2. Establishing a Business in Canada

There are several different structures available when forming a business in Canada. Foreign businesses operating in the country may do so through a branch office or by establishing a separate business enterprise.

Often, the tax considerations and liability determine what business structure is best. The most common business structures used to establish operations in Canada are:

- Corporations
- Sole proprietorships
- Partnerships
- Joint ventures
- Franchises
- Co-operatives

Corporations

A corporation is a business entity with a legal status that is independent of its shareholders. As a result, the corporation's debts, liabilities, and obligations are generally not the responsibility of its shareholders.

Corporations used by foreign investors are typically created through incorporation under the *Canadian Business Corporations Act* (CBCA) or a similar provincial law. Some types of corporations can be formed through other federal legislation, such as the *Trust and Loan Companies Act,* or under provincial equivalents. Provincial corporate legislation in some provinces allow for the creation of an unlimited liability company, which can be used for cross-border tax structuring.

Both federal and provincial corporations are created by filing articles of incorporation with the appropriate government authorities and paying a nominal fee. The articles must include details of the rights, restrictions, privileges, and conditions attached to each class of share. Any number of shares of one or more classes can be created; however, at least one class must have full voting rights.

The articles of a federally registered corporation must name the first directors, and a minimum of 25% of these must be Canadian residents. Corporate legislation of some Canadian provinces do not have any director residency requirement and are sometimes used by foreign businesses in Canada for that reason. While the directors generally exercise management authority on behalf of the shareholders, their power can be restricted through a unanimous shareholder agreement. The corporation, its shareholders, or third parties can hold the directors personally liable for certain aspects of their decisions.

For transactions or events occurring after February 26, 2018, the application of an existing anti-surplus stripping rule has been generally expanded to prevent a non-resident shareholder of a Canadian corporation from extracting (either now or in the future), without withholding tax, the corporation's retained earnings that exceed the amount of capital that has been contributed to the corporation by the shareholder. The rule has been expanded to include a look-through rule where a partnership or trust is used to avoid the purposes of the anti-surplus stripping provision.

Provincial incorporation is often used when a corporation intends to restrict its activities to one province. The provincial acts governing corporations vary somewhat, and while many of their provisions are similar to those of the CBCA, there are a number of differences among the provinces, as pointed out above.

While most foreign investors elect to conduct business in Canada through a Canadian corporation, there are two other options available.

- **Branches of foreign corporations** – A foreign entity can carry on a business in Canada directly through a branch operation. A branch is an extension of the foreign parent corporation and must be licensed or registered in each of the provinces in which it will operate. The taxation of branches and subsidiary corporations varies considerably, and differences also exist in the liability of the parent companies. A non-resident corporation carrying on business in Canada through a Canadian branch is liable for income tax on its Canadian-source business income at the same rates that apply to Canadian residents.
- **Unlimited liability company** – Nova Scotia, British Columbia, and Alberta allow for the incorporation of an "unlimited liability company" as the Canadian subsidiary of a foreign corporation. These corporate entities are treated as ``pass throughs`` for tax purposes and are often used, in combination with other entities, in foreign company structures for various purposes.

A Canadian subsidiary of a non-resident corporation will be considered a resident of Canada for the purposes of the *Income Tax Act* and will be subject to Canadian income tax on its worldwide income. Under Canada's domestic rules, there is no withholding tax on non-participating interest paid to arm's length persons, and under the Canada-US Income Tax Convention, withholding tax on arm's-length or non-arm's-length non-participating interest paid to US persons is generally nil. This type of structure can be used as an alternative to a branch. Though it allows for losses incurred by the corporation in Canada to be deductible by the foreign corporation, it still provides certain advantages of corporate status in Canada. It is important to note that shareholders can be held liable for corporate obligations. The advantages and disadvantages of forming an unlimited liability company in each province differ and should be considered when deciding whether or not to use this vehicle.

Sole Proprietorships

A sole proprietorship is a business owned by one person. The owner is entitled to all the profits and is personally liable for all the debts and other liabilities of the business. This liability can be limited by contract or covered by insurance.

There is no registration requirement for a sole proprietorship, which operates under its owner's legal name. Nonetheless, in some jurisdictions an operating licence may be required to conduct certain types of business.

If the sole proprietorship will operate under a business name other than its owner's legal name or if plurality of ownership is implied (such as by adding "and Company"), a declaration must be filed in each province in which the business operates.

Partnerships

A partnership is an association or relationship formed by a contract between two or more individuals, corporations, trusts, or partnerships. It is governed by provincial legislation and generally must be registered with provincial authorities. In addition, a partnership has no distinct legal personality from its partners and is thus considered a pass-through entity for tax purposes.

There are three types of partnerships:

- General
- Limited
- Limited liability

In a general partnership, all partners are subject to unlimited liability. Unless otherwise agreed upon, the partners have an equal claim on the capital and profits and are equally responsible for all the losses, debts, and liabilities of the partnership.

A limited partnership consists of both general and limited partners. One or more general partners are responsible for managing the business. Limited partners contribute capital and may work for the business but do not participate in its management. Unlike general partners, limited partners are not exposed to unlimited liability – unless they take part in the control or management of the business.

In a limited liability partnership, a partner is generally not liable for the actions of the other partners not under his or her direct supervision or control. The legislation of most provinces and territories provides for the creation of limited liability partnerships.

Joint Ventures

A joint venture is an association of two or more business entities for the purposes of carrying on a single enterprise or specific venture. Joint ventures take several forms. They can be set up through a separate corporation or a general or limited partnership, or the parties in a joint venture can jointly own business assets.

Joint ventures between Canadian and foreign companies are excellent vehicles for combining the strengths of the participating firms while reducing the risk of taking on new markets.

Franchises

A franchise is a business relationship in which a franchisee contracts for the right to sell proprietary products or services using business names and/or trademarks, styles, and methods developed by the franchisor.

The franchisee generally agrees to comply with performance standards set by the franchisor and is granted a licence to use the intellectual property and business methodology of the franchisor.

In return, the franchisee normally pays an upfront fee and ongoing royalties.

For more information on franchising in Canada, see Chapter 15 of this Guide.