Carrying on Business in Canada

AN OVERVIEW OF THE CANADIAN LEGAL AND BUSINESS LANDSCAPE FOR INVESTING, STARTING AND OPERATING A BUSINESS IN CANADA

Heenan Blaikie

Heenan Blaikie LLP ▪ Lawyers | Patent and Trade-mark Agents
heenanblaikie.com

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1. Preface

Carrying on Business in Canada is a general overview of, and introduction to, Canadian legislative and business considerations involving starting and operating a business, and investing in Canada.

Carrying on Business in Canada was written by lawyers from Heenan Blaikie with significant experience and knowledge in the area of the law which each lawyer covered. The commentary herein is intended to be a general overview and should not be regarded as advice or legal opinions of Heenan Blaikie and its practitioners.

Changes to the law can occur at any time. This document reflects the law at a moment in time, but depending on when the document is read, may not reflect recent changes in the Canadian legal and business systems. Qualified advice should be sought when considering investing or starting a business in Canada. Unless otherwise provided, all money amounts are in Canadian dollars.

2. General Information

2.1 LOCATION AND AREA

Canada is located principally above the 49th parallel in North America. Canada is a constitutional, federal state consisting of ten provinces and three territories. The country has an abundance of natural resources including forests, oil and gas, various mineral deposits, and water. Much of Canada is sparsely populated and a large percentage of Canada's population of more than 33 million people live within 160 km of the border with the United States. Ontario and Quebec, with approximately 12.8 million and 7.7 million people respectively, are the two largest and most populous Canadian provinces. The powers of the federal and provincial governments are set out in the *Constitution Act, 1867*. Matters that cross provincial borders such as immigration, banking, the national currency, international trade and intellectual property are within the exclusive jurisdiction of the federal government. The provinces are responsible for private property rights, commerce, education and a number of social programs. The political head of the government of Canada is its Prime Minister. The system of government is similar to that of the United Kingdom, in that the House of Commons is the source of legislative authority in Canada. The Prime Minister is the head of the political party with the most members in the House of Commons. The Supreme Court of Canada is the country's last court of appeal. Below it are two separate court systems, that of the federal government and that of the provincial government, each with its own trial and appellate divisions. Each court system hears cases on issues within either the federal or provincial jurisdiction, although all criminal matters are heard in the provincial courts. The Supreme Court of Canada is the final court for both the federal and provincial court systems.

2.2 POPULATION AND LANGUAGE

Canada has two official languages: English and French. Although most Canadians consider English their mother tongue, French is the mother tongue of most people living in Quebec. The federal and provincial governments have a number of legislative initiatives to ensure the use of both English and French is promoted in Canada. This includes the general requirement to display all information on retail product labels in both English and French. Quebec has its own legislative initiatives promoting the use of the French language, including rules relating to the use of French in business.

2.3 CURRENCY

Canada's currency is the Canadian dollar. As of October 16, 2012, the exchange rate of one Canadian dollar is set out in the following table (current information on exchange rates is available at www.bankofcanada.ca):

Currency	Rate of Exchange
U.S. dollar	0.9854
UK pound sterling	1.5865
Japanese yen	0.0125
Swiss franc	1.0625
Euro	1.2845
Mexican peso	0.0769
Hong Kong dollar	0.1271
Indian rupee	0.0186
Brazilian real	0.4847

3. Immigration

3.1 WORK PERMITS AND PERMANENT RESIDENCY

3.1.1 In General

Immigration to Canada is generally overseen by the federal government and administered under the *Immigration and Refugee Protection Act*. Certain provinces, particularly Quebec, have control with respect to the selection of immigrants. People who are neither Canadian citizens nor permanent residents of Canada are not permitted to work in Canada without obtaining a work permit. However, there are certain exceptions to this general principle as explained hereinafter.

Generally, hiring a foreign worker in Canada requires the employer to obtain a "labour market opinion" (LMO) from Human Resources and Skills Development Canada (HRSDC); thereafter the worker must apply for a work permit, either to a Canadian visa office or at a port of entry. There are specific exemptions from the requirements of obtaining an LMO. These exemptions are provided by the Immigration Regulation and international agreements where Canada is a signatory. Two such examples are the General Agreement on Trade in Services (GATS) to which most European countries are signatories, or the North American Free Trade Agreement (NAFTA) to which both the United States and Mexico are signatories. The most common exemptions provided under NAFTA are intra-company transferees and professionals.

In addition, there are exemptions from the requirements of obtaining work permits for certain categories of individuals such as "business visitors", representative of foreign governments, certain athletes, artists and public speakers to name a few.

3.1.2 Business Visitors

"Business visitors" are people entering Canada on a temporary basis in order to attend business meetings, establish business contacts, sell foreign manufactured goods, provide after-sales service, supervise the installation of specialized merchandise purchased or leased outside Canada, or provide familiarization or training services to prospective users and sales persons for goods and services manufactured and developed outside of Canada.

Business visitors are employees of a foreign enterprise who continue to be paid by that entity throughout their time spent in Canada. At the completion of their visit to Canada, these individuals return to their employment with the foreign entity. Business visitors can facilitate their entry into Canada by carrying a letter from their employer confirming their employment with the foreign entity, the reasons for their visit, and certify that their remuneration will remain outside of Canada and that the profits of the company will accumulate outside of Canada.

Business visitors may request a Visitor's Record to facilitate multiple entries into Canada, particularly if they have to spend several days a month in Canada. As a general rule, business visitors stay in Canada for a short duration on each visit.

3.1.3 Intra-Company Transfers

People who are in an executive or managerial capacity or who possess specialized knowledge, may be transferred from a foreign entity to the Canadian parent, subsidiary, branch or affiliate entity. Work permits for executives and senior managers can be granted for up to seven years and up to five years for specialized knowledge workers.

To qualify as an intra-company transferee, the individual must have been employed by the foreign entity for at least one year in the preceding three-year period and must be currently be employed by the foreign entity. To qualify as a "senior manager", the individual must supervise and control the work of other managers and supervisors or manage an essential function within the organization and have the authority to hire and fire individuals. To qualify as someone who possesses "specialized knowledge", the employee must possess an advanced level of knowledge or expertise critical to the well-being of the entity in Canada. This specialized knowledge cannot be knowledge generally held throughout the industry. Under this category, employers who seek to transfer foreign workers are exempt from obtaining a LMO. If the foreign worker is from a country that requires a visa to enter Canada, an application for the work permit is made to a Canadian visa office abroad. If the foreign worker is from a visa-exempt country, the application for a work permit may be made at the port of entry.

3.1.4 International agreements – Professionals

Both NAFTA and GATS specify occupations that are exempt from the requirement of obtaining LMOs. The list of exempted professions under NAFTA, which is far more extensive than under GATS, includes more than 60 occupations such as management consultants, accountants, computer systems analysts, hotel managers, physicians, dentists and urban planners to name a few. These individuals must have the necessary credentials and, in some instances, will need to be licensed to practice in Canada. Under NAFTA, an initial work permit may be issued for one to two years, and may be renewed; under GATS, a work permit may be issued for a maximum period of 90 days in any one-year period.

3.1.5 Labour Market Opinion

Where there is no applicable exemption, an application for an LMO must be made by an employer to HRSDC. In most instances, the employer must establish that it has attempted to hire a Canadian citizen or permanent resident and that a search has not produced a suitable candidate. In doing so, employers must at least advertise the position nationally for varying periods of time depending on the occupation. Once a positive LMO has been issued, a work permit application can be submitted.

When assessing an application for an LMO, officers will consider various factors in order to determine the impact the employment of the foreign worker is likely to have on the Canadian market. A positive LMO will normally be issued if the employment of the foreign worker is likely to result in direct job creation or job retention, creation or transfer of skills and knowledge to Canadians, and/or to fill a labour shortage. Furthermore, the wage offered must be consistent with the prevailing wage rate for the occupation and region where the worker will be employed. Essentially, the working conditions must be in accordance with acceptable Canadian labour standards.

As a result of recent changes to government policies effective April 1, 2011, an LMO will be refused if during the preceding two-year period, when a new LMO application is submitted, the employer did not offer each foreign national employed by the employer, wages, working conditions and employment that were substantially the same as what was offered in that previous LMO.

3.1.6 Work Permits – Applications

Applications for work permits must either be made at a Canadian visa office outside of Canada for citizens of countries requiring a visa prior to their admission in Canada, or in some circumstances, may be made directly at a port of entry for citizens of visa exempt countries. Applications made at a Canadian visa office may usually be made by mail or in person.

Furthermore, citizens or residents of specific countries will also be required to undergo a medical examination prior to their entry in Canada if they intend to reside for more than six months in Canada.

3.1.7 Provincial Nominees

Many provinces in Canada have signed agreements with the federal government allowing them to nominate foreign workers who wish to settle in their provinces. These programs are referred to as Provincial Nominee Programs (PNPs).

3.1.8 Permanent Residence

There are several ways for a foreign national to obtain permanent resident status in Canada. The most popular categories are that of "skilled worker" and the "Canadian or Quebec experience class".

In order to qualify in the "skilled worker" category, an individual will be selected based on certain criteria including, among others, education, age, work experience, job classification, and abilities in French or English. Provided the individual's score meets the threshold, he or she may obtain permanent residence.

The "Canadian or Quebec experience class" will enable an individual who has been working in Canada or in Quebec for at least twelve months over the last two or three years preceding their application to obtain permanent residency. Said individual needs to be or has been employed on a full-time basis in a skilled or semi-skilled occupation and must meet certain language abilities in English or French.

In addition to these categories, individuals can become a permanent resident in Canada under the "business immigrant category", including self-employed, entrepreneurs and investors.

Once an individual has been physically present in Canada, as a permanent resident, for at least three years within a four-year period, the individual may apply for Canadian citizenship, provided that other criteria have been met.

3.2 LABOUR, EMPLOYMENT & HUMAN RIGHTS

3.2.1 In General

The *Constitution Act* confers broad powers on the federal government. Yet the provinces retain jurisdiction in many fields, including property and civil rights, which encompasses labour and employment law in most sectors. All provinces have enacted employment standards legislation governing such issues as minimum wage, hours of work, overtime, vacation and public holidays, pregnancy and parental leave and notice or pay in lieu of notice upon dismissal. Each province has also enacted legislation governing labour relations and collective bargaining in unionized workplaces. Further, all provinces have enacted human rights legislation, occupational health and safety and workers' compensation legislation.

Most employers fall under provincial jurisdiction. Companies operating in certain sectors are recognized under the *Constitution Act* as federal works, undertakings or businesses. These include federal Crown corporations, the postal service, banks, airlines, radio, television and telecommunications companies, railways, shipping companies and trucking companies providing inter-provincial services. Federally-regulated companies represent approximately ten percent of the workforce and are subject to the application of the *Canada Labour Code*, which governs employment standards, labour relations and collective bargaining. The Northern territories have limited autonomy and, for the most part, fall under federal jurisdiction.

In addition to these statutory regimes, the common law or in the case of Quebec, the *Civil Code*, applies to all contracts of employment.

3.2.2 Worker Representation

In Canada, the *Charter of Rights and Freedoms* provides everyone with the constitutional freedom to associate and meet peacefully.

The freedom to associate has recently been extended by the Supreme Court of Canada to protect a limited, procedural right to engage in collective bargaining. The scope of this right is currently unclear and controversial, although the Supreme Court has emphasized that no particular model of collective bargaining has been constitutionalized. Future cases should provide guidance as to the application of the new right of collective bargaining.

Provincial and federal labour legislation establishes the right to join a union and bargain collectively. Provided the requisite number of employees desire to be represented by a union (generally a simple majority), an employer will be obliged to negotiate with the union for the purposes of creating a collective agreement that governs the terms and conditions of employment and the rights and obligations of the parties.

Rules pertaining to union certification differ from province to province. In Quebec, a union must represent 35% of the employees of a group if it wishes to file a petition to seek certification as the bargaining unit. If less than 50% of the persons have signed, a vote is required. If more than 50% of the employees have signed, the union will be certified to represent the employees without a vote. In Ontario, the 35% level increases to 40% and a vote is required before a union can be certified. The union will be certified if more than 50% vote to support the bargaining union.

3.2.3 Strikes, Lock-Outs & Replacement Workers

An employee strike or employer lock-out is illegal during the term of a collective agreement. These actions only can occur following the termination of the agreement and if the parties have failed to reach an agreement through collective bargaining. In certain instances, the government may mandate conciliation.

The ability to take the following actions during work disruptions depends on the labour legislation applicable to the employer, namely, federal or provincial legislation:

- The right of employers to hire temporary replacement workers
- The right of employers to redeploy non-bargaining unit employees to do bargaining unit work
- The right of bargaining unit employees to cross picket lines and return to work.

3.2.4 Discrimination in Employment

All jurisdictions have enacted human rights legislation designed to ensure that workplaces are free from discrimination and harassment. *The Canadian Charter of Rights and Freedoms* also protects a variety of fundamental individual rights from government action in all jurisdictions.

The prohibited grounds of discrimination under human rights legislation vary to some extent according to jurisdiction and can include age, race, colour, ethnic or national origin, social condition, language, religion, creed or political conviction, gender, sexual orientation, pregnancy, disability, marital status, family status and record of offences. An employer may defend an allegation of discrimination by demonstrating that the job standard or requirement at issue was adopted in the good faith belief that it is a *bona fide* occupational requirement and that it is impossible to accommodate the individual without incurring undue hardship.

3.2.5 Terms of Employment

All jurisdictions have employment standards legislation mandating minimum standards, five of which are referred to below.

a. Hours of Work

Statutory minimum standards governing hours of work vary by jurisdiction. Employers and employees may not opt out of these standards unless this is expressly permitted by the applicable statute. The standard work day is generally eight hours. Legislation in some jurisdictions sets limits on the number of hours that may be worked in a week without a permit. For example, although the weekly maximum in Ontario is 48 hours, upon entering into a written agreement with the employee, the employer may apply for an excess hours permit to exceed this limit up to a maximum of 60 hours per week. Employment standards in some jurisdictions also prescribe the number of consecutive hours an employee must have free from work daily, weekly, bi-weekly and between shifts. Although restrictions on hours of work generally do not apply to managerial employees, professionals (doctors, lawyers, accountants, etc.) and teachers, each jurisdiction has its own excluded categories. Special regulations, which also vary by jurisdiction, govern hours of work in specific industries.

b. Overtime Pay

Although statutory minimum standards vary, in most jurisdictions overtime is triggered at 40 hours a week (44 hours in Alberta, Ontario and New Brunswick; 48 hours in Nova Scotia and Prince Edward Island). Overtime pay is generally calculated at 1.5 times the employee's regular hourly rate. Parties cannot opt out of these minimum standards absent an express statutory provision to the contrary.

Statutory overtime provisions vary by jurisdiction but generally do not apply to managerial employees, professionals and teachers. Special regulations in each jurisdiction also govern the statutory overtime entitlement in specific industries.

c. Vacation and Holidays

In each jurisdiction, employees are entitled to an annual vacation of at least two weeks per year upon completing one full year of employment, although some jurisdictions provide for increased vacation time as the length of employment increases. Employers have significant control over when the vacation may be taken.

Employment standards legislation also entitles eligible employees to paid public holidays. Eligibility requirements vary by jurisdiction. Designated public holidays also vary by jurisdiction but generally include New Year's Day, Good Friday, Canada Day (1 July), Labour Day, Thanksgiving Day, Victoria Day (third Monday in May) in the common law provinces and St. Jean Baptiste Day (24 June) in Quebec. Most employees are not required to work on public holidays, but if they do, local legislation generally entitles them to regular pay plus premium pay for the holiday or the right to take an alternate paid holiday within a specified time thereafter.

d. Leaves of Absence

Employment standards legislation in Canada provides for several types of unpaid leave, including pregnancy leave (17 or 18 weeks), parental or adoptive leave (35 to 37 weeks in most jurisdictions), sick leave and bereavement leave. As stated above, the types of leave available and eligibility requirements vary by jurisdiction. Although the statutory leaves are unpaid, employees may be eligible for compensation during the leave through the federal Employment Insurance (EI) program. EI benefits are also available for eligible employees who take time off work to provide care or support to a gravely ill family member at risk of dying within a 26-week period. Several provincial jurisdictions have revised or are in the process of revising their statutory leave provisions to correspond with this entitlement.

e. Employee Benefits

Canadians have universal access to medical and hospital care funded primarily by general tax revenues. Beyond this, most employers offer some form of extended medical and dental plans and other insurance benefits to supplement the public health insurance system.

Employers are not required to provide supplemental pension or benefit plans. Where an employer elects to do so, the plan must be formulated and administered in accordance with the applicable human rights, employment and pension legislation.

3.2.6 Termination

Employees may be dismissed for "just cause" in which case they are not entitled to notice of termination or payment in lieu of such notice. The threshold for establishing just cause is high. The degree of misconduct must be such that it fundamentally undermines the employment relationship.

In most jurisdictions, an employer may dismiss non-unionized employees without just cause upon providing the requisite statutory and common or civil law notice of termination or payment in lieu of notice. Certain jurisdictions provide exceptions to this general rule. Employment standards legislation in Nova Scotia, Quebec and the federal jurisdiction protects non-managerial employees from dismissal without just cause and provides for the possibility of reinstatement, subject to enumerated exceptions.

In unionized workplaces, the collective agreement generally protects employees from unjust dismissal and arbitrators may order reinstatement of unjustly dismissed employees, with or without compensation.

Where a dismissal is without just cause, employment standards legislation requires employers to provide written notice of termination or payment in lieu of such notice. Although the applicable statutory notice periods vary by jurisdiction, all are directly related to the individual employee's length of service. The federal and Ontario jurisdictions also require the payment of statutory severance pay. In addition, under the common law (and civil law in Quebec) an employee is entitled to a period of "reasonable" notice, the length of which is based on the individual's length of service, age, position and any other factors deemed to be relevant to the individual's ability to secure new employment. In most cases, an employee's common or civil law notice entitlement will exceed the applicable statutory notice period and statutory evidence.

With the exception of Prince Edward Island, every jurisdiction has enacted employment standards legislation regulating collective or mass dismissals. The applicable statutory provisions are triggered when a set number of employees' contracts are terminated with a specific time period.

In Quebec and Nova Scotia, as well as under federal jurisdiction, employees who meet certain requirements may seek reinstatement by filing an unjust dismissal complaint. Further, in all Canadian provinces as well as under federal jurisdiction, employees may also file recourses contesting prohibited and discriminatory practices under employment standards and human rights legislation.

3.2.7 Workers' Compensation and Occupational Health & Safety Legislation

All Canadian jurisdictions are covered by no-fault workers' compensation regimes, which are administered through statutory bodies generally known as workers' compensation boards. Generally, a worker's common law right to sue for workplace injury is statutorily barred and, in lieu of that right, workers can claim statutory benefits for injuries that are shown to be work-related. Workers' compensation in Canada is funded by employers through premiums calculated as a function of total payroll. The amount of premium payable is typically calculated on an industry-by-industry basis, depending on the risks and historical claims costs associated with these industries as determined by workers' compensation boards. Individual employers with poor safety records may also be subject to individual fines or surcharges. In some jurisdictions, injured workers are entitled to reinstatement at modified duties following an accident. Injured workers may also be entitled to vocational rehabilitation services to reintegrate them into the workforce when, due to the nature of their injuries, returning to work at the accident employer is no longer possible.

Workplace occupational health and safety is also regulated in all Canadian jurisdictions. The occupational health and safety legislation of a given jurisdiction typically places responsibility for safety on all workplace parties. Beyond specific legislated safety norms, such as requirements for machine guarding and fall arrest protection, employers are broadly required to take "all steps reasonable in the circumstances for the protection of a worker." Compliance with occupational health and safety legislation is achieved principally through two mechanisms. Government appointed safety inspectors have broad powers to order workplace parties to comply with legislation and to stop work in cases of non compliance. Regulatory prosecutions are also frequently resorted to, especially when non-compliance results in workplace injury or death. The fines under such prosecutions can be substantial, ranging into the hundreds of thousands of dollars. For example, in Ontario each charge resulting in conviction for a corporation can result in a maximum $500,000 fine, plus a 25% gross-up for a "Victim Fine Surcharge." All workplace actors and outside experts taking proactive due diligence to ensure compliance, is often the best defence to avoiding or minimizing the risk of such prosecutions.

4. Investment Factors

4.1 ECONOMIC TRENDS

Canada has a relatively stable economy. Since 2002, the Consumer Price Index has increased 19.4%.[1] From 1992 to 2008, Canada's annual inflation rate has increased on average 1.88% per year.[2] Canada's annual inflation rate, therefore, has been lower than the average of most industrialized countries.

Since 1997, the seasonally adjusted unemployment rate has fallen from 9.1% to as low as 6.0%.[3] Due to the world wide economic crisis beginning at the end of 2008, Canada's unemployment rate rose to a high of 8.5%, but has been decreasing and is currently 7.6%.[4] The Gross Domestic Product (GDP) currently stands in excess of $1.3 trillion.[5] The current prime lending rate is 3%.[6]

4.2 GOVERNMENT ATTITUDE TOWARDS FOREIGN INVESTMENT

Canada has no foreign currency restrictions and generally has a favourable attitude toward foreign investment in most industrial sectors. Although Canada is open to foreign investment, the federal *Investment Canada Act* (ICA) may require a non-Canadian purchaser to comply with a governmental review of certain acquisitions. There are also other federal regimes that are relevant to foreign investment in certain sectors, although this discussion focuses on the application of the ICA. The ICA applies to acquisitions of control of a Canadian business by a non-Canadian, or the establishment of a new Canadian business by a non-Canadian. Non-Canadians include individual non-citizens of Canada and entities that are neither controlled nor beneficially owned by Canadian residents or Canadian citizens. Where certain asset or value thresholds are exceeded in the context of foreign acquisitions, non-Canadians must submit their investments to government review to establish they are of "net benefit" to Canada.

The ICA was amended in March of 2009. Among the most significant amendments to the ICA was the introduction of a comprehensive national security review process in addition to the net benefit test. This national security review process has potentially broad application to foreign investments into Canada, given there is no definition in the ICA for "national security" and investments may be reviewed by the government even if they would not be subject to review under the "net benefit" test. Investments may be reviewed on national security grounds at any time, regardless of whether they have been implemented or not.

4.2.1 The ICA "Net Benefit" Review

Where a non-Canadian investor is not from a member country of the World Trade Organization (WTO), it is necessary to apply for review by the government where the book value of the assets of the Canadian business being acquired pursuant to a direct acquisition exceeds $5 million. Where the acquisition is indirect (i.e., an acquisition of a Canadian business through the acquisition of control of its foreign parent), a review is required if the assets of the Canadian business have a book value in excess of $50 million.

Thresholds are higher if the investor resides in a country that is a member of the WTO. For 2011, the review threshold for direct acquisitions is $312 million. The 2009 amendments to the ICA will, when implemented, incrementally increase the threshold for direct acquisitions by WTO member investors to $1 billion. As well, this threshold will be calculated according to the "enterprise value" of the Canadian business, which is expected to conform more to purchase price than book value of the assets.

In the case of indirect acquisitions by WTO investors, only a *pro-forma* notification, and not review, is required. If the Canadian business being acquired is a cultural business, (e.g. film production, newspaper, book or magazine publication or distribution), the lower non-WTO thresholds ($5 million for direct and $50 million for indirect acquisitions) apply.

Where the applicable review threshold has been exceeded, an application for review must be filed. When such an application is required, a waiting period of up to 45 days following receipt of the application must expire before the transaction can be completed. The government may extend the 45-day period unilaterally for an additional 30 days. If additional time is required, consent of the investor is needed for a further 30-day extension. There is no filing fee required in connection with an application for investment review. Where the asset base of a business falls below the thresholds, no review is required. However, even if the transaction is not reviewable, it is still necessary to file the *pre-forma* notification within 30 days of closing.

When a review is required, the Minister responsible for the ICA[7] must make a determination that the proposed investment is of "net benefit" to Canada before it can be completed. The following economic factors are considered in a Ministerial determination of net benefit:

- The effect on the level and nature of economic activity in Canada
- Participation of Canadians in the business
- The effect on productivity, industrial efficiency, technological development, product innovation
- The effect on competition within Canada
- Compatibility of the proposed investment with national, industrial, cultural and economic policies including the policies of provincial governments
- The effect on Canada's ability to compete in world markets.

Once the investment is found to be of "net benefit" to Canada, the investor may then complete the transaction. In many cases, the Minister will require the investor to provide undertakings (designed to promote the factors identified above in the net benefit analysis) as a condition of issuing a net benefit determination. Where the Minister believes that an investment is not of net benefit to Canada, the investment will not be permitted to proceed.

The government may levy fines and penalties for non-compliance with these provisions.

In general, the effect of the ICA net benefit process is a possible delay in the closing of a proposed transaction pending receipt of a net benefit determination and, if necessary, the obligation to negotiate with the government where it believes concerns exist with respect to any of the above mentioned criteria. In some cases, investors may be required to enter into binding undertakings in support of a determination of net benefit.

4.2.2 The ICA National Security Review

The national security review process under the ICA applies to a much broader range of proposed transactions than the net benefit test. A proposed investment may be subject to national security review even if it does not exceed the threshold for net benefit review. Moreover, the target does not need to fit the definition of a "Canadian business", as is the case with the net benefit review, in order to be eligible for national security review.

If a proposed investment will be subject to national security review, the first step in the process is for the Minister of Industry to determine whether there are reasonable grounds to believe that the investment could be injurious to national security. If the Minister determines that there are reasonable grounds, he may send a notice to the non-Canadian that an order for the review of the investment may be made.

If a non-Canadian receives a notice indicating the possibility of a review, the investment cannot be implemented unless it receives a further notice indicating that no further action will be taken.

The second step in the national security review process is for the Minister to consult with the Minister of Public Safety and Emergency Preparedness. After consultation, if the Minister considers that the investment could be injurious to national security, he will recommend that the Governor in Council (i.e., the cabinet) make an order to review the investment.

If an order for review is made, the Minister must send an notice to the non-Canadian indicating that an order for the review of the investment has been made and advising it of its right to make representations on the subject. Once a non-Canadian receives a notice, the investment cannot be implemented (unless they receive a notice indicating that no further action will be taken or authorization to proceed).

At this stage, the non-Canadian has the opportunity to make representations in support of the investment. The Minister may also require the non-Canadian to provide information the Minister considers "necessary" for the purposes of the review.

Once the Minister has consulted with the Minister of Public Safety and Emergency Preparedness (and presumably once representations have been made, and any requested information supplied), he must make a choice to refer the investment to the cabinet for review or send the non-Canadian a notice that no further action will be taken.

If the Minister refers the investment under review to the cabinet, the Governor in Council may take any measures to protect national security, including, but not limited to:

- Directing the non-Canadian not to implement the investment;
- Authorizing the investment on condition that the non-Canadian give any written undertakings considered necessary or implement the investment on prescribed terms and conditions; or
- Requiring the non-Canadian to divest themselves of control of the target.

It is important to note that investments in certain sectors of the Canadian economy by non-Canadians may be subject to restrictions or outright prohibitions. As a result, investors should not presume, in the absence of advice from counsel, that a particular investment is permissible under Canadian law.

4.3 INVESTMENT INCENTIVES

There are many investment incentives provided by the federal and provincial governments in Canada relating to a broad cross-section of industries. For more information from the federal government regarding investing in Canada, please see: www.investincanada.gc.ca/eng/default.aspx.

4.4 REGULATIONS WITH RESPECT TO TRADE

Canada has one of the world's most trade-oriented and open economies, with over 40% of GDP being directly reliant on international trade. As such, Canada supports a multilateral rules-based international trading system through the auspices of the WTO. Canada is also a signatory to the NAFTA, which includes Mexico and the United States of America. In brief, subject to various exceptions and reservations, goods originating in any one of the three countries may be exported to any other NAFTA country duty-free. Rules of origin require a minimum percentage of NAFTA content to qualify for duty-free access. Due to the extremely detailed and highly complex nature of NAFTA rules of origin, reference should be made to other materials on this subject. The NAFTA applies to all businesses operating in the three countries, irrespective of their ownership. The NAFTA applies not only to trade in goods, but also to trade in services. Moreover, the treaty contains investment protection provisions in Chapter 11 permitting private NAFTA investors to pursue dispute settlement directly against other NAFTA governments (rather than state-to-state dispute settlement) for which money damages can be awarded through arbitration. In addition to NAFTA, Canada has free trade agreements in place with Israel, Costa Rica and Chile and has signed free trade agreements with Colombia, Peru and the European Free Trade Association. Canada is also actively pursuing trade agreements with the European Union, Singapore, Korea, the Andean and Central American Communities and the Caribbean. Canada also has Foreign Investment Promotion and Protection Agreements (FIPAs) with 22 countries and is in negotiations with several countries, including China, Bahrain, Tunisia, India, Peru, Jordan, Kuwait, Mongolia and Vietnam. Canada is a member of the G7, the Organization of Economic Co-operation and Development (OECD), the World Customs Organization (WCO), the World Intellectual Property Organization (WIPO) and the Asian Pacific Economic Co-operation (APEC). Canada operates a modern and sophisticated customs regime, administered primarily by the Canada Border Services Agency (CBSA). Many specialized commercial customs programs help reduce lengthy

border delays. However, while generally business-friendly, customs compliance and enforcement are complex and can be costly. For instance, the administrative monetary penalty system (AMPS) in place can impose significant fines for incorrect filings and other errors under the *Customs Act*. Industrial tariffs in Canada are relatively low or have been entirely eliminated, but tariffs on many agricultural products remain very high to protect a complex supply management system.

Recently, Canadian importers and exporters have experienced an increase in various customs audits initiated by the CBSA—making the creation and maintenance of an up-to-date internal customs compliance program even more important.

Canada also maintains a full arsenal of trade remedy laws, including anti-dumping and countervailing duties on dumped and subsidized goods, as well as safeguard mechanisms. Furthermore, Canada has in place a broad array of export control measures on a variety of goods (including agricultural products, cryptographic, dual and military use goods) and implements UN sanctions in relation to particular goods destined for certain countries.

4.4.1 Trade Practices

The Competition Bureau (Bureau) is an independent law enforcement agency that is responsible for the administration and enforcement of, amongst other things, the *Competition Act* (Act). The Act is a federal law that regulates most types of business conduct in Canada and includes both civil and criminal provisions aimed at preventing anti-competitive conduct in the marketplace. The Act also requires mandatory merger pre-notification where transactions exceed certain thresholds (see below), and grants the Commissioner of Competition (Commissioner) the right to investigate and prosecute anti-competitive practices under the Act. The Commissioner is the head of the Bureau and investigates anti-competitive practices and promotes compliance with the Act. As mentioned above, trade practices under the Act can attract either criminal and/or civil liability. Examples of conduct that may attract criminal liability under the Act are:

- Conspiracies to fix prices
- Bid rigging
- False or misleading representations
- Deceptive telemarketing.

Examples of conduct that may be reviewed under the Act are:

- Abuse of dominant position
- Exclusive dealing
- Refusal to deal
- Mergers
- Joint Ventures
- Deceptive marketing practices.

In the context of a proposed merger transaction, the Act contains substantive provisions which grant the Commissioner the ability to seek a remedial order addressing problematic issues as well as provisions that require the parties to provide advance notice to the Commissioner and await the expiry of certain waiting periods in order to close the transaction. When specified financial thresholds are exceeded, it is necessary for the potential purchaser and vendor to notify the Bureau of the proposed transaction. In the context of an asset or share purchase, notification is required if:

i. All parties to the transaction, including their respective affiliates, have assets in Canada or gross revenue from sales in, from or into Canada, which exceed, collectively, $400 million, and

ii. The size of the transaction either exceeds $73 million as determined by the value of the assets being acquired in Canada, or the assets in Canada of the entity being acquired, or the annual gross revenues from sales in or from Canada generated from those assets exceed $73 million.

Where the transaction is to proceed by share purchase, notification is required if the above thresholds are met and the purchaser (including affiliates) will own 20% or more of the shares of a public corporation or 35% or more of the shares of a private corporation as a result of the purchase. If the prospective purchaser already exceeds the above percentages of share ownership, notification is required only if the purchase will increase holdings to more than 50%. Different thresholds apply where the transaction is

what the Act refers to as an amalgamation or a combination. The parties may request an Advance Ruling Certificate (ARC) from the Commissioner that would exempt the transaction from formal merger pre-notification. This application permits greater certainty with respect to the transaction since it cannot be challenged subsequently for a limited period of time. Requests generally are made where a transaction represents little or no substantive concern.

If notification is required (or if an ARC request is submitted), a fee of $50,000 must be paid. Unless an ARC is granted or a waiver obtained, parties to transactions that exceed the thresholds must file a notification, after which there is a 30-day statutory waiting period. If the Commissioner issues a supplementary information request (a SIR), the waiting period is extended another 30 days from the day when the parties provide the Commissioner with the required information. It should be noted that a transaction cannot close prior to the expiration of the waiting period.

The Commissioner can also apply for an interim order from the Competition Tribunal precluding the parties from completing the transaction in that time frame if the Commissioner believes that the transaction poses serious substantive issues.

The Bureau has established internal standards which give the parties guidance as to the length of time it will need to perform its analysis of the transaction, notwithstanding the waiting periods associated with pre-merger notification.

Most transactions subject to pre-merger notification do not, however, pose significant substantive issues. In many cases, a "no-action" letter is issued (provided the parties have not obtained an ARC). It is important to note that a "no-action" letter does not bar the Commissioner from later challenging the transaction. The Commissioner is entitled to challenge the transaction within one year following its completion, regardless of whether or not the transaction was subject to notification. To succeed in her challenge, the Commissioner must demonstrate that the transaction prevents or lessens, or is likely to prevent or lessen, competition substantially in a relevant market.

4.5 FINANCIAL SERVICES

4.5.1 In General

The financial services sector is regulated by the federal and provincial governments. Canada's federal government has exclusive jurisdiction over banks. Insurance companies and non-bank deposit-taking institutions (such as loan companies and trust companies) may be incorporated under federal or provincial law. Co-operative credit societies may be formed only under provincial law. Investment dealers, and securities market activities, are regulated by provincial law and their actions are supervised by Self-Regulatory Organizations which are empowered under provincial laws. The Department of Finance Canada is the federal department responsible for the regulation and supervision of Canada's banks and other federally regulated deposit-taking institutions and insurance companies. The Office of the Superintendent of Financial Institutions (OSFI), the Canada Deposit Insurance Corporation (CDIC), the Financial Consumer Agency of Canada (FCAC) and the Bank of Canada are agencies under its jurisdiction.

- OSFI monitors financial institutions such as regulated banks, insurance companies and pension plans for capital adequacy, financial condition, operations and regulatory compliance and has input into the development and interpretation of legislation and guidelines as they pertain to such financial entities.
- CDIC insures deposits at Canadian banks up to $100,000, and exercises a regulatory role through its by-laws.
- FCAC protects and informs consumers in the area of financial services and oversees financial institutions to ensure that they comply with federal consumer protection measures.
- The Bank of Canada is Canada's central bank and is responsible for the formulation and implementation of Canada's monetary policy. The Bank of Canada also exercises regulatory oversight of clearing and settlement systems.

4.5.2 Canadian Payments System

The Canadian Payments Association (CPA) is the regulatory body for the settlement and clearing of payments in Canada. It facilitates interaction with other payment systems and the development of new payment methods and technologies. Canadian banks and authorized foreign banks with branches in Canada (except those restricted from taking deposits) are statutorily required to be members of the CPA. Other deposit-taking institutions, life insurance companies, securities dealers and certain money market mutual funds are eligible for membership in the CPA provided they meet the requirements of the CPA.

4.5.3 Provincial Regulation

As an example of provincial regulation, the Financial Services Commission of Ontario (FSCO) is responsible for Ontario's regulated financial services sector, namely co-operatives, credit unions, caisses populaires, insurance, loan and trust companies, mortgage brokers and pensions. Generally, Ontario financial regulation focuses on market conduct, with the trend being to leave solvency regulation to the federal government (except for provincially incorporated insurance companies). FSCO provides regulatory services to protect public interest and enhance public confidence in the regulated sectors. The regulation of securities dealers and securities-related activities, including the issuing of publicly traded securities, is the responsibility of the provincial governments. In Canada, unlike the United States, there is no overriding federal regulation of securities activities, however, the various provincial securities regulatory authorities are working together to harmonize securities regulation across Canada.

4.5.4 Bank Ownership

Canadian banks are incorporated under the *Bank Act* and there are restrictions as to the percentage of ownership by any one person. Subject to specific statutory exceptions (i) large banks, whose equity exceeds $8 billion, are not permitted to have any shareholder own, either directly or indirectly, more than 20% of any class of voting shares or more than 30% of any class of non-voting shares (a "major shareholder"); and (ii) no person may control such a bank.

A bank whose equity is between $2 billion and $8 billion may have a controlling shareholder with ministerial approval; however, at least 35% of the voting shares of such bank must be publicly traded and not held by a major shareholder. Small banks, with up to $1 billion of equity, may be wholly owned. Any person who wishes to hold more than 10% of any class of shares of a bank must be approved by the Minister of Finance who will apply a "fit and proper" test. The minimum capital required to incorporate a new bank is $5 million.

4.5.5 Life Insurance

Many Canadian life insurance companies have been demutualized. That is to say, mutual life insurance companies are converted into publicly traded corporations whose shares are issued to the policyholders. Ownership rules for demutualized life insurance companies parallel rules for banks. Close ownership of other life insurers and property and casualty insurers is permitted (subject to a 35% "public float" requirement if equity exceeds $1 billion) if the Minister of Finance approves ownership of more than 10% of a class of shares.

1 Statistics Canada, The Daily, Consumer Price Index April 19, 2011 (13 May 2011), online: www.statcan.gc.ca/subjects-sujets/cpi-ipc/cpi-ipc-eng.pdf.

2 Bank of Canada, Inflation Calculator, online: www.bankofcanada.ca/rates/related/inflation-calculator/.

3 Statistics Canada, 2010 (Cat. No. 71F0004XVB) (13 May 2011), online: www4.hrsdc.gc.ca/.3ndic.1t.4r@-eng.jsp?iid=16.

4 Statistics Canada, The Daily, Labour Force Survey April 2011 (13 May 2011), online: www.statcan.gc.ca/daily-quotidien/110506/dq110506a-eng.htm;

5 Statistics Canada, Canada: Economic and financial data (13 May 2011), online: www40.statcan.gc.ca/l01/cst01/indi01c-eng.htm.

6 Bank of Canada, Rates and Statistics: Daily Digest (13 May 2011), online: www.bankofcanada.ca/rates/daily-digest/.

7 Generally, the Minister responsible is the Minister of Industry, but the Minister of Canadian Heritage is responsible for cultural sector reviews.

5. Intellectual Property

Intellectual property rights, including patents, trade-marks, copyright and industrial designs, are governed largely by federal legislation and, in certain instances, the common law of the provinces. Canada is also a signatory to various international agreements which relate to intellectual property rights.

5.1 PATENTS

Patent protection in Canada rests on the concept of a bargain between an inventor and the public. In return for disclosure of a new, non-obvious and useful invention to the public, the inventor acquires for a limited time the exclusive right to exploit it. After that time, the invention is available to be used by the public.

Patent rights do not exist at common law. They are governed exclusively by the *Patent Act*, as interpreted and applied by the Courts, especially the Federal Courts, and by the wording of the patent itself.

Acquiring a valid and enforceable patent begins with the filing of a patent application with the Canadian Intellectual Property Office. The application must correctly and fully describe the invention, such that a person of ordinary skill in the "art or science" to which the invention relates would be able to put the invention into practice based on that description. The patent application must also include claims that distinctly and explicitly define the invention. In accordance with the bargain theory, the description provided in the patent specification is the consideration given by the inventors in exchange for the time-limited patent monopoly. Patent applications are typically published by the Office 18 months after filing and can take several years to issue.

A patent application must normally be filed before the invention disclosed therein is made available to the public. If the invention is disclosed publicly before filing, the required novelty of the invention is irretrievably lost. There are two narrow exceptions to this otherwise inflexible rule. Canada is a party to the *Paris Convention*. By its terms, a patent applicant has one year to claim the filing date of an application it filed in another member country for the same invention. Thus, if the requirements are met, a disclosure of the invention to the public by anyone within that year will not deprive the invention of novelty. The *Patent Act* also provides a one-year grace period for disclosures from the patent applicant, made directly or indirectly.

A patent does not grant a patent owner a positive right to practice his or her invention. Practising an invention may be subject to regulatory requirements, legal prohibitions, contractual limitations and even other patents. A patent merely grants its owner the right to prevent others from practising the claimed invention. A patent owner can enforce this right through a legal action seeking a temporary and/or permanent injunction, its damages resulting from infringement or an accounting of the infringer's profits from the infringement and other ancillary relief. Patent rights cannot be enforced until after the patent is granted. After a patent is granted, however, compensation can be obtained for damages suffered from the time the patent application was published by the Office until issuance.

Today, the term of a Canadian patent extends for 20 years from the filing date of the application. However, patents resulting from applications filed prior to October 1, 1989, are entitled to a term of 17 years from the date of issuance of the patent, unless the patent was still in force as of July 12, 2001, in which case the patent is entitled to the longer of these two terms. Similarly, patent applications filed before October 1, 1989, but issued after that date receive the longer of 20 years from filing or 17 years from issuance.

5.2 TRADE-MARKS

A trade-mark is a word or marking that either actually distinguishes or is adapted to distinguish one trader's wares or services from those of others. Trade-mark rights exist at common law to protect the goodwill that a trader builds in his or her brand through the consistent use of a particular mark over time.

Common law trade-mark rights arise through use and are enforceable by way of a passing off action to the extent of the reputation associated with the mark and only to the extent damage is suffered or is likely to be suffered. Registered trade-mark rights overlap common law rights to a significant degree. Registration, however, provides a statutory shortcut that presumes reputation throughout Canada (simplifying enforcement) and grants access to additional statutory causes of action such as "depreciation of goodwill".

Registered trade-mark rights are governed by the *Trade-Marks Act*. A trade-mark registration provides its owner with the exclusive right to use the trade-mark in Canada in association with the wares and/or services identified in the registration. The owner must first file a trade-mark application with the Canadian Intellectual Property Office, identifying the trade-mark and the associated wares and/or services to be entitled to that right. The trade-mark can be a word mark, a design mark (e.g., an emblem or logo) or even the three-dimensional appearance of the goods being sold. The Office is considering accepting applications for other types of marks (holograms and motion marks) but has not yet fixed the procedures or requirements for doing so.

There are several requirements for registration, as well as numerous exclusions.

A fundamental requirement of registration is "use" of the trade-mark, not in the colloquial sense, but in the trade-mark sense of being employed to assist consumers in distinguishing the wares and/or services of one trader from those of others. "Use" has a very particular meaning in the *Trade-Marks Act*. For example, use in association with wares (physical goods) requires that the mark appear on the wares or on their packaging or in any other manner such that notice of the association between the wares and the mark is given at the time of the transfer of property or possession takes place. If the mark stamped on the wares is obscured by packaging that is not removed until after the wares are purchased, there may not be "use" in the trade-mark sense. As another example of the particularity of the meaning of "use," advertising does not constitute "use" for wares, but does for services.

For marks that consist of a shaping of wares or their containers or a mode of wrapping or packaging (e.g., the distinctive glass Coca-Cola® bottle), the additional requirement of distinctiveness acquired through use is required for registration. It is not enough in these cases that the mark has been in use. The mark itself must also "actually distinguish" the wares from those of others (as opposed to merely being capable of doing so).

Trade-marks that are registered and used in a *Paris Convention* country may be applied for and registered in Canada without use in Canada. Trade-marks may also be registered on the basis of "making known" in Canada (a rarely used alternative to "use" that requires the mark in question to be well known in Canada by virtue of distribution of marked goods or through advertising). Apart from these limited exceptions, trade-marks cannot be registered in Canada without "use" in Canada.

Applications for registration may also be made, though not granted, on the basis of proposed use. A "declaration of use" is required before the registration will issue.

As mentioned, there are also numerous exclusions to registration. A mark is not registrable if it is:

- a word that is primarily merely a name or surname unless it has acquired distinctiveness by the date of filing,
- "clearly descriptive" or "deceptively misdescriptive" of the wares or services when depicted, written or sounded in English or French with respect to quality, conditions of production or place of origin, unless it has acquired distinctiveness by the date of filing,
- the name of the wares in any language,
- confusing with a registered trade-mark,
- a prohibited mark (sections 9 and 10 of the *Trade-Marks Act* details these); or
- a protected geographical indication for wines or spirits (e.g., Champagne).

The most significant of these exclusions relates to marks that are already registered or are confusing with a registered trade-mark. The *Trade-Marks Act* establishes a five-part test for confusion in s. 6(5), to which the Courts invariably refer. The distinctiveness of the marks in question, the length of time each has been used, the nature of the wares or services marked, the nature of the respective trades and the degree of resemblance between the marks are all considered in coming to a conclusion on the issue of infringement.

As Canada is a party to the *Paris Convention*, the filing date of a trade-mark application filed in another member country will be accepted as the filing date in Canada if the Canadian application is filed within six months of the foreign filing. After that six-month priority filing window has closed, an applicant is entitled only to its regular filing date in Canada. This can have significant consequences for applicants in certain situations. When multiple parties apply for identical or confusingly similar trade-marks, priority is given to the first person to file an application in Canada, regardless of the person who was first to adopt (use or make

known) the trade-mark in Canada. This means that it is important to file a trade-mark application in Canada at the earliest opportunity. An applicant with an earlier date of first use, but a later filed application may still be entitled to registration but would have to oppose the first filed application and prove that he or she was the senior user of the trade-mark. An applicant may also not be entitled to registration of a mark if the mark is confusing with a trade-mark or trade-name that has been previously used in Canada by another person.

Various causes of action are available to the owner of a registered trade-mark whose mark has been misappropriated. These include an action for infringement (based either on a copying of the mark or based on confusion caused by a similar mark), depreciation of goodwill and the statutory codification of the torts of trade libel and passing-off. These causes of action may be advanced in any of the provincial courts or the Federal Court. The owner of a registered trade-mark may enforce its rights through a legal action on any of the above bases seeking a temporary and/or permanent injunction, and the recovery of damages or profits resulting from misappropriation of the trade-mark.

A trade-mark registration is granted for renewable 15-year periods. The registration is not inviolable in that period, however, and may be cancelled or voided on several grounds. For example, if the trade-mark is not used within the three years preceding the date of commencement of an expungement proceeding.

5.3 COPYRIGHT

Copyright is governed by the *Copyright Act* that applies to literary, artistic, dramatic and musical works. In Canada, there is no requirement to register copyright. Canada is a signatory to the various international agreements some of which establish minimum standard protections that are implemented in domestic legislation.

Canada's copyright legislation protects works created by persons who are citizens or residents of other countries who are signatories to such conventions. Copyright generally extinguishes 50 years after the death of the author. However, the term of protection depends on the nature of the work.

5.4 DESIGNS

The *Industrial Designs Act* governs industrial design rights. A Canadian design registration is directed to the visual appearance of a finished article, and provides the owner with the exclusive right of preventing others from making, selling, offering for sale or importing into Canada any article whose appearance does not differ substantially from the registered design. To be entitled to that right, the proprietor of the design must first file a design application with the Canadian Industrial Designs Office, depicting an article that embodies the design. To be registrable, the design must be sufficiently different in appearance from other prior design registrations so as to not be confused with such design registrations. The design must also not have been published more than one year prior to the date the design application was filed in Canada. The term of a Canadian design registration extends for ten years from the date of registration, subject to a maintenance fee payable after five years. A design owner can enforce its design rights through a legal action seeking a temporary and/or permanent injunction, and the recovery of damages or profits resulting from infringement.

6. Principal Forms of Business Entities

Businesses in Canada can operate through a variety of entities including a branch, general partnership, limited partnership, corporation, joint venture or trust. Income tax rules make it relatively easy to transfer business assets from a branch or partnership to a corporation.

6.1 CORPORATIONS

Most large businesses in Canada are carried on through a corporation with share capital. Canada's provinces, territories and the federal government each allow for the creation of a corporation under their respective jurisdiction and generally provide for incorporation by "articles of incorporation" except for certain regulated businesses. Articles of incorporation are government documents used to outline a corporation's purpose and regulations. In most jurisdictions there is no obligation to describe the objects or business activities, except for certain federally-regulated businesses, thereby permitting the corporation to carry on any business it desires. The jurisdiction of incorporation does not restrict the corporation's capacity to do business in other jurisdictions; provincially incorporated companies are not precluded from doing business outside the province.

6.1.1 Incorporation

Incorporation requires the filing of articles of incorporation or similar documents in prescribed form containing information relating to the name of the corporation, the incorporator, the first director or directors, the address of the registered or head office and the authorized share capital. Incorporation fees vary from jurisdiction to jurisdiction but generally are less than $500. The corporation comes into existence on the date of the issuance of the certificate of incorporation. In some jurisdictions it is possible to apply in advance of the incorporation for clearance of the corporate name. It is also possible to establish the name of the corporation as a number, which is assigned randomly by the incorporating authority. Obtaining a corporate name generally requires a prescribed computer search of the name and clearance to ensure that the name or a similar name is not already in use.

When applying for incorporation, it is necessary to set out whether or not the corporation will be a private corporation, public corporation or reporting issuer. If the corporation is a private or closely-held corporation, the number of shareholders (excluding employees) is generally restricted to 50. Furthermore, the corporation is prohibited from offering its securities to the public and there are usually restrictions on the shareholders' ability to transfer shares without director or shareholder approval. If the above restrictions are not set out in the articles of incorporation, the corporation may become a reporting issuer with various filing and reporting obligations. If securities are to be offered to the public, there is an obligation to comply with various securities' legislation.

6.1.2 Share Capital

Generally, there is no minimum or maximum share capital that a corporation may issue provided that the articles of incorporation do not establish any limits. If only one class of shares is authorized, that class must be voting and fully participating. Incorporating legislation permits a corporation to establish more than one class of shares and the articles will set out the attributes of the shares, including rights relating to voting, receipt of dividends and priority on dissolution. Generally, corporate legislation entitles shareholders of a class (voting or otherwise) to vote on any proposed modification of the terms or conditions relating to that class of shares.

A corporation need only to have one shareholder. Shareholders of a corporation have limited liability. They are not responsible for the liabilities of the corporation nor are they considered to own any of the assets or business of the corporation.

6.1.3 Directors

A private corporation need only to have one director. A public corporation must have at least three directors. As a general rule, a director need not be a shareholder of the corporation. A director must be an individual, at least 18 years of age, who is neither bankrupt nor mentally incapacitated. Most incorporating jurisdictions require that a specified percentage of directors be resident in Canada. An incorporation under the federal Canada *Business Corporations Act* requires that only 25% of directors be residents of Canada. Incorporation under provincial legislation imposes varying Canadian residency requirements depending on the province of incorporation. For example, Ontario and Alberta require that 25% of directors be resident in Canada. Some jurisdictions (e.g. Quebec, British Columbia, New Brunswick, Yukon and Nova Scotia) do not require any director to be resident in Canada. Most incorporating legislation permit all of the corporation's shareholders to enter into "unanimous shareholders' agreements." These agreements allow for the directors to transfer some, or all, of their rights to manage the corporation to the shareholder(s).

Directors are elected by shareholders. Directors are required to manage and supervise the management of the business affairs of the corporation. Directors appoint the officers who manage the corporation on a day-to-day basis. As a general rule, the name for the senior operating officer is "President".

6.1.4 Reporting

A corporation must provide audited financial statements to its shareholders. However, a corporation that is not public can prepare financial statements on an unaudited basis provided all the shareholders agree in writing to the exemption of audit requirements for that year. Financial statements are approved by the board of directors and presented to the shareholders for approval.

6.1.5 Operating Licence

A corporation incorporated either federally or provincially typically must obtain an extra-provincial registration to operate in another jurisdiction. This is a formality, and the registration is granted by the jurisdiction upon the filing of prescribed forms.

6.2 PARTNERSHIPS

Partnerships are governed by provincial law. An individual, trust, partnership or corporation, whether resident in Canada or elsewhere, is entitled to enter into a partnership in Canada. To qualify as a partnership, there must be two or more partners carrying on business in common with a view to profit and that there be arrangements with respect to the sharing of the partnership's profits or losses. A partnership generally is created by way of agreement between the partners. Registration of the partnership can occur after its creation. However, as a general rule, a general partnership requires registration of its name in the locations in which it carries on business.

There are three types of partnerships: a general partnership, a limited partnership and a limited liability partnership.

Where a general partnership is formed, each partner is jointly and severally liable for the liabilities of the partnership, i.e. each partner is liable for all partnership debts and each partner can contract on behalf of the partnership and therefore the partners.

A limited partnership is comprised of general and limited partners. Within a limited partnership, there must be at least one general partner who is responsible for all partnership liabilities.

Conversely, the liability of limited partners is restricted to their respective capital contribution, amounts to be contributed and undistributed profits. In a limited partnership, it is the general partner who manages the business. Limited partners who are involved in the management of a partnership forfeit their limited liability. A partnership is not a limited partnership unless it is registered as a limited partnership.

6.3 BRANCHES OF FOREIGN COMPANIES

A non-resident corporation may carry on its business in Canada through a branch. There are straightforward statutory registration and licensing requirements in each province in which a branch carries on business. For income tax purposes, income or loss of the branch is that of the foreign corporation establishing the branch. Since a branch is not a separate legal entity, any debts and obligations incurred through the Canadian branch are the responsibility of the foreign corporation establishing the branch.

6.3.1 Joint Ventures

A joint venture is not a statutory creation but a business relation based on contracts. Generally, a joint venture is created where two or more parties wish to collaborate in a single business venture for a finite period of time. Members of a joint venture team together for a particular purpose or projects, whereas members of partnerships join for the purpose of running a business in common. Members of joint ventures exercise control over the business and consequently share revenues, expenses and assets. Joint ventures are especially common in certain industries including real estate, construction and natural resources. Where a joint venture operates and is managed in a manner similar to a partnership, the courts may interpret the joint venture to be a partnership and thus impose joint and several liability on the so-called joint venturers. Joint ventures may also be subject to concerns under the conspiracy, abuse of dominance or merger provisions of the *Competition Act*.

6.4 TRUSTS

As a general rule, trusts are not used to operate businesses in Canada. Exceptions exist for real estate investment trusts (REIT) and mutual fund trusts (MFT). A REIT is a trust that owns real estate and its trust units are issued to the public. The REIT enables the holders of trust units to participate in the earnings and growth of the real estate holdings held within the trust without exposing the unit holders to personal liability. An MFT is generally established to own marketable securities. MFTs are structured the same as REITs but allow the trusts to own resource assets such as oil and gas wells and timber resources. More recently, a number of manufacturing and service businesses have begun to operate through MFTs. Despite the creation of the MFT, the business activity itself is carried on by an operating corporation. The insertion of a corporation provides an opportunity to greatly reduce taxes that a corporation and its shareholders would normally have to pay under the traditional corporate structure.

6.5 FOREIGN BANKS AND FINANCIAL SERVICES PROVIDERS

The *Bank Act* regulates the business activities of foreign banks in Canada. A foreign bank is defined to include many non-bank foreign financial services providers including what are generally referred to as "near banks". The legislation permits foreign banks that are near banks to be exempted from many of the rules. A foreign bank without exemption from these rules cannot:

- Carry on any business in Canada
- Establish a branch for any purpose
- Provide services through an automated presence or a remote service unit in Canada
- Control or have an investment in a Canadian entity that exceeds a statutory threshold.

A foreign bank may establish a presence in Canada only with the approval of the federal government. It may maintain a representative office in Canada which is not permitted to carry on business in Canada but which can promote the foreign bank for business outside Canada and serve as a liaison with its offices outside Canada.

Any foreign bank that wishes to provide banking services in Canada may seek approval to establish a Canadian bank, or establish a foreign bank branch that is a full-service branch or lending branch. Branch business powers are similar to those of Canadian banks except with respect to restrictions on deposit taking. A full-service branch may not accept retail deposits of less than $150,000 and lending branches are completely prohibited from accepting retail or wholesale deposits or otherwise borrowing money in Canada.

A foreign bank also may seek approval to own a loan or trust company, insurance company or securities dealer, or make other investments. A foreign insurer or securities dealer may also seek approval to carry on a securities or insurance business in Canada.

7. Taxation

7.1 TAX SYSTEM OVERVIEW

7.1.1 In General

Income tax is levied by the Canadian federal government, and by each of the ten provinces and three territories. The basis for federal government taxation is the *Income Tax Act* (Act). The province of Quebec has its own income tax legislation both for individuals and for corporations. However, each of the other provinces and territories has its own income tax legislation for corporations only but such legislation generally references this legislation to the Act.

Individuals residing in Canada (outside of the Province of Quebec) file one federal income tax return for each taxation year. Individuals who also are liable for taxation in Quebec must file a separate return with that province. Corporations are required to file a federal income tax return which will encompass all activities subject to taxation in each of the provinces and territories, except Alberta and Quebec. Separate income tax returns are required for corporations who are taxable in either of those jurisdictions.

7.1.2 Basis of Taxation

The basis of taxation in Canada is residence. Unlike the United States, citizenship has no bearing on Canadian income tax. A person, whether an individual, corporation or trust, who is resident in Canada at any time in a taxation year is liable to pay income tax to Canada on its worldwide income for that year. However, individuals only who either become resident of Canada in a particular year or cease being a resident of Canada in a particular year are liable for taxation on worldwide incomes only in respect of the period of residency in Canada.

A person who is not resident in Canada at any time of a particular year is subject to Canadian income tax in one of four situations:

i. An individual employed in Canada.

ii. The person carries on business in Canada.

iii. The person disposes of "taxable Canadian property" which is defined to include:

  a. Real estate, resource properties and/or timber properties, situated in Canada;

  b. Property used in the carrying on of a business in Canada. Excluded are assets used in carrying on an insurance business and ships and aircraft used predominantly in international traffic;

  c. Designated insurance property of an insurer;

  d. Shares of a corporation, whether resident in Canada or not, or an interest in a partnership or trust, where more than 50% of the share value is derived from real estate, resource properties and/or timber properties, situated in Canada, or options in respect thereof;

  e. In certain scenarios, shares of a closely-held public corporation or units of a mutual fund trust.

iv. The person receives certain types of payments from persons resident in Canada, including dividends, management fees, royalties and interest. This tax is referred to as "withholding tax."

Where a non-resident person is liable to pay tax to Canada either because the person also is considered resident in Canada under the Act or because the person is a non-resident of Canada but liable for taxation in any of the above four situations, the Canadian liability for taxation can be reduced or eliminated if the person resides in a country with an income tax convention with Canada (a "treaty country"). Canada's treaties are based on the model treaty of the OECD.

A non-resident person who was employed in Canada, carried on business in Canada or disposed of taxable Canadian property must file an income tax return with Canada even if exempt from taxes under an income tax convention.

7.1.3 Residence of a Corporation

The Act deems any corporation incorporated in Canada after April 26, 1965, to be a resident of Canada throughout the taxation year. Any corporation incorporated in Canada prior to that date generally will be deemed resident in Canada if it has carried on business in Canada at any time. Otherwise, the Act does not define the term "resident".

A corporation not deemed to be a resident of Canada may be considered a resident of Canada if its central management and control is located in Canada. The jurisprudence holds that central management and control generally refers to where a corporation is managed and would include where the meetings of a board of directors is held. As a rule, a corporation incorporated outside of Canada and whose management is not based in Canada will not be considered resident in Canada. Under Canada's treaty system, a corporation considered resident both in Canada and in a treaty country generally will be considered resident in the country in which it has been incorporated.

It should be noted that a corporation incorporated in Canada and which has been continued in a jurisdiction outside of Canada will be deemed not to have been incorporated in Canada for purposes of the Act.

7.1.4 Residence of an Individual

An individual is considered to be resident in Canada under the general concept of residence as defined in the jurisprudence. Factors that the courts have used to determine whether an individual is a resident of Canada include:

i. Whether the individual has rented or purchased a dwelling in Canada;

ii. The length of time the individual is in Canada in a year or over a period of years; and

iii. Whether the individual's family has joined him or her in Canada.

Although the Act does not have a general definition of residence, an individual will be deemed to be resident in Canada if he or she "sojourns" in Canada in any calendar year for more than 182 days. The expression "sojourn" is not defined in the Act but is considered the equivalent of presence. Once an individual is present in Canada on more than 182 days in a calendar year, no matter how long the presence may be on any particular day, he or she is resident in Canada.

For Canadian income tax purposes, an individual can be considered resident in Canada even if the individual is considered resident in another country by virtue of the taxation laws of that latter country. If an individual is resident in a treaty country and also is considered resident in Canada, Canada's treaty system generally provides for "tie-breaker" rules to determine whether the individual will be considered resident in the treaty country or in Canada. Treaties between Canada and, for example, the United States, the United Kingdom, France, China, India and Russia contain tie-breaker rules similar to those described below. If a treaty deems an individual to be resident in the treaty country and not to be resident in Canada, then liability for Canadian taxation will arise only to the extent that the individual is liable for taxation in Canada as a non-resident.

The order of the tie-breaker rules is as follows:

i. Residence is first determined by whether or not an individual has a home in Canada and/or the treaty country. If there is a permanent home only in one country, the individual is deemed resident in that country. If there is a home in both or neither, the next test is applied.

ii. An individual is deemed resident in the country with which his or her "personal and economic relations" (centre of vital interests) are closer. Where the individual's family is located may be the determining factor.

iii. If the centre of vital interests cannot be determined, the next tie-breaker rule is whether or not there is an habitual abode in one of the countries. One court decision based the concept of habitual abode by comparing the number of days the individual was in Canada as opposed to in the treaty country.

iv. If residence cannot be determined by habitual abode, the individual will be considered resident in the country of which he or she is a citizen. If the individual is a citizen of both or neither countries, then the determination will be made by the competent authorities.

7.2 TAXATION OF INDIVIDUALS AND CORPORATIONS RESIDENT IN CANADA

7.2.1 Individuals

An individual resident in Canada is liable to pay tax to Canada and to the province in which the individual resides on the last day of the calendar year. However, if such an individual carries on a business in a province other than the one in which he or she is considered resident, then the individual essentially is liable to pay provincial income tax on such business income to that particular province and not to the province of residence.

The maximum federal income tax rate is 29%. The maximum combined federal and provincial income tax rate ranges from 39% in the Province of Alberta, 43.7% in the province of British Columbia, 46.41% in the Province of Ontario and 48.22% in the Province of Quebec.

7.2.2 Corporations

7.2.2.1 General Comments

The effective federal income tax rate of a corporation is 16.5% in 2011. This rate is scheduled to reduce to 15% by 2012. In addition to federal income tax, each province and territory levies income tax in respect of a corporation that has a permanent establishment in its jurisdiction. Provincial income taxes are 10% in each Alberta and British Columbia, 11.9% in Quebec and 11.5% in Ontario.

The provinces of Nova Scotia, Alberta and British Columbia allow for the incorporation of what is referred to as an unlimited liability corporation (ULC). Canada treats any corporation as a separate entity for income tax purposes, that is income of the corporation is taxed in its hands. However, under US income tax law, a ULC can elect to be treated as a pass thought or disregarded entity. Many US corporations will incorporate a Canadian subsidiary as a ULC to maximize the use of its foreign tax credits. ULCs also are used in what are referred to as "double dip" scenarios, although the Canada-US Income Tax Convention contains specific provisions which are designed to eliminate this benefit.

The Act does not allow corporations to file consolidated income tax returns. As a result, losses of a corporation within a group cannot be used to offset the profits of another corporation within the group. Obtaining immediate benefit of losses may require the amalgamation of the particular corporations, or the winding up of the subsidiary into the parent. If the corporations are taxable Canadian corporations, the combination is accomplished without income taxes except in unusual circumstances.

Non-capital losses or business losses may be carried back three taxation years and forward 20 taxation years to offset income in such subsequent years. Such losses incurred in taxation years that ended before March 23, 2004, can only be carried forward seven years; losses incurred from that date to the end of 2005 can only be carried forward 10 years.

Capital losses can be carried back three taxation years and forward indefinitely.

The Act contains detailed rules that prevent a corporation from using its losses (and losses accruing on capital assets that it holds) subsequent to the time that control of that corporation has been acquired. In such a case, all capital losses, including any accruing capital losses, no longer are deductible. Furthermore, non-capital losses can only be deducted to the extent that the business in which losses arose is carried on and then only to the extent of profits from the same or similar business. For the purposes of this provision, control is based on the right to elect a majority of the members of the Board of Directors.

7.2.2.2 Assessments and Reassessments

A corporation is required to file an income tax return within six months of the end of its fiscal or taxation year. A fiscal year cannot be changed without consent of the tax authorities. CRA can reassess a corporation up to four years (three years with respect to certain corporations not controlled by non-resident persons) after the date of its issuance of an original assessment. This limitation period extends for an additional three years solely with respect to transactions with occurring non-residents who do not deal at arm's length with the corporation. In addition, certain provinces extend its ability to issue a notice of reassessment one year beyond the federal limitation period.

7.3 TAXATION OF INDIVIDUALS AND CORPORATIONS NOT RESIDENT IN CANADA

7.3.1 Employment Income

A non-resident who is employed in Canada is liable to pay income tax to Canada in respect of the individual's Canadian employment income. Canada's treaty system generally contains limited exceptions. The OECD model exempts non-residents from taxation in the country of employment where the individual is present in that country less than 183 days in any 12-month period, the remuneration is paid by an employer who is not resident in the country of employment, and the remuneration is not borne by a permanent establishment the employer has in the country of employment. The OECD model generally is followed in treaties with countries such as France, China, Russia, Brazil, the United Kingdom and the United States. In addition, the treaty with the United States exempts from taxation remuneration that does not exceed $10,000 CDN in a year.

7.3.2 Carrying on Business in Canada

7.3.2.1 Individual

An individual who is not resident in Canada is liable for taxation to Canada if he or she has carried on a business in Canada. If the business is not carried on through a permanent establishment in Canada, the individual will pay federal income tax only at a maximum marginal income tax rate of 42.9%. If such an individual carries on a business in Canada through a permanent establishment in one or more provinces, the person will pay income tax in the same manner as an individual resident in Canada.

7.3.2.2 Corporation

The vast majority of non-resident corporations who carry on business in Canada do so through a Canadian subsidiary. The Act defines the term "business" to include a "profession, calling, trade, manufacturer or undertaking of any kind whatsoever and an adventure or concern in the nature of trade." In addition, a non-resident of Canada is deemed to be carrying on a business in Canada if, for example, it directly:

i. Produces, mines, manufactures, improves, packages, preserves or constructs, wholly or in part, anything in Canada, or

ii. Solicits orders in Canada or offers anything for sale in Canada whether through an agent or servant, no matter where the contract is completed.

The term "adventure or concern in the nature of trade" may expand the situations under which a non-resident is said to be carrying on business in Canada. This concept may include, for example, an isolated sale of either real estate or oil and gas leases, whether or not there was an organization established in Canada to carry on such an activity.

Whether a non-resident corporation elects to carry on business in Canada through a Canadian subsidiary or by itself through a branch may depend on a number of factors including:

i. A comparison of the income tax rates of Canada and the country of the non-resident.

ii. The terms of any income tax convention between Canada and the country of the non-resident.

iii. Whether the business will operate at a profit or a loss, and, if at a loss, whether the non-resident may use the losses to offset income in its country of residence.

iv. Whether profits earned from the business carried on in Canada will be repatriated to the country of the non-resident.

If a business operates through a branch, Canadian income tax laws generally will permit the subsequent transfer of the business assets to a Canadian corporation without income tax. Exceptionally, real property cannot be transferred on a tax-free basis unless the property is used in the carrying on of a business. Any accumulated losses of the branch will not be available for use by the Canadian subsidiary to offset any of its income.

If a branch is used, the non-resident corporation will pay federal and provincial income tax at the same rates payable by Canadian resident corporations. However if the corporation does not have a permanent establishment in Canada, the federal income tax is 26% in 2011.

While the definition of what constitutes a permanent establishment may vary from province to province, the concept is similar:

i. A permanent establishment generally includes a fixed place of business such as an office, branch, mine, oil well, timberland, factory or warehouse.

ii. If there is no fixed place of business, a permanent establishment will be the principal place in which its business is conducted.

iii. A corporation that carries on business through an employee or agent established in a particular place and who has general authority to contract will have a permanent establishment in that place.

iv. The use of substantial machinery or equipment also will constitute a permanent establishment.

v. A subsidiary, in and of itself, is not a permanent establishment.

If a corporation has a permanent establishment in only one province, then all taxable income subject to income tax in Canada is taxable in that province. If a corporation has a permanent establishment in more than one province, then the income is allocated proportionately to each province based on the ratios of gross revenue, and salary and wages, attributable to a permanent establishment of that province. The Regulations to the Act contain rules determining attribution of gross revenues and salaries to a particular establishment.

Where a person is a member of a partnership, be it a general partnership or limited partnership, the person is deemed to be carrying on the business that is carried on by the partnership. Furthermore, if a partnership has a permanent establishment in Canada, the partner is deemed to have that same permanent establishment.

For Canadian income tax purposes, a partnership is not subject to income tax (except certain publicly traded partnerships). A partnership computes its income in accordance with the provisions of the Act (with a few exceptions) and such income is allocated to the partners in proportion to their partnership interests. A partnership's source of income is considered that of each partner.

Unlike US income tax rules, a partnership cannot be considered a taxable entity under the Act even though such might be the case under US income tax law.

7.3.2.3 Effect of a Tax Convention or Treaty

A non-resident person who resides in a treaty country and who carries on business in Canada through a branch and not a Canadian subsidiary generally will be subject to taxation in Canada only if that person carries on a business through a "permanent establishment" in Canada and then only to the extent of business profits attributable to such permanent establishment.

In addition to the concept of permanent establishment discussed above, a permanent establishment also exists if a person acting in Canada on behalf of the non-resident has, and habitually exercises, authority to contract in the name of the non-resident. Exceptionally, a permanent establishment does not exist where the agent through whom the non-resident carries on business is a broker, general commission agent or other agent acting in the ordinary course of its business. A subsidiary in and of itself does not constitute a permanent establishment.

Canada's income tax treaties generally define a permanent establishment to mean a fixed place of business through which the business is wholly or partially carried on and includes, specifically:

- A place of management
- A branch
- An office
- A factory
- A workshop
- A mine
- An oil or gas well
- A quarry or other place of extraction of natural resources

In certain instances, a building site or installation can constitute a permanent establishment, depending on how long it lasts.

A number of Canada's income tax treaties provide that a permanent establishment does not include a fixed place of business used solely for storage, or display of goods or merchandise, the maintenance of the stock of goods for sale or processing and advertising, the supply of information, scientific research or similar activities which have an auxiliary character of the non-resident.

The term "business profits" is not defined in Canada's treaty system. However, as a general rule, business profits that otherwise are dealt with in a treaty or convention will be taxed under that specific provision, and not under the rules pertaining to the taxation of business profits. Income from real property (including income from agriculture, forestry or other natural resources such as mining or oil and gas) and royalty income are the two principal examples of business profits that will be subject to tax under a specific provision of a treaty and will not be taxable under the business profits provision of a treaty.

The treaties generally provide that business profits are reduced by expenses incurred for the purposes of the permanent establishment, including executive and administrative expenses such as those for the head office. The Canadian courts have held that a charge by a non-resident corporation to its branch for the use of equipment is not an executive or administrative expense. To obtain deduction of such an expense in Canada would require that a non-resident corporation transfer the equipment to another corporation (not resident in Canada) that would rent the equipment to the Canadian entity.

7.3.2.4 Computation of Business Income

The liability for taxation in Canada is based upon a computation of business income which, less certain deductions, becomes income (if the person is resident in Canada) or taxable income earned in Canada (if the person is a non-resident of Canada). For the purposes of computing income from a business or property, income is the taxpayer's profit from such business or property. Profit is to be computed using ordinary principles of accounting. The jurisprudence suggests that a different computation of profit using commercial principles may be made for income tax purposes than for financial statement purposes. The Act then requires a taxpayer to modify the computation of profit by various additions to and/or deletions from the profit, to arrive at a computation of income. Specific examples of those modifications include:

- Depreciation (called capital cost allowance) of capital assets is based upon a scheduled set of rates. The cost of a depreciable asset is amortized on a declining balance basis. For buildings, the rate is 4%. Capital cost allowance (CCA) need not be claimed in a particular year and the amount that may be deducted can be any portion of, or all of, the maximum deductible amount for the year. CCA cannot be claimed until an asset is in use.
- The acquisition of "goodwill" also is deductible on a declining balance basis at a rate of 7% on 75% of the cost.
- Reserves or contingent liabilities are deductible only to the extent that they are in respect of doubtful debts or certain services to be provided in the future. A reserve in respect of product warranty may not be deductible.
- Interest on money borrowed, and property taxes, in respect of acquisitions of land or in respect of construction of a manufacturing or other facility, must be capitalized until the property is put in use.
- Expenditures for scientific research and experimental development incurred in Canada, be it on account of income or on account of capital, may be deducted in the year incurred or in any subsequent taxation year.

7.3.3 Disposition of Taxable Canadian Property

A person who is not resident in Canada is liable to pay income tax to Canada in respect of gains arising from the disposition of taxable Canadian property which term was previously defined. The Act subjects 50% of the gain to income tax.

Prior to recent changes to the Act, the definition of taxable Canadian property included the shares of all private Canadian corporations. The definition now is limited to such corporations where more than 50% of its share value is derived from real estate, resource properties and/or timber properties, situated in Canada. The primary purpose for the amendment is because most income tax conventions provide that shares of private Canadian corporations are exempt from tax under the treaty, except those corporations whose assets are based on real property. By amending the definition of taxable Canadian property in the Act, it eliminated the administrative need for vendors to seek income tax clearance certificates with respect to the dispositions of such shares.

As a general rule, a person resident in a treaty country is not subject to income tax in respect of gains arising from the disposition of taxable Canadian property. Nevertheless, almost every convention permits Canada to tax gains in respect of "real estate" (including the sale of shares of a corporation resident in Canada or an interest in a partnership, trust or estate whose value is derived principally from real estate situated in Canada) and gains in respect of property which is used in a business carried on in Canada through a permanent establishment. Real estate is defined to include oil and gas properties, mines and timber resource properties. In addition, tax treaties generally allow Canada to tax gains arising from the sale of personal property forming part of a Canadian permanent establishment. Goodwill, patents and trademarks for example are not considered personal property.

Where a non-resident disposes of taxable Canadian property, the non-resident vendor must obtain a clearance certificate from the tax authorities. Where such certificate is not obtained, it is the obligation of the purchaser to withhold 25% of the purchase price being paid for the property. Should the purchaser not obtain this clearance certificate, the purchaser becomes liable for this 25% tax. It is for this reason, therefore, that purchasers insist on obtaining the clearance certificate, if it is not obtained they will withhold the required amount. It is in the interest of a non-resident to seek this clearance certificate since it usually will be the case that the taxes owing in respect of the disposition will be less than 25% of the purchase price.

The obligation to obtain this certificate exists even where the taxable Canadian property would be exempt from taxation in Canada under a particular treaty or where no income tax liability to Canada arises in respect of the disposition, either because the proceeds of sale are less than the tax base or the non-resident has been able to obtain a deferral of tax through the use of various provisions in the Act that allow for tax-free transfers.

The Act provides that a clearance certificate need not be obtained if the following conditions are met:

- The purchaser concludes that the vendor resides in a country with an income tax convention with Canada.
- The property is a "treaty protected property." This term is defined to mean a property which would be exempt from income tax under the provisions of the convention of the country of residence of the non-resident vendor.
- Within 30 days of the disposition, the purchaser provides information to CRA relating to the acquisition including the property acquired and the purchase price, the name and address of the non-resident and the treaty of reliance.

Since it is the purchaser's responsibility to ensure that a certificate is obtained, in an arm's length transaction, it is likely that the purchaser still will require the clearance certificate since the purchaser needs to satisfy itself of certain factual matters in determining whether or not, for example, the vendor would be exempt from income tax under the provisions of the convention with Canada. The clearance certificate need not be obtained where, for example, the vendor and purchaser are related and the purchaser is aware of the vendor's status and can conclude that the certificate need not be obtained.

7.3.4 Withholding Taxes

7.3.4.1 Introduction

Non-residents of Canada who receive certain types of payments from persons resident in Canada are subject to withholding tax at a rate of 25%. The Act imposes an obligation on the payer to withhold and remit this amount. Canada's treaty system may reduce or eliminate the withholding obligation.

7.3.4.2 Management or Administration Fees

Management or administration fees or charges are subject to withholding tax. The Act provides two exceptions:

i. Where the services are performed by a non-resident person who deals at arm's length with the payer and who provides the services in the ordinary course of its business. A subsidiary and its parent do not deal at arm's length.

ii. In all other cases, withholding tax will not be payable only in respect of the cost of the specific expense incurred to perform the service. In other words, only the profit arising from the providing of the service will be subject to withholding tax.

Canada's treaty system generally provides that business profits earned by a non-resident are not subject to Canadian income tax so long as the profits are not attributable to a permanent establishment of the non-resident in Canada. Business profits should include management or administration fees. As a result, a non-resident of a treaty country should be exempt from Canadian withholding tax in respect of management fees (including profit) charged by it to a Canadian resident, whether or not the parties are at arm's length.

It should be noted that certain provinces, including Ontario, impose a withholding tax on such fees paid to a non-resident which applies even if a treaty exemption is available.

What constitutes a management or administration fee or charge is relevant to non-residents who do not reside in a treaty county. There is little jurisprudence on the matter. It was suggested that management or administration extends beyond the provision of those functions necessary for day-to-day operations. Fees for market research and product direction, operations and financial planning, and an annual audit assessment were held to be management or administration fees and subject to withholding tax under this provision.

7.3.4.3 Interest

With certain important exceptions described below, the Act provides that all interest paid by a person resident in Canada will be exempt from withholding tax. This exemption is applicable no matter when the loan was made. Prior to this amendment, there was an exemption from withholding tax to the extent of interest paid by only by a corporation to an arm's length person where the borrower was not required to repay more than 25% of the principal within five years of the date of the issue of the loan, except in limited circumstances.

There are two specific situations where withholding tax is still payable:

i. Where interest is paid to a person with whom the resident does not deal at arm's length. Under the Act, persons are deemed not to be dealing at arm's length if, for example, one is the subsidiary of another or a sister corporation of another. This withholding tax continues to apply in respect of interest payable, for example, by a Canadian resident subsidiary to its parent or to another subsidiary of its parent.

ii. Interest payable on an obligation where any portion of the interest is contingent or dependant on the use of, or production from, property in Canada or is computed by reference to revenue, profit, cash flow or other similar , on such debt, whether the interest is participating or otherwise. Once any portion of the interest payable in respect of the debt is contingent, then all of the interest payable, even the portion of interest that is fixed, becomes subject to withholding tax. If a loan is made under these conditions, consider whether the loan can be divided such that one loan is in respect of the fixed rate of interest.

Where withholding tax is payable, Canada's income tax conventions, such as those with France, the United Kingdom, Luxembourg and Switzerland, generally reduce the withholding rate to 10%. Under the Canada-US Income Tax Convention there is no withholding tax payable on interest payments except those described above.

7.3.4.4 Dividends and Branch Tax

All dividends, whether they are considered to be taxable or non-taxable dividends for purposes of the Act, paid by a Canadian corporation to non-resident shareholders are subject to withholding tax, except in very limited circumstances. The rate of withholding generally is reduced to 15% where the recipient is resident in a treaty country. The withholding rate can be reduced further where the percentage of ownership in the Canadian corporation of the non-resident corporation exceeds a certain threshold. Currently, the convention with the United Kingdom provides that the rate of withholding reduces to 5% where the recipient controls at least 10% of the voting power of the corporation paying the dividends. In the conventions with Germany and the United States, the rate also is reduced to 5% if the beneficial owner of the dividends controls at least 10% of the voting power of the payer.

Where a non-resident corporation carries on business in Canada, the Act provides for an additional tax, commonly referred to as "branch tax," equal to 25% of a detailed calculation. Essentially, the branch tax is payable on profits earned by the non-resident corporation in respect of any business carried on in Canada to the extent that the profits have not been reinvested in the business. The purpose of the tax is to subject a non-resident corporation to the withholding tax that would have been levied on distributions of profit of a business carried on by a Canadian subsidiary instead of the branch. Again, Canada's convention network reduces the withholding rate to the dividend rate in such treaty.

7.3.4.5 Real Estate

Gross revenues derived from the use of, or production from, real property situated in Canada are subject to a 25% withholding tax. Canada's tax convention system does not provide for a reduction in the rate of withholding. Real property situated in Canada will include real estate, mines, oil and gas properties and timber resource properties. This withholding obligation overrides the general business profits provisions of a tax convention even where the non-resident is carrying on a business with respect to such real property.

Where the non-resident derives the revenue from a business attributable to a permanent establishment or elects to file an income tax return as if it were deriving the income from a permanent establishment in Canada, the obligation to withhold still is applicable unless a waiver of such withholding is obtained from the tax authorities.

Where the non-resident files an income tax return either because it is carrying on business in Canada or is electing to file the return, the non-resident will be entitled to a refund of the income tax withheld to the extent that the actual liability is a lesser amount.

If an election is required, it must be filed within two years of the end of year in which the revenues were earned. Such an election would be filed where the combined federal and provincial income tax is less than the 25% withholding tax payable on the gross revenue. As a general rule, the non-resident will elect to file such a return since such deductions as capital cost allowance (or depletion and other allowances in respect of mining and oil and gas properties) and interest payable on monies borrowed to acquire the property would reduce the income tax rate on the profits to an amount less than the withholding tax.

7.3.4.6 Rents and Royalties

Canada further subjects to withholding tax payments for:

i. The use or right to use in Canada of any property, invention, trade-name, patent, trade-mark, design or model, plan, secret formula, process

ii. Information relating to industrial, commercial or scientific experience where the payment is dependent, in whole or in part, on the use made of the information, production or sales of goods or services, or profits.

Specifically excluded from withholding are:

i. Payments for the production or reproduction of a literary, dramatic, musical or artistic work (excluding films). This exemption provides that royalties for computer software generally are not subject to withholding tax.

ii. Payments made under a bona fide cost-sharing arrangement where the person making the payment shares on a reasonable basis with one or more non-residents research and development expenses in exchange for an interest in the property. This latter exemption is important as it permits payments for research and development to be free of withholding where, for example, the Canadian payer has rights to use the product in Canada without further royalty payment.

Most income tax conventions reduce the rate of withholding on such rent or royalty payments to 10%. In addition, a number of conventions exclude from withholding tax payments for use of patents or information concerning industrial, commercial or scientific experience. Sweden, Switzerland, the Netherlands, France and the United States are examples of countries to which exemption applies.

7.4 TRANSFER PRICING AND REPORTING REQUIREMENT

Transfer pricing issues often are a significant income tax issue facing a non-resident.

The Act contains rules that set out detailed reporting obligations with respect to transactions between a resident in Canada and non-resident persons who do not deal at arm's length with the Canadian resident. Prescribed forms must be filed with the Canadian tax authorities within the time limit that the taxpayer is required to file its income tax return with the Canadian tax authorities. These forms must summarize the various transactions between the parties, including those relating to licensing fees, royalties, management charges and the cost of goods acquired or sold.

The Act requires that contemporaneous documentation supporting the transfer pricing method used be made available to the tax authorities within three months of a request to provide such documentation. The documentation must provide a description of:

i. The property and services to which the transactions relate;

ii. The terms and conditions of the transactions and their relationship, if any, to any other transactions between the parties;

iii. The identity of the parties and their relationship to each other;

iv. Functions performed, risks assumed and property used in the transaction;

v. The data and methods considered, and analysis performed to determine either the transfer price, the allocation of profit and loss or allocation of costs; and

vi. All assumptions, strategies and policies that influenced the transfer price, allocation of profit or loss and/or allocation of costs, as the case may be.

The calculation of a transfer price must be based on an "arm's length transfer price ",that is the amount that would have been the transfer price if the participants had been dealing at arm's length. Similarly, all allocations must be made on an "arm's length allocation".

The Canada Revenue Agency (CRA) has issued guidelines in respect of its determination of what constitutes an appropriate transfer price. The guidelines adhere to the OECD model. In summary, it will use as a guideline prices or margins on similar transactions between arm's length persons. The CRA circular sets outs its analysis in some detail.

The Act provides for penalties where transfer pricing adjustments exceed certain thresholds and the taxpayer has not made reasonable efforts, including the providing of documentation, to support the transfer prices.

A taxpayer is entitled to request an advance pricing arrangement (APA) from CRA. If an APA is agreed to, then the transfer price set out in the APA will be that which is accepted by the CRA. The request will require the taxpayer to provide sufficient detail regarding the mechanism and basis for the transfer price. CRA will not necessarily agree with your submission. If the parties cannot come to a conclusion, the taxpayer may withdraw the APA filing.

7.5 SPECIAL TAX SITUATIONS

7.5.1 Interest Payable to Non-Residents

As a rule, the Act does not restrict the ability of a taxpayer to deduct in computing income interest expense based on debt/equity ratios. In addition, the Act does not deem debt to be equity or vice versa. Nevertheless, there is a limitation on the amount of interest that will be deductible when paid to non-residents who also have a significant shareholding in the Canadian debtor corporation. These rules are commonly referred to as "thin capitalization" rules.

These rules apply in respect of interest paid by a corporation to a non-resident shareholder which is a "specified shareholder". This term is defined to mean a non-resident person who owns 25% or more of a corporation's voting shares, or shares representing 25% or more of the fair market value of all shares of a corporation. Shares of such non-resident person and any person (resident in or out of Canada) that does not deal at arm's length with that person are aggregated to determine whether someone is a specified shareholder.

Interest on loans payable to a specified non-resident shareholder is not deductible in computing income to the extent that the average of the greatest amount of such loans in each month in a taxation year exceeds two times the aggregate of:

i. Retained earnings of the corporation at the beginning of the year computed on a non-consolidated basis. If the corporation has a deficit, the amount would be nil.

ii. The average of a corporation's contributed surplus at the beginning of each month of the taxation year contributed by the specified shareholder.

iii. The average of the paid-up capital at the beginning of each month of the taxation year allocable to the shares of a specified shareholder.

The Act contains specific avoidance rules which apply where a non-resident corporation provides monies to a third party (without regard to residency) who, in essence, uses those funds to lend to a Canadian corporation. That loan would become subject to the thin capitalization rules. This could apply to a situation where a non-resident provides funds to a third party financial institution which lends the funds to a Canadian subsidiary of the non-resident.

The Act does not contain any rules pertaining to the debt/equity ratio of a Canadian corporation where the debt is with arm's length borrowers. In theory, the only debt/equity limitations with respect to interest deductibility apply in respect of the debt of a corporation only owing to a specific non-resident shareholder, as described above. The rules technically apply to a loan made to a partnership even if all the partners are corporations.

The following structure technically would allow a non-resident to acquire a Canadian corporation and use this lacuna to reduce Canadian income tax owing on businesses carried on in Canada.

i. A non-resident corporation incorporates a subsidiary (NRCO) and provides between 75%-90% of the contribution with interest-bearing debt.

ii. NRCO incorporates Purchaseco with debt and equity.

iii. Prior to the acquisition, the Target transfers a business division to a partnership. The transfer can be undertaken without Canadian income tax.

iv. Purchaseco acquires all of the shares of the Target.

v. The Target winds up into Purchaseco and the partnership interest is increased to its fair market value.

vi. Purchaseco then sells the partnership interests to NRCO for fair market value reducing NRCO debt and equity in Purchaseco by an equivalent amount. No Canadian income tax would be payable.

vii. Although NRCO carries on business in Canada through the partnership and is liable for Canadian taxation in respect of the partnership profits, the interest expense payable by NRCO on the loan owing to its parent should be deductible in computing partnership profits. NRCO will be required to withhold in respect of the interest paid. If the asset(s) transferred to the partnership are patents, the profits realized by NRCO may not be subject to Canadian tax if the business is not carried on in Canada.

The thin capitalization rules do not apply where a loan is made to a partnership, even a partnership whose partners are Canadian corporations. Therefore, in theory, a non-resident can lend money to a partnership without being subject to the thin capitalization rules.

7.6 PURCHASE OF THE SHARES OF A CANADIAN CORPORATION

The acquisition of an existing business located in Canada generally is accomplished through the acquisition of shares of the corporation operating the business (the Target). And for reasons described below, the purchaser will often form a Canadian subsidiary (Purchaseco) to acquire the Target.

The Act allows a shareholder of a Canadian corporation to repatriate without Canadian income tax an amount equal to the paid-up capital (PUC) of the shares of the corporation. PUC is based on corporate capital as determined under the statutory laws of incorporation but is modified in limited circumstances. Where the purchase price for shares of the Target exceed the PUC, the incorporation of a Canadian parent to acquire the shares of the target is advantageous if only for this reason.

Assuming the PUC of a Target is $200 million and the purchase price of the shares is $1 billion. If the purchaser acquires the shares of the Target directly, the non-resident cannot repatriate more than $200 million without income tax payable on the excess, which excess is treated as a dividend for Canadian income tax purposes. Avoidance rules prevent a non-resident subsequently from transferring the shares to a non-arm's length Canadian corporation and increasing the PUC to the tax base. However, if Purchaseco incorporates a Canadian subsidiary to purchase the Target, the PUC of the shares of the Canadian subsidiary would be $1 billion and the non-resident could repatriate from Canada without income tax $1 billion and not $200 million.

A second advantage to incorporating a Canadian corporation to acquire the Target is that the Act permits the step-up in tax base of capital assets of the Target that are not depreciable property essentially equal to their fair market value at the time of the acquisition. This step-up requires that 90% of each class of shares of the Target be acquired by the purchaser with the remaining 10% owned by persons who are arm's length to the purchaser. Capital assets would include, for example, the land used in the business, shares of subsidiaries and interests in partnerships. This increase in tax base is created either by an amalgamation of Purchaseco and the Target or the winding-up of the Target into Purchaseco. Both the amalgamation and wind-up generally are tax-free reorganizations so long as both corporations are taxable Canadian corporations (i.e., they must be incorporated in Canada).

The Act contains a number of technical rules that prohibit the step-up described above. No step-up is permitted in respect of assets of the Target that subsequently are sold to former shareholders of the Target who owned collectively at least 10% of any class of the target. Furthermore, effectively no step-up is permitted where the shareholders of the Target receive as consideration shares of the purchaser that is not a public Canadian corporation.

Canada does not permit consolidation of income tax returns. Therefore, any interest expense incurred by Purchaseco on borrowings incurred to acquire the shares cannot be used to offset the profits of the Target unless the Target and the Purchaseco amalgamate or the Target winds up into the Purchaseco or wind-up, which would be a tax neutral transaction. Where the amalgamation or wind-up cannot be undertaken for business reasons, there is a mechanism that allows the debt incurred by the Purchaseco to be assumed by the Target thereby transferring the interest expense to the Target. A somewhat oversimplification of the structure has the Target borrowing funds equal to the Purchasco's debt, and using the funds to subscribe for dividend bearing preferred shares of the Purchaseco which uses the funds to retire its debt. Intercompany dividends are tax free so that the Target pays no income tax on the dividends and the Target is entitled to deduct in computing income the interest paid.

7.7 OTHER TAXES

7.7.1 Goods and Services Tax

Canada imposes a goods and services tax (GST) at a rate of 5%. This tax is similar to a value added tax. Most goods and services are subject to the GST. Those goods and services not subject to GST are described as "tax exempt" or "zero-rated". Goods and services not subject to GST include most groceries, lending activities, residential rent and the purchase of shares. Furthermore, goods and services provided for export are not subject to GST. A taxpayer who is required to collect GST must register under the legislation.

A business whose goods and services are subject to GST may claim a rebate of the GST paid by it (referred to as an input tax credit). In addition, the input tax credit also may be claimed where the goods and services are zero-rated. Groceries and exports are examples of zero-rated goods. The Maritime provinces, Quebec, Ontario and British Columbia have similar or identical systems to the GST. The combined GST and provincial tax generally, is called the HST (TVQ in Quebec).

The remaining Canadian provinces, with the exception of Alberta (which levies no sales tax), impose a sales tax that is a tax on the end user. As a general rule, goods used in the manufacture of a product for final consumption by a client are not subject to sales tax. Unlike the GST, sales tax is not a recoverable tax.

7.7.2 Employer Taxes

Employers are subject to tax in respect of unemployment insurance and contribute equally with the employees to the federal or Quebec pension plan systems. A number of provinces levy a health tax payable by employers on the salaries payable to employees in the particular province. The rate in Ontario is 1.95%. The rate in Quebec is 2.7% if salaries are less than $1 million, and increases to 4.26% once salaries exceed $5 million. Provinces also levy workman's compensation tax which tax rate depends on the type of business operated.

8. Securities

Raising money in Canada is governed by the separate set of securities laws of each of Canada's 13 provinces and territories. The provinces of Ontario, Quebec, British Columbia and Alberta represent the four largest capital markets in Canada. Though provincial and territorial securities laws are based on similar principles and objectives, and in many areas are substantively similar, not all of them are identical.

Recognizing the difficulties inherent in this fragmented regulatory structure, the Canadian Securities Administrators (CSA) was created as a forum for Canada's provincial and territorial regulators to improve regulation of Canadian capital markets. The CSA has undertaken several significant initiatives to harmonize securities laws and administration of those laws across Canada including, the implementation of a significant number of "National Instruments" that attempt to provide more seamless access to the Canadian capital markets. These national instruments cover key areas such as prospectus requirements, prospectus exempt distributions, continuous disclosure obligations, mutual fund regulation, take-over bids, exemption applications, dealer registration issues and marketplace operations. Members of the CSA, other than Ontario, have adopted a "passport system" for dealing with one principal regulator for certain securities filings and regulatory issues.

Recently, the federal government and certain provincial governments have been in continuing discussions to replace the current regime with a single federal securities regulator supported by a national statutory and regulatory regime. This proposal has been, and will continue to be, challenged constitutionally by some provinces.

8.1 OVERVIEW

Canadian securities laws regulate the trade of securities in the public and private sectors of the marketplace. A "trade" is defined broadly to include any sale or disposition of securities for valuable consideration and any act in furtherance of a trade, such as advertising. Therefore, a trade includes a company issuing shares to raise capital or making an offer to sell shares. All trading of securities in Canada is regulated. A trade must either comply with the prescribed rules and regulations or there must be a basis within the statutory framework that permits the trade to be "exempt" from the prescribed rules and regulations. A "security" is also broadly defined. Canadian securities laws provide a non-exhaustive list of different types of instruments that may be construed as securities (for example, stocks, bonds, investment contracts, income or annuity contracts, etc.). The test used to determine whether or not any particular instrument is a security is generally as follows:

i. Is there is an investment of money/assets?

ii. Is there an expectation of profit?

iii. Will the profit result solely from the efforts of others?

The two fundamental tools of Canadian securities laws regulating the sale of securities are the "registration" requirement and the "prospectus" requirement. Any person or company engaging in or holding himself, herself or itself out as engaging in the business of trading in, or advising with respect to, securities in a province or territory must be registered with the applicable securities regulator, unless an exemption is available. The prospectus requirement refers to the rules that require certain kinds of trades – distributions – to be undertaken only if the seller (or issuer) prepares, files and delivers a prospectus to purchasers. Prospectus exemptions are also available.

8.2 RAISING MONEY IN CANADA

There are two forums in which to raise money in Canada. One is the public or regulated market and the other is the private or exempt market. Because Ontario constitutes Canada's largest capital market, most financings will involve Ontario investors.

8.2.1 The Public Market

Canadian securities laws governing the distribution of securities in the public marketplace are designed to protect investors by requiring that issuers of securities provide extensive disclosure of their business to prospective investors. This disclosure obligation is satisfied by the issuer delivering a prospectus to a prospective investor. There are two types of prospectuses in Canada, short form and long form. A short form prospectus is a document which includes a description of the securities being distributed

and how the proceeds will be used. Most of the other information about the business and financial situation of the issuer is incorporated by reference from the continuous disclosure documents previously filed by the issuer. A long form prospectus is a lengthy, detailed disclosure document containing information about the issuer. Generally, companies making their initial public offering in Canada and smaller issuers who have not filed an annual information form, and/or whose securities are not listed on a prescribed stock exchange, must use a long form prospectus. Most other issuers are able to use the short form prospectus. In each case, the prospectus and, if applicable, the documents incorporated by reference, are required to provide "full, true and plain disclosure" of all material facts relating to the securities offered by the document. The purpose of the prospectus and, if applicable, the documents incorporated by reference, is to provide prospective investors with all the information they need to make informed investment decisions. There is statutory liability imposed on an issuer, certain of its officers and its board of directors (as well as on securities dealers and certain experts) for inaccurate or incomplete information. Assembling a prospectus is an expensive undertaking and should only be considered when raising a large amount of money. Expenses include the cost of hiring lawyers, securities dealers, accountants and sometimes experts in other fields such as engineers, geoscientists or appraisers; the cost of any promotional touring (i.e., "roadshows") with securities dealers to sell the offering; the cost of printing the prospectus; the cost of translating the prospectus into French if the offering is to be made into Quebec; and, the regulatory fees associated with filing the prospectus. Once shares have been issued pursuant to a prospectus, the shares are considered "freely tradable" meaning that there is generally no restriction on further trading of those securities. However, the dealer regulation requirements continue to apply to subsequent trades.The issuer of the prospectus will become thereafter a "reporting" issuer and will be required to abide by the continuous disclosure rules mandated by the securities regulators. In the event the issuer fails to abide by these rules, the securities regulators may impose sanctions on the issuer, including suspending the issuer's shares from trading. US issuers who meet certain qualification criteria may be able to take advantage of the multijurisdictional disclosure system that allows them to offer securities in Canada in accordance with US securities laws supplemented by additional Canadian disclosure requirements.

8.2.2 The Exempt Market

The rules applicable to prospectus exempt distributions in Canada have generally been harmonized. Canadian securities laws provide a number of exemptions from the prospectus requirements. The most commonly used exemptions can be grouped into exemptions based on:

i. The nature of the security being traded; or

ii. The identity of the person acquiring the securities.

For example, with respect to the former exemption, bonds issued by the Canadian federal government or by a provincial government may be sold free of the prospectus requirement on the basis that this type of security is considered so inherently safe that the protection afforded by a prospectus is unnecessary.

In connection with the "identity of the person," if the buyer is an "accredited investor", the issuer does not need to deliver a prospectus as the legislation deems the accredited investor able to protect its own interests. Generally speaking, accredited investors are purchasers who are sophisticated or are deemed to be sophisticated because of certain characteristics they possess. An issuer may lawfully distribute securities to this group without the need for preparing and delivering a prospectus. This group of accredited investors includes certain designated institutions (banks, credit unions, trust or loan corporations), governments and persons who meet certain specified income or asset thresholds or persons who have applied to the securities regulators for and have been granted accredited investor status. Another frequently used exemption is based on the aggregate purchase price paid by the investor. This exemption is available if, among other things, the investor is purchasing securities having an acquisition cost of at least $150,000. In addition to the above, the other key prospectus exemption employed by issuers in Canada is the "private issuer exemption". This exemption attempts to address the practical need of small enterprises to raise capital in a cost-efficient manner. Generally, the exemption is available to any issuer who wishes to issue shares to specified investors if the issuer has fewer than 50 security holders (with certain exceptions), the shares of the issuer are subject to restrictions on transfer contained in its constating documents or security

holders' agreements and its shares have only been issued to certain classes of persons. Shares that are issued in the exempt market are not ordinarily "freely tradable" unless other conditions have been satisfied. This may require that shares be held for a specified period of time.

8.3 CONTINUOUS DISCLOSURE

Once an issuer becomes a "reporting issuer," Canadian securities laws require those reporting issuers to comply with rules relating to two basic types of continuous disclosure obligations:

i. Regular or periodic disclosure of, among other things, annual and quarterly financial statements, an annual information form (for certain issuers, which describes the business of the issuer) and information circulars in connection with soliciting proxies for shareholders' meetings; and

ii. Timely disclosure of material business developments when they occur.

The Canadian continuous disclosure regime is similar in many respects to the regime in place in the United States. Certain foreign issuers that have become reporting issuers in Canada (e.g. by listing on a stock exchange in Canada) may file their own foreign jurisdiction documents to generally satisfy these requirements. Securities legislation also imposes civil liability for continuous disclosure misrepresentations or failure to make timely disclosure.

8.4 TAKE-OVER AND ISSUER BIDS

As Canadian securities laws require issuers of securities to abide by a strict code of rules in the interests of investors, the law also governs the activities of certain purchasers of securities. Two cases of regulatory concern are in the case where:

i. One company seeks to acquire control of another by purchasing a significant block of shares (a take-over bid); and

ii. A company wishes to repurchase some of its own outstanding shares from its existing shareholders (an issuer bid).

Canadian securities laws aim to protect the interests of the shareholder of the company that is the target of a take-over or issuer bid. Generally, the rules attempt to ensure that such shareholders receive adequate time, adequate information and equal treatment from any bidder.

Under the "early warning system", investors must disclose acquisitions of beneficial ownership of, or control or direction over, 10% or more of the voting or equity securities of any class of a reporting issuer (along with securities convertible into such securities). In this way, the market is advised of accumulations of significant blocks of securities that may influence control of a reporting issuer, which may then signal that a take-over bid is imminent or, at least, advise the market of a significant reduction in the public float.

A take-over bid is generally defined as an offer to acquire outstanding voting or equity securities of a class made to any person or company where the securities subject to the offer to acquire, together with the offeror's securities, constitute in the aggregate 20% or more of the outstanding securities of that class of securities at the date of the offer to acquire. The definition is broad and the sub-set of rules which underlie it is complex. Those rules address bids made jointly or in concert with others, direct and indirect acquisitions of the subject security, and historical acquisitions made immediately prior to the formal bid. A detailed discussion of these rules in either the context of a take-over or issuer bid and the exemptions which may be available is beyond the scope of this publication.In general, Canadian securities laws require a person who is making a take-over bid to prepare, file and deliver a take-over bid circular. This document contains the offer to acquire the shares of the target company and certain prescribed information. If the purchase price for the target shares is payable in whole or in part in securities, then the take-over bid circular will generally be required to contain information similar to a prospectus, providing disclosure about the offeror's business and financial condition. The directors of the target company are required to prepare, file and deliver a directors' circular containing their recommendation and certain other prescribed information. A formal issuer bid is subject to similar, and often, additional disclosure requirements.

8.5 CORPORATE GOVERNANCE

Canadian jurisdictions have supplemented their existing Canadian corporate governance standards with some of the corporate governance aspects reflected in the *United States Sarbanes–Oxley Act* of 2002 and related United States Securities Exchange Commission rules. The Canadian regulators have published a non-mandatory list of corporate governance guidelines. Companies are required to disclose their corporate governance practices and how they differ from the published guidelines. Generally, all members of an audit committee of a reporting issuer in Canada must be independent. "Venture issuers" are not subject to this independent audit committee requirement, but most likely be required to have a majority of members who are independent. The chief executive officer and chief financial officer of a reporting issuer are required to certify its interim and annual filings, including financial statements and other disclosure documents, and to certify certain internal controls over financial reporting (ICFR) and disclosure controls and procedures (DC&P). Subject to certain conditions, US and other foreign issuers are exempt from these Canadian certification requirements. Venture issuers can file a modified form of certificate that does not include representations relating to ICFR and DC&P.

Pressure from increased shareholder activism in Canada, along with recent changes in US corporate governance regulation, have encouraged some public companies to adopt higher corporate governance standards, such as allowing (non-binding) "say on pay" shareholder voting regarding executive compensation and providing for individual rather than "slate" voting of directors. The Ontario Securities Commission has recently requested comments on these and other related shareholder democracy issues.

8.6 STOCK EXCHANGES

TMX Group Inc. owns and operates the Toronto Stock Exchange (exchange for senior issuers), the TSX Venture Exchange (public venture equity marketplace) and the Montreal Exchange (financial derivatives exchange). The TMX Group's equity exchanges are the eighth largest exchange group in the world by market capitalization. As of December 31, 2010, there were 1,516 companies listed on the Toronto Stock Exchange and 2,376 companies listed on the TSX Venture Exchange.

The Canadian National Stock Exchange is a relatively new stock exchange which serves as an alternative market for trading in equity securities of small cap companies.

There are also several alternative trading systems (ATSs) which have been launched in recent years to compete with TMX Group Inc. for trades in Canadian listed securities. ATSs are not regulated as stock exchanges but match buyers and sellers on a different electronic trading platform with lower transaction costs.

CANADA

Calgary
215 - 9th Avenue SW, Suite 1900
Calgary, Alberta T2P 1K3
T +1 403 232.8223 • F +1 403 234.7987

Montreal
1250 René-Lévesque Blvd. West, Suite 2500
Montreal, Quebec H3B 4Y1
T +1 514 846.1212 • F +1 514 846.3427

Ottawa
55 Metcalfe Street, Suite 300
Ottawa, Ontario K1P 6L5
T +1 613 236.1668 • F +1 613 236.9632

Québec
900, boul. René-Lévesque Est, bureau 600
Québec (Québec) G1R 2B5
T +1 418 524.5131 • F +1 418 524.1717

Sherbrooke
455, rue King Ouest, bureau 210
Sherbrooke (Québec) J1H 6E9
T +1 819 346.5058 • F +1 819 346.5007

Toronto
Bay Adelaide Centre, P.O. Box 2900
333 Bay Street, Suite 2900
Toronto, Ontario M5H 2T4
T +1 416 360.6336 • F +1 416 360.8425

Trois-Rivières
1500, rue Royale, bureau 360
Trois-Rivières (Québec) G9A 6E6
T +1 819 373.7000 • F +1 819 373.0943

Vancouver
1055 West Hastings Street, Suite 2200
Vancouver, British Columbia V6E 2E9
T +1 604 669.0011 • F +1 604 669.5101

Victoria
1005 Langley Street, 3rd Floor
Victoria, British Columbia V8W 1V7
T +1 250 381.9321 • F +1 250 381.7023

INTERNATIONAL

Paris
7, place d'Iéna
75116 Paris, France
T +33 (0)1 40 69 26 50 • F +33 (0)1 40 69 26 99

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