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# Canada

**Last Reviewed - 16 June 2019**

## Overview

Canada is the largest country in the western hemisphere and one of the largest in the world. Located in the northern part of North America, Canada extends from the Atlantic Ocean in the east to the Pacific Ocean in the west, and northward into the Arctic Ocean. It has a stable government, a skilled workforce, and its residents enjoy a high standard of living. The country has a well-developed transportation system and is rich in natural resources. Canada's official languages are English and French, and Ottawa is its federal capital. A parliamentary democracy, the country is divided into ten provinces and three territories. The official currency is the Canadian dollar (CAD).

Canada has a thriving free-market economy, with businesses ranging from small owner-managed enterprises to multinational corporations. Canada's economic development was historically based on the export of agricultural staples, especially grain, and on the production and export of natural resource products, such as minerals, oil and gas, and forest products. However, secondary industry has evolved to the stage where Canada ranks as one of the top manufacturing nations of the world. The service industry has also expanded rapidly and has transformed the Canadian economy from one based primarily on manufacturing to one with a significant service-based sector. Canada is among the world's major trading nations, with the United States (US) its primary trading partner.

Despite Canada’s abundant natural resources, skilled labour force, modern capital plant, and strong banking system, significantly lower crude oil prices in recent years have taken a considerable toll on the oil and gas sector and the country’s overall economy. However, lower energy costs helped consumers and the non-resource based sectors. Along with the lower Canadian dollar and the improved US economy, Canada’s manufacturing sector has grown, with higher exports to the United States.

US President Trump’s ‘Buy American’ policy and the renegotiation of the North American Free Trade Agreement (NAFTA) have introduced uncertainty for Canadian businesses who export into the US market. Even though the NAFTA's replacement, the United States-Mexico-Canada Agreement (known in Canada as the CUSMA), has been negotiated, it is uncertain whether the CUSMA will be ratified by all three countries. Passage of the US tax reform legislation in December 2017, and the resulting decrease in the US federal corporate tax rate, are also expected to hurt Canadian exports and the level of foreign investment in Canada. Canada’s 2018 Federal Fall Economic Statement addressed US tax reform indirectly by enhancing the first-year capital cost allowance deductions for most depreciable property, as well as an immediate 100% deduction for newly-acquired manufacturing and processing and clean energy equipment. Strong employment figures have been reported for the first few months of 2019, showing an increase in the number and quality of full and part-time positions. The unemployment rate has remained constant, suggesting more people have entered the workforce. Both of these factors will bolster the Canadian economy moving forward.

Interest rates have continued to rise in the past year, so consumers who are heavily indebted due to low interest rates in recent years may exercise fiscal restraint. Likewise, most provincial governments are generally reining in spending to balance their books and likely will make only minimal contributions to overall economic growth in 2019. In contrast, the federal government has incurred large deficits in recent years and is still committed to invest in improving Canada’s infrastructure. Canada’s new and resale housing markets have been strong, especially in British Columbia and Ontario, creating extremely high residential house prices in parts of those provinces. Those provinces have each implemented

measures to stabilise the housing market, including an additional tax on foreign purchases of residential housing in specified locales. This has generally resulted in cooling the housing market in British Columbia. Elevated home prices and household debt, along with an uncertain United States trade landscape, pose a risk to Canada's economy.

In Canada, PwC has more than 6,700 partners and staff in locations from St. John's on the Atlantic coast to Vancouver on the Pacific. With more than 110 years of excellence in Canada, we provide industry-focused professional services, including audit and assurance, risk assurance, tax, deals, and consulting in areas such as cybersecurity and privacy, human resources, digital transformation, and forensics. As tax laws constantly change, professional advice is essential. PwC in Canada works with companies of all sizes and in all industries to help tailor solutions using local knowledge and global experience. The priority of PwC Canada's Personal Tax, Estate and Wealth Planning Team is to understand your overall financial affairs and planning so we can identify tax strategies that help you achieve your goals. Linked into our global tax practice, we draw from a broad network of professionals who are trained to understand a spectrum of wealth matters to assist you in planning for the future.

# Corporate - Significant developments

**Last Reviewed - 17 June 2019**

Canada's corporate tax summary reflects all 2019 federal, provincial, and territorial budgets, except for those of Alberta and Prince Edward Island. The 2019 federal budget continues the focus on improving the fairness and integrity of the tax system by tightening perceived loopholes or inequities, and by cracking down on tax evasion and tax avoidance. It proposes to invest an additional 150.8 million Canadian dollars (CAD) over five years to fund new Canada Revenue Agency (CRA) initiatives and extend existing programmes to further combat tax evasion and tax avoidance. Additionally, the budget proposes to spend CAD 65.8 million over five years to improve the CRA's information technology systems so that the infrastructure used to fight tax evasion and aggressive tax avoidance continues to evolve.

This summary is based on enacted and proposed legislation, and assumes that the proposed legislation will become law. Generally, budget proposals and draft legislation are enacted into law, especially if there is a majority federal government, which is currently the case.

## 100% first-year deduction for certain newly acquired property

Draft legislation allows an immediate 100% capital cost allowance (CCA) deduction for:

- manufacturing and processing and specified clean energy equipment acquired after 20 November 2018, and
- zero-emission vehicles purchased after 18 March 2019,

if available for use before 2024. The 100% deduction is gradually phased out for property that becomes available for use after 2023 and before 2028. In addition, an increased first-year CCA deduction is available on most other eligible depreciable property acquired after 20 November 2018 and available for use before 2028. *See Depreciation and amortisation in the Deductions section for more information*.

## Derivatives

The 2019 federal budget amends the definition of 'derivative forward agreement' to prevent fully taxable ordinary income from being recharacterised into more favourably taxed capital gains under these agreements, in certain cases, for transactions generally entered into after 18 March 2019. *See Derivatives in the Income determination section for more information*.

## Equity-based financial arrangements

Recently enacted legislation expands existing synthetic equity arrangement and securities lending arrangement (SLA) rules to prevent taxpayers from realising artificial losses through the use of equity-based financial arrangements to circumvent these rules. *See Synthetic equity arrangements and Securities lending arrangements (SLAs) in the Income determination section for more information*.

## Foreign affiliate dumping rules

The 2019 federal budget extends the foreign affiliate dumping rules to Canadian-resident corporations controlled by non-resident individuals, non-resident trusts, or a group of non-resident corporations, individuals, and/or trusts who do not deal with each other at arm's length, for transactions or events occurring after 18 March 2019. *See Foreign affiliate dumping rules in the Income determination section for more information*.

## Transfer pricing

The 2019 federal budget introduces a new ordering rule to prioritise transfer pricing adjustments, and broadens the definition of a 'transaction' for purposes of the extended reassessment period that applies to non-arm's-length cross-border transactions, for transactions beginning after 18 March 2019. *See Transfer pricing in the Group taxation section and Statute of limitations in the Tax administration section for more information*.

## Cross-border securities lending arrangements (SLAs)

The 2019 federal budget modifies the withholding tax (WHT) rules for dividend compensation payments that a Canadian borrower makes to a non-resident lender under an SLA, to address planning undertaken by certain non-residents that attempts to avoid the Canadian dividend WHT, for dividend compensation payments generally made after 18 March 2019. *See Cross-border SLAs in the Income determination section for more information*.

## Cross-border surplus stripping

Recently enacted legislation amends the existing cross-border surplus stripping rules to add comprehensive 'look-through' rules for partnerships and trusts, to ensure that these rules cannot be avoided inappropriately. The amended rules apply to transactions occurring after 26 February 2018. *See Cross-border surplus stripping in the Income determination section for more information*.

## Foreign affiliates

Recently enacted legislation advances the filing due date of T1134 information returns for foreign affiliates. The following filing deadlines are for taxation years of a taxpayer beginning:

- Before 2020: 15 months after year-end.
- In 2020: 12 months after year-end.
- After 2020: 10 months after year-end.

In addition, for taxation years of a taxpayer's foreign affiliate beginning after 26 February 2018, recently enacted legislation:

- deems activities carried out by a foreign affiliate and accruing to a specific Canadian taxpayer under a tracking arrangement to be a separate business; each separate business will have to meet specific conditions, including the 'six employees' test, to be excluded from the investment business definition
- adds certain minimum capital requirements to the trading or dealing in indebtedness rules for an affiliate to qualify for the regulated foreign financial institution exception, and
- deems a foreign affiliate of a taxpayer to be a controlled foreign affiliate of the taxpayer if foreign accrual property income (FAPI) attributable to specific activities of the foreign affiliate accrues to the benefit of the taxpayer under a tracking arrangement.

*See Controlled foreign affiliates and foreign accrual property income (FAPI) in the Group taxation section and Foreign reporting in the Tax administration section for more information.*

## Reassessment periods

Recently enacted legislation extends the reassessment period of a taxpayer:

- for income arising in connection with a foreign affiliate of a taxpayer
- if a requirement for information or compliance order is being contested in court, and
- for a loss carryback previously claimed, if the loss results from a transaction involving a taxpayer and a non-arm's length, non-resident person.

*See Statute of limitations in the Tax administration section for more information.*

### Sharing information for criminal matters

Recently enacted legislation allows:

- the CRA to use the legal tools available under the Mutual Legal Assistance Criminal Matters Act to facilitate sharing of information related to tax offences under Canada's tax treaties, Tax Information Exchange Agreements (TIEAs), and the Convention on Mutual Administrative Assistance in Tax Matters, and
- tax information to be shared with Canadian mutual legal assistance partners for acts that, if committed in Canada, would constitute terrorism, organised crime, money laundering, criminal proceeds offences, or designated substance offences.

*See Sharing information for criminal matters in the Tax administration section for more information.*

### Mandatory Quebec Sales Tax registration for non-residents of Quebec

The mandatory Quebec Sales Tax (QST) registration rules are expanded to non-residents of Quebec. Suppliers that are not residents of, and have no physical or significant presence in, Quebec, and that make digital and certain other supplies to 'specified Quebec consumers', may be required to register for QST under a new specified registration system, starting:

- 1 January 2019, for non-residents of Canada, and
- 1 September 2019, for residents of Canada that reside outside Quebec.

*See Provincial retail sales tax in the Other taxes section for more information.*

# Corporate - Taxes on corporate income

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As a general rule, corporations resident in Canada are subject to Canadian corporate income tax (CIT) on worldwide income. Non-resident corporations are subject to CIT on income derived from carrying on a business in Canada and on capital gains arising upon the disposition of taxable Canadian property (*see Capital gains in the Income determination section for more information*). The purchaser of the taxable Canadian property is generally required to withhold tax from the amount paid unless the non-resident vendor has obtained a clearance certificate.

Canadian CIT and WHT can be reduced or eliminated if Canada has a treaty with the non-resident's country of residence. *A list of treaties that Canada has negotiated is provided in the Withholding taxes section, along with applicable WHT rates.*

### Federal income tax

The following rates apply for a 12-month taxation year ending on 31 December 2019. For non-resident corporations, the rates apply to business income attributable to a permanent establishment (PE) in Canada. Different rates may apply to non-resident corporations in other circumstances. Non-resident corporations may also be subject to branch tax (*see the Branch income section*).

| | Federal rate (%) |
|---|---|
| Basic rate | 38.0 |
| Less: Provincial abatement (1) | (10.0) |
| Federal rate | 28.0 |
| Less: General rate reduction or manufacturing and processing deduction (2) | (13.0) |

| | Federal rate (%) |
|---|---|
| Net federal tax rate (3, 4) | 15.0 |

Notes

1. The basic rate of federal tax is reduced by a 10% abatement to give the provinces and territories room to impose CITs. The abatement is available in respect of taxable income allocated to Canadian provinces and territories. Taxable income allocable to a foreign jurisdiction is not eligible for the abatement and normally is not subject to provincial or territorial taxes.
2. The general rate reduction and manufacturing and processing deduction do not apply to the first CAD 500,000 of active business income earned in Canada by Canadian-controlled private corporations (CCPCs), investment income of CCPCs, and income from certain other corporations (e.g. mutual fund corporations, mortgage investment corporations, and investment corporations) that may benefit from preferential tax treatment.
3. Provincial or territorial taxes apply in addition to federal taxes. Provincial and territorial tax rates are noted below.
4. For small CCPCs, the net federal tax rate is levied on active business income above CAD 500,000; a federal rate of 9% (10% before 1 January 2019) applies to the first CAD 500,000 of active business income. Investment income (other than most dividends) of CCPCs is subject to the federal rate of 28%, in addition to a refundable federal tax of 10⅔%, for a total federal rate of 38⅔%. Access to the reduced federal tax rate on active business income of 9% is restricted for CCPCs that earn passive investment income exceeding CAD 50,000 in the previous taxation year and unavailable at CAD 150,000 of investment income.

## Provincial/territorial income tax

All provinces and territories impose income tax on income allocable to a PE in the province or territory. Generally, income is allocated to a province or territory by using a two-factor formula based on gross revenue and on salaries and wages. Provincial and territorial income taxes are not deductible for federal income tax purposes. The rates given apply for a 12-month taxation year ending on 31 December 2019 and do not take into account provincial tax holidays, which reduce or eliminate tax in limited cases.

| Province/territory | Income tax rate (%) (1, 2) |
|---|---|
| Alberta (3) | 11.5 |
| British Columbia | 12.0 |
| Manitoba | 12.0 |
| New Brunswick | 14.0 |
| Newfoundland and Labrador | 15.0 |
| Northwest Territories | 11.5 |
| Nova Scotia | 16.0 |
| Nunavut | 12.0 |
| Ontario (4) | 11.5 or 10.0 |
| Prince Edward Island | 16.0 |
| Quebec (5) | 11.6 |

| Province/territory | Income tax rate (%) (1, 2) |
|---|---|
| Saskatchewan (6) | 12.0 or 10.0 |
| Yukon | 12.0 or 2.5 |

Notes

1. When two rates are indicated, the lower rate applies to manufacturing and processing income.
2. In all provinces and territories, the first CAD 500,000 (CAD 450,000 in Manitoba before 2019; CAD 600,000 in Saskatchewan) of active business income of a small CCPC is subject to reduced rates that range from 0% to 6% (8% before 28 March 2018), depending on the jurisdiction.
3. Alberta's rate will decrease from 12% to 11% on 1 July 2019, to 10% on 1 January 2020, to 9% on 1 January 2021, and to 8% on 1 January 2022.
4. The lower Ontario rate applies to profits from manufacturing and processing, and from farming, mining, logging, and fishing operations, carried on in Canada and allocated to Ontario.

   Corporations subject to Ontario income tax may also be liable for corporate minimum tax (CMT) based on adjusted book income. The CMT is payable only to the extent that it exceeds the regular Ontario income tax liability. The CMT rate is 2.7% and applies when total assets are at least CAD 50 million and annual gross revenue is at least CAD 100 million on an associated basis.
5. Quebec's rate decreased from 11.7% to 11.6% on 1 January 2019, and will decrease to 11.5% on 1 January 2020.
6. The manufacturing and processing reduction from the general rate is determined by multiplying the maximum rate reduction (2%) by the corporation's allocation of income to Saskatchewan.

### *British Columbia Liquefied Natural Gas Income Tax Act*

British Columbia has repealed the Liquefied Natural Gas Income Tax Act (the LNG Act) effective 11 April 2019. The LNG Act had implemented an income tax on income from liquefaction activities at or in respect of an LNG facility located in British Columbia. The LNG income tax was in addition to federal and provincial income taxes.

The LNG income tax was a two-tier income tax, calculated as follows:

- Tier 1 tax rate of 1.5% applied on the net operating income (NOI), the taxpayer's profit or loss (with specific adjustments) less up to 100% of the net operating loss account, and less an investment allowance (the Tier 1 tax paid was added to a tax credit pool that could be used to reduce Tier 2 tax), and
- Tier 2 tax rate of 3.5% applied on the net income (NI), the NOI less up to 100% of the capital investment account (CIA) (the Tier 2 tax would not apply until the CIA was fully depleted and was reduced by the tax credit pool balance).

Upon repealing the LNG Act, the province amended the British Columbia Income Tax Act to allow for a 3% tax credit for qualifying LNG investments. For taxation years that begin after 31 December 2019, a non-refundable natural gas tax credit is available to qualifying corporations that develop natural gas, and have an establishment, in British Columbia. The credit can reduce the effective provincial CIT rate to a minimum of 9% (from 12%). Any unused credit can be carried forward indefinitely.

# Corporate - Corporate residence

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Under the Income Tax Act, a corporation incorporated in Canada (federally or provincially/territorially) will be deemed to be resident in Canada. A corporation not incorporated in Canada will be considered to be resident in Canada under

Canadian common law if its central management and control is exercised in Canada. Where a corporation's central management and control is exercised is a question of fact, but typically it is where the board of directors meets and makes decisions, provided the board takes action.

A corporation incorporated outside of Canada but with its central management and control situated both in and outside Canada will be deemed to be a non-resident of Canada if it qualifies as a non-resident of Canada under treaty tie-breaker rules.

A corporation incorporated in Canada will cease to be a Canadian resident if it is granted Articles of Continuance in a foreign jurisdiction. Similarly, a foreign corporation will become resident in Canada if it is continued in Canada or is a predecessor corporation of an amalgamated corporation that is resident in Canada.

## Permanent establishment (PE)

Canada's tax treaties generally provide that the business profits of a non-resident corporation are not subject to Canadian tax unless the non-resident corporation carries on business in Canada through a PE situated in Canada and the business profits are attributed to that PE. Canada's tax treaties may also restrict the imposition of branch tax to situations where the non-resident corporation carries on business in Canada through a PE situated in Canada and/or limit the applicable branch tax rate. While the wording of tax treaties varies, a PE generally is defined as:

- a fixed place of business through which the business of the non-resident corporation is wholly or partly carried on
- a place of management, a branch, an office, a factory, and a workshop; a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources; a building site, construction, or assembly project that exists for a specified period, and
- a dependent agent or employee who has and habitually exercises an authority to conclude contracts in the name of the non-resident corporation.

In some circumstances, a Canadian PE may also arise where services are rendered in Canada and certain requirements (e.g. relating to the duration of the services) are met.

The Canadian domestic definition of PE (federal and provincial/territorial) generally mirrors the above.

The interpretation of what constitutes a PE is expected to be re-evaluated in light of the final report issued in 2015 by the Organisation for Economic Co-operation and Development (OECD) and Group of 20 (G20) on Action 7, which is focused on preventing the artificial avoidance of PE status.

# Corporate - Other taxes

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## Consumption taxes

### *Federal Goods and Services Tax (GST)*

The GST is a federal tax levied at a rate of 5% on the supply of most property and services made in Canada. It is a value-added tax (VAT) applied at each level in the manufacturing and marketing chain. However, the tax does not apply to supplies that are zero-rated (i.e. taxed at 0%) or exempt (e.g. used residential real property and most health care, educational, and financial services). Examples of zero-rated supplies include basic groceries, medical and assistive devices, prescription drugs, feminine hygiene products, agriculture and fishing, and most international freight and passenger transportation services.

Generally, registrants charge GST on their sales and pay GST on their purchases, and either remit or claim a refund for the amount of net tax reported (i.e. the difference between the GST charged and the GST paid). Suppliers are entitled to claim input tax credits for the GST paid or payable on expenses incurred relating to making fully taxable and zero-rated supplies (i.e. commercial activity), but not on expenses relating to the making of tax-exempt supplies.

### *Harmonised Sales Tax (HST)*

Five provinces have fully harmonised their sales tax systems with the GST and impose a single HST, which includes the 5% GST and a provincial component. HST applies to the same tax base and under the same rules as the GST. There is no need to register separately for GST and HST because both taxes are accounted for under one tax return and are jointly administered by the CRA. The HST rates follow.

| Province | HST rate (%) |
|---|---:|
| New Brunswick | 15 |
| Newfoundland and Labrador | 15 |
| Nova Scotia | 15 |
| Ontario | 13 |
| Prince Edward Island | 15 |

### *Provincial retail sales tax (PST)*

The provinces of British Columbia, Manitoba, and Saskatchewan each levy a PST (in addition to the 5% GST) at 7%, 8% (7% after 30 June 2019), and 6%, respectively, on most purchases of tangible personal property, software, and certain services.

PST generally does not apply to purchases of taxable goods, software, and services acquired for resale; registered vendors can claim this resale exemption by providing to their suppliers either their PST number or a purchase exemption certificate. Certain exemptions also exist for use in manufacturing, farming, and fisheries.

PST is administered by each province's tax authority, separate from the CRA. Unlike GST/HST, PST is not a VAT and could apply to a business' inputs that are not acquired for resale (e.g. charges for telecommunications services). Therefore, any PST paid on purchases by a business cannot generally be claimed as a credit or otherwise offset against PST charged on sales.

Alberta and the three territories (the Northwest Territories, Nunavut, and the Yukon) do not impose a retail sales tax. However, the GST applies in those jurisdictions.

Quebec's sales tax is a VAT structured in the same manner as the GST/HST. The QST is charged in addition to the 5% GST and is levied at the rate of 9.975% on the supply of most property and services made in the province of Quebec, resulting in an effective combined rate of 14.975%. Registrants charge QST on taxable supplies (that are not zero-rated) and can claim input tax refunds for QST paid or payable on their expenses incurred and/or purchases made in the course of their commercial activity. The resulting net tax is reported to Revenu Québec (Quebec's tax authority) and is either remitted or claimed as a refund. Revenu Québec also administers the GST/HST on behalf of the CRA for most registrants that are resident in the province.

The mandatory QST registration rules were recently expanded to non-residents of Quebec. Suppliers that are not residents of, and have no physical or significant presence in, Quebec, and that make digital and certain other supplies to 'specified Quebec consumers' may be required to register for QST under a new specified registration system, starting:

- 1 January 2019, for non-residents of Canada that make supplies of incorporeal moveable property (IPP) and services, and
- 1 September 2019, for residents of Canada that reside outside Quebec and make supplies of corporeal moveable property, IPP, and services.

The requirement to register also applies to digital property and services distribution platforms in regards to taxable supplies of IPP or services received by specified Quebec consumers if these digital platforms control the key elements of the transaction.

## Customs and import duties

Customs tariffs (also known as duties) are tariffs and/or taxes levied on goods imported into Canada. The amount of customs duty that applies to imported goods depends on a number of factors, including the nature of the duty (i.e. *ad valorem* or specific), tariff classification, country of origin, and value for duty declared. The Tariff Schedule to the Customs Tariff, which is based on the World Customs Organization's Harmonized Commodity Description and Coding System, sets out the customs duty rates for goods imported into Canada. Goods that originate from most countries with which Canada does not have a free trade agreement (FTA) or other preferential tariff arrangement will generally attract the 'Most Favoured Nation' (MFN) duty rate or tariff treatment.

There are currently 14 FTAs available for benefits where applicable. The most significant FTA for Canada is the North American Free Trade Agreement (NAFTA). The NAFTA applies to goods imported from both the United States (US) and Mexico. Most goods that originate in the NAFTA territory and qualify as originating for the NAFTA are eligible for duty-free treatment when imported into Canada from the other NAFTA partner (some exceptions apply). NAFTA may be replaced by the United States-Mexico-Canada Agreement (USMCA) (*see below*).

Canada's newest FTA is the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which entered into force on 30 December 2018 between Canada, Australia, New Zealand, Mexico, Singapore, and Japan; and on 14 January 2019 with Vietnam. The other four member countries (Brunei, Malaysia, Peru, and Chile) will enter into force once they complete their ratification process and notify the repository in New Zealand.

Canada's other FTAs are with Chile, Colombia, Costa Rica, the European Free Trade Association (which includes Iceland, Liechtenstein, Norway, and Switzerland), the European Union (EU), Honduras, Israel, Jordan, the Republic of Korea, Panama, Peru, and Ukraine. Under these FTAs, the originating goods imported from these countries may be eligible for reduced tariff benefits at rates more favourable than the MFN rate.

Canada recently negotiated a new FTA, the USMCA (known in Canada as the CUSMA), with the United States and Mexico. The CUSMA revises and updates the terms of the existing NAFTA, and will serve to replace NAFTA once it has been ratified and implemented by all three countries. Canada is also in negotiations with several other countries (e.g. Japan, India, and Dominican Republic) or country groupings (e.g. the Mercosur countries, consisting of Argentina, Brazil, Paraguay, and Uruguay). Like the NAFTA, these FTAs will set out the rules of origin for determining whether goods are eligible for preferential tariff treatment, among other things. Canada is also currently exploring the potential for FTAs with other countries (e.g. China, Turkey) or country groupings (e.g. the Association of Southeast Asian Nations, including Cambodia, Thailand, Vietnam, etc.).

Canada also extends preferential tariff rates to many (but not all) products imported from certain countries via the General Preferential Tariff, the Least Developed Countries Tariff, the Commonwealth Caribbean Countries Tariff, the Australia Tariff, and the New Zealand Tariff. To qualify for preferential tariff rates, goods must meet various requirements with respect to the rules of origin and transshipment, among other things.

### *Other import duties and levies*

Importations into Canada may also be subject, in certain cases, to anti-dumping duties and/or countervailing duties, excise duties, and excise taxes. In limited circumstances, Canada may also impose a surtax on certain imports, as evidenced by the recent retaliatory tariffs on certain US origin goods (e.g. certain steel and aluminum) that were imposed in July 2018 and eliminated in May 2019.

## Excise taxes and duties

Excise duties are levied at various rates on spirits, wine, beer, malt liquor, and tobacco products. When these goods are manufactured or produced in Canada, duty is payable on the goods at the point of packaging and not at the point of sale. When these goods are imported into Canada, duty is generally payable by the importer at the time of importation. Manufacturers who produce alcohol and tobacco in Canada must be licensed. Excise duties also apply to cannabis products, now that non-medicinal cannabis is available for legal sale. Persons who manufacture, produce, and/or sell cannabis products in Canada must be licensed.

Excise tax is imposed on automobile air conditioners and fuel-inefficient automobiles, in addition to aviation fuel, gasoline, and diesel fuel. A 10% federal excise tax is imposed on premiums paid for insurance against a risk in Canada if the insurance is placed by insurers through brokers or agents outside Canada or with an insurer that is not authorised under Canadian or provincial/territorial law to transact the business of insurance. Premiums paid under contracts for life,

personal accident, marine, and sickness insurance, as well as reinsurance and insurance not available in Canada, are exempt.

## Property taxes

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

In British Columbia, starting in 2018, an annual speculation and vacancy tax (SVT) is imposed on residential property in certain urban centres in British Columbia (i.e. Metro Vancouver Regional District, Capital Regional District, Kelowna-West Kelowna, Nanaimo-Lantzville, Abbotsford, Chilliwack, and Mission; most islands are excluded). The SVT targets foreign and domestic homeowners who do not pay income tax in British Columbia, including those who leave their homes vacant. The tax rate, as a percentage of the property's assessed value at 1 July of the previous year, is, after 2018 (for 2018, 0.5% for all property owners subject to the tax):

- 2% for foreign investors and satellite families.
- 0.5% for British Columbians and all other Canadian citizens or permanent residents who are not members of a satellite family.

Up-front exemptions are available for most principal residences and for qualifying long-term rental properties and certain special cases. A tax credit may also be available in varying amounts (depending on the type of owner) for owners subject to the SVT.

## Land transfer tax

All provinces and territories levy a land transfer tax or registration fee on the purchaser of real property within their boundaries. These levies are expressed as a percentage, in most cases on a sliding scale, of the sale price or the assessed value of the property sold and are generally payable at the time title to the property is registered. Rates generally range from 0.02% to 3%, depending on the province or territory, but may be higher if the purchaser is a non-resident. Some exemptions (or refunds) are available. Additional land transfer taxes apply for properties purchased in the municipalities of Montreal or Toronto. Other municipalities may also impose these taxes and fees.

In British Columbia, a 20% land transfer tax (in addition to the general land transfer tax) is imposed on foreign entities (i.e. foreign nationals and corporations and certain Canadian corporations controlled by such foreign persons) and certain trusts and/or their trustees that have a foreign connection (a taxable trustee) that purchase residential property in the Metro Vancouver Regional District, the Capital Regional District, the Regional District of Central Okanagan, the Fraser Valley Regional District, and the Regional District of Nanaimo. Failure to pay this tax or file the required forms can result in interest, plus significant penalties, and/or imprisonment. Anti-avoidance rules capture transactions that are structured to avoid this tax. Relief from the additional land transfer tax is available to:

- foreigners who become Canadian citizens or permanent residents within one year of purchasing a principal residence, or
- foreign workers coming to British Columbia under the British Columbia Provincial Nominee Program who purchase a principal residence.

In an effort to stop tax evasion when property ownership is hidden behind numbered companies and trusts, the British Columbia government will, starting 16 May 2019, require trustees and corporations that acquire property to identify all individuals with a beneficial interest in the trust or significant interest in the corporation on the property transfer tax return. For beneficiaries of trusts that are corporations, information about each director must be disclosed. This will apply to all property types, including residential and commercial, with exemptions for certain trusts (e.g. charitable trusts) and corporations (e.g. hospitals, school, and libraries).

In Ontario, a 15% land transfer tax (in addition to the general land transfer tax and Toronto's land transfer tax) is imposed on foreign entities (i.e. foreign nationals and corporations and certain Canadian corporations controlled by such foreign

persons) and taxable trustees (i.e. trustees of a trust that has at least one trustee or beneficiary that is a foreign entity) that purchase residential property in the Greater Golden Horseshoe (a defined region of Southern Ontario surrounding and including the City of Toronto). For this tax to apply, the land transferred must contain at least one, but not more than six, single family residence(s). The tax also applies to unregistered dispositions of a beneficial interest in such residential property when the purchaser of the interest is a foreign entity or taxable trustee. Failure to pay this tax can result in a penalty, fine, and/or imprisonment. Exemptions from the 15% land transfer tax are available in certain circumstances (including for foreign workers coming to Ontario under the Ontario Immigrant Nominee Program or for refugees under the Immigration and Refugee Protection Act, who purchase a principal residence), and rebates of the tax can be obtained in certain situations.

## Federal capital taxes

The federal government does not levy a general capital tax. It imposes the Financial Institutions Capital Tax (Part VI Tax) on banks, trust and loan corporations, and life insurance companies at a rate of 1.25% when taxable capital employed in Canada exceeds CAD 1 billion. The threshold is shared among related financial institutions. The tax is not deductible in computing income for tax purposes. It is reduced by the corporation's federal income tax liability. Any unused federal income tax liability can be applied to reduce Part VI Tax for the previous three and the next seven years. In effect, the tax constitutes a minimum tax on financial institutions.

## Provincial capital taxes

The provinces do not levy a general capital tax, but most do impose a capital tax on financial institutions. Capital taxes are deductible for federal income tax purposes. The federal government had proposed to limit the deductibility of capital taxes, but has delayed implementing this proposal indefinitely. The territories do not impose capital taxes.

Provincial capital taxes on financial institutions are imposed at the following rates for 31 December 2019 year-ends.

| Province | Banks, trust and loan corporations (%) |
|---|---:|
| Alberta | - |
| British Columbia | - |
| Manitoba (1) | 6 |
| New Brunswick (2) | 4 or 5 |
| Newfoundland and Labrador (3) | 6 |
| Nova Scotia (4) | 4 |
| Ontario | - |
| Prince Edward Island (5) | 5 |
| Quebec (6) | - |
| Saskatchewan (7) | 4 |

Notes

1. Financial institutions in Manitoba with taxable paid-up capital of an associated group under CAD 4 billion are not subject to capital tax.
2. New Brunswick’s capital tax rate is 5% for banks and 4% for other financial institutions. The first CAD 10 million of taxable paid-up capital is exempt from capital tax.
3. In Newfoundland and Labrador, a CAD 5 million exemption applies if taxable capital for the related group is CAD 10 million or less.

4. In Nova Scotia, the first CAD 500,000 of taxable paid-up capital is exempt from capital tax. However, if a trust and loan company has its head office in Nova Scotia, a CAD 30 million exemption applies. The maximum capital tax payable by financial institutions in Nova Scotia is CAD 12 million annually.
5. In Prince Edward Island, the first CAD 2 million of taxable paid-up capital is exempt from capital tax.
6. In Quebec, financial institutions are subject to a compensation tax of 4.22% (4.29% before 1 April 2019; 4.14% after 31 March 2020; 2.8% after 31 March 2022; nil after 31 March 2024) on payroll. Payroll subject to the compensation tax is limited to CAD 1.1 billion annually.
7. Saskatchewan's rate for financial institutions that have taxable paid-up capital of CAD 1.5 billion or less is 0.7%. Financial institutions that qualified for the 0.7% capital tax rate in taxation years ending after 31 October 2008 and before 1 November 2009 are subject to a 0.7% capital tax rate on their first CAD 1.5 billion of taxable capital and a 4% capital tax rate on taxable capital exceeding CAD 1.5 billion. In Saskatchewan, the capital tax exemption is up to CAD 20 million (CAD 10 million plus an additional CAD 10 million, which is shared with associated companies).

## Additional taxes on insurers

All provinces and territories impose a premium tax ranging from 2% to 5% on insurance companies (both life and non-life). In addition, Ontario and Quebec impose a capital tax on life insurance companies. Quebec also levies a compensation tax on insurance premiums at a rate of 0.48% (0.3% after 31 March 2022; nil after 31 March 2024).

## Part III.1 tax on excess designations

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

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

- public corporations, or other corporations that are not CCPCs, that are resident in Canada and are subject to the federal general CIT rate (i.e. 15% in 2018), or
- CCPCs, to the extent that the CCPC's income is:
    - not investment income (other than eligible dividends from public corporations), and
    - subject to the general federal CIT rate (i.e. the income is active business income not subject to the federal small business rate).

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

## Payroll taxes

### *Social security taxes*

For 2019, employers are required to pay, for each employee, government pension plan contributions up to CAD 2,748.90 and employment insurance premiums up to CAD 1,204.31. However, Quebec employers instead contribute, per employee, a maximum of CAD 2,991.45 in Quebec government pension plan contributions, CAD 929.25 in employment insurance premiums, and CAD 563.04 to a Quebec parental insurance plan.

The government pension plan was enhanced starting 1 January 2019. Employers and employees are required to pay higher government pension plan contributions (to be phased-in over seven years).

### *Provincial/territorial payroll taxes*

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

### *Withholding tax for non-resident employees*

Under Regulation 102 of the Income Tax Act, employers (whether residents of Canada or not) that pay salaries or wages or other remuneration to a non-resident of Canada in respect of employment services rendered in Canada are required to withhold personal income tax (PIT) unless a waiver has been received prior to commencing work physically in Canada. There are no '*de minimis*' exceptions, and this requirement applies regardless of whether the non-resident employee in question will actually be liable for Canadian income tax on that salary pursuant to an income tax treaty that Canada has signed with another country. Complying is time-consuming and administratively burdensome.

An amount paid by a 'qualifying non-resident employer' to a 'qualifying non-resident employee' is exempt from the Regulation 102 withholding requirement.

Generally, a 'qualifying non-resident employer' must meet the following two conditions:

- is resident in a country with which Canada has a tax treaty (treaty country), and
- is at that time certified by the Minister.

A 'qualifying non-resident employee' must meet the following three conditions:

- is resident in a treaty country
- is exempt from Canadian income tax under a tax treaty, and
- either:
    - is present in Canada for less than 90 days in any 12-month period that includes the time of payment, or
    - works in Canada for less than 45 days in the calendar year that includes the time of payment.

To become certified, a non-resident employer must file Form RC473 (Application for Non-Resident Employer Certification) with the CRA. Certification is valid for two calendar years (after which time employers must submit a new Form RC473), subject to revocation if the employer fails to meet certain conditions or to comply with its Canadian tax obligations.

The conditions to maintain non-resident employer certification include:

- track and record, on a proactive basis, the number of days each qualifying non-resident employee is either working in Canada or present in Canada, and the income attributable to these days
- evaluate and determine whether its employees meet the conditions of a 'qualifying non-resident employee'
- obtain a Canadian Business Number
- complete and file the annual T4 Summary and slips, if required
- file the applicable Canadian CIT returns if the corporation is 'carrying on business in Canada', and
- upon request, make its books and records available to the CRA for inspection.

## Withholding tax on payments to non-residents for services rendered in Canada

Under Regulation 105 of the Income Tax Act, every person (including a non-resident), paying to a non-resident, a fee, commission, or other amount in respect of services rendered in Canada (excluding remuneration paid to non-resident employees that are subject to payroll withholding requirements, *see Withholding tax for non-resident employees above*) is required to withhold and remit 15% of the payment to Canadian tax authorities unless a waiver has been received before payment. Regulation 105 withholding is not a final tax, but an instalment payment against possible Canadian tax liability if the non-resident is determined to have a PE in Canada. A non-resident corporation that does not have a PE in Canada and is eligible under one of Canada's tax treaties can file a 'treaty-based' corporate tax return to have the previously withheld Regulation 105 amounts refunded. These tax returns may result in the Canadian tax authorities challenging the non-resident's assertion that no PE exists within Canada.

## Carbon taxes

To advance the objectives of the Pan-Canadian Framework on Clean Growth and Climate Change (the Framework) and reduce greenhouse gas emissions, the federal government passed the Greenhouse Gas Pollution Pricing Act, which received royal assent on 21 June 2018. In accordance with the Framework, all provinces and territories are required to adopt a form of carbon pricing. The federal government established a Federal Carbon Pricing Backstop (FCPB) program

for provinces and territories that either do not have their own carbon tax program or whose provincial or territorial program does not meet federal standards (or who cancel their own system in the future). The FCPB program has two components:

- Carbon levy: A charge on certain fuels, effective 1 April 2019 in Manitoba, New Brunswick, Ontario, and Saskatchewan; and 1 July 2019 in Nunavut and the Yukon. The carbon levy is generally imposed on producers, distributors, emitters, importers, and certain users of fuel and combustible waste, along with air, marine, rail, or road carriers, that have business activities in these provinces and territories. Rates vary by type of fuel and are equivalent to CAD 20 per $CO_2$e tonne in 2019, increasing annually until they reach CAD 50 per $CO_2$e tonne in 2022. There are different types of registration, depending upon the operations of the particular business.
- Output-based pricing system (OBPS): Applies as of 1 January 2019 to industrial facilities whose greenhouse gas emissions exceed certain thresholds. Facilities below the thresholds may elect to opt in to the OBPS, allowing for similar treatment as their competitors with varying emissions outputs.

Each type of registration will trigger specific calculations and reporting requirements. Returns are filed on a monthly or quarterly basis, depending on each particular entity's type of registration. Provinces and territories that have their own carbon programme are not subject to the FCPB. The provincial and territorial carbon programmes vary by province, as follows:

- Alberta: For 2019, carbon tax was levied at a rate of CAD 30 per tonne. Entities that emitted 100,000 tonnes or more of $CO_2$e were required to register for the Carbon Competitiveness Incentive, a kind of cap-and-trade system. However, Alberta's new government repealed the province's carbon tax effective 30 May 2019. As a result the FCPB may also apply in Alberta.
- British Columbia: Carbon tax is levied at CAD 40 per tonne as of 1 April 2019, and will increase by CAD 5 per tonne each year, until it reaches CAD 50 per tonne on 1 April 2021.
- Newfoundland and Labrador: Carbon tax is levied at a rate of CAD 20 per tonne in 2019.
- Northwest Territories: Carbon tax, which will be effective 1 July 2019, will be levied at CAD 20 per tonne, increasing annually to CAD 50 per tonne by 2022.
- Nova Scotia: Cap-and-trade system.
- Prince Edward Island: Carbon tax, became effective 1 April 2019, is levied at CAD 20 per tonne, increasing to CAD 30 per tonne on 1 April 2020.
- Quebec: Cap-and-trade system.

# Corporate - Branch income

**Last Reviewed - 17 June 2019**

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

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

Whether or not a treaty applies, a non-resident corporation that has a PE in Canada may be subject to federal and provincial capital taxes (i.e. financial institutions only). *See the Other taxes section*.

# Corporate - Income determination

**Last Reviewed - 17 June 2019**

## Inventory valuation

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

## Capital gains

Half of a capital gain constitutes a taxable capital gain, which is included in the corporation's income and taxed at ordinary rates. Capital losses are deductible, but generally only against capital gains. Any excess of allowable capital losses over taxable capital gains in the current year can be carried back three years and carried forward indefinitely, to be applied against net taxable capital gains from those years, except in the case of an acquisition of control. No holding period is required. Intent is a major factor in determining whether the gain or loss is income or capital in nature.

Non-resident corporations are subject to CIT on taxable capital gains (50% of capital gains less 50% of capital losses) arising on the disposition of taxable Canadian property. Taxable Canadian property of a taxpayer includes, among other things:

- Real estate situated in Canada.
- Both capital and non-capital property used in carrying on a business in Canada.
- In general, shares in a corporation that are listed on a stock exchange if, at any time in the preceding 60 months:
    - 25% or more of the shares of the corporation are owned by the taxpayer or persons related to the taxpayer, and
    - more than 50% of the FMV of the shares is derived from real property situated in Canada, Canadian resource properties, and timber resource properties.
- In general, shares in a corporation that are not listed on a stock exchange if, at any time in the preceding 60 months, more than 50% of the FMV of the shares is derived, directly or indirectly, from property similar to that described above for shares of a public corporation.

However, in specific situations, the disposition by a non-resident of a share or other interest that is not described above may be subject to Canadian tax (e.g. when a share is deemed to be taxable Canadian property).

The general requirement is that a non-resident vendor of taxable Canadian property must report the disposition to the CRA and obtain a clearance certificate in respect of the disposition. If no certificate is obtained, the purchaser is required to withhold and remit to the CRA 25% of the sales proceeds.

Relief from the reporting and 25% withholding requirements may be available if specified conditions are met (e.g. if the gain from the disposition is not taxable in Canada by virtue of a tax treaty Canada has with another country). However, if the parties to the transaction are related, relief is available only if the CRA is notified.

The CRA can reassess tax after the end of the normal reassessment period (three years after the date of the initial notice of assessment for most taxpayers) on a gain from the disposition of real or immovable property if the taxpayer does not initially report the disposition.

## Dividend income

Dividends received by one Canadian corporation from another Canadian corporation generally can be deducted in full when determining taxable income. However, dividends received by a ‘specified financial institution’ on certain preferred shares are an important exception and are taxed at full corporate rates.

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

Dividends received by private corporations (or public corporations controlled by one or more individuals) from Canadian corporations are subject to a special refundable tax of 38⅓%. The tax is not imposed if the recipient is connected to the payer (i.e. the recipient owns more than a 10% interest in the payer) unless the payer was entitled to a refund of tax in respect of the dividend. When the recipient pays dividends to its shareholders, the tax is refundable at a rate of 38⅓% of taxable dividends paid.

### *Stock dividends*

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

### *Synthetic equity arrangements*

For dividends that are paid or become payable after April 2017 (after October 2015 for agreements or arrangements generally entered into, acquired, extended, renewed, or modified after 21 April 2015), the dividend rental arrangement rules deny the inter-corporate dividend deduction on dividends received by a taxpayer on a Canadian share in respect of which there is a synthetic equity arrangement. A synthetic equity arrangement, in respect of a share owned by a taxpayer, will be considered to exist when the taxpayer (or a person that does not deal at arm’s length with the taxpayer) enters into one or more agreements that have the effect of providing to a counterparty all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share.

When a person that does not deal at arm’s length with the taxpayer enters into such an agreement, a synthetic equity arrangement will be considered to exist if it is reasonable to conclude that the non-arm’s length person knew, or ought to have known, that the effect described above would result. An exception to the revised rule will apply, in general terms, when the taxpayer can establish that no ‘tax-indifferent investor’ (including tax-exempt Canadian entities and certain trusts, partnerships, and non-resident entities) is a counterparty. Certain other exceptions are provided.

Recently enacted legislation further expands the existing synthetic equity arrangement rules to prevent taxpayers from realising artificial losses through the use of equity-based financial arrangements to circumvent these rules, by clarifying that the no tax-indifferent investor exception to the synthetic equity arrangement rules cannot be met when a tax-indifferent investor obtains all or substantially all of the risk of loss or opportunity for gain or profit in respect of a share, for dividends that are paid or become payable after 26 February 2018.

### *Securities lending arrangements (SLAs)*

In general terms, in a security lending and repurchase arrangement, a counterparty transfers or lends a Canadian share to a taxpayer, and the taxpayer agrees to transfer or return an identical share to the counterparty in the future. Over the term of the arrangement, the taxpayer is obligated to pay to the counterparty amounts (dividend compensation payments) as compensation for all dividends received on the transferred or lent Canadian share. In certain circumstances, a taxpayer can realise artificial losses on this type of arrangement. As a result, recently enacted legislation expands the SLA rules to prevent taxpayers from realising artificial losses through the use of equity-based financial arrangements to circumvent these rules, by:

- broadening the SLA definition to include arrangements that are substantially similar to those that fell within the SLA definition, and
- clarifying that the two existing rules that provide for a deduction for dividend compensation payments do not both apply to the same payment,

for dividend compensation payments made after 26 February 2018, unless the securities lending or repurchase arrangement was in place before 27 February 2018, in which case the measure will apply for dividend compensation payments made after September 2018.

### Cross-border SLAs

The 2019 federal budget modifies the WHT rules for dividend compensation payments that a Canadian borrower makes to a non-resident lender under an SLA, to address planning undertaken by certain non-residents that attempts to avoid the Canadian dividend WHT. *For information on SLAs, see Securities lending arrangements (SLAs) above*.

For compensation payments made after 18 March 2019:

- the rules will now apply to compensation payments made under both SLAs and 'specified SLAs' (equity-based financial arrangements, which are similar to SLAs)
- all dividend compensation payments made under SLAs and specified SLAs will be treated as dividends for WHT purposes, regardless of whether the arrangement is fully-collateralised, and
- certain new rules apply for purposes of determining the WHT rate available under a tax treaty (the general effect of these rules is to make it more difficult for a lender to access the reduced WHT rates that are available under certain treaties where the dividend recipient owns at least 10% of the shares of the dividend payer [in terms of voting rights and fair market value]).

For securities loans entered into before 19 March 2019, the new measures will apply only to compensation payments made after September 2019.

The 2019 federal budget also introduces a relieving measure for dividend compensation payments made in respect of non-Canadian shares after 18 March 2019, to ensure that such payments will be exempt from WHT if the related SLA is fully-collateralised. The scope of an existing exemption for interest compensation payments is also expanded.

## Interest income

Interest that accrued, became receivable by, or was received by a corporation is taxable as income from a business or property.

## Rental income

Rents received by a corporation are taxable as income from a business or property.

## Royalty income

Royalties received by a corporation are taxable as income from a business or property.

## Derivatives

Derivatives are sophisticated financial instruments whose value is derived from the value of an underlying interest.

### Elective use of the mark-to-market method

It was historically uncertain if taxpayers could mark to market their derivatives held on income account under the general principles of profit computation. Legislation enacted in December 2017 clarifies the timing of gains and losses on derivatives held on income account. For taxation years beginning after 21 March 2017, taxpayers can elect to mark to market all of their eligible derivatives held on income account. The election remains effective until it is revoked with the consent of the Minister of National Revenue. Without this election income or losses from derivatives on income account are to be reported on a realised basis. For eligible derivatives that were previously subject to tax on a realisation basis, the recognition of any accrued gain or loss at the beginning of the first election year will be deferred until the derivative is disposed of.

### Character conversion transactions

Existing rules, intended to prevent fully taxable ordinary income from being recharacterised into more favourably taxed capital gains under a 'derivative forward agreement', provide an exemption to facilitate certain commercial transactions where the economic return from a purchase or sale agreement is based on the economic performance of the actual property being purchased or sold, rather than an underlying reference property. To prevent potential misuse of this exemption, the 2019 federal budget amends the definition of derivative forward agreement to provide that the commercial transaction exemption is unavailable if it can reasonably be considered that one of the main purposes of the agreement to purchase a security in the future is for a taxpayer to convert ordinary income into capital gains. This will apply to transactions entered into after 18 March 2019; and also after December 2019 to transactions that were entered into

before 19 March 2019, including those that extended or renewed the terms of the agreement after 18 March 2019, subject to certain transitional rules.

## Foreign exchange gains and losses

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

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

### *Debt parking to avoid foreign exchange gains*

To avoid realising a foreign exchange gain on the repayment of a foreign currency debt, some taxpayers have entered into debt-parking transactions. As a result, the rules require any accrued foreign exchange gain on foreign currency debt to be realised when the debt becomes a parked obligation. The debtor will be deemed to have a gain, if any, that it otherwise would have if it had paid an amount (expressed in the currency in which the debt is denominated) to satisfy the principal amount of the debt equal to:

- when the debt becomes a parked obligation as a result of it being acquired by the current holder, the amount for which the debt was acquired, and
- in other cases, the FMV of the debt.

A foreign currency debt will become a parked obligation if:

- at that time, the current holder of the debt does not deal at arm’s length with the debtor or, when the debtor is a corporation, has a significant interest (i.e. generally together with non-arm’s length persons, 25% or more of the votes or value) in the corporation, and
- at any previous time, a person who held the debt dealt at arm’s length with the debtor and, when the debtor is a corporation, did not have a significant interest in the corporation.

Exceptions will apply to certain *bona fide* commercial transactions, and related rules will provide relief to financially distressed debtors.

## Partnership income

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

Corporate partners are generally prevented from deferring taxation on partnership income in respect of partnerships in which they (together with related parties) hold an interest greater than 10% (share of income or entitlement to assets); income from these partnerships must be accrued up to the end of the corporation’s taxation year. The accrual is based on the partnership income for the fiscal period ending in the corporation's taxation year (the 'formulaic amount'), unless a lower amount is designated by the partner. Penalties can apply if the designated amount reported is less than both the formulaic amount and the actual prorated income of the subsequent partnership fiscal period. Upon request, permission to change the partnership's fiscal period may be granted. Partnerships in multi-tier structures must adopt the same fiscal period (generally, 31 December).

## Joint venture income

An unincorporated joint venture is not recognised as a separate legal entity, and no specific statutory rules govern the taxation of a joint venture in Canada. However, many business arrangements that are set up as joint ventures may be considered partnerships, and treated as such for Canadian tax purposes. Whether a partnership exists in a particular situation is a legal question based on the specific facts and circumstances.

Consistent with the partnership anti-deferral rules (*discussed in Partnership income above*), corporate participants must report their actual share of joint venture income or loss up to the end of their own year-end.

## Non-resident trusts (NRTs) and offshore investment funds

An NRT will generally be deemed to be resident for Canadian tax purposes if (i) it has Canadian resident contributors or (ii) certain former Canadian residents have contributed to an NRT that has Canadian resident beneficiaries. However, an election can be filed to deem the creation of a separate notional trust for tax purposes, referred to as a 'non-resident portion trust'. Canadian tax will apply only to the income or gains from the properties held by the trust that are not included in the non-resident portion trust. Properties included in the non-resident portion trust are those properties that have not been directly or indirectly contributed by a Canadian resident or certain former Canadian residents (or property substituted for those properties or income derived from those properties). Many direct or indirect transfers or loans of property or services can be deemed to be contributions to an NRT.

An NRT is deemed to be resident in Canada if a Canadian-resident taxpayer transfers or lends property to the trust (regardless of the consideration received) and the property held by the trust may revert to the taxpayer, pass to persons to be determined by the taxpayer, or be disposed of only with the taxpayer's consent.

The offshore investment fund rules affect Canadian residents that have an interest as a beneficiary in these funds. If the rules apply, the taxpayer will be required to include in its income an amount generally determined as the taxpayer's cost of the investment multiplied by a prescribed income percentage (i.e. the prescribed rate of interest plus 2%) less any income received from the investment. Also, for certain non-discretionary trust funds in which a Canadian-resident person, and persons that do not deal at arm's length with the person, have interests in aggregate of 10% or more of the total FMV of the total interests in the trusts, the trust is deemed to be a controlled foreign affiliate of the Canadian beneficiary and is thereby subject to the Canadian FAPI rules (*discussed below*).

## Earnings of specified investment flow-throughs (SIFTs)

Certain earnings of SIFTs (i.e. publicly traded income trusts and partnerships) are subject to a SIFT tax and are deemed to be a dividend when distributed. The rules are intended to discourage corporations from converting to income trusts. The rules do not apply to Real Estate Investment Trusts (REITs) that meet certain conditions.

## Foreign income

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

Foreign investment income earned directly by Canadian resident corporations, other than dividends, is taxed as earned, with a non-business foreign tax credit and a deduction for foreign income or profits taxes available, subject to certain limitations. Dividends received by Canadian resident private corporations (or public corporations controlled by one or more individuals) from non-connected foreign corporations are subject to the special refundable tax of 38⅓% (*see above*), to the extent that the dividends are deductible in determining taxable income.

The tax treatment of foreign dividends received by a Canadian resident corporation will depend on whether the payer corporation is a foreign affiliate of the recipient. Dividends received by a Canadian resident corporation from foreign corporations that are not foreign affiliates are taxed when received, with a non-business foreign tax credit and a deduction for foreign income or profits taxes available, subject to certain conditions. Dividends received by a Canadian resident corporation from foreign affiliates may be permitted to flow tax-free, subject to certain limitations pertaining to the nature of the earnings from which the dividends were paid, the foreign income or profits taxes paid, and WHTs paid in respect thereof.

To date, 24 Tax Information Exchange Agreements (TIEAs) have entered into force (one on behalf of five jurisdictions), one has been signed (but not yet in force), and Canada is currently negotiating five other TIEAs. To encourage non-treaty countries to enter into TIEAs:

- an exemption is available for dividends received by a Canadian resident corporation from the active business earnings of its foreign affiliates resident and carrying on their active business operations in non-treaty countries that have entered into a TIEA with Canada, and
- active business income earned by foreign affiliates in non-TIEA, non-treaty countries that have not signed the Convention on Mutual Administrative Assistance in Tax Matters will be treated as FAPI, which is taxable to the relevant Canadian resident corporation on an accrual basis, if a TIEA with Canada is not concluded within a specified period from a written request to commence negotiations or from the commencement of negotiations.

*See Controlled foreign affiliates and foreign accrual property income (FAPI) in the Group taxation section for a discussion on foreign affiliates, controlled foreign affiliates, and FAPI.*

### *Shareholder loan rules*

Non-resident controlled Canadian corporations are permitted to make certain loans to foreign parent companies or related non-resident companies without being subject to the deemed dividend WHT if appropriate elections are filed. The election may be filed on a loan-by-loan basis, and the Canadian corporation must then include in income interest at a prescribed rate. The legislation also applies to loans made by, or to, certain partnerships.

In recent years, the shareholder loan rules were amended to include rules that are similar to the existing back-to-back loan rules, except that the amended rules apply to debts owing to Canadian-resident corporations rather than debts owing by Canadian-resident taxpayers, for back-to-back shareholder loan arrangements that are outstanding:

- if there is only one intermediary, after 21 March 2016 (debts arising before 22 March 2016 are deemed to arise on 22 March 2016), and
- if there are multiple intermediaries, after 31 December 2016 (debts arising before 1 January 2017 are deemed to arise on 1 January 2017).

A back-to-back shareholder loan arrangement is considered to exist when an ‘intermediary’ that is not connected with the shareholder:

- is owed an amount by the shareholder (the shareholder debt), and
- owes an amount to the Canadian corporation or has a specified right (as defined) relating to a particular property, and

this obligation or property is linked to the shareholder debt (certain conditions must be met).

If the rules apply to the debt owing by a shareholder of a Canadian-resident corporation, the shareholder will be deemed to be indebted directly to the corporation.

### *Cross-border surplus stripping*

Section 212.1 of the Income Tax Act contains an ‘anti-surplus-stripping’ rule that applies when a non-resident person (or designated partnership) disposes of its shares in a corporation resident in Canada (the subject corporation) to another corporation resident in Canada (the purchaser corporation) with which the non-resident person does not deal at arm’s length. The rule is intended to prevent the tax-free receipt by the non-resident person of distributions in excess of the paid-up capital of its shares in the subject corporation and an artificial increase in the paid-up capital of such shares. This rule results in a deemed dividend to the non-resident person or a suppression of the paid-up capital of the shares that would otherwise have been increased as a result of the transaction.

An exception to the anti-surplus-stripping rule ensures the rule does not apply when a non-resident corporation is ‘sandwiched’ between two Canadian corporations and the non-resident corporation disposes of the shares of the lower-tier Canadian corporation to the Canadian parent corporation to unwind the structure.

Some non-resident corporations with Canadian subsidiaries have used this exception by reorganising the group into a sandwich structure to qualify for this exception in a manner that increases the paid-up capital of the shares of those Canadian subsidiaries. As a result, this exception has been amended, for dispositions occurring after 21 March 2016, to ensure that it does not apply when a non-resident corporation:

- owns, directly or indirectly, shares of the Canadian purchaser corporation, and
- does not deal at arm's length with the Canadian purchaser corporation.

The government will also continue to challenge, under other provisions (including the general anti-avoidance rule), certain transactions undertaken before 22 March 2016 if in its view the taxpayer has inappropriately relied on the exception to the anti-surplus stripping rule.

The existing cross-border surplus stripping rules also do not expressly address certain internal reorganisations that involve situations where a non-resident disposes of an interest in a partnership that owns a Canadian subject corporation to a Canadian purchaser corporation, nor do they deal with similar planning involving trusts. A corresponding corporate immigration rule may be ineffective in similar circumstances. Recently enacted legislation amends these provisions to add comprehensive 'look-through' rules for partnerships and trusts, to ensure that the rules cannot be avoided inappropriately, for transactions that occur after 26 February 2018. These rules will allocate the assets, liabilities, and transactions of a partnership or trust to its members or beneficiaries, as the case may be, based on the relative fair market value of their interest.

### *'Foreign affiliate dumping' rules*

Transactions described as 'foreign affiliate dumping' involve an investment in a foreign affiliate by a corporation resident in Canada (CRIC) that is controlled by a non-resident of Canada. When these rules apply, a dividend will be deemed to have been paid by the CRIC to its foreign parent, to the extent of any non-share consideration given by the CRIC for the 'investment' in the foreign affiliate, and any increase in the paid-up capital pertaining to the investment will be denied. The rules define 'investment' broadly to include:

- an acquisition of shares in or a contribution of capital to the foreign affiliate
- an indirect acquisition by the CRIC of shares of the foreign affiliate that results from a direct acquisition by the CRIC of the shares of another corporation resident in Canada if the total FMV of all of the shares that are held, directly or indirectly, by the other corporation and are shares of foreign affiliates held by the other corporation exceeds 75% of the total FMV of all properties owned by the other corporation
- transactions where the foreign affiliate becomes indebted to the CRIC (or a related Canadian company), and
- an acquisition of certain options in shares or debt of the foreign affiliate.

Any deemed dividend is automatically reduced to the extent of available paid-up capital, in accordance with the paid-up capital offset rules (subject to compliance requirements), and any remainder will be subject to Canadian WHT (as reduced by the applicable treaty).

Subsequent legislation further expanded these rules. They now apply when the CRIC makes an investment in a non-resident corporation that is not a foreign affiliate of the CRIC but is a foreign affiliate of another corporation resident in Canada that does not deal at arm's length with the CRIC.

The 2019 federal budget proposes to extend the scope of the foreign affiliate dumping rules, to include situation where a CRIC is controlled by:

- a non-resident individual
- a non-resident trust, or
- a group of non-resident corporations, non-resident individuals, and/or non-resident trusts, who do not deal with each other at arm's length.

The proposed changes apply to transactions or events occurring after 18 March 2019.

## Emissions trading regimes

Under emissions trading regimes, regulated emitters must deliver emissions allowances to the government. These allowances may be purchased by emitters, earned in emissions reduction activities, or provided by the government at a reduced price or no cost. Specific rules clarify the tax treatment of emissions allowances and eliminate the double taxation of certain free allowances. Specifically, emissions allowances will be treated as inventory for all taxpayers; however, the 'lower of cost and market' method cannot be used to value the inventory.

If a free allowance is received, there will be no income inclusion on receipt of the allowance. In addition, the deduction for an accrued emissions obligation will be limited to the extent that the obligation exceeds the cost of any emissions allowances that the taxpayer has acquired and that can be used to settle the obligation. If a deduction is claimed in respect of an emissions obligation that accrues in one year (e.g. 2019) and that will be satisfied in a future year (e.g. 2020), the amount of this deduction will be brought back into income in the subsequent year (2020) and the taxpayer will be required to evaluate the deductible obligation again each year, until it is ultimately satisfied.

If a taxpayer disposes of an emissions allowance otherwise than under the emissions allowance regime, any proceeds received in excess of the taxpayer's cost, if any, for the allowance will be included in computing income.

# Corporate - Deductions

**Last Reviewed - 17 June 2019**

Business expenses that are reasonable and paid out to earn income are deductible for income tax purposes unless disallowed by a specific provision in the Income Tax Act. Some expenses are deductible subject to limitation (e.g. charitable donations, entertainment expenses, the cost of providing an automobile to employees). Deduction of capital expenditures is specifically prohibited, but special provisions may allow depreciation or amortisation of these expenditures.

Because Canadian corporations are taxable on worldwide income, there are no territorial limits on the deductibility of related expenses. Payments to affiliates are deductible if they reflect arm's-length charges. Transfers of losses and other deductions between unrelated corporate taxpayers are severely limited after an acquisition of control.

## Depreciation and amortisation

Depreciation for tax purposes (capital cost allowance) is generally computed on a pool basis, with only a few separate classes (pools) of property. Annual allowances are generally determined by applying a prescribed rate to each class on the declining-balance basis. For example, the prescribed annual rate is 20% on most furniture and fixtures, 30% on automotive equipment, and 4% to 10% on most buildings. In the year of acquisition, only half of the amount otherwise allowable may be claimed on most classes of property.

Generally, capital cost allowance (CCA) may not be claimed until the taxation year the property is available for use. The taxpayer can claim any amount of CCA up to the maximum. CCA previously claimed may be recaptured if assets are sold for proceeds that exceed the undepreciated cost of the class. Temporary incentives to accelerate depreciation for eligible manufacturing and processing machinery and equipment acquired before 2026 revise the rate and/or method to 50% declining-balance (returning to 30% declining-balance in 2026).

Draft legislation proposes to:

- introduce the Accelerated Investment Incentive (AII), which provides an increased first year CCA deduction for 'eligible' property acquired after 20 November 2018 and available for use before 2028 (generally equivalent to three times the usual first-year CCA deduction); the AII will apply to all capital property subject to the CCA rules, except manufacturing and processing and specified clean energy equipment (*see below for enhanced rules that apply to these properties*), property previously owned by the taxpayer or a non-arm's length person or transferred to the taxpayer on a tax-deferred 'rollover' basis, and
- allow a 100% CCA deduction to be claimed in the first year the property becomes available for use, for:
    - manufacturing and processing and specified clean energy equipment acquired after 20 November 2018 and available for use before 2024 , and

- zero-emission vehicles acquired after 18 March 2019 and available for use before 2024.

The increased first year deduction and 100% CCA deduction is gradually phased out if the property becomes available for use after 2023 and before 2028.

### *Eligible capital property (ECP)*

Before 2017, three-quarters of capital expenditures for goodwill and certain other intangible properties were included in a cumulative eligible capital (CEC) pool and could be amortised at a maximum annual rate of 7%, on a declining-balance basis. A portion of proceeds could be taxable as recapture or as a gain on disposition.

Starting 1 January 2017, the ECP regime was repealed and replaced with a new CCA pool, Class 14.1. Transitional rules apply. 100% of eligible capital expenditures are included in Class 14.1 and subject to a 5% declining-balance CCA rate. The rules that apply to depreciable property, such as the 'half-year rule', recapture, and capital gains, also apply to the properties included in Class 14.1.

Special rules apply to expenditures that do not relate to a specific property of a business. Every business is considered to have goodwill associated to it (even if no expenditures on goodwill have been made). Expenditures that do not relate to a particular property will increase the capital cost of the goodwill of the business and, consequently, the balance of the Class 14.1 pool.

A receipt that does not relate to a specific property will reduce the capital cost of the goodwill of the business, and therefore the balance of the Class 14.1 pool, by the lesser of the cost of the goodwill (which may be nil) and the amount of the receipt. Any excess will be treated as a capital gain. Any previously deducted CCA will be recaptured to the extent that the receipt exceeds the balance of the Class 14.1 pool.

CEC balances at 31 December 2016 were transferred to the new Class 14.1 pool as of 1 January 2017. The CCA depreciation rate for the transferred property in the Class 14.1 pool is 7% until 2027. Proceeds received after 31 December 2016, relating to property acquired, expenditures made, or goodwill generated before 1 January 2017, reduce the Class 14.1 pool at a 75% rate.

## Mining and oil and gas activity

Generally, mining and oil and gas companies are allowed a 100% deduction for grassroots exploration costs. Other development costs are deductible at the rate of 30% on a declining-balance basis. Generally, for expenses incurred after 20 March 2013, pre-production mine development expenses are treated as 'Canadian development expenses' (CDEs) (30% declining balance) instead of as 'Canadian exploration expenses' (CEEs) (100% deduction). If certain grandfathering criteria are met, taxpayers can continue to treat pre-production mine development expenses as CEEs. In addition, mining expenses incurred after 28 February 2015 that relate to environmental studies, and community consultations that are required to obtain an exploration permit or meet a legal or informal obligation under the terms of the permit, will be treated as CEEs, which may provide an immediate 100% deduction.

For oil and gas expenses generally incurred after 2018, expenditures related to drilling or completing a discovery well (or building a temporary access road to, or preparing a site of, any such well) are classified as CDEs, instead of as CEEs.

Note that draft legislation introduces the AII (*see Depreciation and amortisation above*). The AII provides an enhanced first year deduction and also generally applies to eligible CDE and Canadian oil and gas property expenses incurred after 20 November 2018.

Capital property costs are subject to the depreciation rules *noted above under Depreciation*. In addition, in certain cases, significant asset acquisitions and assets acquired for a new mine or major expansion benefit from accelerated depreciation of up to 100% of the income from the mine. For certain oil sands assets acquired after 18 March 2007, accelerated depreciation was eliminated in 2015. For other mining assets, the accelerated depreciation is being phased out over the 2017 to 2020 calendar years, generally for expenses incurred after 20 March 2013, unless certain grandfathering criteria are met.

For assets acquired before 2025, CCA rates are:

- 30% for equipment used in natural gas liquefaction (returning to 8% in 2025), and
- 10% for buildings at a facility that liquefies natural gas (returning to 6% in 2025).

Provinces levy mining taxes on mineral extraction and royalties on oil and gas production. Most are deductible for income tax purposes. For taxation years that begin after 31 December 2019, British Columbia has introduced a non-refundable 3% tax credit for qualifying LNG investments. *See British Columbia Liquefied Natural Gas Income Tax Act in the Taxes on corporate income section*.

ITCs are available federally (and in some provinces if certain criteria are met) to individuals who invest in shares to fund prescribed mineral exploration expenditures. The federal credit in 2019 for qualified 'flow-through' share investments is 15% of qualifying mining grassroots exploration expenditures. The credit can be used to offset current taxes payable or carried over to certain previous or subsequent taxation years.

### *Extractive Sector Transparency Measures Act*

The Extractive Sector Transparency Measures Act requires public disclosure of government payments made by mining and oil and gas entities engaged in the commercial development of oil, gas, or minerals in Canada or elsewhere. It also applies to entities that control another entity that engages in these activities. However, an entity will be required to report only if it:

- is listed on a stock exchange in Canada, or
- has a place of business in Canada, does business in Canada, or has assets in Canada, and, based on its consolidated financial statements, meets minimum asset, revenue, and/or employee thresholds.

This mandatory reporting standard for extractive companies applies to payments of CAD 100,000 or more in a year that have been made to foreign and domestic governments at all levels, including Aboriginal groups. Both monetary payments and payments 'in kind' must be reported.

## Scientific research and experimental development (SR&ED)

Canada provides a generous combination of deductions and tax credits for SR&ED. Current expenditures on SR&ED can be deducted in the year incurred or carried forward indefinitely to be used at the taxpayer's discretion to minimise tax payable. *See Scientific research and experimental development (SR&ED) credit in the Tax credits and incentives section for information on the tax credits currently available*.

## Start-up expenses

Expenses related to the incorporation, reorganisation, or amalgamation of a corporation (e.g. cost of affidavits, legal and accounting fees, costs of preparing articles of incorporation) are not deductible for income tax purposes (except for the first CAD 3,000 of incorporation expenses, which are deductible beginning 1 January 2017). They are considered to be eligible capital expenditures, for which 100% of the capital cost of the expenditure is included in Class 14.1 and subject to a 5% declining-balance CCA rate. Expenses incurred after the date of incorporation generally are deductible for income tax purposes if reasonable in amount and incurred to earn income from the business.

## Interest expenses

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

## Doubtful accounts and bad debts

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

## Business meals and entertainment

Deductions for business meals and entertainment expenses are limited to 50% of their cost. This includes meals while travelling or attending a seminar, conference, or convention, overtime meal allowances, and room rentals and service

charges, etc. incurred for entertainment purposes. If the business meal and entertainment costs are billed to a client or customer and itemised as such, the disallowance (i.e. the 50% not deductible) is shifted to the client or customer.

## Insurance premiums

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

## Charitable contributions

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

## Fines and penalties

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

## Taxes

Federal, provincial, and territorial income taxes are not deductible in determining income subject to tax. The tax treatment of federal capital taxes and provincial payroll and capital taxes is discussed in the *Other taxes section.*

## Net operating losses

Net operating losses generally may be carried back three tax years and forward 20. Special rules may prohibit the use of losses from other years when there has been an acquisition of control of the corporation.

### *Corporate loss trading*

Where there has been an acquisition of control of a corporation, an anti-avoidance measure to support the restrictions on the deductibility of losses, and the use of certain other tax benefits, applies:

- when a person or group of persons acquires shares of a corporation to hold more than 75% of the FMV of all of the shares of the corporation without otherwise acquiring control of the corporation, and
- if it is reasonable to conclude that one of the main reasons that control was not acquired was to avoid the loss restriction rules.

## Payments to foreign affiliates

Interest, rents, royalties, management fees, and other payments made to related non-residents are deductible expenses to the extent that they are incurred to earn income of the Canadian corporation and do not exceed a reasonable amount. In certain cases, the receipt of these payments by a foreign affiliate of the Canadian corporation or of a related person can give rise to FAPI, which is taxable on an accrual basis in Canada.

# Corporate - Group taxation

**Last Reviewed - 17 June 2019**

Group taxation is not permitted.

## Transfer pricing

Canadian transfer pricing legislation and administrative guidelines are generally consistent with the OECD Guidelines. Statutory rules require that transactions between related parties be carried out under arm's-length terms and conditions. The CRA has indicated that it will apply the revised OECD guidance on transfer pricing by multinational enterprises (MNEs) arising from the base erosion and profit shifting (BEPS) project (the BEPS final report was issued October 2015;

*see Base erosion and profit shifting [BEPS] in the Tax administration section for more information)*. The government's view is that the revised guidance is generally consistent with the CRA's interpretation and application of the arm's-length principle and that, consequently, CRA audit practices are not expected to change significantly.

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

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

Canada has an Advance Pricing Arrangement (APA) program that is intended to help taxpayers obtain a level of certainty on transfer prices acceptable to the local tax authorities and, when negotiated as bilateral or multilateral APAs, with tax authorities in other jurisdictions.

Many of Canada's international tax agreements contain provisions concerning income allocation in accordance with the arm's-length principle. These include a Mutual Agreement Procedure, which is a treaty-based mechanism through which taxpayers can petition competent authorities for relief from double taxation resulting from transfer pricing adjustments.

### *Transfer pricing adjustments*

When the Canadian transfer pricing rules have applied to adjust, for tax purposes, amounts related to transactions between a Canadian corporation and one or more non-arm's length non-residents (a 'primary adjustment'), the related benefit to the non-residents is treated by the CRA as a deemed dividend (a 'secondary adjustment'), subject to WHT, which can be eliminated, at the discretion of the Minister of Revenue, if the amount of the primary transfer pricing adjustment is repatriated to the Canadian corporation.

The 2019 federal budget introduces an ordering rule, which clarifies that adjustments resulting from the transfer pricing rules must be made before applying any other provisions of the Income Tax Act, for taxation years beginning after 18 March 2019. This ordering could affect the determination of penalties under the transfer pricing rules. It does not affect the existing exemption from the transfer pricing rules for certain loans and guarantees provided by Canadian-resident corporations to controlled foreign affiliates.

## Country-by-country (CbC) reporting

Annual CbC reporting is required for MNEs with total annual consolidated group revenue of 750 million euros (EUR) or more (approximately CAD 1 billion). To facilitate the sharing of this information with its international treaty partners, Canada, along with 76 other jurisdictions, has signed the OECD's Multilateral Competent Authority Agreement on CbC reporting. The reporting includes key metrics for each country the MNE operates in, such as: revenue, profit, tax paid, stated capital, accumulated earnings, number of employees, and tangible assets, as well as a description of the main activities of each of its subsidiaries. The reporting is due within one year of the end of the fiscal year to which the report relates. The first exchanges between jurisdictions of CbC reports occurred in July 2018. Before any such exchanges, the CRA will have formalised an exchange arrangement with the other jurisdiction and ensured that appropriate safeguards are in place to protect the confidentiality of the reports. Form RC4649 'Country-by-Country Report' is the CRA's reporting form that follows the CbC reporting format recommended by the OECD in its October 2015 BEPS report on transfer pricing documentation and CbC reporting. Publication RC4651 (E) 'Guidance on Country-By-Country Reporting in Canada' provides further guidance that is generally consistent with the OECD's recommendations, but includes several differences.

It is important to determine a Canadian entity's CbC report filing obligation by identifying whether Canada has a qualified competent authority agreement with a particular country for purposes of exchanging CbC reports. If this agreement does not exist, a Canadian MNE must file a CbC report in Canada as a constituent entity, even if a CbC report has been prepared and filed by an ultimate parent entity or a surrogate parent entity in that particular country.

Canada and the United States have signed a bilateral competent authority arrangement to allow for the exchange of CbC reports. The reports should be exchanged for fiscal years of MNE groups beginning on or after 1 January 2016, no later than 15 months after the year end, but with an extra three months for the 2016 report.

## Thin capitalisation

Thin capitalisation rules can limit interest deductions when interest-bearing debt owing to certain non-residents (or persons not dealing at arm's length with certain non-residents) exceeds one and a half times the corporation's equity. The rules also apply to debts of:

- a partnership of which a Canadian-resident corporation is a member, and
- Canadian-resident trusts and non-resident corporations and trusts that operate in Canada.

Disallowed interest is treated as a dividend for WHT purposes.

## Back-to-back loan arrangements

The Canadian Income Tax Act contains 'back-to-back loan' rules that prevent taxpayers from interposing a third party between a Canadian borrower and a foreign lender to avoid the application of rules that would otherwise apply if a loan were made directly between the two taxpayers. The back-to-back loan rules currently ensure that the amount of WHT on a cross-border interest payment cannot be reduced through the use of back-to-back loan arrangements. Anti-avoidance provisions also apply to certain back-to-back loan arrangements undertaken by taxpayers using an interposed third party:

- in the thin capitalisation rules for taxation years that begin after 2014, and
- relating to WHT on interest payments for amounts paid or credited after 2014.

In addition, these back-to-back loan rules:

- apply to cross-border payments of rents, royalties, or similar payments made after 2016 (an exception is available for certain arm's-length royalty arrangements that do not have a main purpose of avoiding WHT)
- include character substitution rules so the back-to-back loan rules cannot be avoided through the substitution of economically similar arrangements between the intermediary and another non-resident person, for interest and royalty payments
- apply to back-to-back shareholder loan arrangements that are outstanding after 21 March 2016 (if there are multiple intermediaries), and
- apply to back-to-back arrangements involving multiple intermediaries, for interest and royalty payments made after 2016, and for shareholder debts as of 1 January 2017.

## Controlled foreign affiliates and foreign accrual property income (FAPI)

Under Canada's FAPI rules, Canadian corporations are taxed on certain income of controlled foreign affiliates (typically, certain income from property, income from a business other than active, income from a non-qualifying business, and certain taxable capital gains) as earned, whether or not distributed. A grossed-up deduction is available for foreign income or profits taxes and WHTs paid in respect thereof. In general, a foreign corporation is a foreign affiliate of a Canadian corporation if:

- the Canadian corporation owns, directly or indirectly, at least 1% of any class of the outstanding shares of the foreign corporation, and
- the Canadian corporation, alone or together with related persons, owns, directly or indirectly, at least 10% of any class of the outstanding shares of that foreign corporation.

The foreign affiliate will be a controlled foreign affiliate of the Canadian corporation if certain conditions are met (e.g. more than 50% of the voting shares are owned, directly or indirectly, by a combination of the Canadian corporation, persons at non-arm's length with the Canadian corporation, a limited number of Canadian-resident shareholders, and persons at non-arm's length with those Canadian-resident shareholders).

Income from an 'investment business' of a foreign affiliate is generally included in its FAPI. When the income attributable to specific activities carried out by a foreign affiliate accrues to a specific Canadian taxpayer under a tracking

arrangement, recently enacted legislation deems such activities to be a separate business, for taxation years of a taxpayer's foreign affiliate beginning after 26 February 2018. Each separate business will need to meet specific conditions, including the 'six employees' test, to be excluded from the investment business definition.

When the principal purpose of a business carried on by an affiliate is to derive income from trading or dealing in indebtedness, the income from that business is generally included in its FAPI. Recently enacted legislation adds certain minimum capital requirements to the trading or dealing in indebtedness rules for an affiliate to qualify for the regulated foreign financial institution exception, for taxation years of a taxpayer's foreign affiliate beginning after 26 February 2018.

#### *Controlled foreign affiliate status*

Recently enacted legislation deems a foreign affiliate of a taxpayer to be a controlled foreign affiliate of the taxpayer if FAPI attributable to specific activities of the foreign affiliate accrues to the benefit of the taxpayer under a tracking arrangement, for taxation years of a taxpayer's foreign affiliate beginning after 26 February 2018.

# Corporate - Tax credits and incentives

**Last Reviewed - 17 June 2019**

## Foreign tax credits

Taxpayers that have foreign-source income and are resident in Canada at any time in the year are eligible for foreign tax credit relief. Separate foreign tax credit calculations are prescribed for business and non-business income on a country-by-country basis. All provinces and territories also allow a foreign tax credit, but only in respect of foreign non-business income taxes.

Income or profits taxes paid to foreign governments generally are eligible for credit against a taxpayer's Canadian income taxes payable. The credit in respect of taxes paid on foreign income is restricted to the amount of Canadian taxes otherwise payable on this income. Generally, foreign tax credits are available only to reduce Canadian tax on foreign-source income that is subject to tax in the foreign country.

Foreign business income or loss is computed for each foreign country in which a branch is located. Excess foreign business income tax credits may be carried back three years or forward ten. The foreign non-business income tax credit applies to all foreign taxes other than those classified as business income tax. No carryover is allowed with respect to the non-business income foreign tax credit. Unused foreign non-business income tax may be deducted in computing income.

## Regional incentives

In specified regions of Canada (i.e. Atlantic provinces, the Gaspé region, and Atlantic offshore region), a 10% federal ITC is available for various forms of capital investment (generally, new buildings, machinery and equipment, and/or clean energy generation equipment to be used primarily in manufacturing or processing, logging, farming, or fishing). The ITC is fully claimed against a taxpayer's federal tax liability in a given year. Unused ITCs reduce federal taxes payable for the previous three years and the next 20, or may be 40% refundable to CCPCs.

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

## Industry incentives

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

- research and development (*see below*)
- film, media, computer animation and special effects, interactive digital media, and multi-media productions

- manufacturing and processing
- liquefied natural gas development, and
- environmental sustainability.

### *Scientific research and experimental development (SR&ED) credit*

In addition to the SR&ED deduction, a taxpayer can benefit from a federal ITC, which is generally a 15% non-refundable credit on SR&ED expenditures that can be applied against federal taxes payable. Alternatively, this tax credit can be carried back 3 years or forward 20, to be applied against federal taxes owing.

A qualifying CCPC can qualify for a 35% refundable tax credit annually on its first CAD 3 million in expenditures. This enhanced credit is subject to certain capital limitations and, for taxation years ending before 19 March 2019, to certain income limitations. For taxation years ending after 18 March 2019, draft legislation no longer required taxable income to be used as a factor when determining a CCPC's annual expenditure limit for purposes of the CCPC qualifying for the 35% enhanced SR&ED ITC rate.

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

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

### *British Columbia natural gas tax credit*

For taxation years that begin after 31 December 2019, a non-refundable natural gas tax credit under the British Columbia Income Tax Act is available to qualifying corporations that develop natural gas, and have an establishment, in British Columbia. The credit can reduce the effective provincial CIT rate to a minimum of 9% (from 12%). Any unused credit can be carried forward indefinitely.

# Corporate - Withholding taxes

**Last Reviewed - 17 June 2019**

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

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

| Recipient | WHT (%) | | |
|---|---|---|---|
| | Dividends | Related-party interest (1) | Royalties (2) |
| Resident corporations and individuals | 0 | 0 | 0 |
| Non-resident corporations and individuals: | | | |
| Non-treaty | 25 | 25 | 25 |
| Treaty: | | | |
| Algeria | 15 | 15 | 0/15 |
| Argentina | 10/15 (4) | 12.5 | 3/5/10/15 (5) |

| Recipient | WHT (%) | | |
|---|---|---|---|
| | Dividends | Related-party interest (1) | Royalties (2) |
| Armenia | 5/15 (4) | 10 | 10 |
| Australia (9) | 5/15 (4) | 10 | 10 |
| Austria | 5/15 (4) | 10 | 0/10 |
| Azerbaijan (7) | 10/15 (4) | 10 | 5/10 |
| Bangladesh | 15 | 15 | 10 |
| Barbados | 15 | 15 | 0/10 |
| Belgium | 5/15 (4) | 10 | 0/10 |
| Brazil | 15/25 (4) | 15 | 15/25 |
| Bulgaria | 10/15 (4, 5) | 10 | 0/10 (5) |
| Cameroon | 15 | 15 | 15 |
| Chile (5) | 10/15 (4) | 15 | 15 |
| China, People’s Republic of (6, 9) | 10/15 (4) | 10 | 10 |
| Colombia | 5/15 (4) | 10 | 10 (5) |
| Croatia | 5/15 (4) | 10 | 10 |
| Cyprus | 15 | 15 | 0/10 |
| Czech Republic | 5/15 (4) | 10 | 10 |
| Denmark | 5/15 (4) | 10 | 0/10 |
| Dominican Republic | 18 | 18 | 0/18 |
| Ecuador | 5/15 (4) | 15 | 10/15 (5) |
| Egypt | 15 | 15 | 15 |
| Estonia (7) | 5/15 (4) | 10 | 0/10 |
| Finland | 5/15 (4) | 10 | 0/10 |
| France | 5/15 (4) | 10 | 0/10 |
| Gabon | 15 | 10 | 10 |
| Germany (9) | 5/15 (4) | 10 | 0/10 |
| Greece | 5/15 (4) | 10 | 0/10 |
| Guyana | 15 | 15 | 10 |

| Recipient | WHT (%) | | |
|---|---|---|---|
| | Dividends | Related-party interest (1) | Royalties (2) |
| Hong Kong (6) | 5/15 (4) | 10 | 10 |
| Hungary | 5/15 (4) | 10 | 0/10 |
| Iceland | 5/15 (4) | 10 | 0/10 |
| India | 15/25 (4) | 15 | 10/15/20 |
| Indonesia | 10/15 (4) | 10 | 10 |
| Ireland, Republic of | 5/15 (4) | 10 | 0/10 |
| Israel | 5/15 (4) | 10 | 0/10 |
| Italy | 5/15 (4) | 10 | 0/5/10 |
| Ivory Coast | 15 | 15 | 10 |
| Jamaica | 15 | 15 | 10 |
| Japan | 5/15 (4) | 10 | 10 |
| Jordan | 10/15 (4) | 10 | 10 |
| Kazakhstan (7) | 5/15 (4) | 10 | 10 (5) |
| Kenya | 15/25 (4, 5) | 15 | 15 |
| Korea, Republic of | 5/15 (4) | 10 | 10 |
| Kuwait | 5/15 (4) | 10 | 10 |
| Kyrgyzstan (7) | 15 (5) | 15 (5) | 0/10 |
| Latvia (7) | 5/15 (4) | 10 | 10 (5) |
| Lebanon (3) | 5/15 (4) | 10 | 5/10 |
| Lithuania (7) | 5/15 (4) | 10 | 10 (5) |
| Luxembourg | 5/15 (4) | 10 | 0/10 |
| Madagascar (3) | 5/15 (4) | 10 | 5/10 |
| Malaysia (9) | 15 | 15 | 15 |
| Malta | 15 | 15 | 0/10 |
| Mexico | 5/15 (4) | 10 | 0/10 |
| Moldova | 5/15 (4) | 10 | 10 |
| Mongolia | 5/15 (4) | 10 | 5/10 |

| Recipient | WHT (%) | | |
|---|---|---|---|
| | Dividends | Related-party interest (1) | Royalties (2) |
| Morocco | 15 | 15 | 5/10 |
| Namibia (3) | 5/15 (4) | 10 | 0/10 |
| Netherlands (9) | 5/15 (4) | 10 | 0/10 |
| New Zealand | 5/15 (4) | 10 | 5/10 |
| Nigeria | 12.5/15 (4) | 12.5 | 12.5 |
| Norway | 5/15 (4) | 10 | 0/10 |
| Oman | 5/15 (4) | 10 (5) | 0/10 |
| Pakistan | 15 | 15 | 0/15 |
| Papua New Guinea | 15 | 10 | 10 |
| Peru (5) | 10/15 (4) | 15 | 15 |
| Philippines | 15 | 15 | 10 |
| Poland | 5/15 (4) | 10 | 5/10 |
| Portugal | 10/15 (4) | 10 | 10 |
| Romania | 5/15 (4) | 10 | 5/10 |
| Russia (7) | 10/15 (4) | 10 | 0/10 |
| Senegal | 15 | 15 | 15 |
| Serbia | 5/15 (4) | 10 | 10 |
| Singapore | 15 | 15 | 15 |
| Slovak Republic | 5/15 (4) | 10 | 0/10 |
| Slovenia | 5/15 (4) | 10 | 10 |
| South Africa | 5/15 (4) | 10 | 6/10 |
| Spain | 5/15 (4) | 10 | 0/10 |
| Sri Lanka | 15 | 15 | 0/10 |
| Sweden | 5/15 (4) | 10 | 0/10 |
| Switzerland (9) | 5/15 (4) | 10 | 0/10 |
| Taiwan | 10/15 (4) | 10 | 10 |
| Tanzania | 20/25 (4) | 15 | 20 |

| Recipient | WHT (%) | | |
|---|---|---|---|
| | Dividends | Related-party interest (1) | Royalties (2) |
| Thailand | 15 | 15 | 5/15 |
| Trinidad and Tobago | 5/15 (4) | 10 | 0/10 |
| Tunisia | 15 | 15 | 0/15/20 |
| Turkey | 15/20 (4) | 15 | 10 |
| Ukraine (7) | 5/15 (4) | 10 | 0/10 |
| United Arab Emirates | 5/15 (4) | 10 | 0/10 |
| United Kingdom | 5/15 (4) | 10 | 0/10 |
| United States (8) | 5/15 (4) | 0 | 0/10 |
| Uzbekistan (7) | 5/15 (4) | 10 | 5/10 |
| Venezuela | 10/15 (4, 5) | 10 | 5/10 |
| Vietnam | 5/10/15 (4) | 10 | 7.5/10 (5) |
| Zambia | 15 | 15 | 15 |
| Zimbabwe | 10/15 (4) | 15 | 10 |

Notes

1. Interest: Canada does not impose WHT on interest (except for 'participating debt interest') paid or credited to arm's-length non-residents. Most treaties have an explicit provision for higher WHT on interest in excess of FMV in non-arm's-length circumstances.
2. Royalties: A zero royalty rate generally applies to:
    - copyright royalties and payments for a literary, dramatic, musical, or other artistic work (but not royalties for motion picture films, work on film or videotape, or other means of reproduction for use in television), and/or
    - royalties for computer software, a patent, for information concerning industrial, commercial, or scientific experience (but not royalties for a rental or franchise agreement), or for broadcasting.

   Most treaties explicitly provide for higher WHT on royalties in excess of FMV in non-arm's-length circumstances. A zero rate of tax may apply in certain cases.
3. The treaty has been signed, but is not yet in force. In the absence of a treaty, Canada imposes a maximum WHT rate of 25% on dividends, interest, and royalties.
4. The lower (lowest two for Vietnam) rate applies if the beneficial owner of the dividend is a company that owns/controls a specified interest in the paying company. The nature of the ownership requirement, the necessary percentage (10%, 20%, 25%, or higher), and the relevant interest (e.g. capital, shares, voting power, equity percentage) vary by treaty.
5. If the other state (Canada for the treaty with Oman) concludes a treaty with another country providing for a lower WHT rate (higher rate for Kenya), the lower rate (higher rate for Kenya) will apply in respect of specific payments within limits, in some cases.
6. Canada's treaty with China does not apply to Hong Kong.
7. The treaty status of the republics that comprise the former USSR is as follows:

- Azerbaijan, Estonia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Russia, Ukraine, and Uzbekistan: New treaties entered into force (*see table for rates*).
- Other republics: No negotiations are underway.

Belarus, Tajikistan, and Turkmenistan will not honour the treaty with the former USSR. As a result, Canada will impose a maximum WHT rate of 25% on dividends, interest, and royalties until a new treaty enters into force. For other republics that comprise the former USSR, the status of the former treaty with the USSR is uncertain. Because the situation is subject to change, Canadian taxpayers are advised to consult with the CRA as transactions are carried out.

8. For the United States, the reduced treaty rates apply, subject to the Limitation on Benefits article.
9. The treaty or protocol is under renegotiation.

# Corporate - Tax administration

**Last Reviewed - 17 June 2019**

## Taxable period

The tax year of a corporation, which is normally the fiscal period it has adopted for accounting purposes, cannot exceed 53 weeks. The tax year need not be the calendar year. Once selected, the tax year cannot be changed without approval from the tax authorities.

## Tax returns

Both the federal and the provincial/territorial corporation tax systems operate on an essentially self-assessing basis. All corporations must file federal income tax returns. Alberta and Quebec tax returns must also be filed by corporations that have PEs in those provinces, regardless of whether any tax is payable. Corporations with PEs in other provinces that levy capital tax must also file capital tax returns. Tax returns must be filed within six months of the corporation's tax year-end. No extensions are available.

Certain corporations with annual gross revenues exceeding CAD 1 million are required to electronically file (e-file) their federal CIT returns via the Internet. Also, information return filers that submit more than 50 information returns annually must e-file via the Internet. Penalties are assessed for failure to e-file.

## Payment of tax

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

## Functional currency

The amount of income, taxable income, and taxes payable by a taxpayer is determined in Canadian dollars. However, certain corporations resident in Canada can elect to determine their Canadian tax amounts in the corporation's 'functional currency'.

## Tax audit process

The tax authorities are required to issue an assessment notice within a reasonable time following the filing of a tax return. These original assessments usually are based on a limited review, if any, of the corporation's income tax return. However, the notice of assessment will identify any changes made (e.g. correcting discrepancies on any balances carried forward).

Traditionally, all corporations with gross income over CAD 250 million, and their affiliates, are assigned a large case file team and undergo an annual risk assessment. Corporations rated as high risk are generally audited annually. Medium-sized corporations (gross income between CAD 20 million and CAD 250 million) generally are selected based on a screening process and identified risks. Smaller corporations, which are usually CCPCs with gross income under CAD 20 million, have been subject to compliance or restricted audits, selected based on statistical data and a screening process. Audits of CCPCs are generally restricted to covering the current and one previous taxation year.

In general, the CRA targets its resources on high-risk taxpayers, with minimal resources spent on lower-risk taxpayers.

## Statute of limitations

A reassessment of the tax payable by a corporation that is not a CCPC may be made within four years from the date of mailing of the original notice of assessment, usually following a detailed field audit of the return and supporting information. The limitation period is three years for CCPCs. The three-year and four-year limits are extended a further three years in some cases (e.g. transactions with non-arm's-length non-residents). The CRA can also reassess tax, after the end of the normal reassessment period, on a gain from the disposition of real or immovable property if the taxpayer does not initially report the disposition. Reassessments generally are not permitted beyond these limits unless there has been misrepresentation or fraud. Different time limits may apply for provincial reassessments.

Recently enacted legislation extends the reassessment period of a taxpayer by:

- three years for income arising in connection with a foreign affiliate of a taxpayer, for taxation years of a taxpayer beginning after 26 February 2018
- adding a 'stop-the-clock' rule when a requirement for information (excluding foreign-based information, for which an existing 'stop-the-clock' rule already applies) or compliance order is being contested in court, for challenges instituted after 13 December 2018; the reassessment period is extended by the amount of time during which the requirement or compliance order is being contested, and
- three years to the extent the reassessment relates to a loss carryback previously claimed, where a reassessment is made to the loss as a consequence of a transaction involving a taxpayer and a non-arm's-length non-resident, for taxation years in which a carried back loss is claimed, if that loss arises in a taxation year ending after 26 February 2018.

For the purposes of the extended reassessment period relating to transactions between a taxpayer and non-arm's-length non-resident persons, the 2019 federal budget proposes to apply the definition of 'transaction' used in the transfer pricing rules for taxation years beginning after 18 March 2019.

## Appeals

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

## Topics of focus for tax authorities

Topics of interest to Canadian tax authorities include:

- Transfer pricing (inbound and outbound), including the quantum and deductibility of:
  - royalty payments made by Canadian corporations to non-arm's-length non-residents
  - goods and services
  - business restructuring expenses incurred by a group of corporations located in more than one country
  - interest rates and interest paid on loans if the funds derived from the loans are used offshore
  - guarantee fees paid by Canadian corporations to related non-resident corporations
  - management fees and general and administrative expenses, and
  - 'hybrid mismatch' financial instruments (the CRA is denying a Canadian interest deduction by recharacterising debt as equity when the recipient of the interest is not taxable in their home country).
- Offshoring of Canadian-source income by factoring the accounts receivable of Canadian corporations.
- Treaty shopping to reduce Canadian WHT and capital gains tax.
- Manipulation of tax attributes, including:

  - surplus stripping to reduce Canadian WHT by increasing a Canadian corporation's paid-up capital and subsequently distributing the surplus as a return of capital
  - arrangements that manipulate the adjusted cost base of capital assets, and
  - the acquisition of tax losses realised by arm's-length entities.
- The requirement to withhold tax on certain payments made to a non-resident that relate to fees, commissions, or other amounts in respect of services rendered in Canada.
- Transaction costs, including professional fees, related to business restructuring.
- Deductibility of reserves (contingent or unsupported amounts).
- Foreign exchange gains and losses (current or capital).
- Cash pooling arrangements.

## General Anti-Avoidance Rule (GAAR)

The GAAR was first introduced in 1988 and was designed to challenge transactions or series of transactions that would directly or indirectly result in a tax benefit when:

- a taxpayer relies on specific provisions of the Income Tax Act to achieve an outcome that those provisions seek to prevent
- a transaction defeats the underlying rationale of the provisions that are relied upon, or
- an arrangement circumvents the application of certain provisions, such as specific anti-avoidance rules, in a manner that frustrates or defeats the object, spirit, or purpose of those provisions.

If GAAR applies, the CRA may deny any deduction, exemption, or exclusion in computing taxable income or the nature of any payment or other amount may be recharacterised to deny the tax benefit that would result from an avoidance transaction.

## Foreign reporting

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

Recently enacted legislation advances the filing due date of T1134 information returns for foreign affiliates. The following filing deadlines are for taxation years of a taxpayer beginning:

- Before 2020: 15 months after year-end.
- In 2020: 12 months after year-end.
- After 2020: 10 months after year-end.

## Tax avoidance

An 'avoidance transaction' that meets certain conditions is a 'reportable transaction' and must be reported to the CRA. As well, Ontario and Quebec each have a provincial reporting regime for certain aggressive tax planning transactions. Other provinces are considering implementing similar disclosure rules for these transactions.

## Tax evasion and aggressive tax avoidance

In recent years, Canada has made significant investments to strengthen the CRA's ability to unravel complex tax schemes, increase collaboration with international partners, and ultimately bring offenders to justice. Initiatives that have been introduced include:

- hiring 100 additional auditors to investigate high-risk multinational corporations
- increasing the number of CRA annual examinations of high-risk wealthy taxpayers from 600 to 3,000
- increasing twelve-fold the number of transactions examined by the CRA
- creating a special CRA programme to stop 'the organisations that create and promote tax schemes for the wealthy'
- creating an independent advisory committee to focus on offshore tax evasion and aggressive tax planning (the Offshore Compliance Advisory Committee was established on 11 April 2016)
- hiring additional auditors and specialists with a focus on the underground economy

- developing robust business intelligence infrastructure and risk assessment systems to target high-risk international tax and abusive tax avoidance cases, and
- extending the reassessment period by three years in respect of income arising in connection with a foreign affiliate.

Previously implemented tax measures to help the CRA combat international tax evasion and aggressive tax avoidance follow:

- Certain financial intermediaries are required to report to the CRA international electronic funds transfers of CAD 10,000 or more.
- The 'Offshore Tax Informant Program' compensates certain persons who provide information that leads to the assessment or reassessment of over CAD 100,000 in federal tax (Quebec has a similar program, the 'Reward Program for Informants of Transaction Covered by the General Anti-Avoidance Rule and Sham Transactions').
- If a taxpayer fails to report income from a specified foreign property on Form T1135 (Foreign Income Verification Statement), and the form was not filed on time or a specified foreign property was not, or not properly, identified on the form, the normal assessment period for this form is extended by three years.

There are now over 1,100 offshore audits, and more than 54 criminal investigations with links to offshore transactions. The government is also aggressively pursuing those who promote tax avoidance schemes, imposing penalties on these third parties.

The 2019 federal budget announced that Canada will invest an additional CAD 150.8 million over five years to further combat tax evasion and aggressive tax avoidance, allowing the CRA to fund new initiatives and extend existing programmes, including:

- Hiring additional auditors, conducting outreach, and building technical expertise to target non-compliance associated with cryptocurrency transactions and the digital economy.
- Creating a new data quality examination team to ensure proper withholding, remitting, and reporting of income earned by non-residents.
- Extending programmes aimed at combating offshore non-compliance.

The 2019 federal budget also proposes to invest CAD 65.8 million over five years to improve the CRA's information technology systems, including replacing legacy systems, so that the infrastructure used to fight tax evasion and aggressive tax avoidance continues to evolve.

Finally, the 2019 federal budget proposes an additional CAD 50 million over five years to create four dedicated residential and commercial real estate audit teams in high risk regions. These teams will ensure that tax rules relating to real estate are being followed.

## Voluntary Disclosures Program (VDP)

The CRA's VDP was significantly tightened for applications received after 28 February 2018.

Key aspects of the VDP now include:

- two 'tracks' of disclosures:
  - a Limited Program when there is intentional conduct to be non-compliant or for corporations with gross revenue exceeding CAD 250 million in at least two of their last five taxation years and any related entities; requires participants to waive their right to object and appeal in respect of the issue disclosed, and
  - a General Program when the Limited Program does not apply
- a pre-disclosure discussion service, instead of a 'no-name' disclosure
- referral of transfer pricing applications to the Transfer Pricing Review Committee (and therefore, no relief will be granted under the VDP)
- specialist review of complex issues or large dollar amounts
- payment of the estimated tax at the time of the VDP application
- disclosure of the identity of an adviser who assisted the taxpayer in respect of the non-compliance, and

- cancellation of previous relief if a VDP application was incomplete due to misrepresentation.

VDP relief is not considered for applications that depend on an agreement being made at the discretion of the Canadian competent authority under a tax treaty provision. If a VDP application does not qualify for VDP relief, a taxpayer may still qualify for penalty and interest relief under the taxpayer relief provisions.

## Sharing information for criminal matters

Effective 13 December 2018, recently enacted legislation allows:

- the CRA to use the legal tools available under the Mutual Legal Assistance Criminal Matters Act to facilitate the sharing of information related to tax offences under Canada's tax treaties, TIEAs, and the Convention on Mutual Administrative Assistance in Tax Matters; these tools include the ability for the Attorney General to obtain court orders to gather and send information, and
- tax information to be shared with Canadian mutual legal assistance partners for acts that, if committed in Canada, would constitute terrorism, organised crime, money laundering, criminal proceeds offences, or designated substance offences.

## Base erosion and profit shifting (BEPS)

Canada has been an active participant in the BEPS Action Plan, a project of the OECD and the G20. BEPS refers to tax planning strategies that exploit gaps and mismatches in national tax laws to shift profits to low- or no-tax locations. The government will act on the recommendations from the BEPS Action Plan (final report issued 5 October 2015) relating to:

- CbC reporting (*see Country-by-country [CbC] reporting in the Group taxation section for more information*)
- transfer pricing guidance (*see Transfer pricing in the Group taxation section for more information*)
- treaty abuse (*see Treaty shopping below*), and
- the spontaneous exchange of tax rulings.

In its 2019 federal budget, the government reconfirmed its commitment to safeguard Canada's tax system and continue to be an active participant in the OECD/G20's BEPS initiative. The government continues to work with its international partners to improve and update the international tax system and to ensure a coherent response to fight cross-border tax avoidance.

### *Spontaneous exchange of tax rulings*

The CRA shares select Canadian tax rulings with certain countries, in accordance with BEPS Action 5. The types of tax rulings shared include cross-border rulings related to 'preferential regimes', transfer pricing legislation, and those providing a downward adjustment not directly reflected in the taxpayer's accounts, as well as PE rulings and related-party conduit rulings. Canada will share a summary of the applicable ruling with the countries of residence of the immediate parent company, the ultimate parent company, and certain other parties.

## Treaty shopping

The government is committed to addressing treaty abuse in accordance with the minimum standard contained in the final OECD and the G20 BEPS report on treaty shopping (Action 6). The minimum standard requires countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements. The minimum standard also requires the adoption of one of two approaches in addressing treaty abuse, either the limitation-on-benefits approach or the limited principal purpose test.

Canada, along with 86 other jurisdictions, has signed the Multilateral Convention to Implement Tax Treaty Related Measures to prevent Base Erosion and Profit Shifting (the MLI). The MLI covers the minimum standards, and various other recommendations, of Action 6 (treaty abuse) and Action 14 (dispute resolution), among other things. Canada has chosen to have the MLI apply to 75 of its 93 tax treaties (the Covered Tax Agreements).

With respect to treaty abuse, Canada will adopt, as an interim measure, a principal purpose test for the Covered Tax Agreements, but intends to adopt a limitation on benefits provision, in addition to or in replacement of the principal

purpose test, through bilateral negotiations. To meet the minimum standards for dispute resolution, Canada has agreed to implement mutual agreement procedure and binding arbitration. For the MLI to take effect, Canada must enact legislation to implement the MLI in Canadian law. A legislative bill to implement the MLI in Canada was tabled in Canada's Parliament on 20 June 2018. This bill must be debated and approved by Canada's Parliament before it can receive royal assent and be enacted in Canadian law.

### Quebec 'Tax Fairness Action Plan'

Quebec's 'Tax Fairness Action Plan' contains actions that address tax havens, aggressive tax planning, transfer pricing, and e-commerce with suppliers having no significant presence in Quebec, among other things. Many of the actions rely on cooperation with federal authorities. It is an evolving plan that is modified as challenges arise. Key actions relating to corporations include:

- Improving income tax auditing of CIT:
  - The CRA will give the Quebec government CbC reports and ask other jurisdictions to give Quebec access to similar reports concerning those jurisdictions.
  - The CRA should obtain permission from tax authorities of foreign governments with which Canada has tax treaties to transfer to Quebec information obtained under these treaties.
  - The CRA will give Quebec certain foreign reporting information.
- Collecting sales taxes on supplies of incorporeal moveable property and services to 'specified Quebec consumers' by requiring foreign suppliers with no significant presence in Canada, in addition to suppliers in other provinces and territories that supply goods and services in Quebec, to register for QST (*see Provincial retail sales tax in the Other taxes section for more information*).
- Increasing penalties in respect of GAAR-based assessments to 50% (from 25%) of the amount of the tax benefit denied.
- Strengthening the mandatory disclosure mechanism, which requires reporting to Revenu Quebec of certain transactions resulting in a tax benefit, including transactions involving:
  - an adviser who requires confidentiality from the client,
  - an adviser's remuneration that is conditional on certain events occurring, or
  - contractual coverage to protect the client from certain events.
- Requiring mandatory disclosure to Revenu Quebec of nominee agreements made as part of a transaction of series of transactions.
- Blocking access to public contracts for businesses and promoters that have used abusive tax avoidance strategies.
- Establishing a special regime to counter tax schemes based on sham transactions, by adding new penalties for taxpayers, advisers, and promoters, and extending the standard reassessment period for an additional three years.

# Corporate - Other issues

**Last Reviewed - 17 June 2019**

### Forms of business enterprise

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

- Corporation: A legal entity distinct from its shareholders, whether public or private, incorporated federally, provincially, or territorially.
- Partnership: A business relationship between two or more 'persons' (i.e. individuals, corporations, trusts, or other partnerships) formed for the purpose of carrying on business in common. Not treated as a legal entity distinct from its partners.
- Sole proprietorship: An unincorporated business operated by an individual that is carried on under the individual's own name or a trade name.

- Trust: A relationship whereby property (including real, tangible, and intangible) is managed by one person (or persons, or organisations) for the benefit of another. May hold commercial enterprises.
- Joint venture: Generally, the pursuit of a specific business objective by two or more parties whose association will end once the objective is achieved or abandoned. Not treated as a legal entity distinct from the participants.

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

## Cross-border tax compliance

### *Convention on Mutual Administrative Assistance in Tax Matters*

Under the Convention on Mutual Administrative Assistance in Tax Matters, Canada exchanges tax information with other signatories to the convention (member states of the Council of Europe and the member countries of the OECD), based on OECD standards, but is not required to collect taxes on behalf of another country, or provide assistance in the service of related documents. Canada will continue to negotiate a provision on helping to collect tax on a bilateral basis, and has agreed to include such a provision in some of its bilateral tax treaties.

### *Common Reporting Standard (CRS)*

The CRS for the automatic exchange of financial account information between foreign tax authorities requires Canadian financial institutions to have procedures to identify accounts held by residents of any country other than Canada or the United States, and to report the required information to the CRA. Having satisfied itself that each jurisdiction has appropriate capacity and safeguards in place, the CRA will formalise exchange arrangements with other jurisdictions leading to the exchange of information on a multilateral basis.

### *US Foreign Account Tax Compliance Act (FATCA)*

Canada reports enhanced tax information to the United States under an intergovernmental agreement between Canada and the United States to improve international tax compliance and to implement the US FATCA.

## Factual control

The Canadian Income Tax Act recognises two forms of control of a corporation: *de jure* (legal) control and *de facto* (factual) control. The concept of factual control is broader than legal control and is generally used to restrict access to certain corporate tax advantages. Legal control of a corporation is determined generally based on the right to elect the majority of the board of directors. Factual control is defined to exist where a person has directly or indirectly, in any manner whatever, influence that, if exercised, would result in control in fact of the corporation. Many court cases have discussed which specific factors may be useful in determining whether factual control exists.

However, a 2016 court decision held that for a factor to be considered in determining whether factual control exists, it must include a legally enforceable right and ability to effect a change to the board of directors or its powers, or to exercise influence over the shareholder or shareholders who have that right and ability. Legislation enacted in December 2017 clarifies that a determination of factual control is not limited in the manner contemplated by the court decision.

# Individual - Significant developments

**Last Reviewed - 17 June 2019**

Canada's individual tax summary reflects all 2019 federal, provincial, and territorial budgets, except for Alberta's and Prince Edward Island's. The summary is based on enacted and proposed legislation and assumes that the proposed legislation will become law. Generally, budget proposals and draft legislation are enacted into law, especially if there is a majority federal government, which is currently the case.

## Employee stock options

Draft legislative proposals limit the use of the current employee stock option tax regime and move towards aligning the tax treatment of stock options with the United States for employees of large, long-established, mature firms. *See Equity compensation in the Income determination section for more information.*

### Mutual fund trust redemptions

The 2019 federal budget addresses deferral and character conversion benefits realised by mutual fund trust unitholders on redemption of their mutual fund trust units, by denying deductions to mutual fund trusts under certain conditions, for taxation years of mutual fund trusts beginning after 18 March 2019. *See Capital gains in the Income determination section for more information.*

### British Columbia speculation and vacancy tax (SVT)

The SVT was imposed, starting in 2018, on residential property in certain urban centres in British Columbia. This new property tax targets foreign and domestic home owners who do not pay income tax in British Columbia, including those who leave their homes vacant. Up-front exemptions are available for most primary residences, qualifying long-term rental properties, and certain special cases. *See Property taxes in the Other taxes section for more information.*

# Individual - Taxes on personal income

**Last Reviewed - 17 June 2019**

Individuals resident in Canada are subject to Canadian income tax on worldwide income. Relief from double taxation is provided through Canada's international tax treaties, as well as via foreign tax credits and deductions for foreign taxes paid on income derived from non-Canadian sources.

Non-resident individuals are subject to Canadian income tax on income from employment in Canada, income from carrying on a business in Canada and capital gains from the disposition of taxable Canadian property.

Individuals resident in Canada for only part of a year are taxable in Canada on worldwide income only for the period during which they were resident.

Personal tax credits, miscellaneous tax credits, and the dividend tax credit are subtracted from tax to determine the federal tax liability.

### Personal income tax rates

2019 federal tax rates are as follows:

| Federal taxable income (CAD*) | | Tax on first column (CAD) | Tax on excess (%) |
|---|---|---|---|
| Over | Not over | | |
| 0 | 47,630 | 0 | 15.0 |
| 47,630 | 95,259 | 7,145 | 20.5 |
| 95,259 | 147,667 | 16,908 | 26.0 |
| 147,667 | 210,371 | 30,535 | 29.0 |
| 210,371 | | 48,719 | 33.0 |

* Canadian dollars

### Provincial/territorial income taxes

In addition to federal income tax, an individual who resides in, or has earned income in, any province or territory is subject to provincial or territorial income tax. Except in Quebec, provincial and territorial taxes are calculated on the federal return

and collected by the federal government. Rates vary among the jurisdictions. Two provinces also impose surtaxes that may increase the provincial income taxes payable. Provincial and territorial taxes are not deductible when computing federal, provincial, or territorial taxable income.

All provinces and territories compute income tax using 'tax-on-income' systems (i.e. they set their own rates, brackets, and credits). All except Quebec use the federal definition of taxable income.

The following table shows the top 2019 provincial/territorial tax rates and surtaxes. The provincial/territorial tax rates are applicable starting at the taxable income levels shown below. Surtax rates apply to provincial tax above the surtax thresholds shown.

| **Recipient** | **Provincial/territorial tax** | | **Provincial/territorial surtax** | |
|---|---|---|---|---|
| | **Top rate (%)** | **Taxable income (CAD)** | **Rate (%)** | **Threshold (CAD)** |
| Alberta | 15.0 | 314,928 | N/A | N/A |
| British Columbia | 16.8 | 153,900 | N/A | N/A |
| Manitoba | 17.4 | 70,610 | N/A | N/A |
| New Brunswick | 20.3 | 157,778 | N/A | N/A |
| Newfoundland and Labrador | 18.3 | 187,913 | N/A | N/A |
| Northwest Territories | 14.05 | 140,267 | N/A | N/A |
| Nova Scotia | 21.0 | 150,000 | N/A | N/A |
| Nunavut | 11.5 | 147,667 | N/A | N/A |
| Ontario | 13.16 | 220,000 | 20 and 56 | 4,740 and 6,067 |
| Prince Edward Island | 16.7 | 63,969 | 10 | 12,500 |
| Quebec (1) | 25.75 | 106,555 | N/A | N/A |
| Saskatchewan | 14.5 | 129,214 | N/A | N/A |
| Yukon | 15.0 | 500,000 | N/A | N/A |
| Non-resident | 15.84 (2) | 210,371 | N/A | N/A |

Notes

1. Quebec has its own personal tax system, which requires a separate calculation of taxable Income. Recognising that Quebec collects its own tax, federal income tax is reduced by 16.5% of basic federal tax for Quebec residents.
2. Instead of provincial or territorial tax, non-residents pay an additional 48% of basic federal tax on income taxable in Canada that is not earned in a province or territory. Non-residents are subject to provincial or territorial rates on employment income earned, and business income connected with a permanent establishment, in the respective province or territory. Different rates may apply to non-residents in other circumstances.

Combined federal/provincial (or federal/territorial) effective top marginal tax rates for 2018 are shown below. The rates reflect 2019 federal, provincial, and territorial budgets (which usually are introduced in the spring of each year), except

those of Alberta and Prince Edward Island. The rates include all provincial/territorial surtaxes, and apply to taxable incomes above CAD 210,371 in all jurisdictions except:

- CAD 314,928 in Alberta.
- CAD 220,000 in Ontario.
- CAD 500,000 in Yukon.

| Recipient | Highest federal/provincial (or territorial) tax rate (%) | | | |
|---|---|---|---|---|
| | Interest and ordinary income | Capital gains | Canadian dividends | |
| | | | Eligible (1) | Non-eligible (1) |
| Alberta | 48.0 | 24.0 | 31.7 | 42.31 |
| British Columbia | 49.8 | 24.9 | 31.4 | 44.6 |
| Manitoba | 50.4 | 25.2 | 37.8 | 46.7 |
| New Brunswick | 53.3 | 26.7 | 33.5 | 47.7 |
| Newfoundland and Labrador | 51.3 | 25.7 | 42.6 | 44.6 |
| Northwest Territories | 47.1 | 23.5 | 28.3 | 36.8 |
| Nova Scotia | 54.0 | 27.0 | 41.6 | 48.3 |
| Nunavut | 44.5 | 22.3 | 33.1 | 37.8 |
| Ontario | 53.5 | 26.8 | 39.3 | 47.4 |
| Prince Edward Island | 51.4 | 25.7 | 34.2 | 45.2 |
| Quebec | 53.3 | 26.7 | 40.0 | 46.2 |
| Saskatchewan | 47.5 | 23.8 | 29.6 | 40.4 |
| Yukon | 48.0 | 24.0 | 28.9 | 42.2 |
| Non-resident (2) | 48.8 | 24.4 | 36.7 | 40.8 |

Notes

1. *See Dividend income in the Income determination section for more information on eligible and non-eligible dividends*.
2. Non-resident rates for interest and dividends apply only in limited circumstances. Generally, interest (other than most interest paid to arm's-length non-residents) and dividends paid to non-residents are subject to Canadian withholding tax (WHT).

## Alternative Minimum Tax (AMT)

In addition to the normal tax computation, individuals are required to compute an adjusted taxable income and include certain 'tax preference' items that are otherwise deductible or exempt in the calculation of regular taxable income. If the adjusted taxable income exceeds the minimum tax exemption of CAD 40,000, a combined federal and provincial/territorial tax rate of about 25% is applied to the excess, yielding the AMT. The taxpayer then pays the greater of regular tax or the AMT. Taxpayers required to pay the AMT are entitled to a credit in future years, when their regular tax liability exceeds their AMT level for that year.

## Kiddie tax

A minor child that receives certain passive income under an income splitting arrangement is subject to tax at the highest combined federal/provincial (or territorial) marginal rate (i.e. up to 54%), referred to as 'kiddie tax'. Personal tax credits, other than the dividend, disability, and foreign tax credits, or other deductions cannot be claimed to reduce the kiddie tax.

### ‘Income sprinkling’

Starting with 2018 taxation years, ‘income sprinkling’ (i.e. shifting income that would otherwise be realised by a high-tax individual [e.g. through dividends or capital gains] to low or nil tax rate family members) using private corporations is restricted by expanding the ‘kiddie tax’ rules and making certain aspects of those rules also apply to adults in certain situations. The ‘split income’ of an adult family member is subject to tax at the highest combined federal/provincial (or territorial) marginal rate (i.e. up to 54%). Personal tax credits, other than the dividend, disability, and foreign tax credits, or other deductions cannot be claimed to reduce this tax.

# Individual - Residence

**Last Reviewed - 17 June 2019**

Generally, an individual is resident in Canada for tax purposes if there is a continuing relationship between the individual and Canada. In determining an individual's residence, all relevant facts must be considered. Residential ties of particular significance include the maintenance of a dwelling place available for the individual's occupation and the residence of the individual's spouse and dependants. Ordinarily, individuals are considered to be resident where they maintain a fixed abode for themselves and their families. Secondary factors include social and business ties and personal property, such as memberships in clubs and religious organisations, driver's licences, vehicle registration, and medical insurance coverage.

Citizenship and domicile under the tax laws of another country are not relevant.

If an individual, who, as a matter of fact, is considered not a resident of Canada, sojourns (i.e. is temporarily resident) in Canada for 183 days or more in a calendar year, the individual is deemed to be resident in Canada for that entire year.

Sometimes an individual is considered to be a resident of both Canada and of another country under that country's domestic tax laws. In these cases, to eliminate any conflicts and the double taxation that might otherwise result, Canada's tax treaties often provide special residency 'tie-breaker' rules for determining residency. Normally, under Canadian law and the residency provisions of most tax treaties, an individual is considered resident in the jurisdiction to which the individual has closer personal and economic ties, although other factors may influence this conclusion. The tie-breaker rules override the general residency tests applied under Canadian domestic law.

# Individual - Other taxes

**Last Reviewed - 17 June 2019**

### Social security contributions

For 2019, Canadian-resident employees are required to pay government pension plan contributions of up to CAD 2,748.90 and employment insurance premiums of up to CAD 860.22. However, Quebec employees instead contribute a maximum of CAD 2,991.45 in Quebec government pension plan contributions, CAD 663.75 in employment insurance premiums, and CAD 402.39 to a Quebec parental insurance plan.

Starting 1 January 2019, Canadian government and Quebec government pension plan contributions were increased by an enhancement that will be phased in over seven years. The enhanced portion of the contributions is deductible, while a credit equal to 15% of the lesser of the base (non-enhanced) amount payable and the required base premiums for the year is allowed in computing an individual's federal taxes payable.

Self-employed persons contribute double the employee's government pension plan contribution (i.e. for 2019, up to CAD 5,497.80, or if in Quebec, CAD 5,982.90) and are permitted to deduct half of the base (non-enhanced) contribution and

100% of the enhanced contribution. The non-deductible portion qualifies for a tax credit. Self-employed persons are not liable for employment insurance premiums, but may opt to pay them. Self-employed persons in Quebec must contribute up to CAD 714.51 to the Quebec parental insurance plan.

## Consumption taxes

### *Federal Goods and Services Tax (GST)*

The GST is a federal tax levied at a rate of 5% on the supply of most property and services made in Canada. It is a value-added tax (VAT) applied at each level in the manufacturing and marketing chain. However, the tax does not apply to supplies that are zero-rated (i.e. taxed at 0%) or exempt (e.g. used residential real property and most health care, educational, and financial services). Examples of zero-rated supplies include basic groceries, medical and assistive devices, prescription drugs, feminine hygiene products, agriculture and fishing, and most international freight and passenger transportation services.

Generally, registrants charge GST on their sales and pay GST on their purchases, and either remit or claim a refund for the amount of net tax reported (i.e. the difference between the GST charged and the GST paid). Suppliers are entitled to claim input tax credits for the GST paid or payable on expenses incurred relating to making fully taxable and zero-rated supplies (i.e. commercial activity), but not on expenses relating to the making of tax-exempt supplies.

### *Harmonised Sales Tax (HST)*

Five provinces have fully harmonised their sales tax systems with the GST and impose a single HST, which includes the 5% GST and a provincial component. HST applies to the same tax base and under the same rules as the GST. There is no need to register separately for GST and HST because both taxes are accounted for under one tax return and are jointly administered by the Canada Revenue Agency (CRA). The HST rates follow.

| Provinces | HST rate (%) |
|---|---:|
| New Brunswick | 15 |
| Newfoundland and Labrador | 15 |
| Nova Scotia | 15 |
| Ontario | 13 |
| Prince Edward Island | 15 |

### *Provincial retail sales tax*

The provinces of British Columbia, Manitoba, and Saskatchewan each levy a provincial sales tax (PST) at 7%, 8% (7% after 30 June 2019), and 6%, respectively, on most purchases of tangible personal property, software, and certain services. PST generally does not apply to purchases of taxable goods, software, and services acquired for resale; registered vendors can claim this resale exemption by providing to their suppliers either their PST number or a purchase exemption certificate. Certain exemptions also exist for use in manufacturing, farming, and fisheries.

PST is administered by each province's tax authority, separate from the CRA. Unlike GST/HST, PST is not a VAT and could apply to a business's inputs that are not acquired for resale (e.g. charges for telecommunications services). Therefore, any PST paid on purchases by a business cannot generally be claimed as a credit or otherwise offset against PST charged on sales.

Alberta and the three territories (the Northwest Territories, Nunavut, and the Yukon) do not impose a retail sales tax. However, the GST applies in those jurisdictions.

The Quebec Sales Tax (QST) is a VAT structured in the same manner as the GST/HST. The QST is charged in addition to the 5% GST and is levied at a rate of 9.975% on the supply of most property and services made in the province of Quebec, resulting in an effective combined rate of 14.975%. Registrants charge QST on taxable supplies (that are not zero-rated) and can claim input tax refunds for QST paid or payable on their expenses incurred and/or purchases made in

the course of their commercial activity. The resulting net tax is reported to Revenu Québec (Quebec's tax authority) and is either remitted or claimed as a refund. Revenu Québec also administers the GST/HST on behalf of the CRA for most registrants that are resident in the province.

The mandatory QST registration rules were recently expanded to non-residents of Quebec. Suppliers that are not residents of, and have no physical or significant presence in, Quebec, and that make digital and certain other supplies to 'specified Quebec consumers' may be required to register for QST under a new specified registration system, starting:

- 1 January 2019 for non-residents of Canada that make supplies of incorporeal moveable property (IPP) and services, and
- 1 September 2019 for residents of Canada that reside outside Quebec and make supplies of corporeal moveable property, IPP, and services.

The requirement to register will also apply to digital property and services distribution platforms in regards to taxable supplies of IPP or services received by specified Quebec consumers if these digital platforms control the key elements of the transaction.

## Net wealth/worth taxes

There are no net wealth/worth taxes in Canada.

## Inheritance, estate, and gift taxes

There are no federal or provincial/territorial inheritance, estate, or gift taxes. However, an individual who dies is deemed to have disposed of any capital property immediately before death. This can result in any accrued capital gains being subject to income tax in the manner discussed under *Capital gains in the Income determination section*. In addition, all provinces and territories impose probate fees or administrative charges for probating a will.

## Property taxes

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

In British Columbia, starting in 2018, an annual speculation and vacancy tax (SVT) is imposed on residential property in certain urban centres in British Columbia (i.e. Metro Vancouver Regional District, Capital Regional District, Kelowna-West Kelowna, Nanaimo-Lantzville, Abbotsford, Chilliwack, and Mission; most islands are excluded). The SVT targets foreign and domestic home owners who do not pay income tax in British Columbia, including those who leave their homes vacant. The tax rate, as a percentage of the property's assessed value at 1 July of the previous year, is, after 2018 (for 2018, 0.5% for all property owners subject to the tax):

- 2% for foreign investors and satellite families.
- 0.5% for British Columbians and all other Canadian citizens or permanent residents who are not members of a satellite family.

Up-front exemptions are available for most principal residences and for qualifying long-term rental properties and certain special cases, including home renovation, illness, and divorce. A tax credit may be available in varying amounts (depending on the type of owner) for owners subject to the SVT.

All residential property owners in the areas subject to the SVT must:

- make a declaration (i.e. register and claim an exemption) online by 31 March of the following year, and
- if no exemption is available, pay any tax owing by 2 July of the following year.

If a property has multiple owners, each owner must complete a declaration, even if they are married to another owner of the property. An owner with multiple properties must complete a separate declaration for each property. Failure to file a

declaration for a calendar year will result in assessment at the 2% tax rate for the taxpayer, regardless of residency status or exemption eligibility.

## Land transfer tax

All provinces and territories levy a land transfer tax or registration fee on the purchaser of real property within their boundaries. These levies are expressed as a percentage, in most cases on a sliding scale, of the sale price or the assessed value of the property sold, and are generally payable at the time title to the property is registered. Rates generally range from 0.02% to 5%, depending on the province or territory, but may be higher if the purchaser is a non-resident. Some exemptions (or refunds) are available. Additional land transfer taxes may apply for properties purchased in the municipalities of Montreal or Toronto. Other municipalities may also impose these taxes and fees.

In British Columbia, a 20% land transfer tax (in addition to the general land transfer tax) is imposed on foreign entities (i.e. foreign nationals and corporations, and certain Canadian corporations controlled by such foreign persons), and certain trusts and/or their trustees that have a foreign connection (a taxable trustee), that purchase residential property in the Metro Vancouver Regional District, the Capital Regional District, the Regional District of Central Okanagan, the Fraser Valley Regional District, and the Regional District of Nanaimo. Failure to pay the tax or file the required forms can result in interest, plus significant penalties, and/or imprisonment. Anti-avoidance rules will capture transactions that are structured to avoid this tax. Relief from the additional land transfer tax is available to:

- foreigners who become Canadian citizens or permanent residents within one year of purchasing a principal residence, or
- foreign workers coming to British Columbia under the British Columbia Provincial Nominee Program who purchase a principal residence.

In an effort to stop tax evasion when property ownership is hidden behind numbered companies and trusts, the British Columbia government will, starting 16 May 2019, require trustees and corporations that acquire property to identify all individuals with a beneficial interest in the trust or significant interest in the corporation on the property transfer tax return. For beneficiaries or trusts that are corporations, information about each director must be disclosed. This will apply to all property types, including residential and commercial, with exemptions for certain trusts (e.g. charitable trusts) and corporations (e.g. hospitals, schools, and libraries).

In Ontario, a 15% land transfer tax (in addition to general land transfer tax and Toronto’s land transfer tax) is imposed on foreign entities (i.e. foreign nationals and corporations, and certain Canadian corporations controlled by such foreign persons) and taxable trustees (i.e. trustees of a trust that has at least one trustee or beneficiary that is a foreign entity) that purchase residential property in the Greater Golden Horseshoe (a defined region of Southern Ontario surrounding and including the city of Toronto). For this tax to apply, the land transferred must contain at least one, but not more than six, single family residence(s). The tax also applies to unregistered dispositions of a beneficial interest in such residential property, when the purchaser of the interest is a foreign entity or taxable trustee. Failure to pay the new tax can result in a penalty, fine, and/or imprisonment. Exemptions from the 15% land transfer tax are available in certain circumstances (including for foreign workers coming to Ontario under the Ontario Immigrant Nominee Program or for refugees under the Immigration and Refugee Protection Act, who purchase a principal residence), and rebates of the tax can be obtained in certain situations.

## Luxury and excise taxes

Excise duties are levied at various rates on spirits, wine, beer, malt liquor, and tobacco products. When these goods are manufactured or produced in Canada, duty is payable on the goods at the point of packaging and not at the point of sale. When these goods are imported into Canada, duty is generally payable by the importer at the time of importation. Excise tax is also imposed on automobile air conditioners and fuel-inefficient automobiles, in addition to aviation fuel, gasoline, diesel fuel, and certain insurance premiums.

# Individual - Income determination

**Last Reviewed - 17 June 2019**

## Employment income

Salaries, wages, commissions, directors' fees, and all other remuneration received by an officer or employee are included in income from employment. Canadian residents are taxable on worldwide income, whether remitted in Canada or not. Most fringe benefits (e.g. interest-free or low-interest loans) received or enjoyed in connection with employment are also taxed as employment income. Foreigners working temporarily or permanently in Canada are eligible for special concessions for employment at a special work site or remote location. The rules exempt from tax most amounts received as allowances for board and lodging, as well as transportation between the special work site and the employee's principal place of residence.

Employer contributions to a registered pension plan or deferred profit sharing plan will be taxed when the employee receives a distribution from the plan.

A non-resident of Canada is subject to a 25% WHT on plan withdrawals. The plan administrator is responsible for withholding and remitting this tax. However, a non-resident individual can elect to have the withdrawal taxed at graduated rates. In certain circumstances, this election enables the taxpayer to withdraw the funds tax-free up to an annual threshold, which is usually the personal tax credit for the year. The 25% rate may also be reduced under the provisions of an income tax treaty.

### *Employee Profit Sharing Plans (EPSPs)*

A 'specified employee' (generally an employee who has a significant interest in, or does not deal at arm’s length with, the employer) is subject to a special tax on the portion of an employer’s EPSP contribution, allocated by the trustee to the employee, that exceeds 20% of the employee’s salary received in the year from the employer. The tax rate will equal the top combined marginal rate of the province or territory in which the employee resides (except for Quebec residents, for whom the tax rate will equal the top federal marginal tax rate, which is 33%).

## Equity compensation

Employees who exercise options to acquire shares of their employer corporation (or a related corporation) will be considered in receipt of a benefit in the year of exercise, based on the difference between the market value of the shares on the date of purchase and the total price paid to acquire the options and the shares themselves. In most cases, 50% of this benefit (25% for Quebec tax purposes, except for options of small- or medium-sized businesses conducting innovative activities, and for options granted after 21 February 2017, in shares of public corporations with at least CAD 10 million payroll in Quebec) is deductible from taxable income. As a result, only half of this benefit (75% for Quebec tax purposes if none of the above exceptions apply) is included in income.

Employees who cash out their stock option rights will be eligible for the stock option deduction only if their employer makes an election to forgo deducting the cash payment from its income. The cost of the shares to the employee for capital gains purposes is the market value of the shares on the day the option is exercised. Any capital gain or loss accruing after the date of exercise will arise only on the ultimate disposition of the shares. An exception is provided for stock options of Canadian-controlled private corporations (CCPCs) granted to employees of CCPCs, which are not subject to tax until the employee disposes of the underlying shares.

Draft legislative proposals limit the use of the current employee stock option tax regime and move towards aligning the tax treatment of stock options with the United States for employees of large, long-established, mature firms. The draft legislative proposals:

- impose a CAD 200,000 annual vesting limit (based on the value of an option's underlying shares at the date of grant) on options that can qualify for the 50% employee stock option deduction, and
- introduce an employer deduction for the amount of stock option benefits that exceeds the new annual vesting limit, subject to certain conditions.

The proposed rules will not apply to Canadian-controlled private corporations, or employers that will be specified in the Income Tax Regulations.

## Business income

Business income for self-employed individuals includes most income earned from any activity that is intended to be carried on for profit. Evidence must exist to support this intention. It does not include employment income.

Loss relief is available for self-employed individuals. Business losses from self-employment can be offset against income from the self-employment. Business losses can be carried back for a period of three years and carried forward for a period of 20 years.

## Billed-basis accounting

Taxpayers in certain designated professions (accountants, dentists, lawyers, medical doctors, veterinarians, and chiropractors) may elect to exclude the value of work in progress in computing their income. This election effectively allows such taxpayers to defer tax by deducting costs associated with work in progress in advance of the matching revenue inclusion.

For taxation years that begin after 21 March 2017, the ability of these taxpayers to deduct the cost of work in progress in computing income is restricted, subject to a transitional period. As a result, the lower of the cost and the fair market value of work in progress will gradually be included in income over five years. For these purposes, the fair market value of work in progress at the end of a year is considered to be the amount that can reasonably be expected to become receivable in respect thereof after the end of that year.

## Capital gains

Half of a capital gain constitutes a taxable capital gain, which is included in the individual's income and taxed at ordinary rates.

No special concessions are available to short-term residents with respect to the taxation of capital gains. However, a step-up in the cost base is available to new residents of Canada, which may reduce the amount of capital gains otherwise subject to tax.

The purchaser of taxable Canadian property is generally required to withhold tax from the proceeds paid to a non-resident vendor, unless the non-resident vendor has obtained a clearance certificate.

Taxable Canadian property of a taxpayer includes, among other things:

- Real estate situated in Canada.
- Both capital and non-capital property used in carrying on a business in Canada.
- In general, shares in a corporation that are listed on a stock exchange if, at any time in the preceding 60 months:
    - 25% or more of the shares of the corporation are owned by the taxpayer or persons related to the taxpayer, and
    - more than 50% of the fair market value of the shares is derived from real property situated in Canada, Canadian resource properties, and timber resource properties.
- In general, shares in a corporation that are not listed on a stock exchange if, at any time in the preceding 60 months, more than 50% of the fair market value of the shares is derived directly or indirectly from property similar to that described above for shares of a public corporation.

However, in specific situations the disposition by a non-resident of a share or other interest that is not described above may be subject to Canadian tax (e.g. when a share is deemed to be taxable Canadian property).

### *Capital gains reserve*

When capital property is sold at a profit in the year or in a previous year, a reserve can be claimed on any proceeds that are not due until after the year end. The reserve equals the portion of the gain related to the sale proceeds that are not due until after the end of the year. The reserve mechanism can be used to spread gains over a maximum of five years on most types of capital property. Amounts brought into income each year under the reserve mechanism are treated as capital gains. A reserve cannot be claimed if the taxpayer was not resident in Canada at the end of the year or at any time in the immediately preceding year.

### *Capital gain on sale of residence*

A gain realised on the sale of an individual's home (principal residence) is exempt from tax in most instances. A loss is not deductible. Generally, a capital gain realised on the sale of a principal residence will be fully exempt from tax only if the taxpayer has been resident in Canada and has occupied the home during all the years of ownership (or all years

except one, known as the 'one-plus' rule, which is intended to ensure that an individual who, in the same year, disposes of a home and acquires a replacement residence is not precluded from designating both properties as a principal residence). Only one principal residence per family unit in a tax year is eligible for this treatment.

Special rules permit resident taxpayers who temporarily rent their home to others to elect to continue to treat it as a principal residence for a further period. Generally, the period is up to four years, but it can be extended if the taxpayer is temporarily transferred by the employer and eventually returns to the same residence.

Individuals who sell their principal residence must report the sale (i.e. date of acquisition, proceeds of disposition, and a description of the property) and the principal residence designation on their income tax returns to claim the full principal residence exemption.

The 'one-plus' rule (*see above*) is eliminated if the purchaser of Canadian residential real estate was not resident in Canada during the year the property was purchased. As a result, non-residents who acquire residential properties in Canada can no longer claim a portion of the principal residence exemption to shelter gains on a later sale.

### *Assessments and reassessments*

The CRA can reassess tax, after the end of the normal reassessment period (three years after the date of the initial notice of assessment, for most taxpayers), on a gain from the disposition of real or immovable property if the taxpayer does not initially report the disposition.

### *Capital gains exemption*

A lifetime capital gains exemption (LCGE) allows a Canadian-resident individual to realise, tax free:

- up to CAD 866,912 for 2019 (indexed thereafter) in capital gains on the disposition of shares of a qualifying small business corporation, and
- up to CAD 1 million for dispositions of qualified farm and fishing properties.

An individual resident in Canada for only part of the year may be eligible to claim the exemption if that individual was a resident of Canada throughout the immediately preceding or following year.

### *Mutual fund trusts: Allocation to redeemers methodology*

When a mutual fund trust unitholder redeems its units, the trust often must dispose of investments to fund the redemption, recognising accrued gains in the trust. Although a 'capital gains refund' mechanism is available under the Canadian Income Tax Act to prevent potential 'double taxation' that could result, the mechanism does not always work well. Accordingly, the mutual fund trusts often use the 'allocation to redeemers methodology' to match the capital gains realised by the mutual fund trust on its investments with the capital gains realised by the redeeming unithholders on their units. The methodology allows a mutual fund trust to allocate capital gains realised by it to a redeeming unitholder and claim a corresponding deduction. The allocated capital gains are included in computing the redeeming unitholder's income, but its redemption proceeds are reduced by that amount.

Certain mutual fund trusts have been using the allocation to redeemers methodology:

- to allocate capital gains to redeeming unitholders that exceed the capital gains that would otherwise have been realised by these unitholders on the redemption of their units, resulting in a deferral benefit to the remaining unitholders (the deferral benefit), and
- to allow the mutual fund trust to convert the returns on an investment that would have the character of ordinary income to capital gains for their remaining unitholders, which is possible when the redeeming unitholders hold their units on income account, but others on capital account (the character conversion benefit).

For taxation years of mutual fund trusts beginning after 18 March 2019. the 2019 federal budget introduces new rules to deny a mutual fund trust a deduction to address:

- the deferral benefit on the portion of an allocation made to a unitholder on a redemption of a unit of a mutual fund trust that is greater than the capital gain that would otherwise have been realised by the unitholder on the redemption if:

  - the allocated amount is a capital gain, and
  - the unitholder's redemption proceeds are reduced by the allocation, and
- the character conversion benefit in respect of an allocation made to a unitholder on a redemption if:
  - the allocated amount is ordinary income, and
  - the unitholder's redemption proceeds are reduced by the allocation.

## Dividend income

For 2019, non-eligible and eligible dividends from Canadian corporations are grossed up by 15% and 38%, respectively, for inclusion in income. A federal tax credit can then be claimed for 9.03% (non-eligible) or 15.02% (eligible) of the grossed-up dividend, in addition to a provincial or territorial tax credit.

Personal taxes on non-eligible dividends increased after 2018, as follows:

| Non-eligible dividends | 2018 | After 2018 |
|---|---:|---:|
| Dividend gross up | 16.00% | 15.00% |
| Federal dividend tax credit (on grossed-up dividends) | 10.03% | 9.03% |
| Top federal rate | 26.64% | 27.57% |

Eligible dividends must be designated as such by the payer. Dividends generally will be eligible dividends if the corporation that pays them is resident in Canada and either is a public corporation or is not a CCPC. However, these corporations will pay non-eligible dividends in certain cases (e.g. if they received non-eligible dividends). Dividends from CCPCs will be eligible or non-eligible depending on the source of the dividends paid.

A non-resident's Canadian-source dividends are subject to WHT of 25%. That income is not subject to graduated rates. The 25% WHT, which is deducted at source, may be reduced under an income tax treaty to rates ranging from 5% to 20%.

## Interest income

Interest income is taxed as ordinary income, regardless of whether or not the interest is derived from a source in Canada. Accrued interest income on most debt obligations must be reported annually.

A non-resident's Canadian-source interest (except for most interest paid to arm's-length non-residents) is subject to WHT of 25%. That income is not subject to graduated rates. The 25% WHT, which is deducted at source, may be reduced under an income tax treaty to rates ranging from 0% to 18%.

## Rental income

Rental income is generally taxed as ordinary income.

A non-resident's Canadian-source rental income is subject to WHT of 25%. For real estate rentals that do not constitute income from carrying on a business, a non-resident can elect to be taxed on the net income from these sources at the graduated tax rates that apply to residents. However, the availability of personal and other tax credits to individuals electing to file on this basis is restricted. Any excess tax withheld is refundable to the non-resident. If an election is made, the non-resident can also file an undertaking that results in WHT being levied on only the net income from these sources.

Individuals working temporarily in Canada often have rental income from renting out their foreign home while in Canada. Deductions for expenses incurred to maintain the foreign house are allowed in determining the portion of rental income subject to the graduated tax. Canadian tax law, however, limits the amount of capital cost allowance (i.e. tax depreciation) that can be deducted to the amount required to reduce the rental income to zero. This ensures that a rental loss cannot be created by claiming capital cost allowance. If rental expenses, except for capital cost allowance, exceed rental income, the loss generally may be offset against the individual's other income, provided certain conditions are satisfied. The deductibility of rental losses against other income may be restricted if there is no reasonable expectation of a profit from the rental property.

## Foreign accrual property income (FAPI)

Individuals resident in Canada are taxed on certain investment income (FAPI) of controlled foreign affiliates as it is earned, whether or not distributed. A grossed-up deduction is available for foreign income or profits taxes and WHTs paid in respect of the income. A foreign corporation is considered to be a foreign affiliate of a Canadian individual if the Canadian individual owns, directly or indirectly, at least 1% of any class of the outstanding shares of the foreign corporation and the Canadian individual, alone or together with related persons, owns, directly or indirectly, at least 10% of any class of the outstanding shares of that foreign corporation. The foreign affiliate will be a controlled foreign affiliate if certain conditions are met (e.g. more than 50% of the voting shares are owned, directly or indirectly, by a combination of the Canadian individual, persons at non-arm's length with the Canadian individual, a limited number of Canadian resident shareholders, and persons at non-arm's length with such Canadian resident shareholders).

## Non-resident trusts (NRTs)

An NRT will generally be deemed to be resident for Canadian tax purposes if (i) it has Canadian resident contributors or (ii) certain former Canadian residents have contributed to an NRT that has Canadian resident beneficiaries. However, an election can be filed to deem the creation of a separate notional trust for tax purposes, referred to as a 'non-resident portion trust'. Canadian tax will apply only to the income or gains from the properties held by the trust that are not included in the non-resident portion trust. Properties included in the non-resident portion trust are those that have not been contributed directly or indirectly by a Canadian resident or certain former Canadian residents (or property substituted for those properties or income derived from those properties). Many direct or indirect transfers or loans of property or services can be deemed to be contributions to an NRT.

An NRT will also be deemed to be resident in Canada if a Canadian-resident taxpayer transfers or lends property to the trust (regardless of the consideration received) and the property held by the trust may revert to the taxpayer, pass to persons to be determined by the taxpayer, or be disposed of only with the taxpayer's consent.

## Offshore investment funds

The offshore investment fund rules affect Canadian residents that have an interest as a beneficiary in these funds. If the rules apply, the taxpayer will be required to include in its income an amount generally determined as the taxpayer's cost of the investment multiplied by a prescribed income percentage (i.e. the prescribed rate of interest plus 2%) less any income received from the investment. Also, for certain non-discretionary trust funds in which a Canadian-resident person, and persons that do not deal at arm's length with the person, have interests in aggregate of 10% or more of the total fair market value of the total interests in the trusts, the trust is deemed to be a controlled foreign affiliate of the Canadian beneficiary and is thereby subject to the Canadian FAPI rules (discussed above).

## Exempt income

Few income items are specifically exempt from personal income tax in Canada.

# Individual - Deductions

**Last Reviewed - 17 June 2019**

## Employment expenses

In computing income from employment, an individual can claim only limited, specified deductions. Taxes and interest (except interest related to the earning of business and property income), most life insurance premiums, and casualty losses are not deductible. Allowable deductions in computing employment income include travelling and certain other expenses of officers or employees required as a condition of employment.

### *Registered plans*

A deduction is available with respect to an employee's contributions to a Registered Pension Plan (RPP), a Pooled Registered Pension Plan (PRPP), or to a Registered Retirement Savings Plan (RRSP), within certain limits. Income earned in these plans is taxed only on withdrawal. In certain cases, individuals can deduct their contributions to an employer-sponsored foreign pension plan if they participated in the plan before moving to Canada.

Self-employed individuals can also make deductible contributions to RRSPs.

For both employed and self-employed individuals, the deductible contribution to an RRSP is generally 18% of the total employment, self-employment, and rental income that was subject to Canadian tax in the preceding year, to a maximum annual contribution amount (CAD 26,500 in 2019). The allowable contribution is further limited when an individual is a member of an RPP, PRPP, or a foreign pension plan while working in Canada.

### *Pooled Registered Pension Plans (PRPPs)*

The federal PRPP is a voluntary savings plan aimed at individuals who do not have access to employer-sponsored pension plans. The tax rules for PRPPs complement the existing RPP and RRSP framework, and operate in a manner similar to multi-employer defined contribution RPPs. The provinces and territories must introduce their own enabling legislation to implement provincial and territorial PRPPs.

## Personal deductions

Deductible non-business expenses include alimony and maintenance payments (if taxable to the recipient), certain child care expenses, and eligible moving expenses for relocation within Canada (usually in connection with a change of employment).

### *Alimony and child support payments*

Periodic alimony payments made by a taxpayer under a divorce decree (or under the terms of a written divorce or separation agreement) to a former or separated spouse (or for the spouse's benefit) are generally deductible, subject to restrictions as to the precise nature of these payments. Also, certain supporting documentation usually must be filed with the first Canadian tax return in which the taxpayer claims a deduction for alimony payments. The payments constitute taxable income to the recipient spouse or former spouse if the individual is a resident of Canada.

Treatment of child support payments depends upon when the agreement was entered into or, in certain cases, modified. Payments made under the terms of an agreement made after April 1997 (or when the amount of child support paid under an older agreement is varied after this date) for child support cannot be deducted by the payer and need not be included in the income of the recipient spouse.

Neither alimony nor child support is subject to WHT if paid to a non-resident.

### *Child-care expenses*

Canada allows working parents to deduct child-care expenses if certain conditions are met. To qualify, the expenses must be incurred by the taxpayer (or a person supporting the child) to earn employment or business income, or to pursue training or research activities. The deduction can be claimed for a variety of child-care services, such as babysitting, day nursery, and attendance at a boarding school or camp. To qualify, the services must be provided in Canada and satisfy rules that govern who provides them. If more than one person is supporting a child, the deduction generally must be taken by the supporting person with the lowest 'earned income' (generally employment and/or self-employment income). The maximum yearly deduction is generally CAD 8,000 per child under seven years old and CAD 5,000 per child from seven to 16 years old.

## Interest expense

Interest on money borrowed to acquire investment property or to invest in a business is usually deductible. Interest on loans used for personal purposes, including mortgage interest on a loan to purchase a home for personal use, is not deductible.

## Personal allowances

Unlike countries that permit personal exemptions and allowances in determining taxable income, Canada has adopted a system of tax credits. *See the Other tax credits and incentives section for more information*.

## Business deductions

Business deductions for self-employed individuals generally include all reasonable expenses that have been incurred to earn business income. Business expenses include costs of goods sold, advertising, bad debts, insurance, office expenses, and capital cost allowance. A self-employed individual can also deduct expenses for the business use of a work space in the individual's home, if the home is the individual's principal place of business, or the individual uses the work space only to earn business income and it is used on a regular and ongoing basis to meet business clients,

customers, or patients. Home expenses that may be deducted include utilities, home insurance, property taxes, mortgage interest, and capital cost allowance.

### Capital losses

Capital losses are deductible, but generally only against capital gains. Any excess of allowable capital losses over taxable capital gains in the current year can be carried back three years and forward indefinitely, to be applied against net taxable capital gains from those years. No particular holding period is required. Intent is a major factor in determining whether the gain or loss is income or capital in nature.

# Individual - Foreign tax relief and tax treaties

**Last Reviewed - 17 June 2019**

### Foreign tax relief

Relief for foreign taxes in the Canadian system is accomplished through a tax credit and deduction mechanism. A foreign tax credit of up to 15% for any foreign tax withheld at source on property income (other than income from real property) is allowed, although the credit cannot exceed Canadian tax payable on the foreign income. When the foreign tax exceeds 15% of the income, the excess foreign taxes may be allowed as a deduction from the property income. This provision can have adverse implications for foreign citizens who have foreign property income and live in Canada.

Foreign social security taxes, other than United States (US) social security taxes paid under the United States Federal Insurance Contributions Act (FICA), generally do not qualify as non-business income taxes for foreign tax credit purposes.

### Tax treaties

Canada has concluded double-taxation agreements (DTAs) with the following countries:

| | | | |
|---|---|---|---|
| Algeria | France | Luxembourg | Slovenia |
| Argentina | Gabon | Malaysia | South Africa |
| Armenia | Germany | Malta | Spain |
| Australia | Greece | Mexico | Sri Lanka |
| Austria | Guyana | Moldova | Sweden |
| Azerbaijan | Hong Kong | Mongolia | Switzerland |
| Bangladesh | Hungary | Morocco | Taiwan |
| Barbados | Iceland | Netherlands | Tanzania |
| Belgium | India | New Zealand | Thailand |
| Brazil | Indonesia | Nigeria | Trinidad and Tobago |
| Bulgaria | Ireland | Norway | Tunisia |
| Cameroon | Israel | Oman | Turkey |
| Chile | Italy | Pakistan | Ukraine |

| | | | |
|---|---|---|---|
| China (PRC) - does not apply to Hong Kong | Ivory Coast | Papua New Guinea | United Arab Emirates |
| Colombia | Jamaica | Peru | United Kingdom |
| Croatia | Japan | Philippines | United States |
| Cyprus | Jordan | Poland | Uzbekistan |
| Czech Republic | Kazakhstan | Portugal | Venezuela |
| Denmark | Kenya | Romania | Vietnam |
| Dominican Republic | Korea, Republic of | Russia | Zambia |
| Ecuador | Kuwait | Senegal | Zimbabwe |
| Egypt | Kyrgyzstan | Serbia | |
| Estonia | Latvia | Singapore | |
| Finland | Lithuania | Slovak Republic | |

# Individual - Other tax credits and incentives

**Last Reviewed - 17 June 2019**

## Federal personal tax credits

Federal personal allowances in Canada take the form of tax credits. The following credits apply for 2019.

| Federal personal tax credits (1, 2) | CAD |
|---|---:|
| Basic personal | 1,810 |
| Married (3) | 1,810 |
| Infirm dependants age 18 and over (3) | 1,071 |
| Disability (4) | 1,262 |
| Age - Persons age 65 and over (3, 4) | 1,124 |

| Other key credits (2) | |
|---|---|
| Pension income | 15% of eligible pension income (maximum credit is CAD 300). (4) |
| Tuition fees | 15% of eligible fees (minimum CAD 100 per institution). Unused credits can be carried forward indefinitely. (4) |
| Interest on student loans | 15% of the interest paid on loans under the Canada Student Loans Act and provincial student loan programs. Unused credits can be carried forward five |

| | |
|---|---|
| | years. |
| Medical expenses | 15% of amount by which eligible expenses exceed lesser of CAD 2,352 (1) and 3% of net income (generally, expenses for any 12-month period ending in the year can be claimed). (5) |
| Adoption | 15% of eligible adoption expenses (maximum credit is CAD 2,438). Must be claimed in the year the adoption period ends. (5) |
| Charitable donations (6) | 15% of the first CAD 200 and the excess is at either 29% or 33% (6). Eligible donations are generally limited to 75% of net income. Unused donations can be carried forward five years. (5) |
| Government pension plan (7) and employment insurance plan contributions | 15% of the lesser of the base (non-enhanced) amount payable and the required base premiums for the year (maximum credit is CAD 529; in Quebec, CAD 448 (8)). |
| Employment | 15% of employment income (maximum credit is CAD 183). |

Notes

1. Personal credits are indexed for inflation.
2. Any unused portion of the tax credits is not refundable.
3. The credit is reduced if the income of the individual or dependant exceeds a threshold.
4. In some circumstances, the unused portion of the credit can be transferred to a spouse, parent, grandparent, child, grandchild, sibling, aunt, uncle, niece, or nephew.
5. One spouse can claim the other's medical expenses, charitable donations, and adoption expenses.
6. For total charitable donations in a year exceeding CAD 200, the tax credit rate is:
   - 33%, to the extent the individual has income that is subject to the federal 33% income tax rate, and
   - 29% for other donations.
7. Starting 2019, Canadian government pension plan contributions were increased by an enhancement that will be phased-in over seven years, The enhanced portion is deductible, while the non-enhanced base portion remains eligible for a tax credit.
8. In Quebec, federal values are reduced by 16.5%. The amount shown reflects this reduction.

### Provincial and territorial personal tax credits

The provinces and territories have many personal tax credits that are similar to the federal personal tax credits. However, the provinces and territories set the amounts of their personal tax credits.

# Individual - Tax administration

**Last Reviewed - 17 June 2019**

### Taxable period

The tax year for an individual in Canada is the calendar year.

### Tax returns

In most cases, taxpayers must file tax returns by 30 April of the following year. Married taxpayers file separately; joint returns are not allowed. The filing deadline is extended to 15 June if the individual, or the individual's spouse, carried on an unincorporated business. There is no provision for any extension of these filing deadlines, unless they fall on a weekend, in which case the filing deadline is usually extended to the next business day.

Residents in Canada who own foreign investment properties whose total cost exceeds CAD 100,000 must file an information return (Form T1135) each year they own such properties. Exceptions apply to certain types of assets, such as those held in a foreign pension plan. The filing deadline is the same as for the individual tax return. If the total cost of the taxpayer's foreign property is less than CAD 250,000 throughout the taxation year, the taxpayer can report the property using the streamlined information reporting requirements on Form T1135.

Individuals are also required to file an information report for certain assets held at the time they cease to be a Canadian resident if the total market value of the assets exceeds CAD 25,000. This report must be filed with the Canadian tax return for the year that they cease residency. This reporting is separate from the reporting of assets subject to deemed disposition upon the cessation of Canadian residence.

## Payment of tax

Income tax is withheld from salaries. Any balance of tax owed is due 30 April of the following year. Individuals are required to pay quarterly instalments if their tax payable exceeds amounts withheld at source by more than CAD 3,000 (CAD 1,800 for Quebec residents) in both the current and either of the two previous years.

## Tax audit process

The tax authorities are required to issue an assessment notice within a reasonable time following the filing of a tax return. These original assessments usually are based on a limited review of the individual's income tax return with the notice of assessment explaining any changes made to the return. The CRA may later request additional information or supporting documents for personal deductions claimed. Returns become statute-barred three years after the date of the notice of assessment unless misrepresentation or gross negligence is involved.

The CRA typically does not select salaried employees for audit unless the individual is also involved in a tax shelter or business venture. Self-employed individuals are selected randomly, after considering various factors, such as the individual's business and the type and amount of expenses claimed. Individual shareholders of CCPCs are selected based on the activities of and income reported from the corporation and the individual's transactions with related entities, including trusts and partnerships. To address specific compliance concerns, the CRA is targeting certain individuals and their families who hold interests in privately held domestic and offshore entities that have a value exceeding CAD 50 million.

### *Appeals*

A taxpayer who disagrees with a tax assessment or reassessment may appeal. The first step is to file a formal notice of objection within 90 days from the date of mailing of the notice of assessment or reassessment, setting out the reasons for the objection and other relevant information. The deadline is one year from the due date of the return for the taxation year in issue, if this is later, for ordinary income tax and in other specific instances. The CRA will review the notice of objection and vacate (cancel), amend, or confirm the assessment. A taxpayer that still disagrees has 90 days to appeal the CRA's decision to the Tax Court of Canada. Further appeals can be made to the Federal Court of Appeal and the Supreme Court of Canada. However, the Supreme Court seldom hears income tax appeals.

## Statute of limitations

A reassessment can be issued at any time within three years of the date of mailing of the original notice of assessment, or at any later time if the taxpayer signs a waiver of the three-year limit or if the tax authorities can prove fraud or misrepresentation in the return. 'Misrepresentation' can include neglect or carelessness as well as wilful default. The limit is extended a further three years in some cases (e.g. for transactions with non-arm's-length non-residents).

The CRA can reassess tax, after the end of the normal reassessment period, on a gain from the disposition of real or immovable property if the taxpayer does not initially report the disposition.

## Topics of focus for tax authorities

### *Failure to withhold tax for non-resident employees*

Canadian tax authorities continue to focus their audit activity on employers who fail to withhold tax or apply for a treaty waiver of Regulation 102 withholding for commuters and business travellers. Under this regulation, employers (whether residents of Canada or not) that pay salaries or wages or other remuneration to a non-resident of Canada in respect of employment services rendered in Canada are required to withhold personal income tax unless a waiver has been

received before commencing work physically in Canada. There are no '*de minimis*' exceptions, and this requirement applies regardless of whether the non-resident employee in question will actually be liable for Canadian income tax on that salary pursuant to an income tax treaty that Canada has signed with another country. Complying is time-consuming and administratively burdensome.

An amount paid by a ‘qualifying non-resident employer’ to a ‘qualifying non-resident employee’ is exempt from the Regulation 102 withholding requirement.

Generally, a ‘qualifying non-resident employer’ must meet the following two conditions:

- Is resident in a country with which Canada has a tax treaty (‘treaty country’).
- Is at that time certified by the Minister.

A ‘qualifying non-resident employee’ must meet the following three conditions:

- Is resident in a treaty country.
- Is exempt from Canadian income tax under a tax treaty.
- Either:
    - is present in Canada for less than 90 days in any 12-month period that includes the time of payment, or
    - works in Canada for less than 45 days in the calendar year that includes the time of payment.

To become certified, a non-resident employer must file Form RC473 (Application for Non-Resident Employer Certification) with the CRA. Certification is valid for two calendar years (after which time employers must submit a new Form RC473), subject to revocation if the employer fails to meet certain conditions or to comply with its Canadian tax obligations.

The conditions to maintain non-resident employer certification include:

- Track and record on a proactive basis the number of days each qualifying non-resident employee is either working in Canada or present in Canada, and the income attributable to these days.
- Evaluate and determine whether its employees meet the conditions of a ‘qualifying non-resident employee’.
- Obtain a Canadian Business Number.
- Complete and file the annual T4 Summary and slips, if required.
- File the applicable Canadian corporate income tax returns if the corporation is ‘carrying on business in Canada’.
- Upon request, make its books and records available to the CRA for inspection.

### *Tax avoidance*

An 'avoidance transaction' that meets certain conditions is a 'reportable transaction' and must be reported to the CRA. Additionally, Ontario and Quebec each have a provincial reporting regime for certain aggressive tax planning transactions. Other provinces are considering implementing similar disclosure rules for these transactions.

### *Tax planning using private corporations*

Canada has enacted legislation to combat tax advantages for high income individuals, gained through the use of private corporations. In the end, the proposals were significantly modified, or did not proceed. The final proposals follow:

- ‘Income sprinkling’: Starting with 2018 taxation years, income sprinkling (i.e. shifting income that would otherwise be realised by a high-tax rate individual [e.g. through dividends or capital gains] to low or nil tax rate family members) using private corporations has been restricted. The legislation provides some clarity on whether a family member is to be considered significantly involved in a business, and thus potentially exempted from being taxed automatically at the highest marginal tax rate on non-salary income or gains derived from that business. However, the legislation is also extremely complex when applied to typical business structures. This creates uncertainty for many business owners, without any grandfathering for current income splitting arrangements. The CRA has issued some preliminary guidance on the potential application of the new rules through a number of example scenarios.

- Business income retained in a CCPC to earn income on passive investments: For taxation years beginning after 2018:
  - the annual CAD 500,000 small business deduction limit is reduced, for a CCPC that (together with associated CCPCs) earns more than CAD 50,000 of passive investment income in a year, by CAD 5 for every CAD 1 of investment income over CAD 50,000 (it is eliminated at CAD 150,000 of investment income), and
  - a CCPC is entitled to a refund of taxes paid on certain investment income only by paying 'non-eligible' taxable dividends, which are subject to a higher effective tax rate when received by a shareholder that is an individual.

### *Tax evasion and aggressive tax avoidance*

In recent years, Canada has made significant investments to strengthen the CRA's ability to unravel complex tax schemes, increase collaboration with international partners, and ultimately bring offenders to justice. Initiatives that have been introduced include:

- increasing the number of CRA annual examinations of high-risk wealthy taxpayers from 600 to 3,000
- increasing 12-fold the number of transactions examined by the CRA
- creating a special CRA program to stop 'the organisations that create and promote tax schemes for the wealthy'
- creating an independent advisory committee to focus on offshore tax evasion and aggressive tax planning (the Offshore Compliance Advisory Committee was established on 11 April 2016)
- hiring additional auditors and specialists with a focus on the underground economy, and
- developing robust business intelligence infrastructure and risk assessment systems to target high-risk international tax and abusive tax avoidance cases

Previously implemented tax measures to help the CRA combat international tax evasion and aggressive tax avoidance follow:

- Certain financial intermediaries are required to report to the CRA international electronic funds transfers (EFTs) of CAD 10,000 or more.
- The 'Stop International Tax Evasion Program' compensates certain persons who provide information that leads to the assessment or reassessment of over CAD 100,000 in federal tax.
- If a taxpayer fails to report income from a specified foreign property on Form T1135 (Foreign Income Verification Statement) and the form was not filed on time or a specified foreign property was not, or not properly identified on the form, the normal assessment period for this form is extended by three years.

There are now over 1,100 offshore audits and more than 54 criminal investigations with links to offshore transactions. The government is also aggressively pursuing those who promote tax avoidance schemes, imposing penalties on these third parties. In addition, the CRA continues to receive calls from potential informants and written submissions under the Offshore Tax Informant Program, which has resulted in additional taxpayers being audited by the CRA. Quebec has also recently introduced a similar program, the 'Reward Program for Informants of Transactions Covered by the General Anti-Avoidance Rule and Sham Transactions.'

The 2019 federal budget announced that Canada will invest an additional CAD 150.8 million over five years to further combat tax evasion and aggressive tax avoidance, allowing the CRA to fund new initiatives and extend existing programs, including:

- Hiring additional auditors, conducting outreach, and building technical expertise to target non-compliance associated with cryptocurrency transactions and the digital economy.
- Creating a new data quality examination team to ensure proper withholding, remitting, and reporting of income by non-residents.
- Extending programs aimed at combating offshore non-compliance.

The 2019 federal budget also proposes to invest CAD 65.8 million over five years to improve the CRA's information technology systems, including replacing legacy systems, so that the infrastructure used to fight tax evasion and aggressive tax avoidance continues to evolve.

The CRA has also focused audit efforts on addressing non-compliance in real estate transactions, particularly in the Vancouver and Toronto markets, by improving its tools and methods of obtaining more specific and useful information to enhance its ability to combat tax avoidance. Over the past several years, CRA audits have identified significant additional taxes related to the real estate sector and have assessed related penalties. Areas of specific focus include property flipping, pre-construction assignment sales, rental income from the real estate sharing economy, unreported GST/HST on the sale of a new or substantially renovated property, unreported capital gains, and unreported worldwide income. The 2019 federal budget proposes an additional CAD 50 million over five years to create four dedicated residential and commercial real estate audit teams in high risk regions. These teams will ensure that tax rules relating to real estate are being followed.

### *Joint Chiefs of Global Tax Enforcement (J5)*

Senior officials from the CRA have united with tax enforcement authorities in Australia, the Netherlands, the United Kingdom, and the United States to establish a joint operational group, the J5, to increase collaboration in the fight against international and transnational tax crime and money laundering. The group will focus on building international enforcement capacity by sharing information and intelligence, enhancing operational capability by piloting new approaches, and conducting joint operations, to bring those who enable and facilitate offshore tax crime to account.

### *Voluntary Disclosures Program (VDP)*

The CRA's VDP was significantly tightened for applications received after 28 February 2018.

Key aspects of the VDP now include:

- two 'tracks' of disclosures:
    - a Limited Program when there is intentional conduct to be non-compliant or for corporations with gross revenue exceeding CAD 250 million in at least two of their last five taxation years and any related entities; requires participants to waive their right to object and appeal in respect of the issue disclosed, and
    - a General Program when the Limited Program does not apply.
- pre-disclosure discussion service, instead of a 'no name' disclosure
- referral of transfer pricing applications to the Transfer Pricing Review Committee (therefore no relief will be granted under the VDP)
- specialist review of complex issues or large dollar amounts
- payment of the estimated tax at the time of the VDP application
- disclosure of the identity of an adviser who assisted the taxpayer in respect of the non-compliance, and
- cancellation of previous relief if a VDP application was incomplete due to misrepresentation.

VDP relief is not considered for applications that depend on an agreement being made at the discretion of the Canadian competent authority under a tax treaty provision. If a VDP application does not qualify for VDP relief, a taxpayer may still qualify for penalty and interest relief under the taxpayer relief provisions.

### *Sharing information for criminal matters*

Effective 13 December 2018, recently enacted legislation allows:

- the CRA to use the legal tools available under the Mutual Legal Assistance in Criminal Matters Act to facilitate the sharing of information related to tax offences under Canada's tax treaties, TIEAs and the Convention on Mutual Administrative Assistance in Tax Matters; these tools include the ability for the Attorney General to obtain court orders to gather and send information, and
- tax information to be shared with Canadian mutual legal assistance partners for acts that, if committed in Canada, would constitute terrorism, organised crime, money laundering, criminal proceeds offences, or designated substance offences.

### *Other topics*

Other topics of interest to Canadian tax authorities include:

- The creation of low provincial tax rate income using trust arrangements.

- The conversion of:
  - dividends to capital gains through corporate surplus stripping arrangements
  - ordinary income into capital gains through the use of derivative contracts, and
  - corporate income into tax deferred income within a personal RRSP by way of partnership owned by a mutual fund trust.
  - Intergenerational business transfers.
- Strategies that adhere to Canada's tax laws but contravene its intention.
- Taxable benefits related to employment (e.g. personal use of corporate-owned air crafts, automobiles, and dwellings).

### *Quebec 'Tax Fairness Action Plan'*

Quebec's 'Tax Fairness Action Plan', contains actions that address tax havens, aggressive tax planning, transfer pricing, and e-commerce with suppliers having no significant presence in Quebec, among other things. Many of the actions rely on cooperation with federal authorities. It is an evolving plan that is modified as challenges arise. Key actions relating to individuals include:

- Improving income tax auditing of individuals:
  - The CRA will ask foreign tax authorities for their approval to share, with Quebec and other provinces, information about Canadian residents on financial assets held abroad *(see Common Reporting Standard [CRS] in the Other issues section for more information*).
  - The CRA will give the Quebec government access to information obtained from the CRA's international EFT program *(discussed above)*.
- Increasing penalties in respect of general anti-avoidance rule (GAAR)-based assessments to 50% (from 25%) of the amount of the tax benefit denied.
- Implementing a tax informant reward program that will be similar to the federal 'Stop International Tax Evasion Program' *(discussed above)*.
- Strengthening the mandatory disclosure mechanism, which requires reporting to Revenu Quebec of certain transactions resulting in a tax benefit.
- Requiring mandatory disclosure to Revenu Quebec of nominee agreements made as part of a transaction or series of transactions.
- Establishing a special regime to counter tax schemed based on sham transactions by adding new penalties for taxpayers, advisers, and promoters, and extending the standard reassessment period for an additional three years.
- Fostering tax fairness in the sharing economy by requiring individuals operating a digital accommodation platform to register, collect, and remit the tax on lodging.
- Increasing tax compliance in respect of transactions on financial markets by introducing a new tax slip to facilitate reporting of financial market transactions.

# Individual - Sample personal income tax calculation

**Last Reviewed - 17 June 2019**

This sample calculation applies to a calendar year ending 31 December 2019.

## Assumptions

- Resident husband and wife living in Alberta; two children (under 18); one spouse earns all the income.
- Total remuneration of CAD 110,000.
- Capital gains of CAD 16,000.
- Foreign interest income of CAD 5,000, from which CAD 750 withholding has been deducted.
- Other interest income of CAD 6,000.
- All amounts are in Canadian dollars (CAD).

## Tax computation

| | CAD | CAD |
|---|---|---|
| Net income | | |
| Salary | | 110,000 |
| Interest | | 11,000 |
| Taxable capital gain (one-half of actual gain) (1) | | 8,000 |
| Enhanced government pension plan deduction | | (81) |
| | | |
| Net income/Taxable income | | 128,919 |
| | | |
| Income tax (*see the Taxes on personal income section*): | | |
| Federal tax before credits | | 25,660 |
| | | |
| Less - Personal credits: | | |
| Basic | 1,810 | |
| Spouse | 1,810 | (3,620) |
| | | |
| Less - Other credits: | | |
| Employment tax credit | 183 | |
| Government pension plan and employment insurance plan contributions tax credit | 529 | (712) |
| | | |
| Basic federal tax | | 21,328 |
| | | |
| Less - Foreign tax credit | | |
| Lesser of 750 and (5,000 / 128,919) x 21,328 = 827 | | (750) |
| | | |
| | | |

| | | |
|---|---|---|
| Federal income tax | | 20,578 |
| | | |
| Provincial (Alberta) income tax (2) before credits | 12,892 | |
| | | |
| Less - Personal credits: | | |
| Basic | (1,937) | |
| Spouse | (1,937) | |
| Government pension plan and employment insurance plan contributions tax credit | (353) | |
| | | |
| Alberta tax | | 8,665 |
| | | |
| Total income tax (3, 4) | | 29,243 |

Notes

1. Assuming the capital gains are not in respect of qualified farm property, qualified fishing property, or shares of a small business corporation, no capital gains deduction is available.
2. In Alberta, the following rates are applied to taxable income in 2019.

| Taxable income (CAD) | | Tax on first column (CAD) | Tax on excess (%) |
|---|---|---|---|
| Over | Not over | | |
| 0 | 131,220 | 0 | 10 |
| 131,220 | 157,464 | 13,122 | 12 |
| 157,464 | 209,952 | 16,271 | 13 |
| 209,952 | 314,928 | 23,095 | 14 |
| 314,928 | | 37,791 | 15 |

3. Personal tax credits and miscellaneous tax credits are subtracted from the result to determine Alberta tax. The 2019 Alberta personal tax credit for the government pension plan and employment insurance plan contributions is equal to 10% (maximum credit is CAD 353) of the lesser of the base (non-enhanced) amounts payable and the required base premiums for the year.
4. The taxpayer does not have sufficient tax preference items to be liable for AMT.

# Individual - Other issues

**Last Reviewed - 17 June 2019**

## Treatment of flow-through business entities

### *Specified investment flow-throughs (SIFTs)*

Certain earnings of SIFTs (i.e. publicly traded income trusts and partnerships) are subject to a SIFT tax and are deemed to be dividends when distributed.

### *Partnerships*

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

## Work permits

A person who is not a Canadian citizen or permanent resident that seeks entry to Canada for a temporary assignment must obtain appropriate work authorisation to provide services in Canada, with limited exceptions. The requirement for a work permit has little to do with the duration of the stay in Canada. Rather, the focus is on the work activities to be performed in Canada. 'Work' is defined as an activity for which wages or commissions are earned and/or an activity that competes directly with activities of Canadian citizens or permanent residents in the Canadian labour market. In addition, whether the individual is paid from a foreign country or from Canada does not determine if a work permit is required.

Individuals who do not require a temporary resident visa to enter Canada can apply for a work permit either upon entry to Canada or at a Canadian visa office in their country of nationality or country where they have been legally admitted. Individuals who require a temporary resident visa to enter Canada and who seek work in Canada for a temporary duration must apply for both a work permit and temporary resident visa at a Canadian visa office in their country of nationality or country where they have been legally admitted. In this case, if the application for the work permit is approved, the individual will also receive a non-immigrant visa, typically issued for the duration requested in the work permit application or until the expiry of the individual's passport, whichever occurs first.

Alternatively, an applicant who seeks to reside in Canada permanently can apply for permanent residence; if approved, a permanent resident visa would be issued. The applicant would obtain permanent resident status in Canada by presenting this visa upon entry to the country or, for those currently in Canada with work authorisation, by scheduling an appointment with a local immigration office. Permanent resident status allows an individual to remain and work in Canada indefinitely, subject to certain conditions. Obtaining a permanent resident visa involves longer processing times than a non-immigrant visa.

## Cross-border tax compliance

### *Convention on Mutual Administrative Assistance in Tax Matters*

Under the Convention on Mutual Administrative Assistance in Tax Matters, Canada exchanges tax information with other signatories of the convention (member states of the Council of Europe and the member countries of the Organisation for Economic Co-operation and Development (OECD)), based on OECD standards, but is not required to collect taxes on behalf of another country or provide assistance in the service of related documents. Canada will continue to negotiate a provision on helping to collect tax on a bilateral basis, and has agreed to include such a provision in some of its bilateral tax treaties.

### *Common Reporting Standard (CRS)*

The CRS for the automatic exchange of financial account information between foreign tax authorities requires Canadian financial institutions to have procedures to identify accounts held by residents of any country other than Canada or the United States, and to report the required information to the CRA. Having satisfied itself that each jurisdiction has

appropriate capacity and safeguards in place, the CRA will formalise exchange arrangements with other jurisdictions, leading to the exchange of information on a multilateral basis.

### *US Foreign Account Tax Compliance Act (FATCA)*

Canada reports enhanced tax information to the United States under an Intergovernmental Agreement between Canada and the United States to improve international tax compliance and to implement the US FATCA.

## Personal services business income

The personal services business rules prevent employees from establishing corporations to take advantage of the small business income tax rate, rather than paying the higher personal rate imposed on employment income. They also limit the expenses a personal services business can deduct. The federal corporate tax rate that applies to ‘personal services business’ income is 33%.

## Tax-Free Savings Account (TFSA)

Canadian residents aged 18 years and older who have a social insurance number can contribute each year to a TFSA, up to CAD 6,000 for 2019 and later years (CAD 5,500 for 2016 to 2018). Contributions to a TFSA are not tax-deductible but income (including capital gains) earned in a TFSA is exempt from income tax. Withdrawals (whether from capital or income) are tax-free and will increase the taxpayer’s contribution room in future years. Any unused contribution room can be carried forward indefinitely.

## Trusts and estates

A flat top-rate tax (instead of graduated tax rates) applies to testamentary trusts, estates, and grandfathered *inter vivos* trusts. For estates that are not settled by 36 months after death, the testamentary trust will be required to have taxation year ending on 31 December. Graduated tax rates apply to testamentary trusts that:

- arise as a consequence of an individual’s death (the first 36 months of an estate trust only), or
- have beneficiaries who qualify for the disability tax credit.

### *Reporting requirements for trusts*

The 2019 federal budget confirms the government's intention to implement a 2018 federal budget measure that, starting with 2021 taxation years, requires a trust to report the identity of all trustees, beneficiaries, and settlors of the trust, and each person who has the ability to exert control over trustee decisions regarding appointment of income or capital of the trust (e.g. a protector). The new reporting requirements will apply to certain trusts resident in Canada and non-resident trusts that are currently required to file a T3 ‘Trust Income Tax and Information Return’. A T3 filing obligation could result for certain Canadian-resident trusts for which a filing requirement does not currently exist. Penalties will apply for non-compliance.

# Canada contacts

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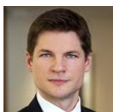

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