DEPARTMENT OF INDUSTRY, OTTAWA

DOING BUSINESS IN CANADA

TAXATION-
INCOME, BUSINESS, PROPERTY

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TAXATION

INCOME, BUSINESS, PROPERTY

PREPARED BY

DEPARTMENT OF INDUSTRY

O T T A W A

F O R E W O R D

The information in this booklet deals with the incidence of taxation on income, business and property. It is intended as a guide in this field of taxation and, as such, refers only to the basic principles involved. Every effort has been made to accurately reflect the legislation in force at the time of preparing the material.

Since the law contains a considerable amount of detail, however, and since changes at all levels occur from time to time, it is suggested that an enquirer consult with relevant authorities or lawyers of his choice, or both, when seeking precise and detailed advice on a given problem.

While the Department of Industry is prepared to assist manufacturers requiring guidance in these matters, specific information can be obtained from any one of the district taxation offices of the Department of National Revenue located throughout the country. Head Office of the Department of National Revenue is in Ottawa.

Other publications available in the "Doing Business in Canada" series are:

The Canadian Environment

Forms of Business Organization

Canadian Customs Duties

Taxation, — Sales, Excise, Commodity

Labour Legislation

Construction and Equipment Standards

Federal Incentives to Industry

Patents, Copyrights and Trade Marks

Tariff Preferences for Canadian Goods Abroad

Also available upon request from the Department of Industry are:

Financing Canadian Industries

Federal Services for Business

TAXATION

INCOME, BUSINESS, PROPERTY

Table of Contents

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TAXATION - INCOME, BUSINESS, PROPERTY

FEDERAL-PROVINCIAL ARRANGEMENTS

There are three levels of taxation in Canada - federal, provincial and municipal. The federal government levies both direct and indirect taxes, the most important of which are the corporate and personal income taxes and the manufacturers' sales tax. The provincial governments levy direct taxes, such as income tax, retail sales tax, and succession duties. Municipalities function under the guidance of provincial legislation and impose direct taxes on real estate, water consumption and places of business.

Generally speaking, all persons (including corporations) resident in Canada are liable to federal and provincial income taxes. These taxes are applied on income received during the taxation year from all sources inside or outside of Canada, less certain allowable deductions. Similarly, branches of foreign companies carrying on business in Canada are liable to Canadian income taxes on profits derived from such transactions. Administrative procedures and interpretive rulings are generally similar at both provincial and federal levels.

In past years, the provinces received grants from the federal government instead of levying their own income taxes. In 1962, the grant system was replaced by the abatement arrangement. The federal government income tax rates were reduced (abated) by a set proportion, this or a greater amount being used by the provinces as their own income tax levies. This arrangement differs essentially from the grant system in that any province now has the power to levy its own income tax at a rate higher or lower than the abatement rate.

The abatement of the federal rate of corporation income tax for 1967 and 1968, in respect of taxable income earned in a province, is 10% of taxable income for all provinces. Abatement of the federal rate for 1967 and 1968 personal income taxes is 28% of the federal tax for all provinces except Quebec. In Quebec, federal personal income tax is reduced by 50% and this arrangement is used as the basis for the province of Quebec in imposing its own tax. The higher abatement for Quebec is compensation for providing its own schooling allowances and for opting out of certain shared-cost programs.

Income taxes are collected by the federal government except in the cases of corporate income taxes imposed by the provinces of Quebec and Ontario, and personal income tax imposed by Quebec.

FEDERAL CORPORATION INCOME TAX

Generally speaking, all companies resident in Canada are liable to federal income tax. The tax is applied upon income received during the taxation year from all sources inside or outside of Canada less certain deductions permitted by the Income Tax Act.

"Income" is not defined in the federal Income Tax Act. The Act merely states that it includes income for the year from all businesses, properties, offices and employment. Nor are detailed instructions given on how to compute income. It is left to management, within certain broad limits, to employ the method best suited to the particular business operation, assuming, of course, that the methods are in accordance with normal usage.

The amount of tax payable is calculated by applying statutory rates of tax to taxable income, which is the amount remaining after making certain deductions from income. The general rates of tax are 18% on the first $35,000. of taxable income and 47% on the balance. In addition, corporations are liable for Old Age Security tax at 3% on total taxable income. When this is added the rates become 21% on the first $35,000. of taxable income and 50% on the remainder. An additional temporary surtax of 3% of tax payable for the years 1968 and 1969 was levied in March 1968.

Corporations deriving more than one-half of their gross revenue from the sale of electrical energy, gas or steam pay tax (including the 3% Old Age Security Tax) on their taxable income from such sources at the rate of 21% on the first $35,000. of taxable income plus 48% on the remainder. Ninety-five per cent of the federal tax collected from these corporations is remitted to the provinces. Corporations that qualify as investment companies pay a tax (including the Old Age Security Tax) of 21% on their taxable income.

Where two or more corporations are associated, they may allocate the whole $35,000. to one, or part of that amount to each. All of the associated corporations may thus calculate part of their tax at the 21% rate but, in total, they may not use the 21% rate on an amount in excess of $35,000.

The Income Tax Act contains a lengthy set of rules defining when companies are deemed to be "associated". Briefly, one corporation is "associated" with another if one of the corporations controls the other, or if both of the corporations are controlled by the same person.

Under the federal-provincial arrangements, the above-mentioned federal rates on corporate income earned in all provinces are reduced (abated) by 10 points to 11% and 40% to allow for the provincial income taxes.

Deductions

The Income Tax Act permits certain deductions in computing "income" and certain additional deductions in computing "taxable income". These notes do not distinguish between the two types of deductions. Among the deductions normally allowable are expenditures incurred for the purpose of earning income, including: interest on money and rent for property used in earning income; reserve for doubtful debts; bad debts; contributions to employee pension funds; expenditures on scientific research; patronage dividends; employer's contributions under profit-sharing plans. Certain special deductions (depletion allowances) are allowed in connection with oil wells, gas wells and mines. More details on this latter subject can be found in an annual publication issued by the Department of Energy, Mines and Resources, Ottawa, entitled "Summary Review of Federal Taxation and Legislation Affecting the Canadian Mineral Industry".

Expenses incurred in the course of issuing or selling shares of its capital stock or in the course of borrowing money used in the company's business (other than amounts in respect of commissions, bonus payments and discounts) are also allowed as a deduction in computing the income of a company.

Of particular importance to a new company is the provision whereby profits and losses may be offset over a seven-year period for the purpose of determining taxable income. A company may deduct from income those business losses suffered in the five years immediately preceding the taxation year or the losses suffered in the year succeeding the taxation year.

Other items generally deductible are dividends received from taxable Canadian corporations and business and property taxes on income from mining operations paid to provincial governments.

One special measure which applies to new mining operations is a three-year tax holiday.

Expenditures not allowable as deductions include organizational expenses, sums transferred to a reserve or sinking fund, unless expressly permitted, and, in general, any expense or outlay not made for the purpose of earning income.

Capital Cost Allowances

A capital cost allowance is a deduction permitted in respect of the cost of capital assets acquired for the purpose of producing income. Capital cost allowances are sometimes referred to as depreciation allowances. Assets are grouped into classes for purposes of capital cost allowances and each class carries a maximum rate of annual write-off, which is applied on the diminishing balance basis.

The maximum rates of capital cost allowance for these classes of most interest are as follows:

Frame buildings and components	- 10%
Buildings in general and component parts	- 5%
Automobiles, trucks, etc.; mining machinery equipment and buildings	- 30%
Certain contractors' equipment for excavating or compacting earth, rock, concrete or asphalt	- 50%
Sundry, not included in specific groups	- 20%
Dies, jigs, patterns; tools costing less than $100	-100%

Capital cost allowances are ordinarily calculated on a diminishing balance rather than a straight line principle. For example, a business asset costing $10,000. and subject to a rate of 5%, could be depreciated up to an amount of $500. at the end of the first year, but only $475. at the end of the second year, i.e. 5% of $10,000. minus $500. The amount of the allowance claimed for taxation purposes is subtracted from the net value of assets in the group to leave a diminished balance which is carried forward to the beginning of the next taxation year as the "undepreciated capital cost" of the property in that class. There is a provision for recapture of any amount of capital cost claimed in excess of the ultimate net cost of an asset. The recaptured amount may be spread over 5 years.

A lesser amount than the maximum may be claimed as a deduction if the taxpayer so chooses. It might be mentioned also that the amount claimed need not conform to the relative provision for depreciation deducted in computing profits as shown on the financial statement to shareholders.

There are special depreciation allowances available to firms qualified under the Area Development Program which locate or expand in "designated areas". Further details on this program are available from the Department of Industry.

Scientific Research

Income tax allowances for expenditures on scientific research have been growing in importance in recent years. In June of 1961, provisions were made to allow 100% write-off of certain capital expenditures in the taxation year during which they were incurred.

For purposes of definition, "scientific research" means a systematic investigation or search by means of experimentation or analysis in the field of science to acquire new knowledge, to devise and develop new products or processes, and/or to apply newly acquired knowledge in making improvements to existing products or processes. In some cases, expenditures to develop, test and evaluate a prototype are considered as scientific research expenditures. However, expenditures for purposes such as market research, sales promotion, quality control, or preparations of specifications are not recognized as scientific research expenditures.

There are incentive programs in addition to the tax allowances, for research and development. These are described in the booklet, "Federal Incentives to Industry", available from the Department of Industry.

Foreign Tax Credit

A credit is allowed against the federal corporation income tax for taxes paid to a foreign government on foreign source income provided the amount so claimed does not exceed the federal income tax on such income. A corporate credit must be calculated in respect of income from each country.

Logging Tax Credit

A corporation may also deduct from federal tax otherwise payable, an amount equal to 2/3 of a provincial tax on income from logging operations, not exceeding 2/3 of 10% of the corporation's income from logging operations in the province.

Returns and Payment of Federal Income Tax

A corporation is required to pay its taxes in twelve monthly instalments, beginning with the fifth month of its taxation year (company fiscal year) and ending with the fourth month following the end of its taxation year. Each of the first ten instalments is 1/12 of either the tax at current rates of the taxable income of the preceding year, or the estimated tax payable for the current year. In the third and fourth months following the end of its taxation year the amount of each instalment is one-half of the balance of tax calculated on the actual taxable income for the taxation year. Corporate returns must be filed within six months of a company's taxation year end.

This was changed by an amendment to the Income Tax Act dated March 15, 1968, which advanced the payment period of corporations by two months with special transition payments for corporations during the 1968 taxation year. Corporations must now make their first instalment payment in the third month of their taxation year and complete their payments on account of their estimated tax by the second month following the taxation year. Since some companies may have difficulty determining their actual tax liability within two months of their year end, they would be permitted to make a final payment adjusting their estimate of tax to their actual liability at the end of the third month following the year end. The change does not affect the date for filing tax returns, which remains at six months following the taxation year end.

PROVINCIAL CORPORATION INCOME TAX

All provinces levy a tax on the income of corporations derived from activities or operations carried on within their boundaries. The taxable income in a province is determined for provincial tax purposes on the same basis as for federal income tax in all provinces except Ontario and Quebec.

Where a corporation carries on operations in more than one province, it must allocate its taxable income among the provinces concerned in accordance with prescribed rules, which for most corporations are based on sales and wages in a province.

The rates of tax levied by the various provinces are as follows:

Province	Rate of tax on taxable income
Newfoundland	11%
Prince Edward Island	10%
Nova Scotia	10%
New Brunswick	10%
Quebec	12%
Ontario	12%
Manitoba	11%
Saskatchewan	11%
Alberta	10%
British Columbia	10%

It will be noted that five of the provinces levy corporate income taxes in excess of the abatement allowed on the federal government tax.

OTHER CORPORATION TAXES

In addition to the federal and provincial corporate income taxes described above, there are some further general types of taxes which affect corporations.

One group of miscellaneous corporation taxes is the provincial taxes on paid up capital, miles of track, land transfer, place of business, registration fees, etc. The municipalities levy property & business taxes and licence fees. These are generally referred to as "corporation taxes" as opposed to corporation income taxes, and are deductible in computing income for federal income tax purposes.

Quebec taxes paid-up capital (total of capital stock, earned surplus, reserve funds, bonds, debentures and mortgages, and loans and advances from other companies of a fixed nature, less certain deductions for good will and investments) at a rate of 1/10 of 1%. The capital tax for Ontario is levied at a rate of 1/20 of 1%, but this tax is payable only to the extent that it, plus other special taxes, including the $50 Ontario Place of Business Tax, exceeds the provincial corporation income tax.

Place of business taxes are levied by the provinces, at a general rate of $50 for Ontario (with the provision just mentioned above) and at a rate of $50 in Quebec, except where the paid-up capital is less than $25,000., in which case the tax is reduced to $25. Banks, railways, telegraph companies, railway-car companies and insurance companies in Ontario are not subject to the general place of business tax or the general capital tax, but are liable for special taxes computed on varying bases to the extent that they (excluding a 2% tax on insurance premiums) exceed the provincial corporation income tax payable.

The provinces of Alberta, Ontario and Quebec levy a land transfer tax based on the price at which ownership to land is transferred. In Alberta, it is considered as an assurance fund on real value, the rate being 1/5 of 1% up to $5000. and 1/10 of 1% over $5000. In Ontario, the rate is a straight 1/5 of 1%; in Quebec it is 2.5% of the purchase price in the case of property transferred under Bankruptcy or Winding-up Acts.

The provinces of British Columbia, Saskatchewan and Manitoba do not have a land transfer tax, but they have an equivalent in land titles fees which are based on land values. While the province of Nova Scotia does not have a land transfer tax, the County of Halifax levies such a tax at the rate of 1/2 of 1% of the total value.

The property and business taxes, and registration fees and licenses, are generally municipal levies. The property taxes are based on the assessed real value of the property (or as a percentage of the value in some centres) and assessment methods vary widely.

The business tax is levied against tenants of rented premises by three general bases of assessment: a fraction of the property assessment, the annual rental value of the premises, and the area of the premises. Business licenses are levied in many municipalities as an annual fee, sometimes in addition to property and business taxes, and in some cases to replace these.

Special provincial corporate taxes also exist for insurance companies and primary industries and on security transfers.

All the provinces have enacted a 2% tax on the premium income of insurance companies derived from business transacted within the province.

Special taxes on specific primary industries are levied by the provinces. Taxes on the income of mining and logging operations are in addition to revenues derived by all of the provinces from rentals, royalties, stumpage dues, and other charges imposed at varying rates on mineral and forest reserves. Nine of the ten provinces levy a tax or royalty on the income of firms engaged in mining operations.

The provinces of British Columbia, Ontario and Quebec levy an income tax on logging operations. In British Columbia, the tax is 10% on income in excess of $25,000. In Ontario and Quebec the rate is 10% on income in excess of $10,000.

Taxes are also applied on oil and gas resources by Ontario, Quebec and Alberta and on gasoline by all provinces. Telephone companies are taxed on paid-up capital in Quebec.

A Security Transfer Tax is levied upon every change of ownership on any bond or share (sale, agreement for sale, transfer, or assignment) effected in Ontario or Quebec. These taxes are imposed upon the vendor and are collected by the stock exchanges, bond dealers, transfer agents, trust companies and banks who assist in effecting the change of ownership. These taxes do not apply to obligations issued or guaranteed by the federal government, the provinces, municipal corporations and school boards within the respective provinces.

<u>Other Levies Affecting Corporations</u>

The Canada Pension Plan, Federal Unemployment Insurance, Provincial Workmen's Compensation and Old Age Security, are another group of miscellaneous taxes of interest to corporations. The Provincial Workmen's Compensation funds are levied by each province on the employer only, at a rate determined in accordance with the hazards of the industry.

The Federal Unemployment Insurance and the Canada Pension Plan are equally shared by employer and employee on the basis of a percentage of employee earnings. The maximum payments by the employer for each employee for the Unemployment Insurance is 94 cents per week and for the C.P.P. is $81.00 per annum (1.8% of earnings up to $5,100. per annum with the first $600 being exempt).

Residents of Quebec are exempt from Canada Pension Plan contributions as this province has its own provincial pension plan which is identical to the C.P.P. thereby facilitating arrangements for portability throughout Canada.

The Old Age Security Tax of 3% of corporate taxable income is included in the 21% and 50% corporation income rates as mentioned earlier.

With the exception of the Old Age Security tax, which is treated as an income tax, these levies are considered as expenses for the purpose of acquiring income and are deductible in computing taxable income.

Corporations must also consider other miscellaneous items such as withholding tax on interest and dividends paid to non-residents, sales and excise taxes and customs duties. The first is dealt with in the applicable section of this booklet, while the remaining four levies are explained in separate publications of the "Doing Business in Canada" series. Firms with foreign connections are treated separately in this booklet due to the variety of special arrangements.

PERSONAL INCOME TAXES

Federal

Every person resident in Canada at any time in a year is liable for personal income tax on his income for the year from all sources inside or outside Canada. The determination of whether a person is resident is a question of fact, but any individual who stays in Canada for 183 days or more, in a year, is deemed to have been a resident in that year. Special rules, described later in this booklet apply to those who reside abroad for part of the year. Income includes income from a business, wages and salary, dividends, director's fees, the interest element of annuity payments, interest, alimony received, income from estates, payments based on the use of real or personal property, etc.

The income from a sole proprietorship, partnership or syndicate is deemed to be the personal income of the owners whether or not it is withdrawn and is not subject to corporate income tax. The income becomes the income of the owners for the calendar year in which the fiscal year of the business ends.

For income tax purposes capital gains and such items as family allowance receipts, unemployment insurance benefits, disability pensions -- to mention only the most important items, -- are excluded from income. The tax base is further reduced by the personal exemptions and other deductions to which taxpayers are entitled.

An unincorporated taxpayer carrying on business may deduct, in general, the same type of expense as the corporate taxpayer, i.e. those incurred for the purpose of earning income. The personal exemption for a single person without dependents is $1,000. For a married person and those who have dependents, the exemption is $2,000, plus a further $300 for each child qualified to receive allowances under the Family Allowance Act, or $550 if the child is not so qualified. Family allowances are paid by the federal government in respect of children sixteen and under. The payments are $72 (for children under 10 years), or $96 (for children 10 to 16 years) per annum per child.

A dependent may earn up to $950 income and still qualify as a dependent. Students attending university, even though over 21 years of age, may be claimed as dependents. Students are allowed to deduct tuition fees paid for recognized courses to gain a university degree, a high school matriculation certificate or to acquire a technical skill to improve their qualifications for employment or business.

Other provisions in the Income Tax Act cover deductions for medical expenses, charitable donations, union and professional dues and contributions to pension plans. In lieu of claiming deductions for charitable donations and medical expenses, an individual may claim a standard deduction of $100. A taxpayer who has outlays for these items which aggregate more than $100 may file receipts and claim for them separately. Deductions for charitable contributions may not exceed 10% of income. Medical expenses in excess of 3% of the taxpayer's income may be deducted. Employees may deduct up to $1,500. per year in computing taxable income as contributions into registered pension plans, and all individuals may deduct amounts, within limits, set aside to provide a future income under registered retirement savings plans.

Income tax on salaries and wages is deducted by the employer according to rates prescribed in deduction tables. The total of these deductions over one year should approximate 100% of the total tax payment due every April 30. The balance to be paid or refunded is calculated when a return for the year is filed. Taxpayers with more than 25% of their income from sources other than salary or wages must pay tax by quarterly instalments.

The amount remaining after deducting the aggregate of exemptions and deductions from income is the taxpayer's taxable income. The rates of federal personal income tax applied to taxable income are given in Appendix "A".

Dividend Tax Credit

Canadian resident individuals are allowed to deduct from tax payable an amount equal to 20% of the net dividends they receive from taxable Canadian companies.

The amount of income tax, excluding old age security tax, of a taxpayer after deduction of the dividend tax credit but before any other deductions from tax is known as his "basic tax".

Adjustments to Basic Tax

Abatement under Federal-Provincial Arrangements

In 1967 and 1968 the tax of an individual resident in a province on income earned in a province is reduced by 28% of basic tax; except in the case of an individual resident in the province of Quebec where it is reduced by 50%.

Foreign Tax Credit

Foreign taxes paid on income from foreign sources may be credited against tax but the credit may not exceed the proportion of tax related to such income.

General Tax Reduction

In 1967 and subsequent years, all individuals may deduct from their tax the lesser of 20% of basic tax or $20.

Surtax

The amendment of March 1968 to the Income Tax Act established for 1968 and 1969 a surtax equal to 3% of basic tax in excess of $200.

The amount of tax remaining after these adjustments is the federal personal income tax liability of an individual. In addition, a 4% surtax is levied on investment income of an individual from sources outside Canada in excess of the greater of $2,400 or the aggregate of the personal exemptions and deductions to which the taxpayer is entitled.

Individual taxpayers are also liable for the Old Age Security Tax which is levied on taxable income at the rate of 4% with a maximum of $240. which is reached at a taxable income of $6,000.

Provincial

All provinces levy a tax on the income of individuals who reside within their boundaries or who earn income therein. The earned and investment income of resident salary and wage earners is allocated to the province where the taxpayer resided on the last day of the calendar year or on his last day of residence in Canada. Where non-residents are employed or carry on business in Canada, their income for provincial income tax purposes is allocated to the province where they were employed or carried on business. The federal Income Tax Regulations outline allocations of income to provinces when individuals earn business or professional income in more than one province.

In all provinces, except the province of Quebec, the provincial income taxes on the incomes of individuals are administered and collected by the federal government. In these nine provinces the provincial income tax equals a certain percentage of the federal basic tax on taxable income in the province. In the provinces of Newfoundland, Prince Edward Island, Nova Scotia, New Brunswick, Ontario, Alberta and British Columbia the tax equals the provincial abatement rate of 28% of federal basic tax, and in Manitoba and Saskatchewan the rate of tax is 33% of federal basic tax. In these nine provinces both federal and provincial income taxes are paid together with single returns and remittances.

The province of Quebec administers and collects its tax on individual incomes. In general, the rules for computing taxable income are the same as the federal personal income tax rules. However, there are certain exceptions to be noted. An amendment to the Quebec Tax Act in 1967 exempts from tax single persons with incomes of less than $2,000. and married persons with incomes of less than $4,000. Effective from July 1, 1967 the $300. deduction allowed for dependent children qualified for the federal family allowances was discontinued. This was offset by the establishment of a provincial family allowance scheme in addition to the federal program. The rate schedule for purposes of determining the amount of tax payable is equal to exactly one-half of the federal rate schedule.

A special surtax of 6% on personal income tax for the province of Quebec is proposed for the years 1968 and 1969.

OTHER LEVIES AFFECTING INDIVIDUALS

Canada Pension Plan, Quebec Pension Plan

Employees: 1.8% of income in excess of $600. up to a maximum contribution of $81 per year.

Self-Employed: 3.6% of income in excess of $600. up to a maximum contribution of $162, provided that income exceeds $800.

Unemployment Insurance

Employees with annual salaries up to $7,800 levy ranges from 10 cents to 94 cents per week.

TAX TREATMENT OF NON-RESIDENT COMPANIES

Corporations Carrying on Business in Canada

"Carrying on business in Canada" is broadly defined in the Income Tax Act. However, in considering the rules which apply in this regard, it should be kept in mind that these are modified by tax agreements which Canada has with a number of countries. These agreements provide that Canada shall tax the industrial and commercial profits of an enterprise of the other country only if the enterprise maintains a permanent establishment in Canada. As of December 31, 1967, Canada has double taxation agreements with the United Kingdom, United States, France, Ireland, Australia, New Zealand, Sweden, Norway, Denmark, Netherlands, Finland, West Germany, the Republic of South Africa, Japan and Trinidad and Tobago.

Canadian Subsidiaries of Foreign Business Firms

Where a non-resident company is carrying on business in Canada through a subsidiary company resident in Canada, the subsidiary company is treated the same as any other Canadian company. The total income of the subsidiary, whether earned in Canada or elsewhere, is subject to income tax in Canada. The subsidiary may claim a credit for taxes paid to a foreign country on the same basis as any other Canadian company.

Methods of computing income and calculating deductions are the same as those outlined in the section dealing with corporate income tax, and the rates of income tax are the same as for any other company resident in Canada.

Payments made by a subsidiary to its parent in connection with management service might usefully be a topic for discussion with taxation authorities. Management service may cover a wide variety of matters. In some instances, it may be desired that the payments should cover: personnel training, product planning, tooling, catalogue preparation, preparation of advertising, sales help on international accounts, demonstration services, use of display material, machinery design, plant layout, patent protection, management assistance, speakers at technical meetings, etc. If there is doubt as to their deductibility, these payments and the service which they are designed to cover should be discussed with the Department of National Revenue prior to finalizing the agreement.

When a foreign company, by reason of its participation in the management or capital of a Canadian enterprise, makes or imposes differing commercial or financial conditions from those which would have been made with an independent enterprise, the Department may consider that any profits which should have normally appeared in the accounts of the Canadian enterprise, and which have been diverted because of such conditions, should be incorporated in the taxable profits of the Canadian enterprise.

Canadian Branches of Foreign Companies

Business dealings under circumstances considered to be "carrying on business in Canada", render a non-resident company liable to Canadian income tax on profits derived from such transactions.

Non-resident companies "carrying on business in Canada" are liable to federal income tax in the same manner as a Canadian company, with the essential difference that a non-resident company is liable to tax only on its income earned in Canada while a resident corporation is liable to tax on its total income from all sources, both inside and outside Canada.

"Income earned in Canada" is, in principle, determined on the basis of separate accounts maintained by the Canadian office of the foreign company. Normally, if the accounts of the branch are so arranged that the income of the branch can be accurately determined, the federal taxation authorities will generally accept such accounts as the basis for determining income taxable under Canadian law. However the Department may rectify the accounts produced to correct errors and omissions, or to re-establish the price or remunerations entered in the books at the value which should prevail between independent persons dealing "at arm's length".

If the branch does not - (a) produce an accounting showing its own operations, (b) adopt accounting practices corresponding to the normal usages of the trade in Canada, or (c) effect rectifications; the Department of National Revenue will determine net profit by applying fair and reasonable methods or formulae to the operations of the establishment. The Department has arbitrary powers to determine the taxable income of any taxpayer, - whether resident or non-resident, subject to applicable measures of appeal.

Permissible deductions for purposes of determining taxable income are almost the same for a non-resident company carrying on business in Canada as for a resident Canadian company. Dividends received by such a non-resident company from Canadian companies are usually regarded as being received by the head office of the company, and are not part of the income from carrying on business in Canada.

The taxable income earned in Canada by a non-resident company is taxed at the same rate as Canadian resident companies. In addition, the profits remaining after deducting both federal and provincial taxes and an allowance in respect of new capital investment in property in Canada are subject to a special 15% tax.

Foreign Companies Outside Double Taxation Agreements

Section 139 (7) of the Income Tax Act which broadly defines the term "carrying on business in Canada" reads as follows: "Where, in a taxation year, a non-resident person - (a) produced, grew, mined, created, manufactured, fabricated, improved, packed, preserved or constructed, in whole or in part, anything in Canada, whether or not he exported that thing without selling it prior to exportation, or (b) solicited orders or offered anything for sale in Canada through an agent or servant whether the contract or transaction was to be completed inside or outside Canada or partly in and partly outside of Canada, he shall be deemed, for purposes of this Act, to have been carrying on business in Canada in the year".

The general definition embraces a very wide field of endeavour. Subsection (a) is self-explanatory. Subsection (b) would appear to leave some doubt as to what could be regarded as carrying on business.

The term "business" includes a "profession, calling, trade, manufacture or undertaking of any kind whatsoever, and includes an adventure or concern in the nature of trade, but does not include an office or employment".

The term "agent" carries with it no technical implication and it must be considered to include commission agents, brokers, travelling salesmen and representatives. Under such circumstances, the effect of subsection (b), when strictly enforced, involves liability to Canadian income tax for any non-resident company selling goods to Canadian customers, through any person in Canada.

Compensation for service rendered in Canada is also considered to be taxable. If the business of the foreign company is that of rendering service, such as engineering or consulting, it would presumably become liable to income tax in respect of the service rendered in Canada, regardless of whether or not it maintained an office or fixed place of business in Canada. However, where a foreign company renders service as part of a contract of sale, the profit derived therefrom would not be subject to Canadian income tax, provided the contract had been made directly with the customer and the foreign company was not otherwise considered to be carrying on business in Canada.

The use of substantial equipment or machinery within Canada at any time in a taxation year might render a non-resident company or individual liable to Canadian income tax.

The Department of National Revenue has made it clear that a non-resident company or individual can become liable to Canadian income tax without having a fixed place of business in Canada. On the other hand, the necessity of obtaining a provincial licence to do business, if and when required, is not a determining factor in ascertaining whether a foreign company is liable to federal income tax.

When profitable contracts by or for non-residents are made in Canada, by persons in Canada, and the goods are delivered (whether from stock kept in Canada or by consignment forwarded from abroad) and payments are received by or for the non-resident in Canada, then business is clearly being carried on in Canada within the meaning of the Act, and the non-resident is liable to income tax assessments on the profits for such Canadian business.

Similarly, liability attaches if the contracts are concluded and the deliveries made in Canada, though payment is made abroad; or if the contracts are concluded and payments made in Canada, but the delivery takes place abroad.

Finally, the mere fact that orders are taken in Canada is, regardless of circumstances, considered sufficient to render the non-resident company or individual liable to income tax on the profits from such business. A Canadian or non-resident salesman, representative or broker may merely solicit orders, which may be accepted, delivery made, and even payments made outside of Canada, but notwithstanding all these facts, the foreign business enterprise would be liable to tax on the profits accruing from such sales.

Profits derived from sales made directly to Canadian customers without the intervention of any person or company in Canada is, apparently, the only clear-cut method that would not entail liability for a foreign business enterprise operating outside a double taxation agreement when the provisions of Subsection (b), Section 139 (7), are applied.

Foreign Companies Under Double Taxation Agreements

"Carrying on business in Canada" is defined, for federal income tax purposes, in the double taxation agreements between Canada and the United Kingdom, United States, France, Ireland, Australia, New Zealand, Sweden, Norway, Denmark, Netherlands, Finland, West Germany, Japan, the Republic of South Africa and Trinidad and Tobago. The provisions of these agreements take precedence over the Income Tax Act itself where a question of definition or application arises.

The agreements provide that an enterprise of one of the contracting countries may be taxed by the other country only on the industrial and commercial profits allocable to its permanent establishment in the latter country. "Permanent establishment" is defined as including branches, mines and oil wells, farms, timber land, plantations, factories, warehouses, offices, agencies and other fixed places of business.

Where an enterprise of one of the above countries carries on business in Canada through an employee or agent established here, who has general authority to contract for his employer or principal, or who has a stock of merchandise from which he regularly fills orders which he receives, such enterprise is deemed to have a permanent establishment in Canada, and is, therefore, liable to Canadian taxation. However, the fact that an enterprise of one of the contracting countries has business dealings in Canada through a commission agent, broker or other independent agent, or maintains in Canada an office used solely for the purchase of merchandise, is not held to mean that the non-resident company has a permanent establishment in Canada.

TAX TREATMENT OF NON-RESIDENT PERSONS

For tax purposes, non-resident persons may be divided very broadly into three main classes: (1) non-resident persons carrying on business in Canada; (2) non-resident persons working in Canada; (3) non-resident persons receiving income from other Canadian sources.

Carrying on Business in Canada

A non-resident partnership or sole proprietorship is considered to become liable to Canadian income tax, in respect of business dealings in Canada, in the same manner as a foreign company carrying on business in Canada through the medium of a branch organization.

Taxable income earned in Canada by a non-resident partner or sole proprietor is considered to be the part of his income for the year that may reasonably be attributed to the business carried on by him in Canada, minus applicable deductions.

The profits on a non-resident partnership or sole proprietorship from business carried on in Canada, whether or not that income is withdrawn by the owner or owners is, for Canadian taxation purposes, allocable to each owner in accordance with his share of the profits. The profits become income of the owner(s) for the calendar year in which the fiscal year of the business ends.

A non-resident individual who is employed in Canada or who carried on business in Canada, either as a sole proprietor or a member of a partnership, pays tax at the graduated rates only on his taxable income attributable to the employment or business in Canada. If he has investment income from

Canadian sources not related to the business carried on in Canada, this investment income is not combined with the income from employment or carrying on business in Canada, but, instead is subject to the tax on non-residents withheld under Part III of the Act. (This same rule applies to non-resident corporations carrying on business in Canada.)

Working in Canada

A person who "sojourns in Canada in a taxation year for a period of, or periods the aggregate of which is, 183 days or more", is deemed to be a resident of Canada and is taxable on income from all sources, both within and without Canada. A credit is allowed for taxes paid to a foreign government on income earned in such other country.

A non-resident who is present for less than 183 days is also liable to Canadian income tax, but only on that part of his income received for work performed in Canada during his stay in this country. Such income is taxable in a manner similar to the taxation of income in the hands of resident Canadians. This person is allowed to claim a pro rata portion of a full year's personal exemption.

Liability may not arise in all cases, however. Exceptions are to be found in the double taxation agreements which Canada has concluded with the United Kingdom, United States, France, Ireland, Australia, New Zealand, Sweden, Norway, Denmark, Netherlands, Finland, West Germany, the Republic of South Africa, Japan and Trinidad and Tobago.

Under these agreements, there are certain situations where the earnings of an employee temporarily resident in Canada are not subject to income tax in this country. However, the Department of National Revenue, must have proof that the individual is exempt from such liability before permission is given to waive the deduction of tax at the source. (See section on Personal Income Tax). Unless permission has otherwise been obtained, an employer is required to make authorized deductions on a monthly basis and forward the amounts so collected to the Receiver General of Canada. The tax deducted at the source and paid in by the employer will be refunded to the employee when he proves that he is entitled to exemption.

Receiving Income from Other Canadian Sources --Withholding Tax

Persons, (corporations or individuals) resident outside Canada who receive income from Canadian sources, are required to pay (via deduction at source) a withholding tax of

15% on payment of amounts credited to their accounts in respect of dividends, interest, income from a trust or estate, rents, alimony, royalties or similar payments, including payments (a) for the use in Canada of property, (b) in respect of an invention used in Canada, (c) for any trade name, franchise, design or other thing whatsoever used or sold in Canada, (d) for a management or administration fee or charge as defined in the Income Tax Act.

The term interest includes income arising from interest-bearing securities, public obligations, mortgages, hypothecs, corporate funds, loans, deposits and current accounts. Interest on bonds of, or guaranteed by, the federal government is exempt from withholding tax when held by national governments of foreign countries and certain designated international agencies. Interest paid to certain non-resident purchasers of Canadian bonds and debentures issued after June 13, 1963, by Canadian borrowers are exempt from withholding tax. To qualify under this exemption non-resident purchasers must be exempt from tax imposed by their country of residence.

Dividends paid or credited to a non-resident shareholder are subject to withholding tax. The term "dividend" includes all distributions of earnings or profits of a corporation. The rate of withholding tax is 15%. However, effective from June 13, 1963, a special rate of 10% is applicable to dividends paid by corporations having a degree of Canadian ownership.

For details concerning the meaning of a "degree of Canadian ownership" see Appendix "B".

Canadian licensees, lessees and others making these payments to a non-resident company or individual must deduct 10% or 15% as the case may be, from every such payment at the time the payment is made or credited to the foreign party. The amount deducted must be remitted to the Receiver General of Canada. Whenever an agent of a non-resident corporation or individual receives payments from which the tax deduction has not been made, he is required to make such deduction before paying over to his principal.

FOREIGN TAXES ON INCOME EARNED IN CANADA

Apart from measures of relief from double taxation as found in the agreements which Canada has concluded with other countries, there are also specific provisions written into the income tax laws of these and most other countries with which a non-resident investor in a Canadian enterprise may be concerned. While these provisions vary from country to country it can be generally stated that Canadian taxes on income earned by foreign investors are normally available as a full or partial credit against taxes payable thereon in the investor's country of residence. In some cases, Canadian tax payments can be considered as a deductible expense in calculating the investor's tax liability in his country of residence.

In all cases investors are well advised to discuss the subject of tax liability on income earned abroad with tax authorities in their country of residence.

APPENDIX "A"

Personal Income Tax Rate Schedule

Taxable Income	Tax	
$ 1,000 or less	11%	
$ 1,000	110 + 14% on next	$ 1,000
$ 2,000	250 + 17% on next	$ 1,000
$ 3,000	420 + 19% on next	$ 1,000
$ 4,000	610 + 22% on next	$ 2,000
$ 6,000	1,050 + 26% on next	$ 2,000
$ 8,000	1,570 + 30% on next	$ 2,000
$ 10,000	2,170 + 35% on next	$ 2,000
$ 12,000	2,870 + 40% on next	$ 3,000
$ 15,000	4,070 + 45% on next	$ 10,000
$ 25,000	8,570 + 50% on next	$ 15,000
$ 40,000	16,070 + 55% on next	$ 20,000
$ 60,000	27,070 + 60% on next	$ 30,000
$ 90,000	45,070 + 65% on next	$ 35,000
$125,000	67,820 + 70% on next	$100,000
$225,000	137,820 + 75% on next	$175,000
$400,000	269,070 + 80% on remainder	

APPENDIX "B"

"Degree of Canadian Ownership"

The following is an abridged version of the actual requirements which must be met if a company is to be reported as having a "degree of Canadian ownership".

1. The company must be a resident of Canada.
2. (a) No less than 25% of the company's issued and outstanding voting shares and no less than 25% of the equity share capital of the company must be owned in Canada (by individuals and/or by Canadian controlled companies)

   OR

   (b) A class or classes of voting shares and a class or classes of equity shares representing not less than 50% of the equity share capital of the company must be listed on a Canadian stock exchange and no more than 75% of the equity share capital, nor more than 75% of the voting shares must be owned abroad by one non-resident person or related persons.

3. At least 25% of the directors of the company must be resident in Canada.

To qualify as having a degree of Canadian ownership in a particular taxation year, a company must have met requirements described above throughout any sixty-day period in the 120 day period commencing 60 days before the first day of the year.

APPENDIX "C"

Examples of Special Incentives and Economic Measures that have been Enacted in Recent Years.

Accelerated Depreciation

1. Straight line depreciation at a rate of up to 50% was granted in respect of certain new machinery and equipment acquired in the period June 14, 1963 to December 31, 1966, for use in manufacturing or processing businesses by individuals resident in Canada or by companies resident in Canada that have a degree of Canadian ownership (see Appendix "B").

2. For new manufacturing or processing businesses in designated areas of slower growth, there was no requirement that they have a degree of Canadian ownership in order to qualify for this 50% straight line depreciation. Moreover the period during which their expenditures on eligible assets qualified for accelerated write-off extended from December 5, 1963 to March 31, 1967. Depreciation at the accelerated rate of 20% on a straight-line basis was also available in respect of new buildings acquired in designated areas of slower growth during the same period.

3. Accelerated depreciation was also allowed in respect of new buildings or other structures for grain storage acquired in the period May 1, 1965 to December 31, 1966 (full write-off in two years).

4. Accelerated depreciation is also allowed in respect of assets acquired in the period from April 27, 1965 to January 1, 1970 to prevent water pollution (full write-off in two years).

5. In addition to the provision allowing all expenditures on scientific research related to the business of the taxpayer to be written off for tax purposes in the year when incurred, corporations were allowed an additional deduction of 50% of their increased expenditures on scientific research in Canada in a five year period ending with their 1966 taxation year.

Economic Measures

The capital cost allowances that could otherwise be claimed for certain classes of assets acquired during the period March 30, 1966 to March 31, 1967 were reduced in the taxation year in which the assets were acquired and in the next two taxation years. The principal classes of assets affected included most kinds of buildings and machinery and equipment with the exception of heavy construction equipment, pipelines and the generating and distributing equipment of public utilities. Assets eligible for accelerated depreciation were not affected by this curtailment of normal capital cost allowances.

Special Refundable Tax on the Cash Profits of Corporations

In 1966 a temporary refundable tax on corporate "cash profits" was introduced for economic stabilization purposes to be payable monthly from May, 1966 to March 31, 1967, at a rate of 5% on applicable taxable cash profits. Legislation has been passed providing for the refunding of this tax, together with interest at 5%. This refunding process began in June of 1968 and is to be completed by May of 1970.

DATE DUE - DATE DE RETOUR

ISTC 1551 (8/88)