



## Issues Relating To Organizational Forms And Taxation

### CANADA – ALBERTA, ONTARIO, QUEBEC Blake, Cassels & Graydon LLP

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1. Identify the forms of organization available in your jurisdiction and discuss the advantages and disadvantages of each (eg., corporation, limited liability company, partnership, limited partnership, co-operative, etc.), describing which type of legal entity is mostly used or is of special interest, namely by foreign investors.

Forms of organization in Canada include corporations, unlimited liability companies (in certain provinces), general, limited and limited liability partnerships, joint ventures, trusts and cooperatives.

Corporations may be formed pursuant to either provincial or federal legislation. A corporation is considered a legal person separate and apart from its shareholders, both in respect of existence and taxation and has the capacity, rights, powers and privileges of a natural person being able to contract, sue and be sued in its own name. Except under special circumstances, shareholders of a corporation are not personally liable for the debts, obligations or acts of the corporation thus making it one of the most attractive forms of organization. Advantages of corporations include limited liability, separate legal entity, transferability of ownership, continuous existence, possible tax advantages and improved ability to raise capital. However, public corporations (i.e. with securities held by members of the public whether or not traded on a stock exchange) are closely regulated and necessitate more extensive recordkeeping

A partnership is formed by two or more individuals or corporations that carry on business for profit. In contrast to a corporation, a partnership is not a separate legal person. The



relationship of the partners is established by contract and is also subject to applicable provincial laws. A partnership may take one of three forms, a “general partnership”, a “limited partnership” or a “limited liability partnership”, the latter being available only to certain professions. In Québec there is an additional form of partnership: the undeclared partnership. This type of partnership is not very common and typically refers to a de facto partnership or one where the parties have omitted to make declarations in the manner prescribed by the legislation concerning the legal publication of partnerships. Subject to the terms of their agreement, all partners in a general partnership are entitled to participate in ownership and management, and each assumes unlimited liability for the partnership’s debts and liabilities. In a limited partnership, there is a separation between the partners who manage the business (“general partners”) and those who contribute only capital (“limited partners”). A limited partnership must have at least one general partner, who will be subject to unlimited liability for the debts of the partnership. Limited partners are liable only to the extent of their capital contribution provided they do not participate in the management of the business. Some of the advantages of a partnership are ease of formation, low start-up costs, possible tax advantages and limited regulation. Disadvantages include unlimited liability, except in the case of a limited partner in a limited partnership, lack of continuity and divided authority.

Unlimited liability companies (ULC’s) may be formed in the provinces of Alberta, British Columbia and Nova Scotia. They are a type of corporation that, as their name suggests, do not limit shareholder liability and are mainly used for U.S.-Canada cross-border tax structuring, as they are capable of being treated (by way of election) as disregarded for purposes of the U.S. Internal Revenue Code.

Two or more parties may engage in a joint venture or syndicate where they collaborate in a business venture. There is no specific statutory definition or regulatory scheme for joint ventures, at either the provincial or federal level, although they are not uncommon in certain industries such as construction and natural resources. To help avoid the presumption that a partnership has been formed, the joint venture agreement should declare that a partnership is not intended, although substance prevails over form. The agreement should also set out the scope of the venture and the method of control and decision-making. It should stipulate the rights and obligations of the participants and provide mechanisms for the settlement of disputes. Unlike a corporation, a joint venture is not a distinct legal entity. It cannot sue or be sued. Such rights and liabilities are attached to the entities involved in the joint venture.

In a trust, legal title to property is held by one person (the trustee) for the benefit of another (the beneficiary). The trustee is legally obliged to manage the property for the benefit of the beneficiary. A trust can be created for any purpose as long as the purpose is not illegal or contrary to public policy. Unless they can prove bad faith or negligence by the trustee, beneficiaries have little right to interfere in the management of the trust. The primary uses of trusts are for estate planning, tax deferral and holding of investments. Except for real estate investment trusts, they are no longer widely used for active business ventures in Canada and will not be discussed in detail in this survey.

Similarly to corporations, a cooperative can be formed under provincial or federal legislation. Considering the complexity of the vehicle and the fact that it is a vehicle that is almost never used by foreign investors, we will not discuss this vehicle further in this survey.

## **2. Are there attributes of the form that you consider unique to your jurisdiction?**



Other than ULC's, generally speaking, forms of organization in Canada do not have attributes that could be considered unique when compared to other jurisdictions. Nevertheless, it can be said that corporations in Canada, and especially privately-held corporations, are subject to flexible rules governing their capital and generally substantially less formalism than in several other non-Canadian jurisdictions.

**3. Describe the management and governance structure for each organizational form.**

A Canadian corporation acts through its board of directors and officers. The directors are elected by the shareholders, generally for a term of one year and subject, in many provinces, to any "unanimous shareholders agreement", manage the business and affairs of the corporation. A "unanimous shareholders agreement" involves the removal of all or part of the powers of the directors and the transfer of these powers (and corresponding liabilities) to the shareholders of the corporation. Directors appoint officers and can delegate many of their powers to the officers. There are a number of general rules governing the qualifications and number of directors, such as a requirement that each director be at least a specified age and not a bankrupt, but there is no requirement that the director hold any shares in the corporation unless the incorporating documents provide otherwise. These rules apply equally to non-resident and resident directors. There are also additional rules that relate only to directors of public corporations. Under the federal statute, a private corporation must have at least one director, and a public corporation at least three. There are similar provisions in the Alberta, Quebec and Ontario legislation.

Subject to the terms of their agreement, all partners in a general partnership are entitled to participate in ownership and management. In a limited partnership, the general partner(s) manage the business, while the limited partners only contribute capital. In order to preserve their limited liability status, limited partners must refrain from getting involved in the management of the entity.

**4. Is there a residency requirement for management or owners? In particular, are there restrictions or prohibitions on foreign investors to perform or have interests in specific activities?**

The federal and Ontario legislations require 25% of the directors of a corporation to be resident Canadians except where there are fewer than four directors, in which case at least one must be a resident Canadian. In Alberta, at least 25% of the directors must be Canadian residents. Permanent residents of Canada who are not Canadian citizens may qualify as "resident Canadians", either absolutely or only for a specified period. There are no residency requirements for officers. Quebec does not impose residency requirements for directors or officers.

Under the *Investment Canada Act* of 1985, foreign capital has equal status with Canadian funds for most purposes. Except for acquisitions above specific thresholds, investors need only notify the investment-review division of Investment Canada of an acquisition or new venture within 30 days of the transaction. To limit the growth of foreign-controlled enterprises within certain industries, federal statutes regulate the amount of allowable foreign ownership. These restrictions apply in the telecommunications, banking, media, cultural industries, airline, insurance, trust and loan industries. The North American Free Trade Agreement (NAFTA) also commits Canada to maintaining and strengthening an open investment climate.



Partnerships do not have residency requirements. The partners need not be resident Canadians to conduct business in Canada, although they are also subject to the same federal regulations that control and limit the amount of foreign ownership in the above mentioned sectors.

**5. Describe the extent to which management and owners are exposed to liability.**

A corporation is considered a legal person separate and apart from its shareholders and its shareholders benefit from limited liability. Please see item 3 above as to unanimous shareholder agreements. In certain rare cases, involving situations such as fraud or unlawful conduct, courts have allowed “lifting the corporate veil”, thus holding shareholders personally responsible for the corporation’s acts.

Directors and officers of a corporation have a duty to act honestly and in good faith with a view to the best interests of the corporation. They must exercise their powers with due care, diligence and skill, and must comply with the corporation’s governing statutes, regulations, constitutive documents, and any unanimous shareholder agreement. They are also subject to conflict of interest rules. Where directors and officers neglect their duties they may be subject to personal liability. They may also be subject to other liabilities, such as with respect to certain unpaid taxes, employee wages, payment of improper dividends, and environmental offences.

In a general partnership, each partner has unlimited liability for the debts and obligations of the partnership. In a limited partnership, the general partner has unlimited liability for the debts and obligations of the partnership whereas the limited partner’s liability is limited to its investment.

**6. Ownership interest: (i) how is it represented? (ii) is it transferable?; and (iii) is there a minimum number of owners?**

(i) Ownership of a corporation is represented by “shares” of the capital of the corporation (also called share capital). The charter documents of a corporation may provide for more than one class of shares including shares with limited or no voting rights and special entitlements to distributions and return of capital. At least one class of shares must be “common shares” namely shares entitling their holders to share in the remaining property of the corporation upon its dissolution.

Partners in a general or limited liability partnership do not form a separate legal entity; they share ownership in the assets and business they are conducting through an agreement that sets out how decisions will be made, profits will be shared, disputes will be resolved, future partners will be admitted to the partnership, partners can be bought out, and what steps will be taken to dissolve the partnership when needed.

(ii) Yes. Shares of a corporation, which are in registered form, may either be publicly exchanged on the stock market or privately transferred. Privately-held corporations are required to provide for share transfer restrictions in their articles of incorporation or other charter documents.

A partnership ownership interest may be transferred unless specified otherwise in the partnership agreement.

(iii) Canadian corporate legislations does not require a minimum number of owners. Corporations may have only one shareholder. The *Canada Business Corporations Act* specifically states that one or more individuals or “bodies corporate” may incorporate a

corporation. Similarly, under Quebec law, a corporation may be constituted by one or more founders, and the articles of incorporation set out the fixed number or the minimum and maximum number of directors. In Ontario and Alberta, one or more individuals or bodies corporate may incorporate a corporation by signing articles of incorporation and by having the governmental regulatory authority endorse the certificate of incorporation.

Similarly, no restrictions exist as for any minimum number of owners in a general partnership, provided of course that there are at least two partners. A limited partnership must have at least one general partner.

#### **7. Is there a minimum capitalization?**

Under corporate law, there are no minimum capitalization requirements in Canada for corporations. Upon incorporation, the corporation will set out in its articles of incorporation the classes and any maximum number of shares that it is authorized to issue, and, if there are two or more classes of shares, the rights, privileges, restrictions and conditions attaching to each class of shares.

Similarly to corporations, there are no minimum capitalization requirements for partnerships. Capital contributions and partner's entitlement to capital are addressed in the partnership agreement. In the absence of a specific agreement as to what is each partner's share in capital, all partners share equally.

#### **8. Is there a security that can be issued to the public?**

Yes. Canada has a federal system of government, with power divided between the federal government and the provinces. To date, securities legislation is governed at the provincial level and each of the provinces and territories has its own securities legislation, although the rules in many areas have been standardized and cooperative systems established between the regulators. The securities laws determine whether or not a prospectus is required for a particular offering of securities and set out the forms and procedures which apply to different forms of offerings.

Provincial securities laws on securities define the different kinds of securities that can be issued to the public in Canada. The definition is very broad including: any document constituting evidence of title or interest in the capital, assets, property, profits, earnings or royalties of a person or organization; a debt obligation; a share, stock, unit, unit certificate, participation certificate, certificate of share or interest, pre-organization certificate or subscription right or warrant.

Typically, in Alberta, Ontario and Quebec, every person intending to make a distribution of securities to the public must prepare a prospectus providing full, true and plain disclosure of all material facts relating to the securities issued or proposed to be distributed and complying with the requirements of the province's securities law. It must also contain a statement of the rights given to the purchaser. Nonetheless, many exemptions to the prospectus requirement exist, for example, for certain debt securities issued or guaranteed by a financial institution.

#### **9. Can the form incur debt, or grant security for debt?**

Yes. Corporate capital may also be raised by borrowing. Directors may authorize borrowing unless the incorporating documents or a unanimous shareholders agreement restricts them. Restrictions upon directors, however, will usually not protect the corporation against third



parties in the case of unauthorized borrowing by directors. Corporations also have the power to grant security interests over their property and to give guarantees.

Generally, partnerships may also incur debt and grant security for debt in the conduct of their business.

#### **10. What is the duration of the form? Can it be renewed?**

Under Canadian corporate law, a corporation is a legal entity separate and apart from its shareholders and it has perpetual existence, unless and until it is dissolved. The dissolution process under most provincial and territorial statutes is similar to that of the *Canada Business Corporations Act*, and can be voluntary or involuntary.

Canadian corporations (including Quebec corporations under the new *Business Corporations Act* that will come into force in early 2011), cannot per se be renewed, but they can be continued under the laws of any other Canadian jurisdiction, including the *Canada Business Corporations Act*. A continuance consists of two steps: the first being the continuance-export of a corporation from its home jurisdiction, and the second being the continuance-import of the corporation under the laws of the new jurisdiction. One of the principal reasons for continuing into another jurisdiction, as discussed below, is for the purpose of “amalgamating” with one or more other corporations, whether or not related. Another reason for continuing into another jurisdiction is to avoid having to meet the Canadian residency requirements for one or more of the directors by continuing in a jurisdiction with no or less stringent residency rules.

Generally, general or limited partnerships can be dissolved in accordance with the causes of dissolution provided in the partnership agreement, by accomplishment or impossibility to accomplish their object, or by consent of all partners. They can also be dissolved by a court for a legitimate cause. In Alberta and Ontario, subject to an agreement between the partners to the contrary, partnerships may also be dissolved by a partner giving notice of its intention to dissolve the partnership, death or bankruptcy of a partner.

#### **11. Describe the process, customary time period and approximate cost of establishing the form.**

A corporation is formed in Canada by filing certain prescribed documents with the appropriate authorities under the *Canada Business Corporations Act* or the corporations’ statute of one of the provinces. A federal corporation is formed under the *Canada Business Corporations Act*, upon the filing of that corporation’s “articles of incorporation” in prescribed form with Corporations Canada. The articles of incorporation of a *Canada Business Corporations Act* corporation are required to include: the name of the corporation, the place where the corporation’s registered office is to be situated, the classes and maximum number of shares that the corporation is authorized to issue, and if there are two or more classes of shares, the rights and restrictions attaching to each class of shares, a statement describing any restriction on the transfer of the corporation’s shares, the number of directors, or the minimum and maximum number of directors, and any restriction on the business the corporation may carry on. The provincial corporate statutes have similar requirements.

The *Canada Business Corporations Act* specifically states that one or more individuals or “bodies corporate” may incorporate a corporation. An incorporating individual must also be eighteen years of age or older, of sound mind and must not have the status of a bankrupt.



The name of a corporation is regulated in all jurisdictions to avoid names that are considered to be too general or misleading. Any proposed corporate name must first be searched and approved by the governing authority in the proposed jurisdiction of the corporation's incorporation. There is a screening process and it is possible to pre-clear a name prior to application for incorporation. In addition, the Quebec Charter of the French Language requires that a corporation carrying on business in Quebec use a French version of its name.

Once the required documents are filed and fees paid, incorporation is automatic. The corporation comes into existence on the date of issue of a certificate of incorporation by the regulators.

The cost of incorporating a Canadian corporation is relatively modest in most Canadian jurisdictions. The fee to incorporate a corporation federally pursuant to the *Canada Business Corporations Act* is C\$250 (or C\$200 if filed online). For Ontario, the fee of incorporation pursuant to the *Business Corporations Act* is C\$360 (or C\$300 if incorporated electronically). For Quebec, the fee of incorporation pursuant to the *Companies Act* is C\$300. For Alberta, the fee of incorporation pursuant to the *Business Corporations Act* is C\$100.

The incorporation of a Canadian corporation can generally be accomplished very quickly, and a routine incorporation can easily be completed within a week.

Partnerships are formed by contract between the different partners and are subject to applicable provincial legislation. Limited partnerships must be constituted by a written agreement distinguishing the rights, powers and liabilities of the limited partners from those of the general partner(s). This information must also be published to inform third parties of the limitations on certain partners' liability. In Alberta, Québec and Ontario partnerships must register with provincial authorities. In Québec, registration takes place with the Quebec Enterprise Registrar and has to be completed within 60 days of the start of operations. In Ontario, businesses register with the Companies Branch of the Ministry of Government Services. In Alberta, ordinary partnerships for the purpose of trading, manufacturing, contracting or mining must register with the Registrar of Corporations and pay a registration fee of C\$10, and limited partnerships must also register with the Registrar of Corporations and pay a registration fee of C\$50.

**12. Describe the process, customary time period and approximate cost of establishing the form.**

No. Generally, there are no requirements for the government to be part of a project or investment vehicle or receive part of the profits therefrom, apart from corporate income and other applicable taxes.

**13. For what taxes is the form liable?**

It is most common for a substantial business undertaking to be organized using a Canadian corporation. The commentaries below are therefore limited to such form of organization. Although a Canadian corporation will normally offer limited liability to its shareholders, a British Columbia, Alberta or Nova Scotia "unlimited liability company" might be chosen by a foreign investor in order to achieve certain foreign tax objectives. However, all taxable Canadian corporations are subject to taxation in Canada.

## Corporate Income Taxes

The Canadian federal *Income Tax Act* (“**ITA**”) levies income tax on the worldwide taxable income of a Canadian corporation, independently from its shareholders. Generally, the taxable income of a Canadian corporation with operations in more than one Canadian province is allocated for provincial income tax purposes among those provinces in which the corporation has an establishment. The Province of Québec levies its own income taxes under the Québec *Taxation Act*.

The effective rate of Canadian federal tax on general active business income is currently 18%, after taking into account a reduction in rate that partially offsets the impact of provincial taxation. This rate is scheduled to decrease gradually to 15% in 2012. Provincial tax rates on general active business income will vary depending on the province:

Province	2010 Provincial Tax Rate (%)	Combined 2010 Federal and Provincial Tax Rate (%)
Alberta	10.0	28.0
Ontario	12.0	30.0
Québec	11.9	29.9

A Canadian corporation may be entitled to various federal and provincial income tax incentives, such as tax credits. The eligibility to such incentives will generally depend on the corporation’s status and business activities.

## Withholding Taxes

The ITA levies a final tax on most types of payments received by a non-resident from a person resident in Canada. Therefore, a Canadian corporation must withhold tax on several types of payments made to a non-resident person (including non-resident corporations) at a rate of 25% (unless such rate is reduced or eliminated by an applicable tax treaty). Payments on which such withholding may apply include certain management or administration fees, rental payments, interest paid to persons not dealing at arm’s length, dividends, royalties and similar payments. The withholding tax is imposed on the non-resident, however, the Canadian payor has withholding, remitting and reporting obligations.

In addition, when a payment is made in respect of services rendered in Canada by a non-resident, the Canadian corporation is generally required to withhold and remit 15% of such payment to the tax authorities, except if an appropriate waiver is obtained. If the service is rendered in the Province of Québec, a further 9% must be withheld and remit to the tax authorities. Unlike the above withholding, the withholding for services rendered in Canada is a collection mechanism requiring withholding on account of any ultimate tax liability of the non-resident arising from its activities in Canada. Such withholding may therefore be refundable to the extent that no Canadian income tax is payable by the non-resident.

## Federal and Provincial Commodity Taxes

Generally, a Canadian corporation must collect the Goods and Services Tax (“**GST**”) at the rate of 5% of the amount payable for taxable supplies made in Canada by the corporation and must pay GST on taxable supplies acquired in Canada. A corporation will usually be entitled to a full reimbursement of the GST paid on taxable supplies acquired in the course of its activities (such refund being described as input tax credit). The corporation must then remit the difference between the GST collected and its input tax credits for the relevant reporting period. If the input tax credits exceed the amount of GST collected, the Canadian corporation may claim a refund.

The Province of Ontario and the Federal government have cooperated to combine GST and provincial sales tax in a 13% harmonized sales tax. There is no provincial sales tax in the Province of Alberta. In the Province of Québec, the provincial government administers both the GST and the Québec Sales Tax (“**QST**”). The QST regime is generally consistent with the GST regime. Currently, the QST rate is 7.5% and will increase to 8.5% and 9.5% in 2011 and 2012, respectively.

## Payroll Taxes

As an employer, a Canadian corporation carrying on business in Canada has to withhold and remit Canadian federal and Québec provincial source deductions and to make employer payroll contributions on remuneration paid to employees working in Canada.

## Duties on transfers of immovables

Generally, a municipality in the Province of Québec is required to collect duties on the transfer of any immovable when the property is situated within its territory. The transferee of the immovable transferred shall generally be liable for payment of the transfer duties to the municipality.

<b>RATES OF QUÉBEC LAND TRANSFER DUTIES</b>	
Taxable basis of up to \$CAN 50,000	0.5%
Part of taxable basis in excess of \$CAN 50,000 but not exceeding \$CAN 250,000	1%
Part of taxable basis which exceeds \$CAN 250,000	1.5% **

**\*\* Effective January 29, 2010, the City of Montreal has increased the marginal rate for the calculation of duties on transfers of immovables to 2% in respect of the part of the consideration for the transfer which exceeds \$500,000.**

In Ontario, land transfer tax is payable on a province-wide basis upon most transfers of ownership of real property interests. This land transfer tax is assessed on the value of the consideration for the transfer and is imposed at the following graduated rates for most commercial transactions:

RATES OF ONTARIO LAND TRANSFER TAX	
Value of the consideration up to and including \$CAN 55,000	0.5%
Value of the consideration exceeding \$CAN 55,000 up to and including \$CAN 250,000	1%
Value of the consideration exceeding \$CAN 250,000	1.5%

For real property situate within the boundaries of the City of Toronto, in addition to the Ontario land transfer tax, a municipal land transfer tax is also payable in most cases upon the transfer of ownership of real property interests. The municipal land transfer tax is also imposed at graduated rates but for most commercial transactions is slightly less than 1.5% of the total consideration for the transfer.

In Alberta, there is no land or property transfer tax or provincial tax payable pursuant to a real estate transaction.

#### **14. What is the tax treatment of payments to foreign owners?**

Except for the withholding taxes described above and other more specific withholding taxes a foreign owner may be liable for, a foreign owner who receives payments from the Canadian corporation and who does not carry on business in Canada will not be liable for income tax in Canada on payments so received.

In addition, subject to any applicable tax treaty, Canada and the Province of Québec tax foreign owners on their gain from the disposition of taxable Canadian/Québec property, which includes shares of certain Canadian corporations that, at any particular time during the 60 month period that ends at disposition, derive or derived their value principally from real or immovable property situated in Canada/Québec. The disposition of a taxable Canadian/Québec property by a foreign owner will result in reporting obligations in Canada.

#### **15. Is there a tax treatment which would impact foreign owners differently than owners resident in the jurisdiction?**

As a Canadian corporation is generally used by foreign owners to carry on business in Canada, the following general comments apply regarding situations where a Canadian corporation is involved.

Owners resident in Canada may benefit from Canada's progressive income tax rate structure whereas foreign owners are generally subject to a single Canadian tax rate under the withholding tax regime briefly discussed above. Although Canadian residents are generally taxed on capital gains, Canadian resident individuals may in certain cases not be taxed on capital gains realized upon the sale of shares of Canadian corporations. Foreign owners will generally be taxed on gains realized upon the disposition of shares of Canadian corporations which constitute taxable Canadian/Québec property, subject to any applicable tax treaty. Also, certain dividends paid by a Canadian corporation to Canadian resident individuals or taxable Canadian corporations may be received tax free. Subject to any applicable tax treaty, dividends paid to non-resident owners will normally be subject to the withholding taxes described above.

At the corporation level, when a private corporation is not controlled by one or more non-resident persons, such corporation may be entitled to a number of tax benefits under the Canadian income tax regime, including a reduced tax rate on certain income, that are not available to Canadian corporations controlled by non-residents.

