

**DOING  
BUSINESS  
IN**

**Canada**



**HLB** Canada

*doing business in  
Canada*

# *foreword*

This booklet has been prepared for the use of clients, partners and staff of HLB International member firms.

It is designed to give some general information to those contemplating doing business in Canada and is not intended to be a comprehensive document. Furthermore, differences in interpretation may have arisen on the translation into English.

You should consult us, therefore, before taking further action.

The information contained in this booklet is believed to be correct at the time of preparation in January 2008.

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Up-to-date information and general assistance on international matters can be obtained from any of the partners of HLB Canada listed in this booklet or from the Executive Office in London:

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# *general information*

## Geography

Canada is a federated country in North America, bounded on the North by the Arctic Ocean; on the east by the Atlantic Ocean; on the south by the United States; and on the west by the Pacific Ocean and Alaska. Canada is the world's second largest country, surpassed in size only by Russia. Canada has a total area of nearly 10 million sq. km (over 3.8 million sq. miles) of which more than 900,000 sq. km (nearly 350,000 sq. miles) is covered by bodies of fresh water such as rivers and lakes, including those portions of the Great Lakes under Canadian jurisdiction. In all, approximately 9% of its total area is composed of fresh water.

Canada is naturally divided into geographic regions that share similar economic factors. Eastern Canada consists of the Maritime provinces and the Saint Lawrence lowlands. This region embraces Newfoundland and Labrador, Nova Scotia, New Brunswick, Prince Edward Island and the Gaspé Peninsula of Quebec. This region is an extension of the Appalachian Mountain system and of the Atlantic Coastal Plain. Further to the west, the Great Lakes Saint Lawrence lowlands region in southern Quebec and Ontario includes the largest expanse of cultivable land in eastern and central Canada and most of the manufacturing industries of the nation.

The Interior Plains stretch from the western border of Ontario to the north eastern corner of British Columbia. They encompass most of Alberta, the southern half of Saskatchewan and southern third of Manitoba. This region contains the most fertile soil in Canada.

The westernmost region of Canada includes the uplifts west of the Interior Plains. In Canada, this region includes part of western Alberta, much of British Columbia, the Inuvik Region, part of the Northwest Territories, as well as all of the Yukon Territory. The eastern portion of this area includes the Rocky Mountains and related ranges. To the west of the Canadian Rockies is a region occupied by numerous mountain ranges and a vast plateau region. Deep river valleys and extensive tracts of arable land are the chief features of the plateau region, particularly in British Columbia. To the west of this plateau is another great mountain system. This system includes the Coast Mountains and various coastal ranges.

Every region of Canada has significant shifts in climate from summer to winter. Coastal areas have moderate climates due to their proximity to the water while central areas of Canada can be snow covered from December through April (substantially earlier onset and later melting in the northern regions).

## Time zones

There are six time zones in Canada ranging from 8 hours behind Greenwich Mean Time on the Pacific Coast to 3.5 hours behind Greenwich Mean Time in Newfoundland and Labrador. Most places in the country observe Daylight Saving Time from the second Sunday in March to the first Sunday in November when clocks are advanced one hour.

## Population Characteristics

Statistics Canada reports the population of Canada to be about 33 million. Approximately 69% of the population are between the ages of 15 and 64 and 13% are age 65 and over.

Of the existing population, about one-third reside in the metropolitan areas of Toronto, Montreal and Vancouver. Approximately three quarters of the people of Canada inhabit a relatively narrow belt along the United States border, with about 62% concentrated in Quebec and Ontario. Overall, approximately 79% of the population lives in urban areas. In descending order of population, the most populated provinces are Ontario, Quebec, British Columbia, Alberta and Manitoba.

The population of Canada is ethnically diverse, with 66% of European origins (including 28% British and 23% French), and others mostly of Asian, African, Arab or mixed backgrounds.

## Political Sub-divisions

Canada consists of ten provinces and three territories, each with a separate legislature and administration.

## Language

The two official languages of Canada are English and French, with French being spoken mainly in Quebec where it is the official language of that province. English is the language spoken in most of the country and is also the generally accepted language of business. The Province of New Brunswick has the largest French speaking population outside of Quebec. All inscriptions on products sold in this country, including the packaging and instructions, must be printed in both official languages.

Urban areas, such as Toronto and Vancouver contain significant populations for whom neither English nor French is a first language.

## Education

Canada maintains a public education system for elementary and secondary schooling, funded and administered by each province individually. Attendance at school is compulsory beginning at age 5 or 6 and continues until the age of 15 or 18, depending on the province or territory.

## Currency

The unit of currency in Canada is the Canadian dollar consisting of 100 cents which was roughly equal to the American dollar at December 31, 2007.

## Economy

Canada's economy is market oriented, with an annual Gross Domestic Product estimated to be in the range of 1.2 trillion dollars for 2007. The GDP is composed of services (68%), industry (29%) and agriculture (3%) and has a real growth rate of about 3%.

The services sector employs 75% of the labour force, and as the average age of Canadians continues to increase, the demand for financial, leisure and other services will make this sector an ever increasing component of the Canadian economy.

The manufacturing sector employs 14% of the labour force in Canada. The major manufacturing industries are transportation equipment, electrical and electronic products, foods and beverages, wood and paper products, unprocessed and processed minerals, chemicals, petroleum and natural gas.

Canada is a large producer and exporter of agricultural products such as wheat, oilseed, barley, fruits, vegetables, and dairy products.

## Foreign Trade

The per capita foreign trade of Canada ranks among the highest of any nation in the world. Most of Canada's foreign trade is with the United States, which typically takes about four-fifths of Canada's exports and supplies almost three-fifths of its imports. The value of the Canada United States merchandise trade is greater than between any other two countries in the world. Components of Canadian exports are increasingly manufactured items; while resource exports such as minerals, timber and grains are still important, their share of total export volume is decreasing. Leading export items to the United States are motor vehicles and motor vehicle parts. The cross border exchange increased particularly after Canada and the United States entered into a free trade agreement in 1989. This agreement was superseded in 1994 when the North American Free Trade Agreement was approved, which admitted Mexico into the pact and continued trade liberalization policies.

Other principal trading partners include Japan, Great Britain and China,

## Government

Canada is mainly governed according to principles embodied in the Constitution Act of 1982, which gave the Canadian Government total authority over its constitution. Canada is a Federal union, with a division of powers between the central and provincial Governments. Originally, the central Government had considerable power over the provinces, but over time the Provincial Governments have increased the scope of their authority.

The Canadian Charter of Rights and Freedoms, added by the passage of the 1982 Constitution Act guarantees fundamental freedoms to all citizens. The Charter changed the Canadian political system by enhancing the power of the courts to make or unmake laws through judicial decisions. It also contains the so called "notwithstanding" clause, which allows Parliament or the Provincial legislatures to designate an act operative even though it might clash with a Charter provision. Although the constitution and Charter apply uniformly throughout Canada, the Province of Quebec has never formally signed the agreement.

The head of state of Canada is the Sovereign of Great Britain. In theory, the head of the national Government is the Governor General, who represents the British Monarch. However, the Governor General adheres to the advice of the majority in the House of Commons (the lower chamber of the legislature) in appointing the Prime Minister, who is the effective head of Government.

### Central Government

The central Government of Canada exercises all powers not specifically assigned to the provinces. It has exclusive jurisdiction over administration of the public debt, currency and coinage, taxation for general purposes, organization of national defense, fiscal matters, banking, fisheries, commerce, navigation and shipping, energy policy, agriculture, postal service, census, statistics, patents, copyright, naturalization, aliens, marriage and divorce. The Provincial Governments are responsible for education, hospitals, Provincial property and civil rights, taxation for local purposes, the regulation of local commerce and the borrowing of money. In certain areas such as immigration, the Federal and Provincial Governments possess concurrent jurisdiction.

### Legislature

The Canadian Parliament consists of two houses: an appointed Senate and elected House of Commons. Members of the House of Commons are elected in 308 Federal electoral districts whose boundaries are periodically adjusted to reflect population growth or redistribution. Federal elections are held at the Prime Minister's discretion, but must be called within a 5 year period; in practice, they are called about every 4 years. The Prime Minister is the leader of the majority party in the House of Commons; if no majority exists, the party with the most seats in Parliament leads a "minority government". A cabinet is appointed by the Prime Minister, comprising of members from the House of Commons and the Senate.

### Judiciary

The legal system in Canada is derived from English common law, except in Quebec, where the Provincial system of civil law is based on the French Code Napoleon. The Federal judiciary is headed by the Supreme Court of Canada and is the final Canadian appellate court for all civil, criminal and constitutional cases. The next leading tribunal, the Federal Court of Canada, is divided into a Trial Division and an Appeal Division. It hears a variety of cases, notably involving tax cases and claims against the Federal Government. Provincial courts are established by each of the Provincial legislatures, and, although the names of the courts are not uniform, each province has a similar three tiered court system. Judges of the Supreme Court, Federal Court and almost all judges of the higher Provincial courts are appointed by the Federal Government.

### Provincial and Territorial Government

The Government of each of Canada's ten provinces is in theory headed by a Lieutenant Governor, who represents the Sovereign of Great Britain and is appointed by the Governor General on the advice of the Federal Prime Minister. The Lieutenant Governor has little actual power and in practice, the chief executive of each province is the Premier, who is responsible to its Provincial legislature. The Yukon, Northwest and Nunavut Territories are governed by federally appointed commissioners, assisted by an elected council and legislature.

## Municipal Government

The city or municipal governments usually consist of an elected mayor and a council. The organization and authority varies depending on the province, but they usually hold extensive powers of self government. Each city or municipality will have its own set of by-laws.

# *investment factors*

## Government Assistance

The Governments in each of the provinces have adopted a pro-active approach to both business development and to foreign investments.

Both Federal and Provincial governments have grant and incentive programmes that vary according to political and economic pressures at any given time. Governments provide assistance in the form of loans, loan guarantees, grants, cost shared training and research programmes and letters of credit. They also provide a number of other services that assist businesses. These include business information centres, assistance with trade shows, market research, statistical information, international insurance, technological research and generous development programmes.

The Business Development Bank of Canada ("BDC") extends financial assistance on a national level to new and existing businesses. The forms of assistance include loan guarantees, equity financing, training and counselling programmes, management seminars, business information and libraries. The BDC has offices in each province and territory and focuses on the needs of small and medium sized businesses. More information can also be obtained from their website, [www.bdc.ca](http://www.bdc.ca).

It is worthwhile to pursue both Federal and Provincial programmes. While Provincial programs are generally more specific in their nature, the application process can be less complex and the approval process may be faster.

## Investing in Canada

The Investment Canada Act ("ICA"), which came into force in 1985, applies to foreign investors who acquire an existing Canadian business or establish a new business in Canada. Generally, notification prior to implementation of the proposed transaction or within 30 days thereafter to Industry Canada is all that is required. However, large acquisitions, both direct and indirect, including the acquisition of one foreign company by another where the acquired corporation has a Canadian subsidiary, are subject to a review process.

Reviewable investments require the investor to file an application for review with the Minister responsible under the ICA. The application must be filed and approval obtained prior to the investment proceedings. If the purchase of a business must meet an early closing deadline, the Minister may approve an accelerated implementation request. Usually the review process will take 45 days, although the Minister may extend the period to 75 days. If the investment involves a business associated with Canadian heritage, then it must be approved by the Minister of Canadian Heritage.

## Foreign Exchange Control

There are no legal constraints on a transfer of profits, royalties or fees out of Canada or on the repatriation of investment capital. The Canadian dollar floats freely on world exchange markets and is not subject to exchange controls. Banks provide complete foreign currency exchange services. There are a number of private exchange firms operating throughout the country.

## Financing

The financial markets in Canada are stable, mature and accessible to everyone. The two primary methods of financing a business are equity and debt financing. Additional sources of financing include leasing, fixed asset financing, accounts receivable financing and inventory financing. There are also extensive Government financial assistance programs (discussed earlier) available to business.

## Equity

There are a number of sources of equity, with the most obvious originating with the individual starting the business. A limited company can obtain equity financing and still remain private if it has less than 50 shareholders and does not offer its shares to the public. Due to the cost of raising funds on a public exchange, investment dealers normally use \$500,000 as the benchmark for undertaking a public issue of securities. As well, there are a number of well established venture capital firms in Canada.

The stock exchanges in Canada (Toronto, TSX Venture, and Montreal) also provide vehicles for companies to raise capital. The Toronto Stock Exchange trades senior equity issues, the TSX Venture Exchange trades junior issues, and the Montreal Stock Exchange trades derivatives and small capital Quebec stocks. Many companies elect to raise funds on the public markets and Canadian companies are listed on both the NASDAQ and New York Stock Exchange. In 2000, NASDAQ Canada was incorporated in Montreal as a wholly owned subsidiary of The NASDAQ Stock Market. HLB has been active in assisting corporations, operating in Canada, to raise funds in the New York NASDAQ market.

## Debt

The primary source of debt financing in Canada is the banking system. There is an extensive network of domestic and foreign owned banks operating across the country. The largest network belongs to the six major Schedule I Canadian banks, but there are also roughly 50 foreign banks (Schedule II and III banks) with branches in the major centres. The domestic banks provide a full range of integrated banking services and maintain offices internationally. Trust companies, insurance companies, credit card companies and regionally operated credit unions also provide a limited range of banking services. The banks are now moving into services that have traditionally been the domain of other industries, including the insurance industry.

The Bank of Canada, which is the central bank, is responsible for Canadian monetary policy, bank notes, central banking services and debt management for the Federal Government. All Canadian banks are regulated by the Office of the Superintendent of Financial Institutions and have strict reporting requirements.

## Imports and Exports

Canada does not generally require licensing for imports. However, certain goods such as agricultural and animal produce, some steel products, weapons and munitions are subject to import controls. As well, export permits are required for a limited number of products, particularly strategic materials or items of agricultural importance. Examples include electricity, petroleum, uranium and some antiques and works of art. Permits are also required for transfer of specific goods to certain restricted countries.

Importing commodities requires the completion of the proper customs forms and payment of duties and tariffs. Duties for different goods vary depending upon a number of factors. These factors change from time to time and it is, therefore, necessary to stay abreast of the current regulations. A business involved in the importing of goods on a regular basis may find it beneficial to retain a customs broker.

Canada has developed regulations that apply to foreign dumping, import quotas on certain products, packaging and labelling requirements as well as prohibited, offensive and controlled products.

## North American Free Trade Agreement

In 1994, Canada entered into the North American Free Trade Agreement ("NAFTA") with the United States and Mexico. The NAFTA Agreement expands upon the objectives set out in the original Free Trade Agreement between Canada and the United States and provides for barrier free access to and from Mexico. Virtually all tariffs on Canadian exports to Mexico were phased out by January 1, 2003. On January 1, 2002, however, Canada's International Trade Ministry announced the earlier elimination of the Mexican tariffs on goods such as motor vehicles, pharmaceutical products, certain wood pulp, railway stock parts and toys.

Tariffs between Canada and the United States on qualifying goods were virtually eliminated as of January 1, 1998, with some tariffs still in place for certain products in Canada's supply managed sectors, as well as sugar, dairy, peanuts and cotton in the United States.

Both the Canada United States Free Trade Agreement and NAFTA have increasingly liberalized trade between Canada, the United States and Mexico while preserving Canadian social, health, safety and environmental standards.

# *labour relations and employment standards*

## General

Responsibility for employment matters in Canada is divided between Federal and Provincial jurisdictions. Most employees fall under Provincial jurisdiction and are governed by various statutes enacted by Provincial legislatures. However, the Federal Government has jurisdiction over employment in federally regulated industries such as banking, inter provincial transportation and communications.

An employer must comply with a number of employment related laws covering employment standards, collective bargaining, human rights, health and safety, workers' compensation and pay equity. Federal laws provide that all employers collect Employment Insurance Premiums, Canada Pension Plan contributions and personal income tax deductions on behalf of the Government. The employer and the employee share payment of the employment insurance premiums and the pension contributions. The three deductions are usually deducted and submitted in a lump sum payment to the Canada Revenue Agency (the "CRA"). Self employed individuals are responsible for their own deductions for Canada Pension Plan contributions and income tax. For 2008, the contributions limits are:

	Employee	Employer
Canada Pension Plan (4.95% of \$41,400)	\$ 2,049.30	\$ 2,049.30
Employment insurance (1.73% of \$41,100)	711.03	
(2.42% of \$41,100)		994.62

Generally, a work week is 40 hours, consisting of five 8 hour days. The minimum wage for employees over 18 years of age varies by province from \$5.90 to \$8.50 per hour. Employees are entitled to be paid 1 1/2 times their hourly rate for overtime and to receive at least 2 weeks paid vacation per year in addition to statutory holidays. White Collar employees frequently do not get paid for overtime and may receive up to 4 weeks of paid vacation per year.

Employees are entitled to unpaid maternity and parental leave. Depending on the jurisdiction, the leave can range from 15 to 70 weeks. The employees have the right to their former employment position upon return.

Federal and provincial laws prohibit employment discrimination for such matters as race, age, sex, religion and disability.

Canadian workers may join trade unions in which the collective bargaining process is governed by federal and provincial labour relations acts and labour codes. Roughly 30% of private sector employees belong to a union.

## Termination

Employees cannot be arbitrarily dismissed. Employment standards legislation sets minimum notice (or pay in lieu of notice) that employers are required to give employees whom they wish to terminate without cause. In some circumstances, the employer may also be obliged to give the employee additional severance pay. There is also a body of law, developed by the courts in wrongful dismissal actions, requiring employers to provide reasonable notice of termination. In most cases, senior or long standing employees are entitled to much longer notice of termination than is specified in employment standard legislation.

## Health and Safety

Employers are required to take reasonable care for the safety of employees. Every jurisdiction has enacted laws giving both employers and employees specific health and safety obligations. In general, Provincial legislation governs workers' compensation. If the worker is injured at work, he or she may receive payments from a Workplace Safety & Insurance Board or the Workers Compensation Board. This fund is generated by contributions from employers based on an industry assessment. All employers must register with the Fund and generally make monthly payments.

## Retirement Income Plans

The Old Age Security Pension is a federal government sponsored plan that is generally available upon application to individuals that are sixty-five or older. The pension is available to persons who reside inside or outside of Canada but is subject to a basic residency test of ten years for those living in Canada and twenty years for those residing outside of Canada.

The Canada Pension Plan (Quebec Pension Plan in Quebec) is a government operated retirement pension that provides minimal post retirement supplemental income for Canadian workers. Employers and employees make tax deductible contributions to this plan. Many employers provide additional funding to provide post retirement funding for their employees.

Employers can make contributions either to a group pension plan or to a group of individual retirement accounts. A number of government regulations affect the design and operation of such plans. Federal and Provincial legislation generally prohibit differentiation of benefits and contributions by reference to age, sex or marital status. The private pension plan must also be approved by government pension authorities and meet certain criteria with respect to funding, vesting and investments. The plan must also be submitted to the Canada Customs and Revenue Agency to permit contributions (by both employer and employee) to be tax deductible.

Individuals are entitled to receive their full pension benefits at age 65 but may elect to start receiving reduced benefits after age 60.

# *immigration*

## Permanent Residents

(Canada assesses individuals applying for permanent resident status according to selection standards for three classes. One of the major classes is the business immigrant class, which is divided into (i) entrepreneurs, (ii) investors, and (iii) self employed persons. The other two classes are the skilled worker and the family class. More information can be obtained from Citizenship and Immigration Canada and its website, [www.cic.gc.ca](http://www.cic.gc.ca).)

## The application procedure

Immigrants must apply for and obtain a landed immigrant visa prior to entry into Canada. Each applicant and each of his/her spouse and dependent children must meet the medical and security requirements for admission to Canada.

## Business immigrant classes

Special regulations address the immigration of entrepreneurs, investors and self-employed persons based on the ability to establish business enterprises or otherwise invest in Canada.

Entrepreneurs must manage and own at least one-third of a business for at least a year within three years of landing in Canada to meet admission conditions. Qualifying entrepreneurs must have the financial ability and proven expertise to become involved in, and actively manage, a Canadian business enterprise. The business must employ at least one Canadian citizen or permanent resident other than the entrepreneur or his/her dependents. There is a minimum net worth requirement of \$300,000. Entrepreneurial applications may be accompanied by business proposals that describe in detail the nature of the business to be undertaken, the business and professional relationships to be established, the relevant background of applicant, and the financial resources of the applicant.

To qualify as an investor, an individual must have operated, controlled or directed a financially successful business or commercial undertaking, be able to demonstrate the legitimate accumulation of a net worth of a prescribed amount of at least \$800,000, and have made a minimum investment of \$400,000 which will be allocated to the provinces and territories by National Headquarters in Ottawa for the creation or continuation of employment opportunities for Canadian citizens or permanent residents other than the immigrant or the immigrant's dependants. The investment will be required to be irrevocable for 5 years and will be returned to the investor without interest at the end of the 5 year holding period.

Both investors and entrepreneurs must submit a detailed application for permanent residence, together with documentation including a resume, personal financial statement and a business plan.

The province of destination must support the application. Unlike the entrepreneurs, investors do not have to take an active role in the management of his or her investment.

The entrepreneur immigrant must have the intention and the ability to establish or purchase a business in Canada. That business must create an employment opportunity at least for the entrepreneur and make a significant contribution to the economy or the cultural or artistic life of Canada.

Self-employed persons are those who can make a significant contribution to the cultural or athletic life of Canada or intend to purchase and manage a farm in Canada.

All business class immigrants must prove that they have enough funds to support their family for the first six months after their arrival in Canada. Generally, the immigrant is expected to have at least \$10,000, plus \$2,500 for each dependent.

#### Skilled worker class

Immigrants under this class are expected to have the skills, experience, language abilities and education required to make a contribution to the Canadian economy. The selection criteria are based on a point system, where points are awarded for education, knowledge of English and/or French, skills, age and experience. Bonus points are given to those who have relatives in Canada who are Canadian citizens or permanent residents.

#### Family immigrant class

Immigrants under this class are sponsored by a relative in Canada such as a parent, spouse or fiancé(e). Sponsors must agree to support the family member and the accompanying dependents for a period of three to ten years to help them settle in Canada. The length of time varies with the age of the immigrant and his/her relationship with the sponsor.

Once the application for emigration is successful, a Permanent Resident (PR) card is issued. The card is required by permanent residents seeking re-entry into Canada on any commercial carrier (train, airplane, boat or bus).

Immigrants can apply for citizenship status if they have lived in Canada for three years out of the four years before the day they apply.

# *business organisations*

The principal forms of business organization in Canada are corporations, partnerships, joint ventures and sole proprietorships. Trusts and co-operatives are used less frequently to carry on business. Both Federal and Provincial laws govern the conduct of business in Canada and in certain instances, for example with corporation statutes, there is overlapping jurisdiction.

A foreign investor has numerous options available for organizing business operations in Canada. These include operating through a Canadian branch or a Canadian subsidiary. The type of business organization chosen is an important decision as each has advantages and disadvantages regarding liability, tax treatment, reporting, repatriation of income and capital as well as legal requirements. For example, it may be easier for a Canadian subsidiary to raise capital in Canada or to qualify for Government grants and assistance.

A non-resident corporation or individual can also conduct business in Canada by means of a partnership or a joint venture arrangement. In addition, there may be situations where the most suitable way to carry on a business in Canada is through an agent or an employee.

## Corporations

A corporation is a legal entity separate and distinct from its individual shareholders. The debts and obligations of the corporation are liabilities of the corporation, not of the individual shareholders. Therefore, the corporation offers the advantage of limited liability. The corporation also offers perpetual existence.

A business can be incorporated under either the Federal Canada Business Corporations Act ("CBCA") or any one of the ten Provincial and three Territorial corporations' statutes. The decision to incorporate, as a Federal or a Provincial company, depends on a number of factors, including: the nature of the business, the area of operations, the share structure desired and the reporting requirements. A Provincial corporation must establish its head office in the province in which it is incorporated. It must hold its annual meeting in the province and it cannot do business in another province unless it becomes registered in that province. Therefore, corporations that intend to operate in only one province may find it advantageous to register provincially. Corporations that plan to operate in more than one province or on a national level must comply with various extra Provincial licensing and filing requirements which are usually mere formalities.

Both public and private corporations may issue shares. A public corporation is, in general, one listed on a Canadian or prescribed stock exchange. To issue securities to the public a corporation must initially file a prospectus (which includes financial disclosure) and it must comply with the reporting and disclosure requirements of the Federal and Provincial securities authorities. A relatively common approach is to takeover a public company, with or without inherent value, to avoid the requirement of a prospectus. These reverse takeovers are more common with smaller capitalization companies, often referred to as junior corporations.

Private companies are restricted to no more than 50 shareholders and they are not permitted to sell shares to the general public.

Regardless of jurisdiction of incorporation and status as public or private, legally all corporations are essentially the same. Any corporation can include the terms Limited/Ltd, Incorporated/Inc., or Corporation/Corp in its name.

The various incorporating acts normally require corporations to have an annual audit. There are some exemptions to this requirement, which smaller corporations (most privately held corporations) can use when appropriate. The shareholders of the corporation appoint an auditor or accountant at the annual meeting. The auditor is required to examine the books and records and provide his or her opinion as to the fairness of the financial statements. The auditor's report and the financial statements must be prepared in accordance with the Canadian Institute of Chartered Accountants' ("CICA") Handbook. Public corporations have additional reporting requirements, including reporting quarterly results. There is no standard year end, although December 31 is common for public corporations. Many private corporations select year ends between August and December to maximize personal tax planning options.

A corporation acts through its board of directors. Most provincially and federally incorporated companies must have at least one director with a majority of the board of directors of the corporation being Canadian residents. The directors are responsible for the management of the corporation's operations and have exclusive authority over the appointment, duties and removal of the agents, officers and employees of the corporation. If a director is grossly negligent or commits a breach of trust, he can be held personally liable to the shareholders or the creditors of the corporation for resulting damages. Directors can also be held liable for unpaid taxes withheld by the corporation on payment of net salary to employees and commodity taxes collected on its sales.

Legal fees for incorporating commonly run from \$500 to \$1,000 which are added to government fees which vary with the jurisdiction of incorporation (for example, \$360 in Ontario or \$250 for Federal).

#### Unlimited Liability Corporations ("ULC")

Alberta, British Columbia and Nova Scotia are provinces that authorize unlimited liability companies. The "unlimited" liability feature of the company exposes the shareholders for the unpaid debts of the company upon dissolution. Accordingly, investors will often hold the shares of the NSULC through a limited liability holding company. ULC's are of special interest to investors living in the U. S. A. since the ULC is considered to be a corporation for Canadian income tax purposes and is eligible for flow through treatment under a check the box entity classification for U. S. income tax purposes.

The ULC permits an entity to have flow through tax consequences while isolating Canadian tax consequences to this local entity.

#### Branch Office - Foreign Corporation

All foreign corporations operating in Canada must be registered or licensed to operate in each province within which they do business. In each case, the branch of a foreign corporation is

registered as an extra Provincial company under Provincial legislation. If the corporation does not have an office in a province where it operates, it is normally necessary to appoint an attorney to represent the firm. The appointment of the attorney as the local representative is filed with the appropriate Provincial agency. Legally, the branch has no separate status from the foreign company itself; it is merely carrying on business in Canada. The foreign company would be liable to the employees and the creditors of the branch for the actions of and business contracted by, its managers and agents on behalf of the branch. A foreign company planning to invest in Canada must also comply with the terms of the Investment Canada Act.

## Partnerships

A partnership is a relationship that exists between two or more persons who have agreed to combine resources to carry on a profit motivated business in common. A characteristic of a partnership is a sharing of profits and losses as opposed to gross revenues. Any number of individuals operating a business in common can establish a general partnership without any government approval.

The partners entering into a legally binding relationship can create general partnerships. A general partnership is created by the partners and is routinely registered within 60 days of creation. That registration can be filed late in Ontario, but parties cannot maintain legal actions in the name of the partnership until it is registered. All general partners share the burden of loss with each other according to the partnership agreement, but each partner bears unlimited liability to third parties for all debts. That is, in the event that the partnership assets cannot satisfy partnership creditors, creditors may elect to collect the debt from any partner they select. Naturally, partners with deeper pockets are usually selected first.

A limited partnership consists of one or more general partners who are personally liable for partnership debts and one or more limited partners who contribute capital and share in the profits or losses of the business. Limited partnerships can only be created by registering with the appropriate Provincial agency. The advantage of limited partnerships is that the limited partners have no financial obligations in excess of agreed upon capital contributions whereas the general partner(s) assumes full financial responsibility for debts. The limited partners cannot participate in the management of the partnership's business if they wish to maintain their limited liability status.

Generally, a partnership may select any fiscal year end for calculating and reporting taxable income. Where a member of the partnership is an individual or professional corporation, the partnership must adopt a December 31 year end for tax purposes. Profits are treated as income of the partner and are taxed at their respective rates.

## Joint Ventures

A joint venture is a business undertaking by two or more parties in which the parties pool their capital and skills for a specific project or venture of a limited scope and duration.

In the pure sense, the ventures do not carry on business as partners but share the costs of creating a product and/or share the gross returns. The ventures are generally responsible for their own proportion of the ventures liabilities unless they are found to be carrying on business in partnership, in which case, they are jointly and severally liable for the debts of the venture.

The joint venture is not taxed as a partnership. Each venturer reports the proportionate share of

revenues and expenses for income tax purposes. As Canadian tax law does not recognize a joint venture, there are no formal reporting requirements for joint venture year ends. Technically, each participant should report joint venture revenue and expense according to its own taxation year. Administratively, the Canada Customs and Revenue Agency usually permits a joint venture to pick a common taxation year end for all venturers.

### Sole Proprietorships

The simplest form of business organization is the sole proprietorship. In this type of organization, the owner is in sole charge of the business and is responsible for its success or failure. Unless the law specifically prohibits an activity, no line of business is closed to an owner. Business is usually carried out under the owner's name without any specific legal registration, subject of course, to the normal requirements such as licence and permits. However, if the owner decides to use a name other than his or her own, the trade name chosen may be registered with the appropriate Provincial agency.

A sole proprietorship is not considered to be a legal entity under the law, but rather is an extension of the individual/entity that owns it. Therefore, the owner has possession of the business assets and is directly responsible for the debts and other liabilities incurred by the business. The owner has unlimited liability. If the business fails, all of the owner's assets, both business and personal, may be used to discharge this liability. One of the advantages of a sole proprietorship is the fact that there are fewer regulations associated with it. Most proprietorships select the fiscal period for the business to match the calendar year since income taxes are payable on income earned in the calendar year.

### Trusts

Trusts are a legal vehicle used when persons (Trustees) hold title and manage assets for the benefit of the beneficial owner(s) of the assets (Beneficiary). One or more persons (the settlor) can establish a trust using a verbal or written agreement. For tax purposes, the courts have held that the parties to a trust must document in writing both the existence and terms of the trust. The terms of this document determine the rights of parties under this relationship, including disposition of income earned by the trust and distribution of the capital of the trust.

Businesses often register title of real estate in another's name under an agency agreement. While the agency agreement is often described as a "bare trust", it is really not a true trust.

Individuals often use trusts for estate planning purposes. Trusts created during one's lifetime are called inter vivos trusts. Trusts arising on death are testamentary trusts. Inter-vivos trusts may be used for creditor protection, income tax planning and estate planning, especially in connection with family held businesses.

Trusts can be established to run businesses but this is uncommon. Recently, the investment community has used income trusts as investment vehicles whereby the trust raises funds from investors through a public offering of units and acquires an investment. The investors generally receive monthly distributions of cash calculated by reference to a formula applied to the business' cash flow and distributed as income and capital. The trust units are normally traded on a recognized stock exchange. The government disliked the tax advantages achieved by income trusts so enacted rules to curb the tax effectiveness. Accordingly, many of the existing trust will disappear in the next few years.

# *accounting and reporting requirements*

## Financial Reporting Requirements

Financial reporting requirements are basically the same for all businesses. Some additional disclosure is required for public companies and federally incorporated businesses. Most corporations are legally required to have annual audits, but there are exemptions available to smaller corporations.

## Reporting Standards

In most cases, financial statements in Canada are prepared in accordance with Generally Accepted Accounting Principles ("GAAP"). Although not statutory, GAAP are referred to in law and certain sources of GAAP have been given the force of law in some jurisdictions. A main, but not exclusive, source of GAAP is the handbook of recommendations of the Canadian Institute of Chartered Accountants.

## Corporations

Reporting standards for corporations emanate from two primary sources:

- (a) Canadian Institute of Chartered Accountants ("CICA") the CICA is the primary standard setting body for accounting in Canada, and
- (b) various industry specific bodies (e.g. banks, other financial institutions, insurance industry and real estate) have established industry guidelines and standards, which may differ from GAAP.

Annual financial statements of corporations not listed for public trading are not available for public review.

# *financing*

## Securities Legislation

Businesses intending to raise financing through the issuance and sale of securities in Canada are subject to the securities laws enacted by each of the provinces and territories of Canada. There is no federal securities law or federal securities commission in Canada, unlike the United States, the United Kingdom or Australia. Regulatory standards imposed by the provincial securities administrators and the Canadian stock exchanges are generally comparable to standards.

## Stock Exchanges

Starting in November of 1999, the major stock exchanges of Canada commenced operations according to functional rather than geographic boundaries. The Canadian TSX Venture Exchange handles junior stocks (i.e. shares of small and mid sized companies), the Toronto Exchange handles all blue chip trading Canadian corporations and the Montreal Exchange handles futures trading. NASDAQ Canada was established in 2000 and provides Canadians with the opportunities to directly invest in NASDAQ stocks from Canada.

### (a) Registration Requirements

Only registered entities may trade, underwrite or advise on securities unless that person or company is exempt from the registration requirements in the securities laws.

### (b) Prospectus Requirements

Generally, no person or company may raise money in financing by selling units from its treasury unless a prospectus has been filed or the securities are those of a "reporting issuer" and have been held for a specified period of time.

### (c) Exemptions

There are statutory prospectus exemptions available to an issuer for distributions of securities where (a) the securities are distributed to "prescribed institutions", which generally include chartered banks, loan corporations, trust companies, insurance companies and various levels of government in Canada, or sophisticated investors, (b) the purchaser acquires as principal and the trade is in a security which has an aggregate acquisition cost of not less than a specified amount (\$150,000 in most provinces), (c) the total number of investors is limited (usually to 25 investors), (d) the offerings are not advertised but can be shown to a limited number of potential investors (usually 50), or (e) the securities are distributed to the issuer's employees, directors, senior officers or those of its affiliates.

Other prospectus exemptions may also be available in individual provinces.

It is desirable to prepare and file an Offering Memorandum. An Offering Memorandum must meet certain limited requirements and in certain circumstances give the purchaser a contractual right of action against the issuer in rescission or damages where the document contains a misrepresentation. More importantly to the issuer, the document should contain all representations and rules related to the investment in detail similar to a prospectus. That can be important in limiting

the issuer's exposure to investors that lose their investment.

(d) Prospectus Disclosure

A prospectus must be prepared in accordance with the regulations of the applicable province and must contain full, true and plain disclosure of all material facts relating to the securities offered. It provides detailed information about the securities to be issued, the management and the financial position of the company. Both the issuer and the underwriters must sign certificates to that effect at the end of the prospectus. In the event the prospectus contains a misrepresentation, the securities legislation imposes liability on the issuer and each underwriter signing the prospectus.

Issuers who receive a receipt on filing a Final prospectus become a "reporting issuer" in that province from the provincial securities commission. Reporting issuers are subject to rules regarding continuous disclosure and ongoing reporting requirements, including those regarding timely disclosure of material changes, preparation of certain financial information for delivery to security holders, solicitation of proxies, preparation of information circulars and insider reporting.

(e) Continuous Disclosure Requirements

A report published in 1970 by a committee of the Ontario Securities Commission (The Merger Report) stated that the general purpose of disclosure is to provide an equality of opportunity for all investors in the market. The object of disclosure was said to be to make available all material facts the investor needs to make an informed investment decision on a timely basis. Filing a prospectus is just the first instance of the continuous disclosure that is required pursuant to Canadian securities law.

Periodic reporting provisions require that, the reporting issuer disclose information through filing annual and interim comparative financial statements, annual reports, proxy circulars and insider trading reports. Timely reporting provisions require issuers to file information regarding material changes as they occur. Filing must include the issuance of press releases for dissemination to the investing public and material change reports with the relevant securities authority.

(f) Take-Over Bids

Every person acquiring 20% or more of a particular class of voting shares or equity securities, or 10% or more in the case of an offeree issuer that is subject to the Canada Business Corporation Act, must immediately issue a press release with certain prescribed information. Within 2 business days, that person must also file a prescribed report with the securities regulators. Depending on the circumstances, additional reporting or restrictions may apply.

(g) Insider Trading

The securities legislation prohibits any person in a special relationship with a "reporting issuer" from purchasing or selling "securities" of the issuer with knowledge of a "material fact or material change" with respect to the issuer that has not been "generally disclosed". Insider trading and tipping are statutory offences carrying criminal penalties. Civil remedies are also available to a purchaser and seller of securities and the issuer, where the trade involves such activity.

(h) Multi-Jurisdictional Disclosure System

Canadian regulators and the Securities and Exchange Commission now accept certain offerings in Canada where disclosure complies with the requirements of other jurisdictions. Such disclosure must be reconciled to Canadian GAAP. These rules, which are referred to as the Canada/Multi Jurisdictional Disclosure System or MJDS, apply to certain rights and exchange offers, take over bids, issuer bids and business combinations and extend to recognition of certain home jurisdiction

continuous reporting obligations.

#### (i) Takeovers (Back Door Listings)

A commonly utilized means of reactivating dormant companies or "public shells" on the stock exchanges in Canada is the process of reverse takeovers. In a reverse takeover, new shareholders acquire more than 50% of the shares of the listed company through newly issued treasury shares. The listed company issues treasury shares in return for assets, which could be shares of a private corporation, or business assets.

#### Initial Public Offerings

An initial public offering of securities ("IPO") of an issuer is the conventional way of "going public" and is made by means of a prospectus which must be filed with and received by the relevant securities commission. While most Canadian corporations go public on a Canadian exchange, more and more are doing so on American exchanges. In Québec, all prospectuses filed with the Québec Securities Commission must be translated into French. This increases the cost and delays the timing of the offering. The process of prospectus clearance with the provincial regulatory authorities in Canada is fundamentally similar to that of the Securities and Exchange Commission.

Implementing the decision to go public is a complex path involving many detailed steps. These are best considered on a case by case basis.

#### Private Placements

Generally a prospectus is not required in two circumstances. One is where the purchaser of a security qualifies as a sophisticated investor and purchases the security as principal. The cost of the security to the purchaser must exceed the sophisticated investor limit of the province in which the investor resides (\$150,000 in most provinces). This private placement exemption is only available if the purchase price is paid in effect by one person and will not apply to a subscription by a number of persons who form a group to meet the minimum subscription threshold. The second exemption requires that issuers neither advertise nor show the investment to more than 50 potential investors and accept no more than 25 investors. Securities issued in a private placement usually carry resale restrictions. The securities are usually required to be held by the placee for a number of months (hold period) subject to further restrictions or conditions that have to be met before the securities can be resold.

These investors must receive substantially the same information as a prospectus would provide and is usually provided in the form of an Offering Memorandum. An issuer can only use this exemption once. In Québec, there is no limit on the number of persons to whom the security may be offered, only on the number who subscribe.

# *general, private and commercial law*

## Personal Property Security

All provinces except Quebec have adopted personal property security legislation modeled after Article 9 of the Uniform Commercial Code. Creditors can register a secured interest by executing and filing an underlying security instrument. The legislation provides for the perfection of security interests and outlines the priority scheme for various security interests perfected under this legislation.

Québec has a system of personal property security under the new Civil Code of Québec.

## Real estate

Provincial governments control the sale and development of real estate. Prince Edward Island has enacted legislation that significantly restricts the amount of land that may be held by persons (whether corporations or individuals) not resident in the Province. Alberta and Québec have legislation, which prohibits the acquisition by non residents of interests in certain types of real property without the prior consent of the province. In some provinces, corporations must comply with provincial licensing or registration requirements to hold land in that province.

Although provincial governments are responsible for land use planning, a variety of planning functions and extensive powers are delegated to the municipalities. Tighter zoning by-laws regulate virtually all aspects of the use of land and the nature of buildings thereon. Building by-laws, including building permit requirements and building code standards, govern such matters as building materials and standards.

## Privacy

Commencing in 2004, the Personal Information Protection and Electronic Documents Act (“PIPEDA”) applies to all business organizations in Canada. This federal law governs the collection, use and disclosure of personal information in the course of commercial activities. Personal information is broadly defined as “information about an identifiable individual” which includes, for example, age, race, religion, employment history, credit history, assets, and even opinions about an individual. Compliance with PIPEDA obligations are overseen by the federal Privacy Commissioner. Some provinces have enacted substantially similar legislation that supplement or supercede PIPEDA for organizations in their province.

# *intellectual property*

## Patents

Patent law in Canada has been greatly influenced by the legal systems of Great Britain and the United States. An inventor is granted the exclusive right in Canada to make, construct, use and sell an invention. An invention is defined as "any new and useful art, process, machine, manufacture or composition of matter" and any new and useful improvement thereof. Patents are granted for inventions, not for workshop improvements. An inventor must demonstrate that the invention incorporates a technological development or improvement that is not obvious.

A patent will not be granted if the invention was published anywhere in the world more than two years before the application was filed in Canada. Inventors usually employ registered patent agents to file the application. The government levies periodic fees, called maintenance fees, to keep the patent in force.

In Canada, the first person to file an application for a qualifying invention will be granted a patent that is valid for 20 years from the date granted. Qualifying inventions must have "absolute novelty" and not have been disclosed or made available to the public more than 1 year before a patent application is filed in Canada. After the 20 years, the patented inventions become public property.

Canada has entered into treaties with many other countries. The treaties enable a person who files a patent in Canada to file, within 1 year, in the treaty countries as well. Such filings involve the payment of fees in the other countries.

## Copyrights

A copyright is an owner's exclusive right to the publication or sale of the rights to a literary, dramatic, musical or artistic work. Upon creation, every such work is protected by copyright. The term of a copyright for written works is the life of the author plus 50 years; for sound recordings and photographs it is 50 years from the date of the original plate or negative. The Act provides explicit protection for computer programs.

Certain remedies are available only if the author can prove actual knowledge on the part of the infringing party of the existence of the copyright. However, actual knowledge is deemed to exist if the author has registered the work. Infringement includes the production or reproduction of a copyrighted work or any substantial part thereof and the knowing distribution or offering of the same to the public. Remedies for infringement are cumulative and include damages, an accounting of profits, delivery of any infringing material and injunctive relief. Criminal sanctions are also available in limited circumstances.

The Copyright Act does not protect items that could be protected under the Industrial Protection Act. Registration of copyright with the Federal Government is optional.

## Trademarks

A trademark is a distinctive word, name, symbol or device used by a manufacturer or merchant to distinguish a product or service from those of the competition. Generally businesses create their right to trade marks by use rather than registration. The extent of protection available to the owner of an unregistered trademark may be limited geographically to the area in which the trademark enjoys some notoriety. In respect of a registered trademark, there is exclusive protection across Canada. In addition, broader remedies are available where there has been an improper use of a registered trademark as opposed to an unregistered one.

In order to be registered, a trademark must be neither clearly descriptive nor deceptively misdescriptive of the character or quality of the goods or services, the persons employed in their production, or the place of origin.

Furthermore, a trademark must not be simply the name of the ware or service in another language, merely the name or surname of an individual who is living or who has died within the past 30 years, nor likely to cause confusion with a trademark enjoying prior rights.

In order to register a trademark, the applicant must claim to have used or made known the trademark in Canada, have registered and used the trademark in another country adhering to the Paris Convention, or propose to use the trademark in Canada.

A trademark is registered for 15 years and may be renewed for further 15 year periods. Infringement of a trademark, which may lead to both civil and criminal liability, occurs when there is a sale, distribution or advertisement of wares or services in association with a confusing trademark or trade name. Infringement also occurs where a person uses a registered mark in a manner likely to have the effect of depreciating the goodwill attached to it.

A trademark registration will be invalid if, at the time, proceedings questioning the validity of the trade mark are commenced, the mark has lost its distinctiveness and, therefore, cannot be said to identify in the minds of the public the particular source of the goods or service. Formerly, the most common means of losing distinctiveness was the licensing of the trademark without registering such licence. However, the requirement for the registration of licensed users of marks has been abolished in Canada. Trademark licensing in Canada now requires the licensor/owner of the mark to maintain direct or indirect control over the character or quality of the wares or services in respect of which the mark is licensed.

Use of a trademark in a competing business may also give rise to an action either at common law or pursuant to statute for passing off or unfair competition.

## Industrial Designs

The federal Industrial Design Act grants exclusive rights with respect to a registered industrial design within Canada for the duration of its registration. Industrial design is defined as "features of shape, configuration, pattern or ornament and any combination of those features that, in a finished article, appeal to and are judged solely by the eye".

Registration requires the filing of a photograph or a description and drawing of the design and a declaration that the design was not being used and had not been used, to the applicant's knowledge, by any other person at the time that the applicant adopted it. A valid registration requires absolute novelty namely the design should neither be found to be identical with some other design already registered nor to so closely resemble some other design as to be confused with it. Initial application must be made within one year of the publication of the design in Canada and may be made by the author, the author's successor in title or the person for whom the author created the work.

The exclusive rights conveyed by the registration of an industrial design are valid for five years and may be renewed for a further period of five years, to a limit of ten years in total. The infringement of a registered industrial design may give rise to both civil and penal remedies. In the absence of marking of the object with the notice provided by statute, only injunctive relief is available. Infringement includes the unauthorized use of an exact copy, an obvious imitation or a fraudulent imitation, the application of the design or an imitation thereof to another article for purposes of sale, exposure for sale or use of the article and the publishing, selling or exposing for sale or use of any such article. It is not, however, an infringement to apply a design similar or identical to that which has been registered to a substantially different article or in a new or novel manner.

# *insolvency and restructuring*

## LIQUIDATION REGIMES

### (a) Insolvency and restructuring

In Canada, insolvency regimes can be divided into two general categories: liquidation regimes and reorganization regimes. Liquidation regimes have one primary purpose, which is the realization of all of the assets of the insolvent entity by the insolvency representative for the benefit of its creditors. The relevant liquidation regime depends in part upon the type of corporation in question.

In contrast, reorganization schemes such as proposal, arrangement and reorganization provisions are intended to allow an insolvent entity time to develop a plan for the continued existence of its business, which might involve the compromise of the existing claims of its creditors, or the provision for a particular body to take control of a troubled organization. The six bankruptcy regimes that fall within these two categories are described as follows.

### (b) Bankruptcy and Insolvency Act

Liquidation/bankruptcy under the Bankruptcy and Insolvency Act (Canada) ("BIA") applies to almost any type of entity including individuals, partnerships, associations and corporations. The BIA defines "corporations" to include not only any company incorporated and authorized to do business by or under a federal or provincial Act, but any incorporated company that has an office in, carries on business in or has assets in Canada. The definition does not include certain entities in the financial services sector such as banks, savings banks, insurance companies, trust companies, loan companies or railway companies, although holding companies of such entities are subject to the BIA.

Among other things, the BIA allows the trustee in bankruptcy to realize the assets of the bankrupt, determine the propriety of claims against the estate and distribute the proceeds. Secured creditors are generally not affected by this proceeding and can, therefore, proceed to exercise their rights. Generally, a trustee takes the property of the bankrupt, subject to the existing rights of third parties. For example, contractual rights of termination are binding on a trustee. Set off is permitted. A trustee can, however, disclaim any lease under which a bankrupt is a tenant.

The trustee is able to challenge payments or transfers of property that have taken place within defined periods prior to the liquidation if they have had the effect of defeating or prejudicing the claims of creditors. Recent provisions facilitate multi jurisdictional insolvencies and securities brokers insolvencies.

### (c) Winding-up and Restructuring Act

Liquidation provisions under the Winding up and Restructuring Act (Canada) ("WURA") apply to federal or foreign banks, federal or provincial loan or trust companies and federal, provincial or foreign insurance corporations carrying on operations in Canada. Although the WURA can apply to "trading companies" (except for corporations incorporated under the CBCA), non financial institution corporations are generally liquidated under the BIA which operates similarly to the WURA.

## Receivership

Liquidation under a court administered receivership applies where a provincial court has been given jurisdiction under a specific Provincial Act to appoint a receiver to realize the assets of a business corporation for the benefit of its creditors. This process is used when there are shareholder disputes, environmental problems, international problems or many conflicting interests.

## REORGANIZATION REGIMES

### (a) Bankruptcy and Insolvency Act

The reorganization of creditor claims under the proposal provisions of the BIA applies to the same types of corporations to which the BIA liquidation provisions apply. Under the Act, a company may give notice of intention to file a proposal which effects a 30 day stay period against all creditors, except secured creditors who have taken possession of their security or given notice of their intention to enforce their security at least 10 days before the first filing of a notice or proposal. During the stay period, a trustee monitors the business while the debtor attempts to negotiate an acceptable proposal with its creditors. If a proposal is not filed within the allowed time (initially 30 days but the debtor may apply for extensions of up to 6 months), the debtor will be deemed to have made an assignment in bankruptcy.

The proposal may be made to both secured and unsecured creditors. Creditors with proven claims are entitled to vote on the proposal and are divided into classes based on commonality of interest, with all of the unsecured creditors normally comprising one class. The approval of a proposal by a particular class requires a favourable vote by creditors representing a majority in number and two thirds in value of those voting. If the creditors accept the proposal, it is submitted to the court for approval. If the creditors reject the proposal, the debtor is automatically bankrupt.

Subject to certain exceptions for eligible financial contracts, the Act provides that contractual terms providing for the termination, amendment or acceleration of payment under a contract, simply by reason that a person is insolvent or has filed a notice of intention or a proposal, will be unenforceable. Similar clauses in leases of real property or licensing agreements, which are triggered by the non payment of rent or royalties, will also be unenforceable. Any further supply of goods and services may, however, be on a cash basis and unsecured unpaid suppliers are given the right, in certain circumstances, to reclaim goods within 30 days of delivering them to a bankrupt or insolvent company.

### (b) Companies' Creditors Arrangements Act

Reorganization of creditor claims under the Companies' Creditors Arrangements Act (Canada) ("CCAA") currently applies to companies with outstanding debt instruments under a trust deed and permits a financially troubled company to continue its business through reorganization by providing for a stay of proceedings during the reorganization period. Banks, insurance companies, railways and federal loan and trust corporations are not subject to the CCAA, although provincial loan and trust corporations might be. In order to take advantage of the CCAA, aggregate claims against the corporation must exceed \$5 million.

In response to an application by any eligible CCAA debtor company, creditor, trustee in bankruptcy or liquidator, a court may grant an order staying the creditors of the company and directing that the company file a plan of arrangement and have a meeting of the creditors to consider and vote on the

terms of the plan. Unlike the BIA provisions where the process is automatic, the decision to gain relief in CCAA proceedings is discretionary and may be denied by a court. In particular, a court may deny the initial application where support by the creditors is slim and there appears to be no chance that a plan will be successful. In order to succeed, the debtor company's plan of arrangement must be approved by a majority in number representing three fourths in value of the creditors in each class. What constitutes a class is open to some interpretation, as the CCAA gives little guidance as to classification, but classes are generally made up of like creditors.

The court is also given complete discretion as to whether to grant a stay, the scope of the stay and the time period in which the stay is in effect. In particular, the courts must be satisfied that a stay is in the best interest of the debtor and creditors. Once a stay is granted, it applies to both secured and unsecured creditors and usually prevents the termination of contracts between the debtor and other parties, although eligible financial contracts are exempted. With the support of major creditors, a stay may also be extended.

(c) Canada Deposit Insurance Corporation Act

Reorganization of financial institutions involves a special procedure under the Canada Deposit Insurance Corporation Act ("CDICA"). It involves provisions to facilitate the restructuring of banks and federal trust and loan companies whose deposits are insured by the Canadian Deposit Insurance Corporation ("CDIC"). Bank insolvencies are, however, a rare occurrence in Canada.

# *taxation*

The governments of Canada, the Provinces and Territories impose income taxes as well as transaction or commodity taxes. Commodity taxes are imposed separately by the Federal government as a Goods and Services Tax ("GST"), which is similar to a Value Added Tax, while most Provinces and Territories impose a separate retail sales tax. In some instances the GST and provincial retail taxes are combined into a harmonized sales tax ("HST").

The Canada Revenue Agency ("CRA") administers the Federal income tax, most Provincial and Territorial income taxes, customs duties, the GST and the HST. The CRA processes tax returns filed, assesses and collects taxes owing and audits the accuracy of the returns. The CRA publishes interpretation bulletins, information circulars, guide books and issues rulings or interpretation letters to assist the public to understand the government's interpretation of the law. Where applicable, the respective Provincial Ministry of Revenue administers its tax laws.

## INCOME TAXATION

### Overview

The Canadian income tax system was created as a temporary measure to fund the cost of World War I and is now a permanent feature of the country's economy. The federal, provincial and territorial governments collect and spend massive amounts of money. Governments use tax laws to encourage taxpayers to engage in activities perceived to be socially advantageous.

Income taxes are payable by persons which includes corporations, individuals, trusts and estates each of whom will file an annual income tax return and pay the calculated tax payable. The income earned by a partnership is allocated to the partners who include the amount in taxable income. The method of computing income subject to tax in each jurisdiction is very similar.

Residents are subject to income tax on their world wide income, whether the source is inside or outside Canada. An individual's residence in Canada is not defined by statute but is determined on a case by case review of the relevant facts. A company incorporated in Canada is automatically a resident for tax purposes while certain non-resident companies may be resident if the mind and management is exercised in Canada.

Non-residents are subject to income tax on their Canadian source income including gains realized from the disposition of certain properties with a Canadian connection, such as an interest in Canadian real estate. A non-resident is taxed at the same progressive tax rates that apply to a resident of Canada.

Non-residents who receive investment income from Canadian sources will be subject to a flat withholding tax which is deducted and remitted to the CRA by the Canadian payer.

The HLB Canadian member firms publish an annual paper booklet entitled "Planning for ... (2008)." The booklet provides more information on the tax issues facing Canadian resident individuals. You may obtain the booklet free of charge by contacting an office of one of the Canadian firms.

#### Taxation year and tax returns

Individuals and trusts calculate their income tax liability for each calendar year while corporations and estates calculate their income tax liability on a fiscal year end basis. The filing deadlines are summarized below. Once an incorporated business or estate establishes a fiscal year end for tax purposes, it may not change the year end without the express written consent of the CRA. A year end will be deemed to occur immediately before the time the corporation is dissolved or amalgamated under corporate law, a private company becomes a publicly traded company or where a person (persons) acquire voting control of the company. Where a year end arises from amalgamation, going public or change of voting control, the company may select any year end it wishes for its first subsequent taxation year.

#### TYPE OF TAXPAYER REQUIREMENT TO FILE NORMAL TAXATION YEAR END FILING DEADLINE

##### TYPE OF TAXPAYER

##### REQUIREMENT TO FILE                      NORMAL TAXATION YEAR END FILING DEADLINE

Corporation	All corporations incorporated in Canada or carrying on business in Canada Selected by the corporation, subject to a limit of 53 weeks from incorporation	after year-end	6 months
Individual	Any taxes payable	December 31	April 30 of the following year (June 15 if self-employed)
Deceased Persons	Any taxes payable	Date of Death	Later of 6 months after death and April 30 of the next year
Testamentary Trust (Estate)	Any income	Selected by the trustee	90 days after year-end
Inter-Vivos Trust	Any income	December 31	90 days after year-end
Partnership	Every Canadian partnership	December 31	March 31 of the following year*
Non-Resident	Employed in Canada or carries on business in Canada Same as comparable Canadian resident entity		Depends on Entity

\* Where all members of the partnership are corporations, the deadline is five months after the fiscal year end. Where the partnership has five or fewer non-corporate partners throughout the fiscal

year, the partnership will not have to file the information returns based on the CRA's publicly stated policy. The administrative concession is not as attractive as first appears because the CRA is not limited to the time period in which it can recalculate income from the partnership and reassess taxes payable to the members. Accordingly, all partnerships should file the annual information return.

Taxpayers who do not file their returns on or before the filing deadline are subject to financial penalties calculated by reference to taxes unpaid on the deadline.

### Carrying on business in Canada

A person may carry on business in Canada as a sole proprietor, a member of a partnership or through an incorporated company. The income earned by the business is allocated to the federal and provincial/territorial jurisdictions in which the business has a permanent establishment by a formula that considers the percentage of gross revenue and gross employee remuneration applicable to that jurisdiction.

A non-resident that engages in some form of business activity in the country will file an income tax return and pay tax on the profits attributed to the Canadian business activity. A non-resident will be deemed to be carrying on business in Canada where it carries on certain activities in Canada including the soliciting of orders or the offering of anything for sale in Canada through an employee or agent whether or not the contract is to be completed inside Canada. A non-resident corporation that carries on business in Canada will be liable to a branch tax over and above the regular income tax.

The non-resident may obtain relief from Canadian tax if the person resides in a country that has a tax treaty with Canada, the person does not have a permanent establishment or fixed base in Canada or has a permanent establishment to which profits cannot be attributed. The non-resident must file a tax return to claim tax treaty relief.

The CRA levies late filing penalties against non-resident corporations that fail to file their returns by the filing deadline whether or not tax is payable.

## INCOME TAXATION - CORPORATIONS

### Overview

A corporation is any incorporated entity whether created in Canada or otherwise. All companies incorporated in a Canadian jurisdiction since April 1966 are considered resident in Canada. Any other company may be resident in Canada if its central management and control is exercised in Canada. Generally, the central management and control will be located where the board of directors of the corporation meets and carries out its responsibilities. In addition, the courts have considered factors such as the place of incorporation, the country in which business activities are conducted, the residence of shareholders, the location of books and records, the location of bank accounts as well as the location of shareholders' meetings.

The income tax system recognizes (i) public companies, (ii) private companies and (iii) Canadian-controlled private corporations. Public companies are generally those companies that have their shares listed on a recognized stock exchange. A private company is normally a closely held company that does not have its shares listed on a recognized stock exchange but excludes those

controlled by public companies. A Canadian-controlled private company ("CCPC") is a private company that is not controlled by non-residents of Canada or public companies or any combination thereof. It is possible for a private company owned 50% by Canadian residents to qualify as a CCPC.

Corporate income tax is calculated as a percentage of taxable income. The tax rate varies with the nature of business or property income and the identity of the beneficial shareholders. Incentive tax rates are available to CCPC's that carry on an active business in Canada.

#### Income subject to tax

A corporation resident in Canada is taxed on its world wide income while a non-resident corporation is taxed on its Canadian source income. Corporations calculate the net income from each business or property separately and aggregate the incomes with all other world wide sources for the same calendar year to arrive at its income subject to tax. Income from property generally refers to income derived from rents, royalties, interest or dividends. The starting point for calculating a corporation's taxable income from a business or property is the net income computed under generally accepted business practices which are similar to Generally Accepted Accounting Principles ("GAAP"). The amounts determined are then modified for specific items that may be taxable, non-deductible or deductible over a period of time (amortization or depreciation of intangible or tangible property, for example).

A corporation that incurs a loss from carrying on a business may deduct that loss against business or other income for the year, the three preceding or the twenty following taxation years. Taxpayers that incur net capital losses may deduct those losses against net capital gains realized in the three preceding years or any future year. Refer to the item (s) comments under "Calculation of net business or investment income."

Groups of companies under common control are not permitted to file a consolidated return so losses of one company do not offset taxable profits of another company.

#### Tax payments

Corporations are responsible for paying the taxes owing on a monthly instalment basis throughout the year with the remaining balance to be paid by the end of the second or third month following the year end. The CRA charges interest on deficient monthly instalments, late payments of tax, unpaid penalties and unpaid interest. Since the CRA's interest charges are not tax deductible, the corporation's non-payment of taxes can be a very expensive form of financing.

#### Penalties

Corporations that file their tax returns after the due date will be subject to a basic late filing penalty calculated by reference to the tax unpaid as of the filing deadline. The basic penalty is 5% of the unpaid tax plus 1% for each of the twelve months following the due date. After one year, the maximum basic penalty is 17% which can be doubled for certain repeat offenders.

Taxpayers are obligated to file information returns for such items as (i) remuneration paid to employees, (ii) fees or commissions paid to non-employees, (iii) interest or royalties paid or (iv) dividends paid in the calendar year. Most of the information returns must be filed with the CRA before the end of February of the subsequent year and are subject to a late filing penalty of \$25 per

day with a minimum of \$100 and a maximum of \$2,500.

A non-resident corporation that late files a return to claim treaty exemption or to report a loss from its branch operations is liable to a filing penalty of \$25 per day with a minimum of \$100 and a maximum of \$2,500.

#### Corporate tax rates

The corporate tax rates vary with the nature of income earned, the nature of the company and the jurisdiction in which the income is earned. For the 2008 calendar year, the approximate combined Federal, Provincial and Territorial rates are:

#### Business income:

\$400,000 income from an eligible active business	18 %
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#### Manufacturing and processing income not eligible

for the 18%	30 %
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Property income	38 to 49 %
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Portfolio dividends	33.3 %
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To be eligible for the 18 % tax rate, the corporation must be a CCPC that earns its business income from an active business carried on in Canada. The entitlement to the rate is shared annually amongst CCPC's under common control.

Note that the 33.3% tax on portfolio dividends and roughly one-half of the tax on property income earned by a CCPC are recoverable on the basis of \$1 for every \$3 in dividends paid to shareholders.

## INCOME TAXATION - INDIVIDUALS

### Overview

An individual is subject to Canadian income tax on his or her worldwide income where the person is ordinarily resident in Canada during the year. Residency differs from domicile, is undefined and is a question of fact. The courts have generally held that an individual is a resident of Canada for tax purposes where the individual's regularly settled routine of his or her life is in Canada including the location of the individual's dwelling place, spouse and dependants, personal property, social ties, banking relations and the existence or lack of existence of a residence in another country. The determination of residency must be made on a case by case basis necessitating the assistance of a tax professional. It is easier to gain residence than to sever residence so a person can be resident in two or more taxing jurisdictions at the same time. An individual who is a dual resident of Canada and another country with which Canada has a tax treaty, will normally be considered to be resident in only one country.

The province in which the individual resides on December 31 is the jurisdiction that is entitled to levy income tax on the person's income for the year. For example, an individual that resided and worked in Ontario from January 1 through November 15, and moves permanently to Alberta before December 31, will be taxable at Alberta's personal income tax rates on all income wherever earned, except business income as noted "taxation year and tax returns" portion of "income Taxation" above. The rules that apply to international residency issues are substantially the same as those that apply to provincial residency.

The CRA publishes checklists for taxpayers to prepare and submit to them for a determination of residency. Since the responses may not properly describe the facts and be misinterpreted, Individuals should seek professional advice before submitting information to the CRA.

An individual is deemed to be a resident if he or she spends 183 days or more in Canada during a calendar year. Such individuals are identified as sojourners and are subject to Canadian income tax as if resident the entire year.

#### Part-year residents

An individual who moves to (immigrates) or moves from (emigrates) Canada in the year will be a part-year resident. A part year resident will generally pay income tax on his or her world wide income for the portion of the year in which resident. For the portion of the year in which the individual was not resident in Canada, he or she will generally be subject to withholding tax on Canadian source income.

#### Emigration

Since the Canadian personal tax system is based on residence, it attempts to tax the increase in wealth occurring whilst resident in Canada. The concept is simple to apply to a person who spends his or her entire lifetime in Canada but is more complex for persons that immigrate to or emigrate from Canada.

An individual who emigrates from Canada during the year will be deemed to have disposed of most of his or her assets at fair market value before departure so that the accrued gains and losses are taxed in the return to the departure date. The taxes payable under this provision are often described as a "departure tax."

#### Immigration

An individual who immigrates to Canada during the year will be deemed to have acquired most of his or her assets at the Canadian dollar equivalent of the foreign asset's fair market value upon arrival. Accordingly, the individual measures his or her gain subject to tax in Canadian dollars for the period in which the person resides in Canada. The immigrant should obtain and retain independent evidence to support the value of assets at the date of entry and the exchange rate in force on that date.

## Short-term residents

An individual who immigrates to Canada and remains resident for less than sixty months over the previous one hundred and twenty months will be eligible for relief from the departure tax. The relief exempts the growth in the value of assets to the date of departure where the assets were owned prior to moving to Canada or the asset was inherited from abroad while living in Canada. The relief also applies in very limited situations to property substituted for property owned on the date of immigration.

## Departure tax

As noted above, an individual is deemed to have disposed of, and immediately reacquired, virtually all his or her property at fair market value immediately before moving from Canada. The accrued gains earned during the period of residence will, therefore, be taxed in Canada.

The most common assets exempt from this rule are Canadian real estate, capital property or inventory used in a business in Canada and certain pension and similar rights which are subject to Canadian income or withholding tax when realized. Accordingly, there is no need to compute a deemed acquisition on arrival or a deemed disposal on departure on these assets.

Individuals who own more than \$25,000 in assets at the time of emigration are required to file a prescribed form to report all property owned at the time of cessation of residency.

## Personal income tax

An individual's tax liability is a function of his or her taxable income, marginal tax brackets and available tax credits. An individual resident in Canada is taxed on his or her world wide income while a non-resident corporation is taxed on its Canadian source income. The computations are similar to those described for corporations above.

While the personal tax rates vary from province to province, the following demonstrates the tax brackets and the approximate tax rates that may apply to the taxable income:

First \$37,000 15% federal plus 6% provincial tax

Next \$37,000 22% federal plus 9% provincial tax

Next \$47,000 26% federal plus 13% provincial tax

Thereafter 29% federal plus 15% provincial tax

## Retirement funds

The Canadian tax system provides for a self-funded retirement plan known as a Registered Retirement Savings Plan ("RRSP") which is registered with the government and administered by a trustee. An individual may create the RRSP for his or her benefit or the benefit of his or her spouse or common-law partner. The individual may deduct contributions made to the RRSP in calculating taxable income for the year subject to an annual contribution limit which is confirmed annually by the CRA. For 2008, the maximum RRSP contribution limit is \$20,000 subject to a lesser amount calculated by reference to the individual's 2007 income from such sources as employment, self

employment and real estate rental income. Investment income, such as interest and dividends, is excluded from the calculation.

The RRSP must mature no later than December 31 of the year in which the beneficiary, not the contributor, reaches age 71. At that time, the beneficiary may withdraw the entire balance in the plan, acquire an annuity or transfer the funds to a registered retirement income fund ("RRIF"). In any case, the amounts received from the plan are taxed in the year of receipt. Normally, the beneficiary selects an annuity or scheduled payments from the RRIF so that the income is taxed over a lengthy time period.

Payments to non-residents are subject to withholding tax of 25% and, if paid on a periodic basis to a resident of a treaty country, may be subject to a withholding tax of 15%.

A person who emigrates from Canada must consider the tax results of future withdrawals from the RRSP along with the tax implications of those assets owned within the plan at the time of establishing residence in a new country. Similarly, individuals that immigrate to Canada must consider the tax implications of funds received from retirement or pension plans in Canada and their former country of residence.

#### Tax payments

Employed individuals will have income tax withheld by their employer and remitted to the CRA on their behalf.

Self-employed individuals or investors will most likely be required to remit taxes owing on a quarterly instalment basis throughout the year with the remaining balance to be paid by April 30 of the following year. The CRA charges interest and penalty interest on deficient monthly instalments as well as interest on late payments of the balance due, unpaid penalties and unpaid interest.

#### Penalties

Individuals that file their tax returns after the due date will be subject to the same late filing penalties described above for corporations.

## INCOME TAXATION - TRUSTS AND ESTATES

### Overview

Since trusts are generally taxed as individuals, the trustees face residency tests that are similar to those that apply to individuals. The residency of a non-Canadian trust can only be determined after a review of the facts which usually look to the place of residence of the majority of trustees or of those who make the important decisions with respect to the trust.

While the concept of a protector is not commonly used in Canadian trusts, it is often used in foreign jurisdictions to provide assistance or review to the trustees in their decision-making. Since Canadian courts have not considered the issue, there is significant uncertainty about the implications flowing from having a protector for a trust. A number of authors believe that the CRA might successfully assert that a protector with substantial powers acts in a fiduciary capacity and is really the trustee. Clearly, the more powers given to the protector, the more likely he or she may be found to be a fiduciary. A protector resident in Canada could, therefore, result in the trust being resident in

Canada and subject to Canadian income tax.

#### Non-resident trusts

Most non-resident trusts are only taxable in Canada on Canadian source income. In addition, Canadian beneficiaries of non-resident trusts will generally be taxed on income distributions received or receivable from non-resident trusts. Accordingly, Canadian resident individuals may attempt to defer or avoid Canadian income tax by transferring assets to a foreign trust so the income accrues offshore. To counteract the loss of tax revenue, the Canadian tax system contains numerous and complex anti-avoidance rules to ensure that the tax on income earned or deemed to be earned by the foreign assets is not avoided or unduly deferred. The tax result may include phantom income being deemed to have been received, the trust subject to the Canadian tax regime or the trust being deemed to be a corporation subject to the tax regime.

Notwithstanding the above, it may be possible to arrange a foreign trust to defer or avoid Canadian income tax but the situations will be unique, complex and expensive to implement and maintain.

The Canadian tax system generally permits an individual who immigrates to Canada to form a non-resident trust to avoid income tax for a maximum period of five years. The planning for the so-called immigration trusts is complex and requires competent professional advice.

#### Tax returns

The trust must file a tax return within ninety days of the end of its fiscal year.

#### CALCULATION OF NET BUSINESS OR INVESTMENT INCOME

Incorporated and unincorporated businesses compute net income subject to tax in the same manner in Canadian dollars. Under rules enacted late in 2007, a qualifying Canadian corporation whose functional currency is U. S. dollars, British pounds or Euros may elect in prescribed form to calculate income and income tax in its functional currency. Generally, the election will apply to tax years that commence in 2008. Qualifying companies must prepare consolidated financial statements pursuant to GAAP and must transact its principal business activities in a functional currency more often than any other currency in the year to which the election applies. Companies that make the election will be subject to transitional rules that convert the reporting from Canadian dollars to the functional currency. If the company fails to meet the functional currency test in a later year, it must convert its currency transactions into Canadian dollars for tax purposes.

The following is a potpourri of tax concepts that apply to the calculation of business or investment income and taxable capital gains:

(a) general - the costs of carrying on a business or to earn property income are deductible from the income source if the amounts are incurred in the income earning process, are reasonable in amount, are not personal or living expenses and are not capital expenditures. Most capital expenditures are deducted from net income over a period of several years on an amortization basis which is briefly described under "capital expenditures" and "depreciation" below.

Transactions with non-arm's length persons, especially non-residents, are subject to close review by the CRA to ensure that the taxable income is not artificially reduced or eliminated.

Expenses, such as rent and interest, payable to a non-arm's length person must be paid by the end of the second taxation year after the year incurred;

(b) branch profits tax - a non-resident corporation that carries on business in Canada will be subject to a tax on the after-tax income earned by the branch to the extent the profits are not re-invested in the branch's business. The branch tax rate is 25% for companies resident in a non tax-treaty country and is equal to the standard withholding rate on dividends. Where the company is resident in a tax treaty country, the branch tax rate is normally equal to the withholding rate that applies to dividends;

(c) capital expenditures - the cost of acquiring tangible or intangible assets or other capital expenditures incurred in the income earning process will be deductible on an amortization or depreciation basis once the asset is placed into use. The rate of annual write-off is established by the nature of the asset acquired;

(d) capital gains - the taxable gain is one-half of the excess of the proceeds of sale (or deemed disposition) of a capital property over the adjusted cost base and the outlays incurred to sell the property. The adjusted cost base is generally, but is not confined to, historical cost. An allowable capital loss is one-half of the excess of the adjusted cost base and the outlays to sell over the proceeds of sale (or deemed disposition). The capital gains calculation is not indexed for inflation. Since one-half of a capital gain is taxable, the CRA may challenge the treatment of a gain as capital where it believes that the gain was realized in the course of business or as an adventure in the nature of trade.

Where the vendor sells the asset on an instalment sale basis, the person may defer a portion of the tax on the capital gain over a five year period pursuant to a formula to the extent that the proceeds of sale are receivable in those future years.

Capital gains may be deferred on the transfer of assets to a taxable Canadian corporation where the consideration paid includes shares of the acquiring corporation and specific tax election forms are filed with the CRA. Capital gains will also not be recognized on qualifying share capital reorganizations, share for share exchanges and statutory amalgamations. A non-resident shareholder may also qualify for tax deferred transfers but also faces the non-resident clearance certificate requirements described in item (g) of the "non-residents" portion below.

In limited situations, capital gains may be deferred where the person acquires a property for the same use as the property sold as described in "replacement property" below.

Capital losses are only deductible against capital gains of the year or certain other years (see "losses of other years" below).

Certain capital losses on investments in qualifying Canadian small business corporations are Business Investment Losses ("BIL"). One-half of the BIL may be deducted from ordinary income rather than taxable capital gains;

(e) depreciation - the cost of capital assets is added to a pool in the year that the asset is available for use in the income earning process and may be deducted as capital cost allowance (tax depreciation) computed on a declining balance basis. The depreciable cost of an asset for the year of purchase is generally one-half of the purchase cost. The taxpayer is not obliged to claim the maximum deduction available but may claim any amount of capital cost allowance up to a

maximum calculated at a specified rate applied to the undepreciated balance of the pool. The pool balance is not reduced where the taxpayer forgoes his deduction for a taxation year. Some of the more common asset classes (pools) and the maximum capital cost allowance rates are:

Buildings	Class 1 - 4 %
Leasehold improvements	Class 13 - straight line over the lease period plus the first renewal
Automobiles	Class 10 or 10.1 - 30 %
Office furniture and equipment	Class 8 - 20 %
Computer hardware	Class 10 - 30 % or Class 45 – 45%
Fixed life contracts or franchises	Class 14 - straight line

Where an asset is sold, the proceeds are credited to the pool as the lesser of proceeds or original cost. In this way, the tax system recovers the depreciation deductions as recaptured depreciation in the year of sale or as reduced deductions in future years because of a lower pool balance. Refer to the comments in “replacement property” below for limited exceptions to the taxation of recaptured depreciation. Where all of the assets of a particular pool have been disposed, the remaining balance may generally be deducted as a terminal loss;

(f) donations - the deductible charitable donations are those paid to Canadian registered charities and, in limited cases non-resident charities, to an annual deductible limit of 75% of net income. Donations not deducted in a year may be carried forward to the following five taxation years;

(g) entertainment - the deductible cost of business meals and entertainment is generally restricted to 50% of amounts expended or a reasonable amount if less;

(h) financing costs - the costs incurred in the course of borrowing money or issuing shares are deductible over five years on a straight line basis;

(i) fines and penalties – the cost of fines or penalties levied by government organizations and public bodies that have such authority to levy the fine are generally not deductible;

(j) foreign exchange - the gains or losses realized on foreign exchange are generally taxed in the same fashion as the foreign denominated transaction. Gains or losses realized on transactions related to the day to day trading activities of the company are normally fully taxable or deductible. Gains or losses realized on transactions related to acquisition of capital assets or to the repayment of related long term debt are normally capital gains or losses;

(k) foreign taxes – the foreign tax paid on amounts included in Canadian income are generally available for credit against Canadian income tax calculated by formula. The taxes available for credit will be the lowest amount payable in the foreign jurisdiction so that excess withholding taxes cannot be offset against Canadian taxes payable;

(l) goodwill and other intangibles - the cost of goodwill and other intangibles are deductible in a

similar fashion to depreciation except that 75% of the expenditure is added to the pool. The deduction rate is calculated at 7% computed on a declining balance basis. Where an asset is sold, 50-75% of the proceeds will be credited to the pool.

Amortization is deductible at the option of the taxpayer;

(m) head office costs – the allocated portion of head office costs will generally be deductible. The portion allocated to the Canadian business must be reasonable, supported by adequate documentation and, in many cases, disclosed in transfer pricing reports. Management, administrative fees may also be deductible but are subject to CRA's review for reasonableness. Where the fees are paid to a non-resident, the amount may be subject to withholding tax of 25% unless relief is provided by tax treaty. In addition, the non-resident may have to file a Canadian tax return;

(n) income taxes - the income taxes paid to the Provincial, Territorial or foreign governments are generally not deductible in arriving at taxable income. Taxes paid to foreign jurisdictions will be available for credit against Canadian taxes payable. Interest or penalties paid on overdue income taxes are not deductible or creditable;

(o) interest expense - the interest expense incurred is generally deductible in the year paid or payable, depending on the method of reporting income. The interest bearing debt must have been incurred to acquire an asset used to gain or produce business or investment income or used to fund the day to day business activities. Interest will be deductible on debt that is used to re-finance debt that was originally used for a qualifying purpose and, in certain cases, to redeem shares, to distribute capital or to pay dividends. Interest must be paid pursuant to an obligation to pay interest and must be reasonable in amount. Compound interest is deductible in the year actually paid rather than the year in which accrued.

Compensation paid on "participating loans" may not be deductible as interest expense but may be deductible (amortized) over five years;

(p) interest expense (thin capitalization) - the deductible interest is restricted to a thin capitalization formula where a non-resident receives interest on debt and has an equity investment in the company. Generally the interest expense paid or payable to the non-resident will be restricted if the debt to equity ratio exceeds 2:1;

(q) interest expense (vacant land) - the deductible interest on debt incurred to acquire vacant land or to construct or renovate a building is restricted until the building is available for occupation;

(r) inventory – a taxpayer must value inventory at the lower of cost or market with any valuation write downs being specifically identified and supported. Cost may be determined on a FIFO or average cost method and should be adopted on a consistent basis from year to year;

(s) losses of other years - the business losses are deductible to the extent that the losses were incurred in the twenty previous taxation years and the three subsequent taxation years. Losses incurred prior to December 31, 2005 will have a seven or ten year carry forward period depending on the year in which the loss was incurred. Generally, a corporation is entitled to deduct business losses incurred prior to acquiring control so long as the actual business that incurred the loss is carried on for profit subsequent to the change of control and in the year of loss application.

Unutilized capital losses of other years will be deductible against capital gains of the three previous years or any subsequent year. Where voting control of a corporation changes, the unutilized capital losses expire and cannot be deducted;

(t) principal residence - the capital gain realized on the disposition of a Canadian resident's principal residence can be received free of tax. The principal residence may come in the form of a direct freehold interest in the housing unit, a leasehold interest in the housing unit or the share of a co-operative housing corporation and must be ordinarily inhabited by the taxpayer, his spouse, common-law partner or child. Each family unit (spouses, common-law partners and children under the age of 18 years) is entitled to designate one residence for each calendar year. The designation is generally made at the time that the property is disposed and can alternate in different years between different residences. For example, if a family owned a city home and a country home for 8 overlapping years, the family could elect the city home as a principal residence for 5 years and the country home for 3 years. However, to be eligible for this exemption, the family must reside in each residence regularly. Foreign properties owned by Canadian residents can qualify so long as the property was used for personal use rather than used to earn rental income;

(u) recreational facilities – the costs of maintaining a yacht, lodge, golf course or facility are not deductible unless the cost was incurred in the ordinary course of business that provides the property for reward or hire. In addition, the membership fees or dues in any club the main purpose of which is to provide recreational or dining facilities is not deductible;

(v) replacement property - a taxpayer who sells a capital asset, goodwill or intangibles and acquires a similar asset to replace the original asset may elect to defer some or all of the capital gain and/or recaptured depreciation or amortization. The replacement property rules generally apply only to assets used in an active business and, in limited situations, a real estate rental property;

(w) reserves – a taxpayer may not deduct general reserves except for those expressly permitted (bad debts, specific goods or services to be delivered after the year end and certain warranty contracts);

(x) salaries and wages - a taxpayer may deduct the amounts paid or payable to its employees in the year. It is common practice for closely held private companies to accrue additional salaries (bonuses) for its owner-managers with the amounts being computed at the end of the corporate year end by reference to profits. This is an important strategy in minimizing the combined total of corporate and personal taxes payable on corporate earnings. All remuneration paid to the key owners that are active in the day to day business will generally be accepted as a tax deduction by the CRA. The deduction of remuneration paid to inactive shareholders and/or persons related to shareholders may be challenged if the CRA considers the amount to be unreasonably high for the value of the services rendered.

Where remuneration is otherwise acceptable to the CRA, the amount deductible in the year in which the expense was incurred so long as the amount is paid to the employee within 179 days of the fiscal year end. Where the payment test is not met, the amount is not deductible in the year incurred but will be deductible in the year paid;

(y) stock option benefits - the benefits realized by employees on the acquisition of shares of the employer or related company is not a tax deductible expenditure of the employer;

(z) amounts due from non-residents - a Canadian corporation that makes low or non-interest bearing loans or has a debt receivable from non-residents will be deemed to earn interest income on the amounts unless the debt was repaid within one year, the debt has been subject to withholding tax, interest was received on the debt or the funds were used by a wholly owned subsidiary to finance a qualifying active business.

## EMPLOYMENT

### General

An individual's taxable employment income includes salary, wages, director's fees and most non-cash benefits received by virtue of employment. The individual's remuneration is subject to withholding taxes at source for income tax, Canada Pension Plan contributions and (Un)employment Insurance premiums. The employer must remit the funds with the employer's portion to the CRA by the fifteenth day of the month following the month in which the remuneration was paid. Employers with significant payroll remittances will have the due date advanced to as little as three working days after the payment of remuneration.

The Act provides a formula for quantifying the taxable portion of certain benefits received on such items as low interest loans, stock options and the personal use of an employer's car. The facts determine the taxable value of other benefits. The employer is entitled to deduct the cost of most benefits provided to employees subject to limitation for club dues, luxury automobiles and most stock incentives.

### Stock options

An employee is considered to have received a taxable benefit on shares of his or her employer or related company where the amount paid by the employee is less than fair market value of the shares on the date the shares are acquired. The difference between the fair market value when exercised and exercise price is employment income in the year of exercise. The employee may claim a deduction for one-half of the stock option benefit on his or her personal tax return where the exercise price established on the date the option was granted equaled fair market value of the stock on that date. In addition, an employee that acquires qualifying stock may elect to defer the taxation of the benefit to the extent of \$100,000 in value of the stock at the time of option. The deferral remains in place until the employee sells the stock, cancels the election or ceases to be a resident of Canada.

Any increase or decrease in value realized on a sale of the stock after the exercise date is a capital gain or loss.

The taxable benefit realized by an employee on the acquisition of stock in a CCPC is treated differently than benefits realized on other stock options. The benefit realized on the exercise may be deferred until the date the shares are sold so long as the shares are owned for two years. The difference in treatment of CCPC stock option benefits is based on the status of the company at the time the option was granted.

## Deductions

Employees are greatly limited to the deductions they may claim from employment income. The most common deduction claimed is the cost of using a car or office as an explicit condition of employment.

Employees may deduct expenses reasonably incurred to earn commission income so long as they were required, as a condition of employment, to incur the expenses. Employees may not deduct expenses in excess of their commission income.

## NON-RESIDENTS

### General

As noted above, a non-resident will be taxable in Canada on business income or employment income earned in Canada or capital gains on certain Canadian based assets unless exempted by tax treaty. A non-resident also faces the following Canadian income tax issues:

(a) withholding tax on property income - a non-resident is liable for withholding tax for amounts received or credited in respect of rents, royalties, interest and dividends. The general rate of withholding is 25% of the gross amount paid and may be reduced by tax treaty. Interest paid to arm's length lenders after December 31, 2007 will generally be exempt from withholding tax unless the interest relates to participating debt. There will be few situations in which interest paid to non-arm's length lenders will be exempt from withholding tax;

(b) withholding on employment income - a non-resident who is employed in Canada will be subject to income tax, government pension and employment insurance withholding taxes on his or her gross remuneration. A non-resident employer will be required to register, withhold and remit employee income tax, Canada pension plan premiums and employment insurance premiums.

The employer will also file information returns for the remuneration paid with the filing due date for the returns being the end of February for the year following payment;

(c) withholding on head office expenses – a non-resident will be subject to Canadian withholding tax of 25% on management fees paid to non-residents of Canada subject to tax treaty exemption. Withholding tax does not apply to the re-imbursment of specific costs incurred by the head office where the appropriate portion is charged to the Canadian corporation and supported by documentation;

(d) withholding on services rendered in Canada - a non-resident who receives an amount with respect to any services rendered in Canada will be subject to a withholding tax of 15% of the gross amount received. The withholding tax applies to the entire payment made where any portion of the service is rendered in Canada by the non-resident or others on behalf of the non-resident. The non-resident who subcontracts services to a Canadian resident or performs a significant portion of the services outside of Canada may obtain relief from the withholding by applying to the CRA for relief prior to receiving payments under the contract or by splitting the fees for services into separate portions for services rendered in and out of Canada. The provision also technically applies to non-residents that carry on a service business in Canada through a permanent establishment;

(e) reduction of withholding tax on rental income - a non-resident who receives a timber royalty or rent from Canadian real estate may be able to have the withholding tax reduced by filing an undertaking to file an annual return with the CRA. Where the undertaking form is filed with and approved by the CRA, the tax withheld subsequent to the approval is determined by subtracting the deductible cash basis expenses from the gross income. Where the undertaking is filed, the non-resident must file a tax return on or before June 30 of the year following. Since the undertaking is guaranteed by a Canadian agent who is responsible for the withholding shortfall if the non-resident fails to file the tax return, it is difficult to find an agent to counter-sign the form;

(f) elective tax return on rental and timber royalty income - a non-resident may elect to file a tax return for a calendar year and to pay a tax on the aggregate of his Canadian source timber royalties and real estate rental income on a net of expenses basis. Where tax has been withheld on a gross rent basis, the non-resident must file the elective return within two years of the end of the calendar year to claim a refund of tax. The elective returns filed are separate from those required to be filed for a non-resident's business or employment income and capital gains. See also comments in item (g);

(g) withholding on the sale of taxable Canadian property - a non-resident will be subject to withholding tax on the sale, gift or other disposition of taxable Canadian property. The withholding is 25% or 50% of the gross selling proceeds unless the non-resident discloses the sale to the CRA and obtains a withholding certificate for a lesser amount. At the present time, the CRA is processing the certificate applications in four to six months. Regrettably, many non-residents and their legal advisors leave the certificate application process to the last minute and find that a substantial portion of the proceeds of sale will be held in trust by the purchaser's lawyer and/or remitted to the CRA.

The most common properties subject to the withholding regime are interests in Canadian real estate owned directly or through a foreign investment vehicle, capital interests in estates or trusts and shares of Canadian resident private companies even if the share sale occurs by redemption or tax free amalgamation or reorganization. Sale proceeds of shares of publicly traded companies are not subject to withholding.

Since the non-resident must provide specific information with respect to the use of real property being sold, the non-resident is often faced with a large unexpected tax bill for back taxes where tax was not withheld on property rents and the time limit for filing the elective return has expired;

(h) tax return for the sale of taxable Canadian property - a non-resident is obligated to file a Canadian tax return to report the dispositions of taxable Canadian properties. The return is separate from the elective rental income returns referred to in items (e) and (f) above.

(i) tax return for employment income – where a non-resident was employed in Canada, the individual should file a Canadian tax return to report the employment income and claim any tax treaty exemptions that might apply to tax withheld in item (b).

## Transfer pricing

Canada followed the lead of the U. S. A. and other countries that aggressively protect their tax base by enacting its own complex legislation dealing with the pricing of international transactions between related parties. The rules cover the price at which services, tangible property and intangible property are transacted, specifies the contemporaneous documentation requirements to be met and provides significant financial penalties for non-compliance. The reporting and document retention regime applies to shareable costs as well as amounts paid or payable to or from non-residents of Canada.

Transfer pricing will be subject to greater scrutiny than in the past because of the new legislated provisions, a redesigned disclosure form T 106 and a significant increase to the CRA's audit staff. There are significant penalties for non-compliance ranging from those invoked for not filing form T 106 to those levied on transfer pricing adjustments. The penalty on transfer pricing adjustments is computed as 10% of the aggregate of income and capital adjustments where the adjustments exceed the lesser of (i) 10% of the taxpayer's gross income and (ii) \$5,000,000. The penalty is tied to the quantum of the adjustment so applies whether or not the taxpayer has taxable income for the year. The transfer pricing penalty will be levied in addition to any income tax or interest assessed as a result of a transfer pricing adjustment.

The transfer pricing penalty is not imposed where a taxpayer has made a reasonable effort to determine the arm's length transfer price in respect of the transaction. Each transaction is separately examined for this purpose so the data supporting recurring transactions must be monitored on a transaction by transaction basis to ensure that current economic factors do not justify a change to the transfer price. Where the industry standards result in prices set for a season or other time period then the standards should be documented in the file.

The CRA has stated that the preferred method for determining a transfer price is the "comparable uncontrolled price" method which considers the nature of the product sold or service rendered, the condition and packaging, the shipping arrangements, the sales volumes and the credit and payment terms and conditions.

The CRA may review, adjust or recharacterize the nature of the inter-company transactions or the amounts thereof at any time within a period ending six years after the date of initial assessment for a particular taxation year. This is three years longer than that the normal reassessing time period for income taxes.

It is possible to obtain an advance pricing agreement with the CRA and other tax administration organizations, such as the Internal Revenue Service in the U. S. A.

## Tax treaties

Canada has entered into agreements with many of the industrialized nations to eliminate or avoid double taxation. Most of the treaties are similar in form to the OECD Model Double Taxation Convention on Income and Capital. The status of Canadian Tax Treaties is summarized on the attached appendix.

For the most part, the treaties provide much of the intended relief but there are situations where individuals will pay extra tax while living in Canada. In particular, a U. S. citizen resident in Canada is subject to U. S. income tax by virtue of his or her citizenship (on investment income for example).

Consider the situation where a U. S. citizen living in Canada realizes a capital gain on the sale of stocks traded on the New York Stock Exchange. Pursuant to the Canada - U. S. tax treaty, the U. S. is entitled to impose tax on the gain since it is U. S. source income. Canada is also permitted to tax the gain but will not grant a foreign tax credit because it is only obligated to allow a credit for taxes paid or accrued to the extent the tax would have been paid by a non-U. S. citizen resident in Canada. Since the U. S. would not be entitled to tax a capital gain realized by a non-resident non-citizen on the stocks, Canada is not obligated to provide a credit.

The U. S. would, however, allow a foreign tax credit for the net Canadian taxes paid after the deduction of all foreign tax credits.

### Immigration trusts

Canada permits wealthy immigrants to establish a trust in a foreign jurisdiction as part of their tax planning for a move to Canada. A properly structured trust set up for the benefit of, say, an immigrant's family can be used to shelter investment income and gains realized from Canadian tax for a period up to the first sixty months from the immigrant's arrival. However, the tax benefits are usually restricted to four years of protection since the trust must qualify as of December 31 in each year.

After the initial period, the immigrant trust may be deemed to be a resident of Canada subject to Canadian tax on its passive income, whether or not that income is actually repatriated.

## PARTNERSHIPS

A partnership is not taxed directly. A partnership calculates its income (or loss) from each source for tax purposes and allocates that income (or loss) to the partners. Each partner includes its share of the partnership's income (or loss) in its taxable income whether or not the profits have been fully distributed.

Limited partnerships are taxed in the same way as general partnerships. However, there are restrictions on the ability of limited partners to utilize losses realized by the limited partnership. A limited partner may claim losses and tax credits to the extent of his or her "at risk amount" in the partnership. The at risk amount is usually the amount actually invested in the partnership plus profits (less losses) allocated for prior taxation years less withdrawals or drawing received.

A non-resident's share of a partnership's profits from a business carried on in Canada will be subject to Canadian income tax. Where the non-resident partners are corporations, they will be subject to tax on branch profits. Where a partner resides in a treaty jurisdiction, the business profits will be taxable in Canada only if they are attributable to a permanent establishment of the partnership in Canada and not exempt by the treaty.

Unlike some other jurisdictions, the CRA does not, under any circumstances, treat partnerships as corporations or vice versa.

## TRUSTS AND ESTATES

Unlike partnerships, trusts are taxed directly. A trust calculates its taxable income from each source in a manner similar to individuals. Trusts, however, are entitled to deduct the amount of income or net taxable capital gain realized by it in the year and paid or payable to beneficiaries. The beneficiaries include the allocations of income from the trust in their taxable income and pay income tax thereon. Where an inter-vivos trust distributes income to non-resident beneficiaries, the distribution will be subject to withholding tax. .

A trust cannot allocate losses to beneficiaries but will use the losses to reduce taxable income of other years.

An inter-vivos trust pays income tax at a flat rate equal to the highest marginal rate applicable to an individual. In addition, the Act contains rules that are similar to the U. S. A.'s "Grantor Trust" provisions whereby a trust settlor who retains control of the trust property may be taxable on all of the income otherwise realized by the trust.

A testamentary trust (estate) is created on a person's death pursuant to his or her will and is taxed as a separate individual on which the incremental tax rates are applied. Therefore, income earned by the estate is taxed at the same low rates that apply to individuals while higher levels of income are subject to tax at the higher individual rates. This allows for the spreading of taxable income over an additional graduated rate scale, which results in potential tax savings. In a tax system that usually prevents access to additional low marginal rates, family units can save over \$9,500 each year for each testamentary trust created by a will. Such savings are subject to specific anti-avoidance rules but are generally not difficult to achieve.

Generally, a trust can distribute its capital to a beneficiary on a tax free (deferred) basis. Assets with accrued gains distributed to non-residents may trigger capital gains tax as if sold at fair market value. In any event, the trustee must disclose the disposition of capital to a non-resident to the CRA and obtain a clearance certificate. Similarly, the non-resident must disclose the transaction to the CRA - refer to the item (g) general comments in the non-resident section above.

## ACCUMULATED PROFITS AND DIVIDENDS

### Overview

Canadian corporations may accumulate profits without being subject to an accumulated earnings tax. While a distribution to a shareholder is generally viewed as dividend income, the character of the payment as a dividend is not dependent on the company having accumulated a sum of taxed earnings and profits available for distribution. Dividends will be considered to have been paid where the issuer repurchases or redeems shares for an amount that exceeds its tax paid-up capital which often differs significantly from the stated or legal capital.

### Dividends received by corporations

Dividends paid to a private corporation from other Canadian corporations will generally be received without corporate income tax so long as the recipient company holds more than 10% of the shares entitled to the votes and value of the payer. Dividends received on publicly traded shares or on private company shares in which the recipient holds less than 10% of the votes and value will be subject to a fully refundable tax of 33.33%.

The refundable tax is intended to discourage individuals from deferring personal income tax on dividends by incorporating their personal investment portfolio. The corporate taxes paid on dividends roughly equates to the top marginal rate of tax for a Canadian resident individual and is refundable to the payer at the rate of \$1 for every \$3 of dividends paid. Where a payer corporation receives a refund of tax, a Canadian resident corporation that receives the dividend is liable for the refundable tax based its proportionate share of the total dividends paid.

Dividends received from foreign subsidiaries may also be received free of corporate tax where the dividends are paid from active business profits.

#### Dividends received by individuals

Dividends paid to individuals are taxable in the year of receipt and, in the case of Canadian resident individuals, will be grossed-up for an amount that reflects a hypothetical portion of the corporate tax paid on income. The gross up is 25% or 45% of the cash dividend depending on the income pool being distributed. Resident individuals and trusts, therefore, pay tax on a “grossed-up” amount and receive a tax credit calculated by formula applied to the gross-up amount.

#### TRANSACTIONS WITH RELATED PERSONS

Generally, a transferor cannot avoid or reduce income tax by transferring property to related persons for consideration that is less than fair market value except for certain transfers between spouses or common-law partners. Where a person gifts or sells property for consideration that is less than fair market value, the person will be deemed to have sold the property for fair market value for tax purposes.

The system is symmetrical for gifts since the person who receives the gifted property will be deemed to acquire the property at fair market value for income tax purposes. The system is not symmetrical for transfers that are greater than or less than fair market value since the fair market value adjustment applies to only one side of the transaction. For example, where a transferor sells property for an amount in excess of fair market value that person’s sale price will not be reduced but the tax cost assumed by the transferee will be reduced. Similarly, where a transferor sells property for an amount that is less than fair market value that person’s sale price will be increased but the tax cost to the transferee will not be adjusted. The bottom line is that related parties can be subject to double tax if the transaction is not carefully planned.

A person who acquires property for consideration that is less than fair market value will be jointly liable for income tax owing by the transferor to the extent of the short fall in value actually paid.

As previously noted in items (a) and (x) of “Calculation of net business or investment income”, a taxpayer claiming certain expenses incurred in a non-arm’s length transaction must actually pay the amount within a specified time period to ensure that the amount is deductible for tax purposes. As previously noted in “Non-Residents”, transactions with non-residents may be subject to contemporaneous documentation and reporting for transfer pricing.

## GENERAL ANTI-AVOIDANCE RULE

While the Act contains numerous rules to prevent the avoidance of tax, it also contains a broadly worded General Anti-Avoidance Rule (“GAAR”). The CRA will use the GAAR when it believes that a taxpayer has “misused or abused” the income tax legislation. GAAR cannot be applied when a taxpayer demonstrates that transactions were undertaken or arranged primarily for bona fide non-tax purposes or the transactions(s) would not result directly or indirectly in a misuse or abuse of the provisions of the Act as a whole.

If the CRA considers a transaction to be an avoidance transaction resulting in a tax benefit, it will apply GAAR to deny the taxpayer’s benefit from the avoidance transaction. The term “tax benefit” is defined to mean a reduction, avoidance or deferral of tax or other amounts payable or an increase in a refund of tax or other amount.

## ADMINISTRATION

### Reporting of foreign asset ownership and transactions

Canada imposes an extensive foreign asset reporting requirement on its residents whereby information returns must be filed annually disclosing investments generally, investments in certain corporations and certain transactions with or loans to trusts. The reporting forms are filed separately from the income tax returns.

The most basic of the reporting forms is a check the box style of report that discloses the value of certain non-Canadian assets by broad asset classification. The form must be filed by individuals, trusts and corporations that hold “specified foreign property” which has an aggregate cost of more than \$100,000 at any time in the year. Partnerships also are reporting entities, unless 90% or more of its income or loss for the particular fiscal period is attributable to non-residents of Canada.

Taxpayers that own shares of foreign affiliated corporations are required to file a separate annual information return each year along with a copy of the financial statements of the affiliate. Generally, a foreign affiliate is a company in which the person owns 1% or more of any class of issued shares and the person or related persons own 10% or more of the issued shares of any class of shares.

Taxpayers that have transferred or loaned funds or property to a foreign based trust at any time before the end of the trust’s taxation year are required to report the transfer or loan.

Taxpayers that received distributions of income or capital from most non-resident trusts are required to file an information return for the year in which they receive a distribution from the trust.

### Assessments, reassessments and appeals

The CRA reviews tax returns filed and issues a Notice of Assessment to confirm the amount of tax payable with respect to any taxation year. Generally, taxpayers may formally object to an assessment of tax within 90 days from the date of the mailing of the Notice of Assessment.

The CRA may reassess the amount of tax payable for a taxation year at any time within three years from the date of mailing of the reassessment. The Minister may assess non-Canadian controlled corporations at any time within four years from the assessment date. The re-assessment limitations apply to matters of interpretation, calculation and the like and do not apply with respect to matters of fraud or misrepresentation.

#### Books and records

Persons who are liable for Canadian income tax are required to keep proper books and records and make them available for inspection by the CCRA upon request. Generally, the day to day business records must be retained for not less than six completed years whilst permanent records must be retained for not less than two years after the company is wound-up. Persons who do not maintain and retain their books and records may be penalized.

#### CAPITAL TAX

The Federal government and most provinces levy a tax ranging from 0.1% to .6% on invested capital employed in the province. While each jurisdiction has its own definition of invested capital, the amount subject to tax generally includes shareholders' equity and long term debt with offsets for investments in and advances to other corporations.

In general, the impact of capital taxes is being lessened as the governments provide larger exemptions, lower rates and/or eliminate the tax entirely.

#### ESTATE AND GIFT TAX

Canada does not impose estate or gift taxes. The Canadian income tax system taxes the increase in wealth by deeming a donor or deceased person to have disposed of his or her assets at fair market value. The resultant gain, if any, is subject to income tax payable by the donor or estate of the deceased. The donee or beneficiary is usually considered to have acquired the assets at the same tax value as the "proceeds" to the donor.

While there are no estate taxes as such, certain provinces impose probate taxes on the value of the deceased's assets. For example, the provinces of Ontario and British Columbia impose probate taxes of about 1.5% of the probated estate.

Estate tax paid in other jurisdictions is not deductible or creditable against Canadian tax except for amounts paid for U. S. A. estate tax (deduction limited by formula).

#### GOODS AND SERVICES TAX

Canada imposes a Goods and Services Tax ("GST") which is a transaction tax similar to a Value Added Tax. The system requires persons that carry on a commercial activity in Canada to register for the tax if the taxable supplies made in the course of a business activity exceed a minimum annual level (\$30,000). In certain provinces, the GST has been combined with the Provincial sales tax to arrive at one Harmonized Sales Tax ("HST").

The system is complex because it creates four basic categories of activities being taxable at 12 % (HST), 5 %, 0 % or exempt. The complexity arises from the need to define exactly what fits into or is excluded from each rate and to grant credits for taxes paid to prevent cascading of tax.

Conceptually, a registrant adds the GST to its invoice amount for taxable supplies, remits the tax to the CCRA and claims input credits for GST or HST tax paid. The not so subtle distinction between 0% and exempt becomes important because businesses that are exempt are not entitled to receive an input credit for taxes paid. The purchaser of commercial real estate or a business may be able to acquire the asset or business without having to remit the GST to the vendor.

It should be noted that a non-resident of Canada may have to register, collect and remit tax where it carries on business in Canada, ships goods into or performs services in Canada.

## CANADA'S INTERNATIONAL TAX TREATIES

Reproduced below is the list showing the status of international tax treaties that have been signed or are being negotiated by Canada.

### I. In force as of October 2007

Algeria	Indonesia	Pakistan
Argentina	Ireland	Papua New Guinea
Armenia	Israel	Peru
Australia	Italy	Philippines
Austria	Poland	
Azerbaijan	Ivory Coast	Portugal
Bangladesh	Jamaica	Romania
Barbados	Japan	Russia
Belgium	Senegal	
Brazil	Jordan	Singapore
Bulgaria	Kazakhstan	Slovak Republic
Cameroon	Kenya	Slovenia
Chile	Korea, Republic of	South Africa
China (PRC) *	Kyrgyzstan	Spain
Croatia	Kuwait	Sri Lanka
Cyprus	Latvia	Sweden
Czech Republic	Lithuania	Switzerland
Denmark	Luxembourg	Tanzania
Dominican Republic	Malaysia	Thailand
Ecuador	Malta	Trinidad & Tobago

Egypt Mexico Tunisia

Estonia Moldova Ukraine

Finland Mongolia United Arab Emirates

France Morocco United Kingdom

Germany Netherlands United States

Guyana New Zealand Uzbekistan

Hungary Nigeria Venezuela

Iceland Norway Vietnam

India Oman Zambia

Zimbabwe

\* excludes Hong Kong

## II. Signed but not yet in force

Gabon Italy Lebanon

United States (fifth protocol)

## III. Under negotiation/re-negotiation

Barbados Bolivia Colombia

Costa Rica Cuba Egypt

Greece Madagascar Malaysia

Namibia Spain Serbia & Montenegro

Singapore Turkey

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