7. Taxation

Certain federal and provincial tax considerations are relevant when one is conducting business in Canada. While Canadian residents are subject to tax on worldwide income, non- residents are generally taxed on their sources of income within the country.

A non-resident is generally subject to taxation on Canadian-source income, such as:

- Income from a business carried on in Canada
- Income from an office or employment in Canada
- Capital gains on the disposition of property, known as "taxable Canadian property"
- Income of a passive nature received from Canadian residents (e.g., dividends, rent, royalties)

Taxable Canadian property includes:

- Real property situated in Canada
- Assets used in a business carried on in Canada
- A share of a private corporation resident in Canada where more than 50% of the fair market value of the share is derived (or was derived at any time in the previous 60-month period) from real property in Canada, Canadian resource properties, timber resource properties, or options in respect of any such property
- A share of a public corporation (or mutual fund trust) where at any time in the previous 60-month period (a) the holder held more than 25% of the issued shares and (b) more than 50% of the fair market value of the share (or unit) was derived from real property in Canada, Canadian resource properties, or timber resource properties
- Options in respect of any of the properties listed above
- Property deemed by the Income Tax Act (ITA) to be taxable Canadian property

Much of the tax payable by non-residents is collected through Canadian withholding taxes.

Generally accepted accounting principles, subject to certain statutory modifications, are typically used to calculate the income upon which tax is levied. Federal income taxation is governed by the ITA, while the provinces also impose their own income taxes.

Types of Income

Both income and capital gains are taxable in Canada. All business, property, and employment income, whether active or passive, falls within the scope of Canadian taxation. Fifty per cent of capital gains are included in income, and, accordingly, only 50% of capital losses may be offset. Capital losses can only be offset against capital gains.

Taxation of Individuals

Like corporations, individuals are taxed on the basis of their residency. Residency for individuals is determined on the basis of a person's center of vital interest, such as the location of the family home, property, and place of employment. An individual who sojourns in Canada for 183 days or more during a year will be deemed a resident of Canada for

that entire year. Both federal and provincial income taxes are imposed upon individuals at graduated rates, and the rate brackets are indexed for inflation.

The federal tax rates for the year 2021 for an individual are as follows:

Taxable Income	Marginal Tax Rate
Up to $49,020	15%
$49,020 to $98,040	20.5%
$98,040 to $151,978	26%
$151,978 to $216,511	29%
Over $216,511	33%

The combined federal and provincial top marginal tax rates on ordinary income for individuals vary from 44.5% (Nunavut) to 54% (Nova Scotia).

Non-residents are taxed on their Canadian-source income, whether from employment, business, capital gains, or passive sources. Various treaties apply to reduce the amount of Canadian withholding tax on certain types of passive income. Individuals who carry on a business, either as a sole proprietor or through a partnership, must calculate income according to statutorily amended and accepted accounting principles that are in accordance with commercial practice. Individuals must calculate their tax liability on a yearly basis.

Taxation of Corporations

Corporate

The federal and provincial corporate tax rates vary, depending on the industry and type of corporation involved. Federal income taxation is levied on resident corporations on their worldwide income.

For 2021, the combined federal and Québec/Ontario rate for non-Canadian-controlled private corporations is 26.5% for active business income. Separate rates exist for general active business income, manufacturing and processing income, and investment income and for Canadian-controlled private corporations. A non-resident corporation pays tax on income earned in Canada, subject to certain tax treaty concessions.

The following tables present a snapshot of the applicable tax rates for 2021:

(a) *Combined Federal and Provincial Income Tax Rates for Income Earned by a Canadian-Controlled Private Corporation (CCPC)*

Jurisdiction	Small Business Income up to $500,000	General Active Business Income	Investment Income
Quebec	12.2%	26.5%	50.2%
Ontario	12.2%	26.5%	50.2%
Alberta	11%	23%	46.7%
British Columbia	11%	27%	50.7%

(b) *Combined Federal and Provincial Income Tax Rates for Income Earned by a Corporation other than a CCPC*

Jurisdiction	General Active Business Income	Investment Income
Quebec	26.5%	26.5%
Ontario	26.5%	26.5%
Alberta	23%	23%
British Columbia	27%	27%

An abatement is allowed against federal tax in an amount equal to 10% of the corporation's taxable income earned in Canadian provinces. This abatement is intended to partially compensate for the provincial tax burden. Generally, under various treaties, the profits attributable to the branch of a non-resident corporation are determined as if the branch were a separate and distinct person dealing independently with the non-resident corporation (see also the commentary below, under "Branch Tax").

Provincial taxes vary from 8% to 16% (again for general active business income) and are only applicable if a corporation has a permanent establishment in that province. Where a corporation has business income attributable to permanent establishments in more than one province, such income is shared across all locations and is subject to taxation in each of the provinces in which they operate.

In 2021, the combined standard federal-provincial corporate income tax rates on taxable income ranges from 23% to 31% on general active business income for non-CCPCs.

Determination of Residence

A corporation incorporated in Canada after April 26, 1965, is deemed to be resident in Canada. A non-resident corporation may be considered to be resident in Canada if its central management and control is in Canada.

Capital Taxes

All provinces have eliminated the general capital tax on corporations with a permanent establishment in the province. However, the federal government and certain provinces continue to levy capital tax on financial institutions.

Corporate Minimum Tax

The province of Ontario also imposes a corporate minimum tax (CMT) on corporations. For taxation years ending after June 30, 2010, the CMT rate is 2.7% and only applies to corporations with total assets that equal or exceed $50 million and annual gross revenues that equal or exceed $100 million.

Corporations in an associated group must aggregate their revenues and assets to determine if they are subject to this tax. The CMT is applied against income allocated to Ontario. This tax will be payable in a year only to the extent that it exceeds regular Ontario corporate income tax. The CMT paid may be carried forward for 20 years and used to reduce regular Ontario corporate income tax provided that the crediting mechanism does not result in an Ontario corporate tax liability below the level of the CMT for the year. Currently, Ontario is the only Canadian jurisdiction that imposes such a tax.

Start-up Losses

Start-up losses incurred by either a branch or a subsidiary may generally be carried forward for Canadian income tax purposes for 20 years and deducted from taxable income earned in Canada. There is no statutory authority to permit the consolidation of income or losses of corporations in related groups. In the 2010 federal budget, the Canadian government made a commitment to explore new rules for the taxation of corporate groups, such as the introduction of a formal system of loss transfers or consolidated reporting.

Tax Treaties

Canada has an extensive network of international tax treaties, including comprehensive treaties with the United States and most of its other major trading partners. Canada generally follows the OECD Model Tax Convention for the avoidance of double taxation when negotiating its tax treaties. These treaties generally reduce the rates of withholding taxes applicable to various types of income and contain other provisions that impact the tax treatment of non-residents' Canadian-source income.

The statutory withholding rate in Canada is 25%, which may be lowered pursuant to the applicable treaty. Withholding taxes apply to various sources of income paid to non-residents, including certain interest (generally only the interest paid to related parties or "participating interest"), rent, royalties, and dividends, and reflect the source country's right to be first in taxing a stream of income.

The Canada–United States tax treaty eliminated source-country withholding tax on most cross-border interest payments, subject to certain exceptions.

In addition to tax treaties, as of August 2, 2019, Canada has ratified the Multilateral Convention on the Implementation of Tax Treaty Measures to Prevent Base Erosion and Profit Shifting (the "Multilateral Instrument" or "MI"). The MI is a multilateral treaty resulting from the collaboration between the G7 countries and the OECD which, among other things, allows for the implementation of several tax treaty measures designed to reduce the opportunities for tax avoidance by multinational enterprises. These various measures may affect cross-border taxation between Canada and other countries.

Death Taxes

Neither the federal government nor any provincial government currently impose succession duties or estate or gift taxes. Instead, at death, individuals are usually subject to federal and provincial income taxation on accrued but unrealized income and capital gains and on income received in the taxation year prior to their date of death. Probate fees may be levied by certain provinces where letters of probate are required to administer an estate. These fees vary by province.

Branch Tax

The purpose of the branch tax is to achieve tax neutrality when one is carrying on business in Canada through a branch or a subsidiary. To the extent that branch profits are repatriated, they are subject to a tax comparable to the dividend withholding rate under the applicable treaty. Relief from Canadian branch tax is available under the *Canada–United States Tax Convention Act*, which provides an exemption on the first $500,000 of after-tax repatriated income of the branch that is attributable to a permanent establishment in Canada.

Thin Capitalization Rules

Generally, interest paid by a corporation is a deductible expense. However, the thin capitalization rules impose a limit on the amount of interest paid to certain non-residents that may be deducted from the income of a Canadian corporation. The acceptable ratio of debt to equity is 1.5 to 1. If the average amount of a subsidiary's outstanding debt exceeds one and a half times its equity, a prorated portion of the interest paid or payable in the year to certain non-residents may not be deducted from the income of the Canadian corporation subsidiary.

Partnerships

A partnership itself is not a taxable entity but is, rather, a flow-through entity for the purpose of calculating income. Each partner is taxed directly on a share of the income of the partnership, generally as allocated by the partnership agreement.

Foreign Tax Credits

To alleviate the effect of double taxation, Canada provides a foreign tax credit mechanism that allows resident taxpayers to claim a credit for the amount of foreign taxes paid on foreign-source income. The credit allowed is generally the amount of tax actually paid (up to the amount of Canadian tax payable on the foreign-source income) and is available as a reduction of Canadian tax.

Dividends from Non-Resident Corporations

Dividends received by corporations from corporations residing in countries with which Canada has entered into a comprehensive tax treaty or a tax information exchange agreement may be exempt from Canadian tax. In such a case, no foreign tax credits are allowed.

Canada has concluded tax information exchange agreements with 24 states and territories, including the Netherlands, Antilles, Bermuda, Bahamas, Cayman Islands, Guernsey, Jersey, and the Isle of Man, and is currently negotiating with five other countries, including Belize, Gibraltar, and Vanuatu. An agreement with Antigua and Barbuda has been signed but is not in force.

Canada has also ratified the OECD Convention on Mutual Administrative Assistance in Tax Matters, which has over 60 signatories and came into force on March 1, 2014.

Tax Incentives: Scientific Research and Experimental Development

Both federal and Québec legislation provide scientific research and experimental development (R&D) incentives through deductions in net income, and investment tax credits (ITCs) can also be obtained (as mentioned later, Québec ITCs are always fully refundable).

A pooling concept is used to record R&D expenditures for tax purposes. In very general terms, the pool is increased by expenditures (current) made and reduced by government and non-government assistance and contract payments that the taxpayer is entitled to receive. Pursuant to this pooling concept, expenditures are not required to be deducted in the year they are incurred and may effectively be carried forward indefinitely.

Federal R&D Incentives

The most significant R&D benefits are available in the form of ITCs, which are computed on qualifying R&D expenditures at rates varying from 15% to 35% depending on, among other things, the status of the corporation.

Where a corporation is throughout a given year a CCPC whose taxable income for the preceding year and taxable capital (both determined on a basis including associated corporations) does not exceed certain limits, an ITC at the rate of 35% is available on the first $3 million of yearly R&D expenditures. This 35% ITC is 100% refundable on qualified R&D expenditures. The limit must be shared by associated corporations. A CCPC can also earn a non-refundable ITC at the rate of 15% on an amount over the $3 million threshold. A CCPC that meets the definition of a qualifying corporation can earn a refundable ITC at the rate of 15% on an amount over the $3 million threshold, of which 40% can be refunded.

For other corporations, individuals, and unincorporated businesses, the ITC rate on R&D expenditures is 15% and may be claimed against payable federal income tax.

The three main components of the incentives in Canada relating to R&D can be summarized as follows:

- The ability to claim a deduction in income for current expenditures incurred during the year
- The ability to claim, in addition to the deduction in income, a tax credit in respect of most R&D expenditures
- A taxpayer entitlement to include, as part of one's R&D expenditures, an amount equal to 55% of R&D salaries

The following table shows an example of the federal incentives on R&D expenditures of $5 million:

	Small Canadian-controlled Private Corporations				Large Canadian or Foreign controlled Corporations			
	Credit Rate	% Refund	Refundable Tax Credit (Cash Back)	Non-Refundable Tax Credit (Reduce Taxes)	Credit Rate	% Refund	Refundable Tax Credit (Cash Back)	Non-Refundable Tax Credit (Reduce Taxes)
First $3 million in SR&ED expenditures	35%	100%	$1,050,000	-	15%	-	-	$450,000
Remaining $2 million in SR&ED expenditures	15%	40%	$120,000	$180,000	15%	-	-	$300,000
Total			**$1,170,000**	**$180,000**			-	**$750,000**

Provincial R&D Incentives

In addition to the federal R&D incentives, most provinces provide additional tax incentives for taxpayers that undertake R&D within their borders.

The provincial rules for deductibility of expenses are generally the same as the federal rules. The main differences concern the availability of tax credits, the applicable rates, the payments on which the credits are based, and the taxpayer's eligibility for a refund (i.e., any credit not used to offset tax payable is paid to the taxpayer). Québec R&D tax credits are always refundable.

The following table summarizes certain provincial incentives:

	Quebec	Ontario	Alberta	British Columbia
Base	**R&D Salaries**	**R&D Expenditures**	**SR&ED Expenditures**	**R&D Expenditures**
Credit Rate:				
CCPC	30%	3.5%	20%	10%
Non-CCPC	14%	3.5%	20%	10%
Refundable:				
CCPC	Yes	No	Yes	Yes
Non-CCPC	Yes	No	Yes	No

Goods and Services Tax/Harmonized Sales Tax

The Canadian Goods and Services Tax (GST)/Harmonized Sales Tax (HST) is a value-added tax that is levied on the supply of most property or services at each stage in the production and distribution chain. Although the GST/HST is a multi-stage tax imposed on purchasers of taxable property or services at all levels of the production and distribution chain, the ultimate tax liability is intended to be borne entirely by the final consumer. To achieve this result, businesses that purchase taxable property or services that are consumed, used, or supplied in the course of their commercial activities are generally permitted to claim a refund of the GST/HST they paid on the property or services they consume. This credit, referred to as an “input tax credit,” is available to qualifying GST/HST registrants (those persons either required to register or those who have registered voluntarily). The ultimate consumers of the property or services are not entitled to claim input tax credits and, accordingly, must bear the full GST/HST liability. The application of the GST/HST can be contrasted with the single- stage provincial retail sales taxes (as described below in the section entitled “Provincial Sales Taxes”) that are levied only at one stage in the production/distribution chain (generally at the retail level).

The federal GST is levied at a rate of 5% in those provinces and territories that either do not have a provincial sales tax or have not fully harmonized their sales tax with the federal GST. These provinces and territories are British Columbia, Alberta, Manitoba, Saskatchewan, Québec, Yukon, Northwest Territories, and Nunavut. The remaining Canadian provinces are referred to as “participating provinces” as each has entered into an agreement with the federal government regarding the harmonization of its provincial sales tax with the federal GST. Pursuant to these agreements, the Canada Revenue Agency (CRA) collects the HST at the rate of 13% in Ontario and 15% in the remaining participating provinces (i.e., 5% federal GST harmonized with an 8% or 10% provincial tax component).

The GST/HST is levied on nearly all supplies of property and services that are either made or deemed to be made in Canada. The limited categories of supplies on which the GST/HST is not levied are either referred to as “exempt” or “zero-rated.” The principal distinction between zero-rated supplies and exempt supplies relates to the availability of input tax credits.

Persons supplying zero-rated supplies (supplies that are taxable at a rate of 0%) are generally entitled to recover the GST/HST incurred to make those supplies through a claim for input tax credits. The zero-rating mechanism ensures that no GST/HST is collected from the final purchaser of the property or services or embedded in the cost of the property or service.

Some of the more common examples of zero-rated supplies are certain medical and health-related property and basic groceries and goods exported from Canada for supply, use, or consumption outside of Canada.

Persons making only exempt supplies (supplies that are not subject to the GST/HST) are generally not entitled to recover the GST/HST incurred to make them (though, in certain limited circumstances, a partial rebate of the GST/HST may be available). Accordingly, some of the GST/HST expense will ultimately be embedded in the cost of any exempt property or service. The most common example of such a supply is that of financial services (which includes insurance).

The GST/HST is automatically levied on tangible property that is imported into Canada. This tax is generally paid by the importer on record at the time of importation. The GST/HST is also levied on intangible property or services that are considered to be supplied outside of Canada and then used in the country. Where such a property or service is used in Canada, the business importing such a property or service is generally required to self-assess the GST/HST, although broad exemptions from this self-assessment also exist.

Registration and Reporting

Businesses that are registered for GST/HST purposes are required to charge, collect, and remit the GST/HST in respect of any taxable supplies made or deemed to be made in Canada. All resident and non-resident businesses that make taxable supplies in Canada (exceeding $30,000 in the last four consecutive calendar quarters) in the course of a business carried on in Canada must register for GST/HST purposes. Non-residents making taxable supplies in Canada but not carrying on business in the country are permitted to register voluntarily for the GST/HST.

Only those businesses that are either required to register or those that register voluntarily can claim input tax credits in respect of the GST/HST they pay. This ability to claim input tax credits prompts many non-residents to register voluntarily, particularly those that import tangible property into Canada and are assessed GST upon import.

GST/HST registrants are required to file tax returns with the CRA on a regular basis. In those returns, registrants are required to report the amounts of the GST/HST that they have collected (or are deemed to have collected) from their customers during the applicable reporting period. Registrants may also claim input tax credits for the GST/HST expenses they incurred during that same period. Where the amounts claimed as input tax credits exceed the amounts collected (or deemed collected), the registrant is entitled to receive a net refund from the CRA. Where the amounts collected (or deemed collected) exceed the amounts claimed as input tax credits, the registrant must make a corresponding payment to the CRA.

New rules were recently introduced to require certain non-resident vendors and distribution platform operators who sell taxable digital products or services to Canadian consumers or Canadian entities that are not registered for GST/HST purposes to register under the GST/HST regime. Such vendors and operators are required to collect GST/HST on certain taxable supplies made in Canada despite the fact that they would otherwise not be considered to be carrying on business in Canada.

Provincial Sales Taxes

All Canadian provinces, with the exception of Alberta, levy a provincial sales tax, either independently or in conjunction with the federal GST. The rates of provincial sales tax range from 5% to 10%. Like Alberta, none of the three Canadian territories (Yukon, Northwest Territories, and Nunavut) levy any sales tax other than the federal GST (at a rate of 5%).

The provinces of New Brunswick, Nova Scotia, Newfoundland and Labrador, Ontario, and Prince Edward Island do not directly levy a provincial sales tax. Instead, each of these provinces has entered into an agreement with the federal government that results in the CRA collecting the provincial tax as a component of the HST.

Businesses that make taxable supplies that are not zero-rated in both HST and non-HST provinces must determine whether they are required to collect tax at the 5% GST rate or the 13% or 15% HST rate. Determining the correct GST/HST rate depends on the application of complex place of supply rules that are contained in the relevant Canadian tax legislation. Failure to collect the provincial portion of the HST where applicable creates exposure to a potential assessment for uncollected tax, non-deductible interest, and penalties.

Because the GST/HST is governed by Canadian federal legislation, any business registered for GST purposes, regardless of where it is located, will be required to charge and collect the HST at the above rates on property and services supplied to customers in HST provinces. The HST is reported and remitted on ordinary GST returns.

Ontario

While the HST is generally subject to the same rules as the GST, there are some province-specific rules, such as point-of-sale rebates for a limited range of consumer products.

In addition, Ontario maintains a separate retail sales tax (levied at a rate of 8%) that remains applicable to insurance products and benefit plans and a separate taxation system that is relevant to fuel, tobacco, and a limited set of other products. Where a business supplies (or is deemed to supply) such taxable products, it will be required to register under a provincial tax regime that is separate from its GST/HST registration.

Quebec

The applicability of the Québec Sales Tax (QST) is governed by the Act Respecting the Québec Sales Tax. Because this tax is based upon the federal GST, it is very similar in its structure and applicability. The QST applies to most property and services that are considered to be supplied in Québec. Similarly, the QST applies to certain importations into Québec. To the extent that a QST-registered business incurs QST expenses to make a subsequent taxable supply of property or services, the business is entitled to claim an input tax refund (which is analogous to the GST input tax credit).

A recent particularity of the QST regime is to bring within the scope of provincial sales taxes certain supplies made by suppliers outside Québec and certain operators of digital platforms providing digital services to Quebec consumers. Such entities are now required to register for the QST in addition to collect and remit the tax on certain taxable supplies made in Québec to government authorities.

The QST is levied at the rate of 9.975%.

British Columbia, Saskatchewan, and Manitoba

British Columbia, Saskatchewan, and Manitoba levy their own retail sales tax. These taxes are separate from the GST/HST. However, each of these taxes is levied in a similar manner and only at one stage in the production/distribution chain (generally at the retail level).

Such retail sales taxes apply to most transfers of tangible personal property and software but are only applicable to certain specifically enumerated services. The most commonly taxed services are telecommunications services and services relating to the repair or installation of tangible personal property and accommodation (hotel) services. Retail sales tax is not applicable to the transfer of real property or related fixtures, as the transfer of such property is generally taxed through separate provincial tax legislation.

Businesses that provide either taxable goods or services in the course of a business carried on in British Columbia, Saskatchewan, or Manitoba, or businesses that are resident in Canada and sell property to British Columbia, Saskatchewan or Manitoba, are generally required to register for retail sales tax purposes and charge, collect, and remit retail sales tax on any taxable sale. More recently, these provinces have introduced rules similar to those implemented in Québec seeking to impose retail sales tax registration and collection obligations on certain out-of-province vendors.

Unlike legislation for the GST/HST and QST, retail sales tax legislation does not permit input tax credits claims or allow for a similar tax refund mechanism. To avoid the cascading of retail sales tax, taxable property intended for resale (e.g., raw materials or inventory) is generally exempt from retail sales tax. In addition, exemptions are generally provided for production machinery or equipment purchased by a manufacturer. As a matter of public policy, certain tangible personal property is also exempt from retail sales tax – even when provided to an end user. The most common examples are grocery items, children’s clothing, and certain educational materials.

The general rates of retail sales tax are 7% in British Columbia, 6% in Saskatchewan, and 7% in Manitoba.