active businesses in Canadian corporations. When an individual later sells the shares for a gain, the gain may qualify for a capital gains exemption. Any gain, on the disposition of the share, would be eligible for an exemption of up to $750,000 (lifetime) if the share is a "qualified small business corporation" share at the time of disposition. In general a share is a QSBC share where at least 90% of the fair market value of the company's assets are used in an active business carried on primarily in Canada.

Where a capital loss arises on the disposition of shares or debts of certain "small business corporations", 50% of the loss may be deducted against all types of income not just capital gains. These types of allowable capital losses are known as allowable business investment losses ("ABIL)".

Capital gains arising on the disposition of an individual's principal residence are not subject to tax. A principal residence can be located in a foreign jurisdiction. Families, however, can only designate one property per calendar year as their principal residence.

When a taxpayer becomes a resident of Canada, he is deemed to have acquired all capital assets, unless specifically excluded, at the fair market value on the date he commences residency. As such, any unrealized but accrued pre-immigration gains would not be subject to Canadian tax when the asset is sold. Similarly, when a taxpayer ceases Canadian residence, he is deemed to have sold all of his capital assets, unless specifically excluded, at fair market value and the resulting taxable capital gain, if any, would be included in his last Canadian tax return. If the individual has not been resident in Canada for more than 60 months, any assets he owned at the time he commenced Canadian residency would be excluded from the departure rules.

Other

Other income would include, for example, the receipt of pensions (Canadian or foreign), annuities, employment insurance (EI), Canadian Old Age Security (OAS), government pension plans such as the Canada Pension Plan (CPP) or U.K. National Insurance, withdrawals from Registered Retirement Savings Plans ("RRSP"), etc.

If a particular item of income, other than employment, business, property or capital gains, is not specifically listed in the Act, it is not subject to taxation. Perhaps the best example would be lottery winnings. Lottery winnings are not subject to tax in Canada since the Act does not specifically include them in the definition of other income and the Act specifically states that any capital gains from lottery winnings is nil.

Tax Rates

Individuals must file personal tax rates. Combined federal/provincial returns (known as a T1, "Income Tax and Benefit Return") are filed for all jurisdictions except Quebec. Quebec residents are required to file form TP1, "Income Tax Return" in addition to their federal T1. The Canadian tax year is the calendar year. In general, personal tax returns are due by the following April 30th. Self employed individuals have until June 15th to file though taxes should be paid by April 30th. Penalties and interest will be applied to late filed returns that have a balance due. Below are the 2012 federal tax rates.

Federal Income Tax Rates - 2012

Taxable Income ($)	Rate (%)	Cumulative tax($)
0 — 42,707	15	6,406
42,708 — 85,414	22	15,802
85,415 — 132,406	26	28,020
over 132,407	29	

Provincial Income Tax

Tax rates vary depending on the province or territory where the individual was resident on December 31st of the taxation year. If the individual ceased residency during the year he will be taxed on his world wide income from January 1 until the date he ceases to be a resident of Canada. In these situations, the provincial tax that will be applied will be based on where he was resident on his last date of residence in Canada.

The maximum Ontario tax rate, for 2012, is 17.41% and when added to federal tax results in a maximum combined rate of 46.41%. Ontario rates are typical of most provinces though Alberta employs a flat tax rate of 10% so that the maximum tax rate is 39%.

4) Trusts

Persons moving to Canada may have connections to foreign trusts. Such trusts require a careful review do determine the Canadian tax implications.

The residence of a trust or estate is a question of fact to be determined according to the applicable facts and circumstances in each case. Generally a trust is considered to be resident where the trustee, executor, administrator, heir or other legal representative who manages the trust or controls the trust assets resides. Where two or more trustees exercise power, residence may be determined based on the residences of the majority of the trustees.

Factors that the CRA look at in making the determination of a trust's residence may include:

(a) control over changes in the trust's investment portfolio,

(b) responsibility for the management of any business or property owned by the trust,

(c) responsibility for any banking, and financing, arrangements for the trust,

(d) control over any other trust assets,

(e) ultimate responsibility for preparation of the trust accounts and reporting to the beneficiaries, and

(f) the power to contract with and deal with trust advisors, such as lawyers and accountants.

The Canadian government, in an attempt to prevent abuse in the use of non-resident trusts has proposed significant changes in how Canada will tax these trusts. Under these proposals, a factual non-resident trust may be deemed to be resident in Canada if the trust has a "resident contributor" or a "resident beneficiary" and a "connected contributor". These proposals were originally introduced in 1999 and had been revised numerous times in response to concerns expressed by the tax community over their complexity and overly broad approach. Some revisions were made, but the rules still remain extremely complex. The changes are generally to be effective as of January 1, 2007.

The Canadian courts have recently looked at the concept of mind and management in determining the residence of the trust. This approach implies that some non-resident trustees may not be exercising their fiduciary responsibilities appropriately and that, in fact, they are acting as agents on behalf of others, who may be the trust settlors or beneficiaries. Care must be taken to ensure that any non-resident trustees have full fiduciary control and exercise it accordingly.

There is no residence tie breaker rule contained in the Treaty. In situations where dual residency arises, the matter would be referred to competent authority. This can be both costly and time consuming.

Trust income or capital gains may be attributed and taxable in the hands of a person if the person transferred property to the trust and the property , or property substituted for it, may revert back to that person or pass to other persons designated by him. In addition, if the property can be disposed of only with his concurrence, any income or loss or taxable capital gain or allowable capital loss from the property, or property substituted for it, will be attributed to that person during his lifetime while he is resident in Canada. In these situations, it does not matter if the trust is resident in Canada.

A new immigrant to Canada may benefit from setting up a non-resident trust. Structured properly, the trust may be tax exempt in Canada for up to 5 years. Also a non-resident may set up a foreign trust for a Canadian beneficiary that will be exempt of Canadian tax indefinitely. A Canadian resident beneficiary is not taxed on capital distributions from a foreign trust.

A trust may be either inter-vivos or testamentary depending on whether the trust was established during the settlor's life or on his death. Inter-vivos trust are always taxed at the highest marginal tax rate. Testamentary trusts use graduated rates.

Resident and deemed resident trusts are taxable on their world wide income in, generally, the same manner as individuals. Trust income, however, can be distributed to a beneficiary and taxed in their hands instead. Distributions on account of capital are not taxable.

The relationship between the settlor(s), beneficiaries and trustees is governed by the trust deed. A properly constructed trust is an extremely flexible planning tool.

An inter-vivos trust must file its return, Form T3, "Trust Income Tax and Information Return", 90 days after its tax year end. Inter-vivos trusts must have a calendar year end. The tax year-end of a testamentary trust may be, but does not have to be, December 31. The first tax period of the trust begins on the day after the person dies, and ends at any time the executor selects within the next 12 months. The tax rates used, and the tax year of the slips issued to the beneficiaries, are based on the year-end of the trust.

Goods and Service Tax ("GST") /Harmonized Sales Tax ("HST") and Provincial Sales Taxes

The GST/HST is a value added tax that applies to most supplies of goods and services in Canada. Registrants who make taxable supplies (other than zero-rated and exempt supplies) collect tax, from their customers, at the applicable rate (see below). Registrants will also have paid GST/HST on goods or services they acquired, imported into Canada, or brought into a participating province for use, consumption, or supply in the course of their commercial activities. The GST/HST that a registrant pays on theses purchases is known as an Input Tax Credit ("ITC"). Registrants would then remit, or receive a refund, for the difference between the GST/HST collected and the ITCs paid.

A supply will be considered taxable unless it meets an exception to be either zero-rated or exempt. Registrants may claim ITCs with respect to zero-rated supplies but may not claim ITCs with respect to exempt supplies.

Some examples of zero-rated supplies would include basic groceries such as milk, bread and vegetables, agricultural products such as wheat, grain, raw wool, prescription drugs, international passenger air travel. Some examples of exempt supplies include most health, medical and dental services, long term rentals of residential accommodation, most services provided by financial institutions.

Rates

Canada imposes a 5% federal goods and services tax (GST) on taxable supplies made in Canada. A registrant would be able to claim an Input Tax Credit (ITC) on the GST it has paid on its supplies.

Suppliers are liable to collect the tax from recipients of the supplies and remit such tax to the government. In some instances (notably certain imports), the recipient of supplies may have an obligation to self-assess and remit the tax.

Most provinces also have or had a provincial sales tax. Four provinces eliminated their sales tax and harmonized it with the federal GST. In those provinces, the GST is known as the HST. The HST rates in those provinces are: New Brunswick (13%), Newfoundland and Labrador (13%), Nova Scotia (15%) and Ontario (13%). The provincial portion of the HST is the amount in excess of the base GST rate of 5%. The GST/HST is collected by the CRA on behalf of the federal government and those provinces who harmonized their sales tax.

The province of Quebec imposes its own VAT, in addition to the federal GST, called the Taxe de ventu du Quebec ("TVQ"). The current rate is 9.5% but the tax is applied to not only the taxable supply but on the GST as well. As such, the effective rate is 9.75%.

Alberta, Nunavut, The Northwest Territories and the Yukon do not impose any provincial sales tax.

The retail sales tax rates for the remaining jurisdictions are: British Columbia (7%), Manitoba (7%), Prince Edward Island (10% - effective 10.5%), and Saskatchewan (5%)

Am I carrying on a business in Canada?

In general, an entity would be carrying on a business if the activity is done on a regular or continual basis. Each particular case would be evaluated on its own particular history and intentions. It is not, however, necessary that the activity be undertaken for profit. An office or employment is not considered a business for GST/HST purposes. For a U.K. entity expanding into Canada, the next question would be whether the entity is carrying on business in Canada and if so, whether that activity is done through a permanent establishment in Canada.

Whether an entity is carrying on business in Canada is a question of fact. Some of the factors that the CRA will look at in making that determination are: the place where agents or employees are located; the place where deliveries are made; the place of payment; the place where purchases are made, the place from which transactions are solicited, the location of assets or an inventory of goods; the place where business contracts are made; the location of a bank account, the place where the non-resident's name and business are listed in a directory; the location of a branch or office; the place where the service is performed; and the place of manufacture or production (for a more detailed explanation see CRA Policy Statement P-051R2, Carrying on business in Canada).

Do I have to Register?

In general, a business is required to register if it provides taxable (including zero-rated) goods or services in Canada in the course of carrying on a commercial activity in Canada and the business is not a small supplier. A business is a small supplier if the total revenues from taxable supplies (before expenses) are Cdn $30,000 or less in the last four consecutive calendar quarters.

In all cases, total revenues from taxable supplies means worldwide revenues from supplies of goods or services subject to GST/HST (including zero rated supplies) OR that would be subject to tax if supplied in Canada.

Where the business does not have a permanent establishment in Canada, the business would have to provide the CRA with a security deposit. The initial amount of the security deposit is equal to 50% of the estimate net tax, whether positive or negative during the 12 month period after the business registers. For subsequent years, the amount of the security deposit is equal to 50% of actual net tax for the previous 12-month period (whether negative or positive). The maximum security deposit that the CRA currently requires is Cdn $ 1million and the minimum is Cdn $5,000.

6) Investing into Canada

An investor looking into investing in Canada faces many alternatives and decisions. Each has different tax consequences. Ignoring factors or making the wrong decision can result in unanticipated tax consequences and/or lost opportunities. Some questions may be:

1) Should I buy the shares of an ongoing business or the underlying assets? What if the seller wants to utilize his capital gains exemption and sell shares - are hybrid deals possible?

2) If I buy the shares of an ongoing company, are there are restrictions on utilizing prior losses?

3) If I buy the assets of the business, do I get an increase in the basis of the assets? Can I deduct purchased goodwill?

4) Should I operate as a branch in Canada or set up a Canadian subsidiary?

5) Am I expecting start up losses in Canada?

6) How do I get my profits out of Canada at a minimum tax cost?

7) Should I retain the profits in the Canadian company to further expand?

8) How should I fund the capital of the new Canadian operations - shares vs. debt?

9) How much interest can I charge on any intercompany loans?

10) Can I pay a management fee to the U.K. parent company?

11) Where should my Intellectual property ("IP") be located? Can I make a deductible royalty payment?

11) Do I have to invest directly from the U.K or can I set up an offshore structure? What would the benefits be?

12) Will setting up an active company in Canada give me access to the U.S. market under the North American Free Trade Act (NAFTA)?

13) Should I move my R&D to Canada to take advantage of the Canadian Scientific Research and Experimental Development (SRED) credits? How much are they worth? How do I access these?

14) Would a Canadian Immigrant trust allow me to reduce Canadian taxes on an eventual sale of the business? Does the trust need to be in Canada?

15) Would a trust structure assist in deferring the Canadian departure tax if I leave Canada?

Unique planning opportunities exist for each question. There are, however, no one-size-fits-all answers to any of the above questions. Cadesky and Associates LLP has prided itself on providing unique solutions tailored to a person's specific facts, objectives and goals. We would welcome the opportunity to discuss your needs.