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Worldwide Tax Summaries
Corporate Taxes 2010/11

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Significant developments

Canada's corporate summary includes all 2010 federal, provincial and territorial budgets. The numerous tax changes this year, many of a highly technical nature, may affect taxpayers engaged in international transactions. Other measures enhance targeted programmes, such as film and media tax credits and incentives for scientific research and experimental development. The summary is based on enacted and proposed legislation and assumes that the proposed legislation will become law.

Corporate income tax rates

Federal corporate income tax rates decreased commencing 2008, and will continue to decline gradually until 2012. Provincial corporate rates tend to be on the decline.

Capital tax

All provincial general capital taxes are scheduled to be eliminated by 1 July 2012.

Taxable Canadian property

Commencing 5 March 2010, taxable Canadian property will exclude shares of corporations, and certain other interests, that do not derive their value (over a 60-month look-back period) principally from real or immovable property situated in Canada, Canadian resource property, or timber resource property. Therefore, with some exceptions, non-residents will no longer be required to report dispositions of these properties and obtain a clearance certificate.

Stock options

Significant changes to the rules for stock options permit only the employer or employee (not both) to claim a tax deduction for cashed-out stock options and eliminate employee elections to defer the payment of tax on stock option benefits until the shares are sold (relief may be available). The changes also eliminate the undue hardship exemption for withholdings on stock option benefits and require withholdings in connection with these benefits after 2010. Grandfathering rules may apply.

Tax avoidance

A proposed regime will make an "avoidance transaction" that meets certain conditions a "reportable transaction" that must be reported to the Canada Revenue Agency. The proposals (as modified to reflect public consultations) will apply to transactions entered into after 2010, and those that are part of a series of transactions completed after 2010.

Non-resident trusts (NRTs) and foreign investment entities (FIEs)

The 2010 federal budget announced that the draft rules for NRTs and FIEs will be somewhat simplified and better targeted. The revised proposals will be subject to further public consultation. The NRT rules generally will apply commencing 2007; trusts subject to the draft rules will be considered resident for Canadian income tax purposes. An election will allow a trust to elect to be deemed resident for the 2001 and subsequent years.

The FIE rules have been essentially eliminated. The enacted version of the rules for offshore investment funds property will continue to apply, with some modifications, for taxation years ending after 4 March 2010. A taxpayer that filed under the FIE proposals for previous years can either have those years reassessed or be entitled to a deduction in the current year for the income previously included.

Specified investment flow-throughs (SIFTs)

Certain earnings of SIFTs (i.e., publicly traded income trusts and partnerships) are subject to a SIFT tax and are deemed to be a dividend when distributed. These rules apply starting the 2007 taxation year, for SIFTs first publicly traded after 31 October 2006, and starting the 2011 taxation year, for other SIFTs. New rules facilitate the conversion of SIFT trusts into corporations, generally for transactions that occur after 13 July 2008 and before 2013.

Group taxation

The federal government will consider whether the tax system could be improved by new rules for the taxation of corporate groups, such as the introduction of a formal system of loss transfers or consolidated reporting.

International Financial Reporting Standards (IFRS)

Canada will move to IFRS from Canadian generally accepted accounting principles (GAAP), which could affect the measurement and reporting of income taxes for financial statement purposes and the calculation of Canadian taxes payable. Canada's adoption of IFRS is effective for fiscal years beginning after 31 December 2010, with earlier adoption permitted in certain circumstances. IFRS will be mandatory for "publicly accountable enterprises" and elective for other enterprises.

Provincial sales tax harmonisation

On 1 July 2010, provincial sales tax in British Columbia and Ontario will be harmonised with the federal goods and services tax (GST).

Taxes on corporate income

Federal income tax

The following rates apply for 31 December 2010 year-ends. For non-resident corporations, the rates apply to business income attributable to a permanent establishment in Canada. Different rates may apply to non-resident corporations in other circumstances. Non-resident corporations may also be subject to branch tax *(see below)*.

	Federal rate
	%
Basic rate	38.0
Less – Provincial abatement (1)	10.0

	Federal rate
Federal rate	28.0
Less – General rate reduction (2), (3) or manufacturing and processing (M&P) deduction	10.0
Net federal tax rate (4), (5)	18.0

Notes

1. The basic rate of federal tax is reduced by a 10% abatement to give the provinces and territories room to impose corporate income taxes. The abatement is available in respect of taxable income allocated to Canadian provinces and territories. Taxable income allocable to a foreign jurisdiction is not eligible for the abatement and normally is not subject to provincial or territorial taxes.
2. The general rate reduction does not apply to the first CAD 500,000 of active business income earned in Canada by Canadian-controlled private corporations (CCPCs), investment income of CCPCs, manufacturing and processing (M&P) income, income of credit unions, most deposit insurance corporations, mutual fund corporations, mortgage investment corporations and investment corporations, which may benefit from preferential tax treatment.
3. The general rate reduction and M&P deduction increased from 9% to 10% on 1 January 2010, and will increase to 11.5% on 1 January 2011 and to 13% on 1 January 2012.
4. Provincial taxes apply in addition to federal taxes. Provincial tax rates are noted below.
5. For small CCPCs, a federal rate of 11% applies to the first CAD 500,000 of active business income. A federal rate of 18% (19% before 2010) is levied on active business income above CAD 500,000. Investment income (other than most dividends) of CCPCs is subject to tax at the federal rate of 28%, in addition to a refundable federal tax of 6-2/3%, for a total federal rate of 34.7%.

Provincial/territorial income tax

All provinces and territories impose income tax on income allocable to a permanent establishment in the province or territory. Generally, income is allocated to a province or territory by using a two-factor formula based on gross revenue and on salaries and wages. Provincial and territorial income taxes are not deductible for federal income tax purposes. The rates given apply to 31 December 2010 year-ends. The rates do not take into account provincial tax holidays, which reduce or eliminate tax in limited cases.

	Provincial/territorial (1), (2)
	%
Alberta	10.0
British Columbia (3)	10.5
Manitoba (4)	12.0
New Brunswick (5)	11.5
Newfoundland and Labrador	14.0 or 5.0
Northwest Territories	11.5
Nova Scotia	16.0
Nunavut	12.0
Ontario (6)	13.0 or 11.0
Prince Edward Island	16.0
Quebec	11.9
Saskatchewan (7)	12.0 or 10.0
Yukon Territory	15.0 or 2.5

Notes

1. When two rates are indicated, the lower rate applies to M&P income.
2. In all provinces and territories, the first CAD 500,000 (CAD 400,000 in some jurisdictions) of active business income of a small CCPC is subject to reduced rates that range from 0.9% to 8.0%, depending on the jurisdiction. British Columbia, Manitoba, Newfoundland and Labrador, Nova Scotia, Ontario and Prince Edward Island intend to decrease their rates for small CCPCs.
3. British Columbia's rate decreased from 11% to 10.5% on 1 January 2010 and will decrease to 10% on 1 January 2011.
4. Manitoba's rate decreased from 13% to 12% on 1 July 2009, and subject to balanced budget requirements, will decrease to 11% at a date to be determined.
5. New Brunswick's rate decreased from 13% to 12% on 1 July 2009, and will decrease to 11% on 1 July 2010, to 10% on 1 July 2011 and to 8% on 1 July 2012.
6. The lower Ontario rate applies to profits from manufacturing and processing, and from farming, mining, logging and fishing operations carried on in Canada and allocated to Ontario. This rate will decrease from 12% to 10% on 1 July 2010.
   Ontario's non-M&P rate will decrease from 14% to 12% on 1 July 2010, to 11.5% on 1 July 2011, to 11% on 1 July 2012 and to 10% on 1 July 2013.
   Corporations subject to Ontario income tax may also be liable for corporate minimum tax (CMT) based on adjusted book income. The CMT is payable only to the extent that it exceeds the regular Ontario income tax liability. The CMT rate will decrease from 4% to 2.7% on 1 July 2010 and the CMT thresholds will increase as shown in the following table:

		Taxation years ending	
		before 1 July 2010	after 30 June 2010
Thresholds for CMT to apply*	Total Assets	> CAD 5 million	≥ CAD 50 million
		or	and
	Annual gross revenues	> CAD 10 million	≥ CAD 100 million

* Thresholds apply on an associated basis.

7. Saskatchewan's M&P rate is as low as 10% (reduced from the 12% non-M&P rate), depending on the extent to which the corporation's income is allocated to the province.

Corporate residence

As a general rule, corporations resident in Canada are subject to Canadian income tax on worldwide income. As a result of special provisions in the Income Tax Act, almost all corporations incorporated in Canada are resident in Canada. A corporation not incorporated in Canada may be considered resident in Canada if its central management and control are exercised in Canada.

A corporation incorporated in Canada will cease to be a Canadian resident if it is granted articles of continuance in a foreign jurisdiction or if it is a predecessor corporation in a cross-border amalgamation. Similarly, a foreign corporation will become resident in Canada if it is continued in Canada or is a predecessor corporation of an amalgamated corporation that is resident in Canada.

Non-resident corporations are subject to income tax on income derived from carrying on a business in Canada and on capital gains arising upon the disposition of taxable Canadian property. The purchaser of the taxable Canadian property is generally required to withhold tax from the amount paid unless the non-resident vendor has obtained a clearance certificate.

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Taxable Canadian property includes, among other things, real or immovable property situated in Canada, both capital and non-capital property used in carrying on a business in Canada and shares in Canadian-resident corporations that are not listed on a stock exchange. In certain circumstances, shares in Canadian-resident corporations that are listed on a stock exchange, shares in non-resident corporations and interests in non-resident trusts will be considered taxable Canadian property. However, commencing 5 March 2010, taxable Canadian property will exclude shares of corporations, and certain other interests, that do not derive their value (over a 60-month look-back period) principally from real or immovable property situated in Canada, Canadian resource property, or timber resource property. Therefore, with some exceptions, non-residents will no longer be required to report dispositions of these properties and obtain a clearance certificate.

Withholding tax at a rate of 25% is imposed on interest (other than most interest paid to arm's-length non-residents, commencing 2008), dividends, rents, royalties, certain management and technical service fees, and similar payments, made by a Canadian resident to a non-resident of Canada.

Canadian income tax and withholding tax can be reduced or eliminated if Canada has a treaty with the non-resident's country of residence. A list of treaties that Canada has negotiated and applicable withholding tax rates is provided under *"Withholding taxes arising in Canada", below*.

Other taxes

Goods and services tax

The federal goods and services tax (GST) is levied at a rate of 5%. It is a value-added tax applied at each level in the manufacturing and marketing chain and applies to most goods and services. However, the tax does not apply to sales of zero-rated goods, such as exports and groceries, or to tax-exempt supplies, such as certain services provided by financial institutions.

Generally, businesses pay GST on their purchases and charge GST on their sales, and remit the net amount (i.e., the difference between the GST collected and the input tax credit for the tax paid on purchases). Suppliers are entitled to claim input tax credits on zero-rated goods and services, but not on tax-exempt supplies.

Harmonised sales tax

Newfoundland and Labrador, New Brunswick and Nova Scotia harmonised their sales tax systems with the GST and impose a single sales tax rate of 13% (15% in Nova Scotia starting 1 July 2010). The 13% rate includes an 8% provincial sales tax component (10% in Nova Scotia starting 1 July 2010) and the 5% GST. It is imposed on essentially the same base as the GST. On 1 July 2010:

- In British Columbia, the 7% Social Services Tax and the 5% federal GST will be replaced with a 12% harmonised sales tax; and
- In Ontario, the 8% Retail Sales Tax and the 5% federal GST will be replaced with a 13% harmonised sales tax.

Transitional rules will apply in British Columbia and Ontario.

Retail sales tax

British Columbia, Manitoba, Ontario, Prince Edward Island and Saskatchewan levy retail sales tax at rates ranging from 5% to 10% on most purchases of tangible personal property for consumption or use in the province and on the purchase of specific services. As mentioned, on 1 July 2010, retail sales tax in British Columbia and Ontario will be replaced with the harmonised sales tax.

Quebec's sales tax is structured essentially in the same way as the GST. Quebec has widened its sales tax base to include most of the goods and services subject to the GST. The general Quebec sales tax rate is 7.5% (8.5% in 2011 and 9.5% after 2011). Quebec administers the GST in that province.

Only Prince Edward Island and Quebec levy their sales tax on prices that include the GST.

Alberta and the three territories (the Northwest Territories, Nunavut and the Yukon) do not impose a retail sales tax.

Property tax

Property taxes are levied by municipalities in Canada on the estimated market value of real property within their boundaries and by provinces on land not in a municipality. In most provinces, a general property tax is levied on the owner of the property. Some municipalities levy a separate business tax, which is payable by the occupant if the premises are used for business purposes. These taxes are based on the assessed value of the property at tax rates that are set each year by the various municipalities. School taxes, also generally based on the value of real property, are levied by local and regional school boards or the province.

Land transfer tax

All the provinces and territories levy a land transfer tax or registration fee on the purchaser of real property within their boundaries. These levies are expressed as a percentage, primarily on a sliding scale, of the sale price or the assessed value of the property sold, and are generally payable at the time title to the property is registered. Rates generally range from 0.02% to 2%, depending on the province or territory, but may be higher if the purchaser is a non-resident. Some exemptions (or refunds) are available. Additional land transfer taxes apply for properties purchased in the municipalities of Montreal or Toronto. Other municipalities may also impose these taxes and fees.

Federal capital taxes

The federal Large Corporations Tax (Part I.3 Tax) was eliminated on 1 January 2006. The Financial Institutions Capital Tax (Part VI Tax) is imposed on banks, trust and loan corporations and life insurance companies at a rate of 1.25% when taxable capital employed in Canada exceeds CAD 1 billion. The tax is not deductible in computing income for tax purposes. It is reduced by the corporation's federal income tax liability. Any unused federal income tax liability can be applied to reduce Part VI Tax for the previous three and the next seven years. Unused income taxes that can be carried back from taxation years ending after 30 June 2006 are calculated using capital tax rates and thresholds that applied before 1 July 2006 (i.e., 1.25% rate for capital over CAD 300 million; 1% between CAD 200 million and CAD 300 million; nil below CAD 200 million). The thresholds are shared among related financial institutions. In effect, the tax constitutes a minimum tax on financial institutions.

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Provincial capital taxes

Every province, except Alberta, imposes a tax on capital employed within the province. The tax is deductible for federal income tax purposes. The federal government has proposed to limit the deductibility of capital taxes, but has delayed implementing this proposal indefinitely. As an interim measure, any increase in these taxes, with certain exceptions, is not deductible. Furthermore, the federal government has proposed to provide financial incentives to provinces that eliminate their capital taxes before 1 January 2011.

Provincial capital taxes are imposed at the following rates for 31 December 2010 year-ends. Certain exemptions and reduced rates apply.

	General (%)	Banks, trust and loan corporations (%)
Alberta	–	–
British Columbia (1)	–	0.082 or 0.247
Manitoba (2)	0.3	3
New Brunswick	–	3
Newfoundland and Labrador	–	4
Nova Scotia (3)	0.125	4
Ontario (4)	0.074	0.223 or 0.179
Prince Edward Island	–	5
Quebec (5)	0.12	0.49
Saskatchewan (6)	–	3.25

Notes

1. British Columbia's financial institutions capital tax was eliminated on 1 April 2010. On 1 April 2009, for financial institutions with either a head office in British Columbia or net paid-up capital of CAD 1 billion or less, the rate decreased from 0.67% to 0.33% and for other financial institutions, the rate decreased from 2% to 1%. A financial institutions minimum tax that was to apply starting 1 April 2010, will not come into effect.
2. Manitoba's general rate decreased from 0.3% to 0.2% for taxation years commencing after 1 January 2010, and will be eliminated on 1 January 2011. These changes do not apply to Crown corporations, for which the rates will remain 0.3%, nor to certain manufacturing and processing companies for which capital tax was eliminated on 1 July 2008. Other rates apply to the first CAD 21 million of taxable capital employed in Manitoba.
3. Nova Scotia's general rate decreased from 0.2% to 0.15% on 1 July 2009, and will decrease to 0.1% on 1 July 2010 and to 0.05% on 1 July 2011. These rates are doubled for corporations with taxable capital under CAD 10 million. The general capital tax will be eliminated on 1 July 2012.
4. Ontario's general capital tax was reduced or eliminated for certain manufacturing and resource corporations on 1 January 2007. On 1 January 2010, Ontario's general rate decreased from 0.225% to 0.15%, and its financial institutions rate decreased from 0.675% (deposit-taking institutions) and 0.54% (other) to 0.45% and 0.36%, respectively. Lower rates apply to financial institutions with taxable capital of CAD 400 million or less. Capital tax will be eliminated for all corporations on 1 July 2010.
5. Quebec's general rate decreased from 0.24% to 0.12% on 1 January 2010, and will be eliminated on 1 January 2011. In addition, capital tax was reduced or eliminated for certain manufacturing corporations, commencing with taxation years ending after 13 March 2008.
   Quebec's financial institution rate of 0.49% includes a 0.24% base rate and a 0.25% compensatory tax on paid-up capital. A compensatory tax of 3.9% (2% for taxation years ending before 31 March 2010 or beginning after 31 March 2014) on payroll also applies.
   Quebec's base rate decreased from 0.48% to 0.24% on 1 January 2010, and will be eliminated on 1 January 2011.
6. Saskatchewan's rate for financial institutions that have taxable paid-up capital of CAD 1.5 billion or less is 0.7%.

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Additional taxes on insurers

All provinces and territories impose a premium tax ranging from 2% to 4.4% on insurance companies (both life and non-life). In addition, Manitoba and Nova Scotia impose a capital tax on all insurance companies, while Ontario and Quebec impose a capital tax on life insurance companies only. Quebec also levies a compensatory tax on insurance premiums at a rate of 0.55% (0.35% for taxation years ending before 31 March 2010 or beginning after 31 March 2014).

Part III.1 tax on excess designations

Federal Part III.1 tax applies at a 20% or 30% rate if, during the year, a CCPC designated as eligible dividends an amount that exceeds its general rate income pool (GRIP), or a non-CCPC pays an eligible dividend when it has a positive balance in its low rate income pool (LRIP). A corporation subject to Part III.1 tax at the 20% rate (i.e., the excess designation was inadvertent) can elect, with shareholder concurrence, to treat all or part of the excess designation as a separate non-eligible dividend, in which case Part III.1 tax will not apply to the amount that is the subject of the election.

Eligible dividends are designated as such by the payor and include dividends paid by:

- Public corporations or other corporations that are not CCPCs, that are resident in Canada and are subject to the federal general corporate income tax rate (i.e., 18% in 2010); or
- CCPCs, to the extent that the CCPC's income is:
  - Not investment income (other than eligible dividends from public corporations); and
  - Subject to the general federal corporate income tax rate (i.e., the income is active business income not subject to the federal small business rate).

Non-eligible dividends include dividends paid out of either income eligible for the federal small business rate or a CCPC's investment income (other than eligible dividends received from public companies).

Provincial payroll taxes

Employers in Manitoba, Newfoundland and Labrador, Ontario and Quebec are subject to payroll tax. Maximum rates range from 1.95% to 4.3%. In addition, Quebec employers with payroll of at least CAD 1 million must allot 1% of payroll to training or to a provincial fund. Employers in the Northwest Territories and Nunavut must deduct from employees' salaries a payroll tax equal to 2% of employment earnings.

Social security taxes

For 2010, employers are required to pay, for each employee, government pension plan contributions up to CAD 2,163.15 and employment insurance premiums up to CAD 1,046.30. However, Quebec employers contribute, per employee, a maximum of CAD 822.53 in employment insurance premiums and up to CAD 442.50 to a Quebec parental insurance plan.

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Excise taxes and duties

Excise duties are levied at various rates on alcohol, alcoholic beverages (other than wines) and tobacco products manufactured in Canada, while imports are subject to customs duties *(see below)*.

Excise tax is imposed on petroleum products and automobiles. In addition, a 10% federal excise tax applies to insurance premiums paid or payable by a Canadian resident to an insurer that is not authorised under Canadian or provincial law to transact the business of insurance. Certain premiums are exempt, including those for life, personal accident, marine and sickness insurance.

Custom duties

Custom duties are generally intended to protect Canadian industry from foreign competition and not as a source of revenue. The majority of most-favoured-nation (MFN) duty rates are below 10%; notable exceptions are textiles and apparel and certain food products (the latter is subject to "tariff rate quotas"). Many products are duty-free regardless of their country of origin. Goods imported from developed countries with which Canada does not have trade agreements will attract the MFN duty rate.

Qualifying goods that originate in the North American Free Trade Agreement (NAFTA) territory (Canada, the United States and Mexico) can enter Canada duty-free. Canada has implemented free trade agreements (FTAs) with several other countries (i.e., Chile, Costa Rica, the European Free Trade Association countries, Israel, Peru) and has signed or is negotiating agreements with several other countries. Like the NAFTA, these agreements set out rules of origin for determining whether the goods are eligible for preferential duty rates under the particular FTA.

Canada extends preferential duty rates to most (but not all) products imported from developing countries (the General Preferential Tariff) and has granted further concessions to goods originating in Least-Developed Developing Countries. In either case, goods must satisfy rules of origin and be shipped directly to Canada from the beneficiary countries to qualify for these rates. Canada applies the general duty rate of 35% to only two countries (North Korea and Libya).

Branch income

A non-resident corporation will be subject to income tax at normal corporate rates on profits derived from carrying on a business in Canada. However, Canada's tax treaties generally restrict taxation of a non-resident's business income to the portion allocable to a permanent establishment located in Canada.

In addition, a special 25% "branch tax" applies to a non-resident's after-tax profits that are not invested in qualifying property in Canada. The branch tax essentially is equivalent to a non-resident withholding tax on funds repatriated to the foreign head office. In the case of a company resident in a treaty country, the rate at which the branch tax is levied may be reduced to the withholding tax rate on dividends prescribed in the relevant tax treaty (generally 5%, 10% or 15%). Some of Canada's treaties prohibit the imposition of branch tax or provide that branch tax is payable only on earnings in excess of a threshold amount. The branch tax does not apply to transportation, communications and iron-ore mining companies. Nor does it apply to non-resident insurers, except in special circumstances.

Whether or not a treaty applies, a non-resident corporation that has a permanent establishment in Canada may be subject to federal capital taxes (i.e., financial institutions capital tax) and provincial capital taxes *(see Provincial capital taxes under Other taxes above)*.

Income determination

Inventory valuation

In most cases, all property included in an inventory can be valued at fair market value, or each item can be valued at its cost or fair market value, whichever is lower. Most well-established and reasonable approaches to inventory costing can be used for tax purposes, except for the last-in, first-out (LIFO) method. Conformity between methods used for book and tax reporting is not mandatory, but the method chosen should be used consistently for tax purposes. Inventory must be valued at the commencement of the year at the same amount as at the end of the immediately preceding year.

Capital gains

Half of a capital gain constitutes a taxable capital gain, which is included in the corporation's income and taxed at ordinary rates. Capital losses are deductible, but generally only against capital gains. Any excess of allowable capital losses over taxable capital gains in the current year can be carried back three years and forward indefinitely, to be applied against net taxable capital gains from those years, except in the case of an acquisition of control. No particular holding period is required. Intent is a major factor in determining whether the gain or loss is income or capital in nature. Complex transitional rules ensure that gains and losses accrued to the end of 1971 have no tax effect. Capital gains were not taxable before 1972.

Interest, rents and royalties

Interest that accrued, became receivable by or was received by a corporation, and rents and royalties received by a corporation are taxable as income from a business or property, as the case may be.

Inter-company dividends

Dividends received by one Canadian corporation from another Canadian corporation generally can be deducted in full in determining taxable income. However, dividends on certain preferred shares are an important exception and are taxed at full corporate rates. The intent is to allow preferred share investors to transfer benefits of accumulated deductions or losses from the entity that incurred the expense.

Dividends on most preferred shares are subject to a 10% tax in the hands of the recipient, unless the payer elects to pay a 40% tax (instead of a 25% tax) on the dividends paid. The payer can offset the tax against its income tax liability. The tax is not imposed on the first CAD 500,000 of taxable preferred-share dividends paid in a taxation year. Nor does it apply to dividends paid to a shareholder with a "substantial interest" in the payer (i.e., at least 25% of the votes and value).

Dividends received by private corporations (or public corporations controlled by one or more individuals) from Canadian corporations are subject to a special refundable tax of $33\frac{1}{3}$%. The tax is not imposed if the recipient is connected to the payer (i.e., the recipient owns more than a 10% interest in the payer) unless the payer was entitled to a refund of tax in respect of the dividend. When the recipient pays dividends to its shareholders, the tax is refundable at CAD 1 for every CAD 3 of dividends paid.

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Foreign income
Corporations resident in Canada are subject to Canadian federal income taxes on worldwide income, including income derived directly from carrying on business in a foreign country, as earned. In addition, resident corporations may be taxable currently on certain passive and active income earned by foreign subsidiaries and other foreign entities. Relief from double taxation is provided through Canada's international tax treaties, as well as foreign tax credits and deductions for foreign taxes paid on income derived from non-Canadian sources.

Canada intends to sign Tax Information Exchange Agreements (TIEAs) with non-treaty countries. To encourage non-treaty countries to enter into TIEAs:

- An exemption will be available for dividends received out of active business income earned by foreign affiliates resident in non-treaty countries that have agreed to a TIEA with Canada; and
- Active business income earned by foreign affiliates in non-TIEA, non-treaty countries will be treated as foreign accrual property income (FAPI), which is taxable on an accrual basis, if a TIEA with Canada is not concluded within a specified time period.

Foreign investment income earned directly, other than dividends, is taxed as earned, with foreign tax credits available in respect of foreign withholding taxes. Dividends received by private corporations from non-connected foreign corporations are subject to the special refundable tax of 33⅓% referred to above, to the extent that the dividends are deductible in determining taxable income.

The tax treatment of foreign dividends depends on whether the payer corporation is a foreign affiliate of the recipient. A foreign corporation is considered a foreign affiliate of a Canadian corporation if the Canadian corporation owns, directly or indirectly, at least 1% of any class of the outstanding shares of the foreign corporation and the Canadian corporation and related persons (together) own, directly or indirectly, at least 10% of any class of the outstanding shares of the foreign corporation.

Dividends received from foreign corporations that are not foreign affiliates are taxed when received, with foreign tax credits available in respect of foreign withholding taxes. Dividends received from foreign affiliates are permitted to flow tax-free between corporations, subject to certain limitations. These limitations pertain to the nature of the earnings from which the dividends were paid, the underlying foreign taxes paid and withholding tax paid.

Canadian corporations are taxed on certain investment income (foreign accrual property income) of controlled foreign affiliates (e.g., more than 50% voting shares owned by the Canadian corporation, related parties or a limited number of Canadian residents, among other things) as it is earned, whether or not distributed. A grossed-up deduction is available for foreign income and withholding taxes paid in respect of the income.

In light of recommendations made by the Advisory Panel on Canada's System of International Taxation and others, the federal government has reconsidered the draft rules that change the tax treatment of certain investments in foreign investment entities (FIEs) and in non-resident trusts (NRTs) that generally were to apply for taxation years beginning after 2006. The 2010 federal budget announced that the draft rules for FIEs and NRTs will be somewhat simplified and better targeted. The revised proposals will be subject to further public consultation.

The FIE rules have been essentially eliminated. The enacted version of these rules for offshore investment funds property will continue to apply, with some modifications, for taxation years ending after 4 March 2010, and the normal reassessment period will be extended by three years for these properties. A taxpayer that filed under the FIE proposals can either have those years reassessed or be entitled to a deduction in the current year for the income previously included.

The NRT rules treat non-resident trusts as being resident for Canadian income tax purposes. The NRT rules will generally apply commencing 2007. An election will allow a trust to elect to be deemed resident for the 2001 and subsequent years.

Stock dividends
If the payer is resident in Canada, stock dividends are treated for tax purposes in the same manner as cash dividends. The taxable amount of a stock dividend is the increase in the paid-up capital of the payer corporation because of the payment of the dividend. Stock dividends received from a non-resident are exempt from this treatment. Instead, the shares received have a cost base of zero.

Foreign exchange gains and losses
The foreign exchange gains and losses of a Canadian taxpayer that arise from business transactions (i.e., on income account), including the activities of a branch operation, are generally fully includable in income or fully deductible, as the case may be. Any method that is in accordance with generally accepted accounting principles may be used to determine foreign exchange gains or losses on income transactions, providing the treatment is consistent with previous years and conforms to the accrual method of accounting.

A foreign exchange gain or loss that is on capital account is treated the same as any other capital gain or loss. The accrual method of accounting cannot be used for purposes of reporting gains or losses on capital account. This follows from the Canada Revenue Agency's view that a taxpayer has not made a capital gain or sustained a capital loss in a foreign currency until a transaction has taken place. Therefore, paper gains and losses are disregarded.

Partnership income
For Canadian tax purposes, a partnership is treated as a conduit, and the partners are taxed on their share of the partnership income, whether or not distributed. A corporation is not restricted from being a member of a partnership. Income is determined at the partnership level and is then allocated among the partners according to the terms of the partnership agreement. However, certain deductions, such as depletion allowances, exploration and development expenses and donations, will flow through to be deducted by the various partners directly, as will any foreign tax credits, dividend tax credits or donation credits. Partners may deduct expenses incurred directly, such as interest on borrowings to acquire partnership interests, in computing income from the partnership.

Earnings of specified investment flow-throughs (SIFTs)
Certain earnings of SIFTs (i.e., publicly traded income trusts and partnerships) are subject to a SIFT tax and are deemed to be a dividend when distributed, starting

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the 2007 taxation year for SIFTs first publicly traded after 31 October 2006, and starting the 2011 taxation year for other SIFTs. These rules are intended to discourage corporations from converting to income trusts and effectively force existing trusts to consider either restructuring or abandoning the income trust model. The rules do not apply to Real Estate Investment Trusts that meet certain conditions.

Deductions

Business expenses

Business expenses that are reasonable and paid out to earn income are deductible for income tax purposes unless disallowed by a specific provision in the Income Tax Act. Some expenses are deductible subject to limitation, e.g., charitable donations, entertainment expenses and the cost of providing an automobile to employees. Deduction of capital expenditures is specifically prohibited, but special provisions may allow depreciation or amortisation of these expenditures. Because Canadian corporations are taxable on worldwide income, there are basically no territorial limits on the deductibility of related expenses. Payments to affiliates are deductible if they reflect arm's-length charges.

Depreciation

Generally, depreciation for tax purposes (capital cost allowance) is computed on a pool basis, with only a few separate classes (pools) of property. Annual allowances are generally determined by applying a prescribed rate to each class on the declining-balance basis. For example, the prescribed annual rate on most furniture and fixtures is 20%, on automotive equipment 30% and on most buildings 4% to 10%. In the year of acquisition, only half of the amount otherwise allowable may be claimed on most classes of property. Generally, capital cost allowance may not be claimed until the taxation year the property is available for use. The taxpayer can claim any amount of capital cost allowance up to the maximum. Capital cost allowance previously claimed may be recaptured if assets are sold for proceeds that exceed the undepreciated cost of the class.

Temporary incentives to accelerate depreciation:

- For eligible manufacturing and processing machinery and equipment acquired after 18 March 2007, and before 2012, revise the rate and method from 30% declining balance to 50% straight-line; and
- For eligible computers and systems software acquired after 27 January 2009, and before 1 February 2011, increase the rate from 55% declining balance (half-year rule) to 100% (no half-year rule).

Mining and oil and gas activity

Generally, mining and oil and gas companies are allowed a 100% deduction for exploration costs and certain preproduction development costs. Other development costs are deductible at the rate of 30% on a declining-balance basis. Capital property costs are subject to the depreciation rules noted above under *Depreciation section*. In addition, in certain cases, significant asset acquisitions and assets acquired for a new mine or major expansion benefit from accelerated depreciation up to 100% of the income from the mine. For certain oil sands assets acquired after 18 March 2007, accelerated depreciation will be reduced gradually starting 2011 and will be eliminated by 2015.

Provinces levy mining taxes and royalties on mineral extraction and on oil and gas production. These provincial levies are mostly deductible.

Investment tax credits (ITCs) are available federally (and in some provinces) to individuals who invest in shares to fund prescribed mineral exploration expenditures. The federal credit in 2010 for qualified "flow-through" share investments is 15% of qualifying mining grassroots exploration expenditures. Certain mining exploration and preproduction expenditures that are incurred by a Canadian corporation and not used for flow-through are eligible for a 10% ITC. These credits can be used to offset current taxes payable or carried over to certain previous or subsequent taxation years.

Net operating losses

Net operating losses generally may be carried back three tax years and forward 20 (10 years if the loss was incurred in taxation years ending before 2006 and after 22 March 2004, seven years if before 23 March 2004). Special rules may prohibit the use of losses from other years when there has been an acquisition of control of the corporation.

Losses from a business or property

In 2003, the federal government released draft legislation that would have allowed a loss from a business or property to be claimed only if there is a "reasonable expectation of profit" from that business or property. Subsequently, the federal government announced that a revised proposal would be developed and released, although one is still forthcoming. When released, the measures likely will apply only prospectively. Furthermore, Quebec has rules that limit the deductibility of investment expenses for Quebec tax purposes.

Payments to foreign affiliates

Royalties, management fees and similar payments to affiliated non-residents are deductible expenses to the extent that they are incurred to earn income of the Canadian company and do not exceed a reasonable amount (fair market value in most cases).

Interest

Interest on borrowed money used for earning business or property income or interest in respect of an amount payable for property acquired to earn income is deductible, provided the interest is paid pursuant to a legal obligation and is reasonable in the circumstances.

Thin capitalisation rules can limit interest deductions when debt owing to certain non-resident shareholders (or persons not dealing at arm's length with a non-resident shareholder) exceeds two times the corporation's equity.

The Anti-Tax-Haven Initiative, which would have restricted the deductibility of certain interest payable after 2011 on investments in debt or equity of foreign affiliates, was repealed. The rule would have prevented multinational corporations from using tax havens and other tax avoidance structures to generate two expense deductions (one in Canada and another in a foreign subsidiary) for only one borrowing (so-called double-dipping).

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Taxes
Neither federal nor provincial income taxes are deductible in determining income subject to tax. The tax treatment of federal capital taxes and provincial payroll and capital taxes is discussed above.

Scientific research and experimental development (SR&ED)
Canada provides a generous combination of deductions and tax credits. Current and capital expenditures on research and development can be deducted in the year incurred or carried forward indefinitely to be used at the taxpayer's discretion to minimise tax payable.

In addition, a taxpayer can benefit from the ITC, which is generally a 20% non-refundable credit on SR&ED expenditures that can be applied against taxes payable. Alternatively, this tax credit can be carried back three years or forward 20 to be applied against taxes owing.

A qualifying CCPC can qualify for a 35% refundable tax credit annually on its first CAD 3 million in expenditures. This enhanced credit is subject to certain income and capital limitations.

SR&ED ITCs have been extended to certain salary and wages (limited to 10% of salary and wages directly attributable to SR&ED carried on in Canada) incurred in respect of SR&ED carried on outside Canada.

In addition to the federal research and development incentives, all provinces (except Prince Edward Island) and the Yukon provide tax incentives to taxpayers that carry on research and development activities.

Business meals and entertainment
Deductions by a corporation for business meals and entertainment expenses are limited to 50% of their cost. This includes meals while travelling or attending a seminar, conference or convention, overtime meal allowances and room rentals and service charges, etc., incurred for entertainment purposes. If the business meal and entertainment costs are billed to a client or customer and itemised as such, the disallowance (i.e., the 50% not deductible) is shifted to the client or customer.

Doubtful accounts and bad debts
A reasonable reserve for doubtful accounts may be deducted for tax purposes. The reserve calculation should be based on the taxpayer's past history of bad debts, industry experience, general and local economic conditions, etc. Special rules apply for determining reserves for financial institutions. A taxpayer may deduct the amount of debts owing that are established to have become bad debts in the year, provided the amount has previously been included in the taxpayer's income or relates to loans made in the ordinary course of business. Recoveries of bad debts previously written off must be included in income in the year of recovery.

Fines and penalties
Most government-imposed fines and penalties are not deductible. Fines and penalties that are not government-imposed are generally deductible, if they were made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property.

Other significant items
Transfers of losses and other deductions between unrelated corporate taxpayers are severely limited after an acquisition of control.

Three-quarters of capital expenditures for goodwill and certain other intangible properties can be amortised at a maximum annual rate of 7%, on a declining-balance basis. A portion of proceeds may be taxable as recapture or as a gain on disposition.

Charitable donations made to registered Canadian charitable organisations are deductible in computing taxable income, generally to the extent of 75% of net income. A five-year carryforward is provided.

Insurance premiums relating to property of a business are generally deductible, but life insurance premiums are generally not deductible if the company is the named beneficiary. However, if a financial institution lender requires collateral security in the form of life insurance, a deduction is allowed for the associated net cost of any pure insurance for the period.

Group taxation

Group taxation is not permitted. However, the federal government will explore whether the tax system could be improved by new rules for the taxation of corporate groups, e.g., the introduction of a formal system of loss transfers or consolidated reporting.

Transfer pricing
Canadian transfer pricing legislation and administrative guidelines are generally consistent with the Organisation for Economic Co-operation and Development (OECD) Guidelines. Statutory rules require that transactions between related parties be carried out under arm's-length terms and conditions.

Penalties may be imposed when contemporaneous documentation requirements are not met. A taxpayer will be deemed not to have made reasonable efforts if the taxpayer does not maintain complete and accurate documentation to evidence that it has determined and used arm's-length prices for its related party transactions. The documentation must be prepared on or before the taxpayer's documentation due date, which is six months after the end of the taxation year.

The transfer pricing penalty is 10% of the transfer pricing adjustment, if the adjustment exceeds the lesser of CAD 5,000,000 and 10% of the taxpayer's gross revenue for the year. The penalty is not deductible in computing income, applies regardless of whether the taxpayer is taxable in the year and is in addition to any additional tax and related interest penalties.

Canada has an Advance Pricing Agreement (APA) programme that is intended to help taxpayers determine transfer prices acceptable to the local tax authorities and, when negotiated as bilateral or multilateral APAs, with tax authorities in other jurisdictions. Under this programme, 210 APAs have been completed or are in progress.

Many of Canada's international tax agreements contain provisions concerning income allocation in accordance with the arm's-length principle. These include a Mutual Agreement Procedure, which is a treaty-based mechanism through which taxpayers

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can petition competent authorities for relief from double taxation resulting from transfer pricing adjustments

Tax incentives

Regional incentives

In specified regions of Canada (i.e., Atlantic provinces, the Gaspé region and Atlantic offshore region) a 10% federal ITC is available for various forms of capital investment (generally, new buildings and/or machinery and equipment to be used primarily in manufacturing or processing, mining, oil and gas, logging, farming or fishing). The ITC is fully claimed against a taxpayer's federal tax liability in a given year. Unused ITCs reduce federal taxes payable for the previous three years and the next 20.

The provinces and territories may also offer incentives to encourage corporations to locate in a specific region. Income tax holidays are available in Newfoundland and Labrador, Nova Scotia, Ontario, Prince Edward Island and Quebec for certain corporations operating in specific industries (e.g., in Ontario and Quebec, commercialisation of intellectual property; in Prince Edward Island, bioscience or aviation) or meeting certain conditions (e.g., major investment projects for Quebec; job creation for Newfoundland and Labrador).

Industry incentives

Canada offers many tax incentives at the federal, provincial and territorial level, for various industries and activities, including those related to:

- Research and development *(see Scientific research and experimental development under Deductions above)*;
- Film, media, computer animation and special effects and multi-media productions;
- Manufacturing and processing; and
- Environmental sustainability.

Withholding taxes (WHT)

Withholding taxes arising in Canada

Canada is continually renegotiating and extending its network of treaties, some with retroactive effect. This table summarises withholding tax rates on payments arising in Canada. The applicable treaty should be consulted to determine the withholding tax rate that applies in a particular circumstance.

Recipient	Dividends (1)	Related-Party Interest (2)	Royalties (3)
	%	%	%
Resident corporations and individuals	Nil	Nil	Nil
Non-resident corporations and individuals:			
Non-treaty	25	25	25
Treaty:			
Algeria	15	15	0 or 15
Argentina	10 or 15 (5)	12.5	3, 5, 10 or 15
Armenia	5 or 15 (5)	10	10
Australia	5 or 15 (5)	10	10
Austria	5 or 15 (5)	10	0 or 10
Azerbaijan (8)	10 or 15 (5)	10	5 or 10
Bangladesh	15	15	10
Barbados	15	15	0 or 10
Belgium	5 or 15 (5)	10	0 or 10
Brazil	15 or 25 (5)	15	15 or 25
Bulgaria	10 or 15 (5), (6)	10	0 or 10 (6)
Cameroon	15	15	15
Chile (6)	10 or 15 (5)	15	15
China, P.R. (7)	10 or 15 (5)	10	10
Columbia (4)	5 or 15 (5)	10	10 (6)
Croatia	5 or 15 (5)	10	10
Cyprus	15	15	0 or 10
Czech Republic	5 or 15 (5)	10	10
Denmark	5 or 15 (5)	10	0 or 10
Dominican Republic	18	18	0 or 18
Ecuador	5 or 15 (5)	15	10 or 15 (6)
Egypt	15	15	15
Estonia (8)	5 or 15 (5)	10	10 (6)
Finland	5 or 15 (5)	10	0 or 10
France	5 or 15 (5)	10	0 or 10
Gabon	15	10	10
Germany	5 or 15 (5)	10	0 or 10
Greece (4)	5 or 15 (5)	10	0 or 10
Guyana	15	15	10
Hungary	5 or 15 (5)	10	0 or 10
Iceland	5 or 15 (5)	10	0 or 10
India	15 or 25 (5)	15	10, 15 or 20
Indonesia	10 or 15 (5)	10	10
Ireland, Republic of	5 or 15 (5)	10	0 or 10
Israel	15	15	0 or 15
Italy (9)	5 or 15 (5)	10	0, 5 or 10
Ivory Coast	15	15	10
Jamaica	15	15	10
Japan	5 or 15 (5)	10	10
Jordan	10 or 15 (5)	10	10
Kazakhstan (8)	5 or 15 (5)	10	10 (6)
Kenya	15 or 25 (5), (6)	15	15
Korea, Republic of	5 or 15 (5)	10	10
Kuwait	5 or 15 (5)	10	10
Kyrgyzstan (8)	15 (6)	15 (6)	0 or 10
Latvia (8)	5 or 15 (5)	10	10 (6)

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Recipient	Dividends (1)	Related-Party Interest (2)	Royalties (3)
	%	%	%
Lebanon (4)	5 or 15 (5)	10	5 or 10
Lithuania (8)	5 or 15 (5)	10	10 (6)
Luxembourg	5 or 15 (5)	10	0 or 10
Malaysia	15	15	15
Malta	15	15	0 or 10
Mexico	5 or 15 (5)	10	0 or 10
Moldova	5 or 15 (5)	10	10
Mongolia	5 or 15 (5)	10	5 or 10
Morocco	15	15	5 or 10
Namibia (4)	5 or 15	10	0 or 10
Netherlands	5 or 15 (5)	10	0 or 10
New Zealand	15	15	15
Nigeria	12.5 or 15 (5)	12.5	12.5
Norway	5 or 15 (5)	10	0 or 10
Oman	5 or 15 (5)	10 (6)	0 or 10
Pakistan	15	15	0 or 15
Papua New Guinea	15	10	10
Peru (6)	10 or 15 (5)	15	15
Philippines	15	15	10
Poland	15	15	0 or 10
Portugal	10 or 15 (5)	10	10
Romania	5 or 15 (5)	10	5 or 10
Russia (8)	10 or 15 (5)	10	0 or 10
Senegal	15	15	15
Singapore	15	15	15
Slovak Republic	5 or 15 (5)	10	0 or 10
Slovenia	5 or 15 (5)	10	10
South Africa	5 or 15 (5)	10	6 or 10
Spain	15	15	0 or 10
Sri Lanka	15	15	0 or 10
Sweden	5 or 15 (5)	10	0 or 10
Switzerland	5 or 15 (5)	10	0 or 10
Tanzania	20 or 25 (5)	15	20
Thailand	15	15	5 or 15
Trinidad and Tobago	5 or 15 (5)	10	0 or 10
Tunisia	15	15	0, 15 or 20
Turkey (4)	15 or 20 (5)	15	10
Ukraine (8)	5 or 15 (5)	10	0 or 10
United Arab Emirates	5 or 15 (5)	10	0 or 10
United Kingdom	5 or 15 (5)	10	0 or 10
United States (10)	5 or 15 (5)	0	0 or 10
Uzbekistan (8)	5 or 15 (5)	10	5 or 10
Venezuela	10 or 15 (5), (6)	10	5 or 10

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Recipient	Dividends (1)	Related-Party Interest (2)	Royalties (3)
	%	%	%
Vietnam	5, 10 or 15 (5)	10	7.5 or 10
Zambia	15	15	15
Zimbabwe	10 or 15 (5)	15	10

Notes

1. Dividends – In its treaty negotiations, Canada is prepared to accept a withholding tax rate of 5% on “direct dividends”, i.e., dividends paid by a Canadian affiliate to a foreign parent or other corporation with a substantial interest in the affiliate.
2. Interest – Commencing 2008, Canadian withholding tax is eliminated on interest (except for “participating debt interest”) paid to arm’s-length non-residents, regardless of their country of residence.
   Most treaties have an explicit provision for higher withholding tax on interest in excess of fair market values in non-arm’s-length circumstances.
3. Royalties – In its treaty negotiations, Canada is prepared to eliminate the withholding tax on arm’s-length payments in respect of rights to use patented information or information concerning scientific experience. It is also willing to negotiate exemptions from withholding tax for payments for the use of computer software.
   Canada does not levy withholding tax on “cultural royalties”, other than payments in respect of motion picture and television films, etc. Different rates may apply in the case of immovable property (e.g., payments that relate to Canadian natural resources). Most treaties explicitly provide for higher withholding tax on royalties in excess of fair market value in non-arm’s-length circumstances. A nil rate of tax may apply in certain circumstances.
4. The treaty has been signed, but is not yet in force. Absent a treaty, Canada imposes a maximum 25% rate of withholding on dividends, interest and royalties.
5. The lower (lowest two for Vietnam) rate applies if or when the beneficial owner of the dividend is a company that owns/controls a specified interest in the paying company. The nature of the ownership requirement, the necessary percentage (10%, 20%, 25% or higher) and the relevant interest (e.g., capital, shares, voting power, equity percentage) vary by treaty.
6. If the other state (Canada for the treaty with Oman) concludes a treaty with another country providing for a lower withholding tax rate (higher rate for Kenya), the lower rate (higher rate for Kenya) will apply in respect of specific payments within limits, in some cases.
7. Canada’s treaty with China does not apply to Hong Kong.
8. The treaty status of the republics that comprise the former USSR is as follows:
   - Azerbaijan, Estonia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Russia, Ukraine and Uzbekistan—new treaties entered into force *(see table for rates)*; and
   - Other republics – no negotiations are underway.

   Belarus, Tajikistan and Turkmenistan will not honour the treaty with the former USSR As a result, Canada will impose a maximum 25% rate of withholding on dividends, interest and royalties until a new treaty enters into force. For other republics that comprise the former USSR, the status of the former treaty with the USSR is uncertain. Because the situation is subject to change, Canadian taxpayers are advised to consult with the Canada Revenue Agency as transactions are carried out.
9. A new treaty with Italy was signed on 3 June 2002. Upon ratification, its provisions will apply:
   - For purposes of non-resident withholding tax, to amounts paid or credited after 31 December of the calendar year the treaty is ratified; and
   - For other taxes, for taxation years beginning after that date.

   The rates in the table are from the new treaty. Under the new treaty, the withholding tax rate will:

- Be reduced from 15% to 5% on dividends paid to a company that owns at least 10% of the payor's voting stock (the rate will remain 15% on other dividends);
- Be reduced from 15% to 10% on interest, but certain interest payments will be exempt; and
- Remain 10% on royalties, but certain royalties for the use of computer software, patents and know-how will be subject to a rate of 5% and certain copyright royalties will be exempt.

10. The fifth Protocol to the Canada-US treaty entered into force on 15 December 2008. The provisions of the Protocol generally apply:
    - For purposes of non-resident withholding tax, to amounts paid or credited on or after 1 February 2009; and
    - For other taxes, to taxable years beginning after 2008.

    The rates in the table are from the Protocol. Under the Protocol, the withholding tax rate will:
    - Remain 5% on dividends paid to a company that owns 10% or more of the payor's voting shares and 15% on other dividends;
    - Be eliminated on cross-border interest payments between:
      - Arm's-length persons – retroactive to 1 January 2008 (however, Canada has already eliminated withholding tax on most interest paid to arm's-length non-residents, *see footnote 2*); and
      - Related persons – subject to the Limitation of Benefits article, over three years from 10% to 7%, retroactively on amounts paid or credited after 31 December 2007, to 4% on 1 January 2009 and to nil on 1 January 2010; and
    - Remain 10% or zero on royalties.

Tax administration

Returns
Both the federal and the provincial corporation tax systems operate on an essentially self-assessing basis. The tax year of a corporation, which is normally the fiscal period it has adopted for accounting purposes, cannot exceed 53 weeks. The tax year need not be the calendar year. Once selected, the tax year cannot be changed without approval from the tax authorities.

All corporations must file federal income tax returns. Alberta and Quebec tax returns must also be filed by corporations that have permanent establishments in those provinces, regardless of whether any tax is payable. Corporations with permanent establishments in other provinces that levy capital tax must also file capital tax returns. Tax returns must be filed within six months of the corporation's tax year-end. No extensions are available.

Effective for taxation years ending after 2009, certain corporations with annual gross revenues exceeding CAD 1 million are required to electronically file (E-file) their federal corporate income tax returns via the Internet. Also, starting 2010, information return filers that submit more than 50 information returns annually must E-file via the Internet. There will be a one-year transitional period before penalties are assessed for failure to E-file.

Functional currency
The amount of income, taxable income, and taxes payable by a taxpayer is determined in Canadian dollars. However, certain corporations resident in Canada can elect to determine their Canadian tax amounts in the corporation's "functional currency" commencing taxation years beginning after 13 December 2007.

Payment of tax
Corporate tax instalments are generally due on the last day of each month (although some CCPCs can remit quarterly instalments, if certain conditions are met). Any balance payable is generally due on the last day of the second month following the end of the tax year.

Assessments, audit cycle and statute of limitations
The tax authorities are required to issue an assessment notice within a reasonable time following the filing of a tax return. These original assessments usually are based on an initial high level review of the corporation's income tax return and either indicate agreement with the return (which is the result in the majority of cases) or outline in detail any differences that arise from this limited initial review.

A reassessment of the tax payable by a corporation that is not a Canadian-controlled private corporation may be made within four years from the date of mailing of the original notice of assessment, usually following a detailed field audit of the return and supporting information. The limitation period is three years for Canadian-controlled private corporations. The three- and four-year limits are extended a further three years to permit reassessment of transactions with non-arm's-length non-residents. Reassessments generally are not permitted beyond these limits unless there has been misrepresentation or fraud. Many larger corporations have their returns audited annually. Smaller corporations generally are subject to less frequent audits, covering more than one year's return. Occasionally, a specific industry or a particular type of transaction may be selected for more intensive examination. Different time limits may apply for provincial reassessments.

Appeals
A taxpayer that disagrees with a tax assessment or reassessment may appeal. The first step is to file a formal notice of objection within 90 days from the date of mailing of the notice of assessment or reassessment, setting out the reasons for the objection and other relevant information. Different time limits may apply for provincial reassessments. Corporations that qualify as "large corporations" must file more detailed notices of objection. The Canada Revenue Agency will review the notice of objection and vacate (cancel), amend or confirm it. A taxpayer that still disagrees has 90 days to appeal the Canada Revenue Agency's decision to the Tax Court of Canada, and if necessary, to the Federal Court of Appeal and the Supreme Court of Canada. However, the Supreme Court accepts few income tax appeals.

Topics of focus for tax authorities
Topics of interest to Canadian tax authorities include:

- The deductibility of:
  - Royalty payments made by Canadian corporations to non-arm's-length non-residents;
  - Business restructuring expenses incurred by a group of corporations located in more than one country;
  - Interest paid on loans if the funds derived from the loans are used offshore; and
  - Guarantee fees paid by Canadian corporations to related non-resident corporations;
- The offshoring of Canadian-source income by factoring the accounts receivable of Canadian corporations;
- Treaty shopping to reduce Canadian withholding taxes and capital gains tax; and

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- Surplus stripping to reduce Canadian withholding taxes by artificially increasing a Canadian corporation's paid-up capital and subsequently distributing the surplus as a return of capital.

Foreign reporting
Reporting requirements apply to taxpayers with offshore investments. The rules impose a significant compliance burden for taxpayers with foreign affiliates. Failure to comply could result in substantial penalties.

Other issues

Forms of business enterprise
Canadian law is based on the British common-law system, except in Quebec where a civil-law system prevails. The principal forms of business enterprise available in Canada are the following:

- Corporation – Whether public or private, incorporated federally or provincially, a Canadian corporation is a legal entity distinct from its shareholders.
- Partnership – A business relationship between two or more "persons" (i.e., individuals, corporations, trusts or other partnerships) formed for the purpose of carrying on business in common. A partnership is not treated as a legal entity distinct from its partners.
- Sole proprietorship – An unincorporated business operated by an individual that is carried on under the individual's own name or a trade name.
- Trust – A relationship whereby property (including real, tangible and intangible) is managed by one person (or persons, or organisations) for the benefit of another. Trusts may hold commercial enterprises.
- Joint Venture – Generally, refers to the pursuit of a specific business objective by two or more parties whose association will end once the objective is achieved or abandoned. A joint venture is not treated as a legal entity distinct from the participants.

Foreign investors usually conduct business in Canada through one or more separate Canadian corporations, although during the start-up period, operation as a branch of a profitable foreign corporation may be preferable. In addition, foreign investors may participate as partners in partnerships carrying on business in Canada or as joint venturers.

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All information in this book, unless otherwise stated, is up to date as of 28 May 2010.

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