

## Doing Business in Canada

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### A WORD OF CAUTION

*This memo provides a summary of some aspects of Canadian law that may be of interest to foreign investors considering an investment in Canada. While all efforts have been made to provide information that is accurate at the time of writing this memo, it should not be considered or interpreted as a legal opinion on any of the matters raised in this memo. No decision should be made on the basis of this memo alone. Any issue that is raised in this memo and other issues related to a potential investment in Canada should be discussed and reviewed with qualified professional advisors.*

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### INTRODUCTION

This memo will serve to provide a summary of a number of key considerations which should be taken into account in making a decision to invest in a business in Canada.

Like the United States, Canada has a federal system. As a result, an organization doing business in Canada is subject to federal legislation as well to the legislation of the provinces where it is conducting business. In Canada, a company can be incorporated either under the authority of the federal government or under the authority of one of the provinces. A company incorporated under the authority of the federal government, is still subject to all the relevant provincial laws that apply to organizations doing business in the province. This memo will focus on the federal legislation as well as on the legislation of the province of Ontario. This memo will also briefly discuss some specific issues related to the province of Québec.

### FOREIGN INVESTMENT LEGISLATION

#### Investment Canada Act

The establishment of a new business in Canada (regardless of the vehicle used to do business) by non residents of Canada is subject to the *Investment Canada Act*. Every foreign investor, regardless of its size, is required to notify the Minister of Industry of its intention to establish a new Canadian business or to acquire control of an existing Canadian business. In some cases, a transaction to acquire an existing business will be considered as a “reviewable transaction”, if the book value of the acquired business’ assets exceeds an annually adjusted threshold. In 2006, the threshold for investors from the United States (and other countries that belong to the World Trade Organization) is \$265 million

(Canadian). The review threshold is significantly reduced if the acquisition is in any of the following four industry sectors: culture, financial services, transportation and uranium.

In all other cases, a transaction or investment will be a “notifiable transaction”. A notifiable transaction is not subject to review and the investor need only notify the Minister of Industry either before or within 30 days of the completion of the investment. The notification requirement under the Investment Canada Act is met by filing a relatively simple two-page form.

## **VEHICLE FOR DOING BUSINESS IN CANADA**

Although other vehicles are available, foreign investors doing business in Canada will most often conduct business either as a branch operation or through a Canadian subsidiary corporation. There are tax considerations both in the home jurisdiction and in Canada that need to be taken into consideration before determining which vehicle is the most appropriate in any given circumstances. Tax consultants with a solid experience in international tax matters should be consulted before making any decision.

Limited liability will also be a key consideration for most businesses. The incorporation of a Canadian subsidiary corporation will ensure that the Canadian operations have a separate legal existence from that of the parent company.

### **Branch operation**

A foreign corporation operating a branch usually must obtain an extra-provincial license from each province where it intends to conduct business. The requirements for extra-provincial registration and the definition of “carrying on business” vary from one province to the other. The law of each province should be consulted in this regard. Generally, however, an entity will be found to be “carrying on business” if it has a resident agent, representative, warehouse, office or place where it carries on its business in the province. In most cases, a person will not be found as carrying on business in Canada or a province merely because it takes orders for or buys or sales goods, wares and merchandise is or offers or sell services of any type, by use of travelers or through advertising or correspondence.

There are penalties for failure to obtain a license where required. Also, a foreign entity which is not licensed where required will generally not be capable of maintaining any action or other proceeding in any court or tribunal in respect of any contract made by it.

### **Subsidiary Corporation**

In Canada, a corporation may be created either under federal or provincial law. A foreign investor who considers operating in more than one province will be well advised to

incorporate under federal law. If on the other hand, the proposed operations are going to be limited to one province, a provincial incorporation might be appropriate.

Corporations incorporated under the federal statute or under the laws of the province of Ontario are required to have a certain number of directors who are resident Canadians. There are provinces which do not have such a requirement. The residency requirement has seldom been a stumbling block for organizations that wish to establish a subsidiary corporation in Canada. In addition to satisfying the legal requirement, the presence of Canadian directors on the Board of Directors will provide the foreign corporation with an important insight into the Canadian market. If the subsidiary is incorporated under the federal legislation, at least 25% of the Board of Directors must be resident Canadians. Under the federal statute, if a corporation has less than four directors, then at least one of them must be a resident Canadian. The federal legislation has a different requirement for corporations involved in uranium mining, book publishing, distribution or retailing, or film or video distribution where a majority of the Board of Directors must be resident Canadians. By contrast, the Ontario provincial legislation requires that a majority of directors be resident Canadians, except where a corporation has two directors, in which case at least one director must be a resident Canadian.

One of the main advantages of selecting a federal corporation is that it can carry on business in every province under its corporate name. The same treatment does not apply to provincially incorporated companies. Consequently, a provincially incorporated company would not be able to use its corporate name in another province if it conflicts with that of an existing corporation or business entity in that province. As a result, if a Canadian subsidiary corporation needs to protect its business name across the country, a federal corporation would be the vehicle of choice.

Both the applicable federal legislation and the Ontario legislation allow shareholders to use a unanimous shareholder agreement (or a shareholder declaration if there is only one shareholder) to partially or entirely restrict the directors' powers to manage the corporation's business and affairs. This can be used to circumvent the Canadian resident directors if the foreign parent corporation wants to retain total control of a Canadian subsidiary corporation. It must be noted, however, that by taking away powers from the directors, the foreign parent corporation also shifts to the shareholders the responsibilities and liabilities of the directors.

With the exception of the province of Ontario, a federal corporation will generally have to register as an extra provincial corporation in the provinces where it is carrying on business. This process, however, is greatly simplified by the fact that the corporate name of the corporation is already protected across Canada.

A federal corporation can be incorporated with a corporate name in English and in French. In such case, each name will be a valid corporate name of the corporation and there is no requirement to use both versions at all times. The use of the French version of the corporate

name will prove particularly useful in the Canadian subsidiary corporation carries on business in the province of Québec. The ability to incorporate a company with a corporate name in Canada's both official languages is also available to corporations incorporated under the laws of Ontario.

### **Hybrid Corporation**

The use of a federal or provincial corporation will generally satisfy the needs of a United States corporation that is entitled to the benefits of the tax treaties between Canada and the United States. This is not necessarily the case for all United States corporations. Where the tax treaty treatment is not available, it may be possible to use a Nova Scotia unlimited liability corporation as an appropriate vehicle to do business in Canada. A Nova Scotia unlimited liability corporation may also be recommended by tax advisors in situations where losses were expected in the initial years of doing business in Canada.

### **TAXATION**

A tax advisor should be consulted early on in the process of planning and investment in Canada in order to determine the most tax efficient structure for the Canadian operation. In addition to considering tax ramifications in the home jurisdiction, a foreign investor should also consider Canadian tax issues such as income tax, capital tax, tax rules concerning cross-border dividends, interest and royalty payments, the mix of debt and equity and withholding taxes.

#### **Federal Goods and Services Tax**

The Goods and Services Tax (GST) is a multi-stage value added tax that generally applies to all domestic supplies of most types of property and services in Canada. Currently, the applicable rate for the GST is 7%. It will decrease to 6% starting on July 1, 2006. A non-resident of Canada who carries on business in Canada and makes taxable supplies in Canada must generally register for the GST. The same applies to Canadian subsidiary corporations. A registered supplier generally collects the GST at the time of sale, or on lease or license payments, as an agent for the tax authorities.

Imports of goods into Canada will generally attract GST. Many exports of goods and services to non residents of Canada, however, are "zero-rated" so that no GST will apply.

An input tax credit is generally available to registered businesses to allow them to recover on their GST returns the GST payable by them on their business expenses and on their capital accounts.

## **Provincial Retail Sales Taxes**

All provinces, other than the province of Alberta, impose a provincial retail sales tax in one form or another. In some provinces, the tax is harmonized with the GST. In the provinces Ontario, Manitoba, Saskatchewan, British Columbia and Prince Edward Island there is a single stage retail sales tax (which is paid only by the final consumer, business, institution or individual). The rate of this tax varies from province to province. The tax is generally payable at the time of purchase or import. A purchaser or user of goods subject to the provincial sales tax may be required to remit the tax on goods imported into the province. Vendors of taxable goods and services within the province in which they carry on business must obtain a vendors retail sales tax license in the province unless they sell only at the wholesale level.

## **INTELLECTUAL PROPERTY**

### **Trade Marks**

The rights of foreign trademark owners are not protected in Canada unless the mark is also registered in Canada. Furthermore, a foreign trademark owner should not assume that it will be able to use its mark in Canada if the same mark or a confusing mark is already in use by a third party. As a result, it is important to properly lay the groundwork by commencing registration of trademarks as soon as possible in the process of establishing a new business in Canada. A registration application may be based on actual use or proposed use of the mark in Canada. Under certain circumstances, a foreign applicant may obtain registration on the basis of registration and use in a foreign country. It is also possible to obtain registration of a mark on the basis of a foreign trademark application.

It is important to note, however, that a Canadian trademark registration is vulnerable to cancellation for non-use within three years of his registration date. *If you don't use it, you lose it!*

Another important feature of the Canadian trademark legislation is the importance to have licensing agreements in place between the owner of the mark and all users (even within the same corporate group) in order to protect the distinctiveness of the trademark. In such case, it is also important for the owner of the mark to have direct or indirect control over the character and quality of the wares or services in association with which the trademark is used.

## **Patents**

As is the case for trademarks, the rights of foreign patent owners are not protected in Canada unless a Canadian patent has been issued. In Canada, a patent holder enjoys a 20 years protection from the date of filing. Canada is a “first to file” and not a “first to invent” patent jurisdiction. A patent application cannot be filed if there has been prior disclosure but an application can be filed in Canada within 12 months of the date of application in a foreign jurisdiction. Inventions made by employees, while in the employ of the employer, will generally (but not in all cases) belong to the employer. For contractors, however, the result will be the opposite.

## **OTHER CONSIDERATIONS**

### **Privacy and Protection of Personal Information**

A federal privacy law (PIPEDA) governs the protection and use of personal information throughout Canada. In addition, the provinces of Québec, Alberta and British Columbia have their own provincial legislation governing this matter. The privacy laws extend to personal information contained in computer databases. As a result, certain contractual safeguards will need to be put in place if data processing is outsourced to a third party, including a member of the same corporate family outside of Canada. Investors from the European Union should note that the EU has determined that the protection granted by PIPEDA is equivalent to that afforded by the EU Directive on Data Protection.

### **Employment Laws**

In most cases, employment matters are governed by the laws of the province where an employee works. All provinces have enacted minimum standards legislation which may include minimum-wage, working conditions, statutory holiday, maternity leave, parental leave, vacation, termination and lay off. Contracting out of the minimum standards is generally not allowed. Investors from the United States should be mindful of the fact that the concept of employment “at will” does not exist in Canada. In each province, there are statutory and common-law employee termination costs that must be expected in case of termination of an employee.

Collective bargaining and unionization is also a matter that is governed by the laws of the province where employees are employed. Each province has its own requirements concerning certification of bargaining units and as to who may belong to a bargaining unit.

Each province has its own workers compensation program and statutes that regulate occupational health and safety. Generally, participation in the government workers compensation program is mandatory and in some cases, employers may have to contribute levies to the workers compensation accident fund.

Canadian employers must also contribute to the Canada Pension Plan (Québec Pension Plan, in the province of Québec) and Employment Insurance on behalf of their employees. Those contributions can, however, be deducted as business expense for income tax purposes.

Each province also has its own human rights legislation, which among others, will govern issues such as discrimination in hiring and in the workplace as well as a sexual harassment.

### **Sale of Goods Legislation**

In most provinces, the Sale of Goods legislation is broader than that in the United States. As a result, it is important to review standard terms and warranties in license agreements or other agreements in order to exclude, as much as possible, implied conditions and warranties that may arise from the statutory provisions.

### **Language Legislation**

The federal *Consumer Packaging and Labelling Act* provides that labelling and packaging on most consumer products must be in both English and French. The Act is considered as the “consumer protection” statute and therefore must be interpreted accordingly.

Provincial legislation in Québec also requires the use of the French language in the province, particularly as it relates to dealings with the general public and to employee relations. The current legislation has been in place for nearly 30 years and there is now a fairly comprehensive body of interpretation and practices that allow business to better understand their obligations under the statute. The law does not require the exclusive use of the French language. Furthermore, contracts (other than form agreements used in consumer transactions) can be drafted in a language other in French, if all parties to the contract agree that it be drafted in another language.

In order to obtain extra provincial registration of a business or corporation in Québec, it will generally be required to have a business or corporate name in French. In such context, the ability to obtain a corporate name in English and in French under the Federal corporations legislation will prove to be useful if the company wishes to eventually carry on business in the province of Québec. There are, however, exceptions to the rule concerning business names. A business or corporate name that is also a registered trademark does not need to be translated in French. A corporate name of a corporation established exclusively outside Québec also does not need to be translated.

While this is not related specifically to the issue of language, it must be noted that the province of Québec uses a Civil Code which has evolved from the French civil law system. While in many instances, the civil law does not differ substantially from the common law (as used in other provinces or in the United States) there are, however, some differences. Contracts and agreements intended to be used in the province of Québec should be

reviewed by a Québec lawyer. It must be noted, however, that a choice of law provision providing that the contract or agreement is governed by the laws of another jurisdiction will generally be enforced by the Québec courts. The situation might be different if both parties to the contract or agreement have a place of business in Québec.

### **DISCLAIMER**

**This document is intended to provide general information and should not be relied upon as legal advice. If you require legal advice we would be pleased to assist you.**

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