Doing Business in Canada: Planning for a Win-Win Cross-Border Situation

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Canada

With its booming economy, dynamic business environment and diverse workforce, Canada presents an increasingly attractive market for growing businesses looking to expand, from both the United States and around the world.

Presentation Summary

This presentation will cover:

- The main structures available to non-resident businesses looking to establish operations in Canada
- The tax & operational considerations involved in these structures
- The common pitfalls to watch out for and avoid
- Tax planning opportunities related to the above

Practical Case Scenarios

The presentation will conclude with practical case scenarios of clients we share with fellow GGI member firms in:

- the United States, and
- Europe

Business Environment in Canada Overview

- Government and Legal Systems
  - Federal / Provincial / Municipal jurisdictions

- Business and Tax Registration Requirements
  - Federal vs Provincial incorporations
  - Provincial Business Licensing requirements
  - Administration of taxes by jurisdiction

- Financing a Foreign Business Carried on in Canada
  - Internal / intercompany financing
  - Access to banking & external loan facilities

Carrying on a Business in Canada & Permanent Establishment - Overview

Two activity levels to assess:

- Whether non-resident is **Carrying on a Business in Canada**
- If yes, whether it is through a **Permanent Establishment**

- Carrying on a Business in Canada (COB):
  - Lower threshold; definition is general; interpretations and case law are utilized to conclude
  - Income tax and sales tax implications (discussed below)
- Permanent Establishment (PE):
  - Higher threshold; typically involving fixed place of business
  - Additional income tax implications (discussed below)

A full determination is recommended, case-by-case based on the facts.

Business Structures in Canada – Options, Benefits and Opportunities

- Canadian incorporation
  - Often used to handle Canadian tax requirements
  - Represents to customers as a Canadian company
  - Facilitates banking access
  - Resident director requirements in some jurisdictions

- Branch of foreign company
  - No Canadian director requirements
  - Foreign company is exposed to Canadian tax requirements
  - Conceptually more complex

Business Structures in Canada – Options, Benefits and Opportunities

- Hybrid Structure – the Unlimited Liability Corporation
  - Often used to handle Canadian tax requirements
  - Represents to customers as a Canadian corporation
  - Treated as flow-through entity for US income tax purposes
  - Functions like any other Canadian corporation for Canadian tax purposes

- Proprietorship / Self-employment / contractor
  - Simplest for individuals rendering services in Canada

Business Structures in Canada – Options, Benefits and Opportunities

- Partnerships & Limited Partnerships (LPs)
  - Partners generally have Canadian tax filing requirements
  - Advantages of Canadian LP structure to foreign investors, if carrying on business outside Canada

- Joint Ventures & Co-tenancies
  - Each member owns it share of assets & liabilities
  - Each member files its own tax return on Canadian income

Foreign Companies Doing Business in Canada – Overview

1) Income taxes & repatriation withholdings
2) Sales taxes
3) Withholding taxes (WHT) on services rendered
4) Payroll withholding requirements
5) Transfer pricing requirements
6) Tax on income & gains from real estate

Canada’s Income Tax System

- Income tax liability generally arises from COB in Canada
- Exception: if COB but no PE, can claim treaty exemption and a refund of any WHT by filing a tax return
- Income tax rates:
  - Combined federal & provincial rate in Ontario of 26.5% (varies slightly by province)
  - For Canadian incorporations, 5% - 25% dividend WHT
  - For branches, 5% - 25% Branch Tax on repatriations

Canada's Sales Tax System

- Sales tax liability generally arises from COB in Canada, regardless of whether or not there is a PE
- Applies at the federal level if COB in Canada, and the provincial level if COB in a province (no municipal sales taxes)

Province	Federal	Provincial
ON, NB, NS, PE, NL	Combined GST/HST (13% ON, 15% others)	
QC	GST (5%)	QST (9.975%)
BC, SK, MB	GST (5%)	PST (6-8%)
AB	GST (5%)	None

Canada’s WHT Requirements

- Reg 105 WHT generally applicable whenever a **non-resident** (individual or company) renders services in Canada

Type of fee	WHT Rate	Administered by	Waivers Available?
Fees **received** by a non-resident client	15%	Customer	Yes
Fees **paid** by a non-resident client to *another* non-resident	15%	Client	Yes

- Waivers available:
  - If WHT is expected to ultimately be refundable
  - Must be applied for in advance
  - Cashflow only – tax filing requirements & liabilities unchanged

Canada's Payroll Withholding Requirements

- Payroll withholdings generally applicable on **any services rendered in Canada by an employee**, regardless of their residence

Type of employee	Rate	Withholdings on	Waivers Available?
Canadian resident employee	Graduated	All payroll	Yes
Non-resident employee (Reg 102)	Graduated	Services rendered in Canada only	Yes

- Waivers available for non-residents in certain circumstances
- Waiver can be obtained by client or by employee
- Application required in advance; cashflow only
- Employees are still required to file a tax return regardless

Canada's Transfer Pricing Requirements

- Intercompany transactions with related parties are required to be reported on an annual basis – Form T106
- Transfer pricing methodologies are required to be reported
- Contemporaneous documentation is required
- Watch out for other foreign reporting requirements

Canada's Tax on Income and Gains from Real Estate

- Includes income from:
  - Real estate property rental
  - Sale of real estate property
  - Sale of shares of corporations investing in real estate

- Default position:
  - Gross rent subject to 25% WHT
  - Gross proceeds of disposition subject to 25% WHT
  - Tax return is required to be filed:
    - » Net rental income taxed at 50%
    - » Capital gains taxed at 25% (1/2 is exempt)

Canada's Tax on Income and Gains from Real Estate

Planning Opportunities

- A certificate can be obtained such that 25% WHT applies to the **net rental income or net gain** only
- Must be obtained in advance
- Cashflow advantages can be significant
- Final tax liability and filing requirements are unchanged

Foreign Companies Doing Business in Canada - Summary

Canadian income and sales tax requirements are based broadly on 3 levels of business activities in Canada:

- Sale of goods to Canada, or services rendered in Canada, without carrying on business in Canada – no income or sales tax requirements

- Carrying on business in Canada without a permanent establishment – income tax return filing requirements (with potential treaty exemption), and sales tax requirements

- Carrying on business in Canada through a permanent establishment – income tax returns required (with potential for treaty-reduced rates on branch tax), and sales tax requirements

Case Scenario #1

Facts

US corporation (musical group) performing concerts in North America

- Three performances across Canada in 2017, on three separate dates
- US individual employees and subcontractors were hired by the client and were paid for performances and equipment setup in Canada

Case Scenario #1

Analysis and Advice on Tax Requirements

- Based on an analysis of the nature of activities and length of stay in Canada, among other factors, determined there was **no PE** in Canada
- Determined the client was **not COB**, based on the nature of activities and the length of stay in Canada, among other factors
- The client's customer had withheld 15% of the client's fee under Regulation 105 (no waiver)
- Client has withholding requirements for US employees and subcontractors for services rendered in Canada

Case Scenario
#1

Advisory & Compliance Work

- Advised on no sales tax requirements, due to no PE & not COB
- Filed the treaty-based income tax return to claim exemption from income tax and refund of the WHT
- Calculated the WHT & remittances required for the subcontractors
- Calculated the payroll remittances required for the employees
- Filed the relevant annual WHT & payroll returns for the above

Case Scenario #2

Facts

UK client acting and performing in Canada

- Separate income tax regime for actors (film/TV) – 23% WHT under Part XIII (unlike the 15% WHT under Reg 105 on other services rendered)

Case Scenario #2

Analysis and Advice on Tax Requirements

- Considered the tax implications of performing services through a corporation vs directly as an individual

- Decided to perform services directly after weighing overall tax savings (combined corporate & personal taxes in 2 countries) vs additional compliance requirements

- Two filing options for non-resident actors:
  - Treat the 23% WHT as final tax in Canada
  - File an elective tax return, to pay tax at graduated rates on net income after deducting expenses

Case Scenario #2

Advisory & Compliance Work

- In this case, length of the actor's stay in Canada led to residency issues
- Performed a full residency determination based on the facts, including length of stay in Canada & location of home, among other factors
- Eventually determined they were **Canadian resident** for tax purposes
- Filed the personal tax return as a resident, including worldwide income

Case Scenario
#3 – Part 1

Facts

US corporation, part of an international business based in Italy, manufacturing heavy machinery and selling goods to Canadian customers

- Initially, all machinery sales made & concluded outside Canada
- After-sale installation; incidental & included in machine price
- Concluded no **PE or COB**, and no income/sales tax filing requirements

Case Scenario
#3 – Part 1

Planning Opportunities and Advice Provided

- Voluntarily register for sales tax:
  - Where the client is the importer of record, GST is paid upon import at the border, on importing goods to Canada
  - If registered, can claim back the GST as an input tax credit
  - Required to charge sales tax to customer, but customer will be incurring the sales taxes regardless

Case Scenario #3 – Part 2

<u>Change of Circumstances</u>

- Client hired a local sales agent to solicit sales in Canada at trade shows
- There was now a **PE** in Canada, based on the sales agent soliciting & concluding sales in Canada
- Transfer pricing requirements are triggered
- Sales tax & income tax requirements triggered
- Payroll withholding and reporting requirements on the local employee and US employees performing services in Canada

Case Scenario #3 – Part 2

<u>Advisory & Compliance Work</u>

- Reviewed pros & cons of **incorporation vs branch** with client, who elected to remain as a branch
- Advised on structuring of transactions &documentation requirements for tax purposes

- Advised on preparation of branch financial statements
- Filed a branch income tax return reporting Canadian activity

- Advised on transfer pricing requirements
- Advised on and completed foreign reporting

- Registered for sales tax and filed quarterly GST/HST returns

Case Scenario #3 – Part 2

<u>Advisory & Compliance Work (cont'd)</u>

- Registered for payroll and advised on withholdings & remittances for Canadian & US employees performing services in Canada
- Obtained waiver on payroll withholding for US employees performing services in Canada

This highlights the importance of:

- Ongoing monitoring of clients' tax obligations in Canada
- Re-performing a PE/COB determination, when circumstances change

Disclaimer

This presentation and its contents are for discussion only and not intended to constitute tax or legal advice for any particular client or potential client of our firm, and shall not be relied on to avoid taxes and related penalties and interest charges. Tax legislations and interpretations apply based on the specific facts in each case. It is recommended that you consult your own tax and legal advisors regarding your own circumstances.