# Italy: Invest in Canada

In partnership with

Blakes
CANADIAN LAWYERS

REPVBBLICA ITALIANA
EMBASSY OF ITALY
OTTAWA

ITA
ITALIAN TRADE COMMISSION
DELEGATION COMMERCIALE D'ITALIE

Ottawa, 26 October 2018

In order to act efficiently in trade, the appropriate information is needed.

For this purpose, I deemed it necessary to make new tools available, tools that can properly complement the existing information and services that both the Italian Embassy and the Italian Trade Commission (ITC) already provide to Italian businesses.

Canada, whose market is increasingly opening to foreign investment, offers in fact a wealth of opportunities. These opportunities need to be made public and properly analyzed through an instrument aimed at facilitating knowledge about the market and its structure.

With this in mind, we designed "Italy: Invest in Canada" in partnership with Blakes. This guide can assist Italian investors in navigating the Canadian market. It is the fruit of a joint effort by the Italian Embassy to Canada and the ITC, and would not have been possible without the special commitment and great experience of Blakes.

I do believe that this tool will provide preliminary answers to the many questions that could arise before choosing to invest in a foreign country, and will encourage Italian investors to learn more about the Canadian economic landscape.

Claudio Taffuri

REPVBBLICA ITALIANA

**EMBASSY OF ITALY**
**OTTAWA**

# Italy: Invest in Canada

# **Why Invest** in Canada?[1]

## Innovation + Stability = **Profitability**

Canada welcomes Italian business investments and offers many competitive advantages:

### A welcoming business environment

Canada is the second best country in the G20 to do business, according to Forbes.

Source: Forbes

### Low business tax costs

Total business tax costs in Canada are by far the lowest in the G7.

Source: KPMG

### A strong growth record

Canada continues to lead all G7 countries in economic growth over the past decade (2008-2017).

Source: Organisation for Economic Co-operation and Development[2]

### Competitive R&D environment

Canada offers the lowest business costs in the G7 for R&D-intensive sectors.

Source: KPMG

### Unparalleled market access

Now that the EU-Canada Comprehensive Economic Agreement (CETA) has been implemented provisionally, EU investors have preferential access to Canada and NAFTA, and indirectly to CUSMA once it comes into force. North America is a vibrant free trade area with a combined GDP of over US$22 trillion, or nearly one-third of the world's output of goods and services.

### Financial stability

The World Economic Forum consistently declares Canada's banking system to be one of the soundest in the world.

Source: World Economic Forum

### A highly educated workforce

Canada's workforce is the most highly educated among members of the OECD, with half of its working-age population having a tertiary level education.

Source: Organisation for Economic Co-operation and Development

### A great place to invest, work, and live

Canada is one of the most multicultural countries in the world, with world-class universities, a universal health care system and clean and friendly cities. The OECD's Better Life Index shows Canada as best in the G7 in terms of overall living conditions and quality of life.

Source: Organisation for Economic Co-operation and Development

[1] "Why Invest in Canada?," *The Canadian Trade Commissioner Service, Government of Canada,* current to 2016: http://www.international.gc.ca/investors-investisseurs/advantage-avantage/advantage-avantage.aspx?lang=eng.

[2] "OECD Economic Outlook," OECD, September 2017: http://www.oecd.org/eco/outlook/

[3] NAFTA-related information in this publication is as of October 1.

# **Cross-Border** Private M&A in Canada:

# 10 Tips for Italian Acquirers

While Canadian M&A takes many cues from the United States and Europe, it is unique in many ways. A successful Italian acquirer advised by Canadian legal counsel will be armed with knowledge about these differences.

## 1 The Canadian Market Has Matured

Gone are the days of foreign purchasers founder-operated businesses to acquire in Canada at a low multiple. The majority of sellers and buyers in reported private M&A transactions in Canada are strategic corporations or financial players rather than founders. Canadian M&A deals are increasingly done with the assistance of representation and warranty insurance. On the vendor side of multinational auction transactions, Canadian law firms have started providing vendor due diligence reports to bidders on a non-reliance basis.

## 2 What Is Market?

Typical material deal terms in Canada are not just carbon copies of the U.S. or European practice. For example, as compared to the U.S., buyers of Canadian companies have been able to insist on higher caps to indemnification exposure in Canada. Survival periods tend to be longer in Canada. Anti-sandbagging provisions are often handled differently in Canadian transactions. Legal opinions have become much less common in private deals other than in the financial services and venture capital sectors.

## 3 Canadian Foreign Investment Review

Canada regulates all foreign investments under the *Investment Canada Act*. Transactions over a certain dollar-value threshold or in sensitive industries (e.g., cultural) are subject to review by the federal government, in which case a pre-closing waiting period will apply. All other foreign acquisitions of Canadian businesses are subject to post-closing notification. Reviewable investments made by state-owned enterprises (SOEs) are subject to other additional considerations.

## 4 Anti-Trust Regime and a Uniquely Canadian Defence

The anti-trust and competition regime established under the *Competition Act* (Canada) requires pre-notification merger filings when transaction and party-size thresholds are exceeded. Pre-closing waiting periods may apply. All acquisitions, whether pre-notifiable or not, are subject to possible competition review for one year following closing. The buyer can obtain an advance ruling certificate or no-action letter to foreclose the risk associated with a review. Canada now has a unique efficiencies defence to an otherwise anti-competitive merger.

## 5 Forget Everything You Know About Employment

There is no "at-will" employment in Canada, unlike the U.S. Absent valid contractual provisions limiting the employee's severance entitlements, employees are entitled to "reasonable notice" of termination or payment in lieu of such notice. This means that, on an asset transaction, employment of non-unionized employees does not transfer automatically; employees must be offered employment by the acquiror. Severance entitlements for employees tend to be much higher in Canada than in other jurisdictions. The defined-benefit and defined-contribution pension plans that are used by many Canadian employers to supplement the federal Canada Pension Plan are subject to a web of federal and provincial legislation. Relevant to the acquisition of a Canadian business, these rules govern such things as recognition of an employee's past service and transfers of plan assets.

## 6 Regulated Commerce

Regulatory regimes in Canada are often more robust than in other jurisdictions. For example, federal and provincial restrictions on the collection, use and disclosure of personal information in Canada must be observed during and after transactions. Canadian privacy legislation requires knowledgeable consent to, and not merely notice of, intended purposes. Canada has enacted its own comprehensive corruption legislation that prohibits bribery of foreign public officials, among other things, by criminal sanction with no limitation period.

## 7 Canadian Intellectual Property Protection

Unlike other jurisdictions, Canada follows a "first-to-file" system for patents. Canada has not adopted the International Patent Classification system, providing distinct cost advantages for applicants. Canadian trade-mark law elevates the importance of licences, requiring licences even for wholly owned subsidiaries. Also, registrants can renew trade-marks without the requirement of proof of use. The copyright "bundle" of rights is different than in the U.S., with no right to prepare "derivative works." A "work made for hire" is limited to the employment context and transfers of ownership must otherwise be in writing. Moral rights are protected more extensively and apply to all types of works. IP licences that are silent as to assignability or sublicenseability are generally not assignable or sublicenseable without the licensor's consent.

## 8 Structuring and Taxes

Normally, foreign buyers of Canadian shares or assets will want to incorporate a Canadian acquisition company, which allows for the pushdown of any acquisition financing and the Canadian tax-efficient repatriation of funds up to the purchase price from Canada without Canadian withholding tax. Transactions in Canada involving the sale of "taxable Canadian property" (generally, Canadian real property interests) can require clearance from the Canada Revenue Agency or a partial holdback of the purchase price. Canadian thin capitalization rules require that debt owing to related non-resident parties not exceed 1.5 times equity. In asset deals, it is also important to consider sales taxes and whether exemptions are available.

## 9 To Sue or Not to Sue

While litigation costs in Canada tend to be lower than in the U.S. due to streamlined rules of civil procedure, frivolous litigation is not common in Canada. This may in part be a result of Canada's loser pay system. The successful party in Canadian litigation is generally awarded at least part of their costs and damage awards tend to be lower than in the U.S. Also, punitive damages are extremely rare. Jury trials are extremely rare in Canadian civil matters, except for certain limited types of litigation, for example, libel or personal injury. In Ontario, commercial disputes are heard at a special division of the courts by judges with specialized commercial knowledge. Judges are appointed, not elected. While Canada allows contingency fees, the practice is not widespread and, generally speaking, the contingency payments are not as large as in the U.S. Most provinces require pre-trial mediation, which tends to encourage pre-trial settlement.

## 10 Quebec Is Distinct

The province of Quebec, unlike all other Canadian jurisdictions, is governed by a civil law system derived from the Napoleonic Code. Its laws can differ dramatically from the rest of Canada and need to be taken into account when acquiring or selling a business with assets or employees there. In addition, Quebec has legislation that protects the use of the French language.

# Doing Business in Canada

This Guide provides non-Canadians with an introduction to the laws and regulations that affect the conduct of business in Canada and, in particular, in the province of Ontario. In some cases, this Guide also identifies issues in the provinces of Alberta and British Columbia. Because of Canada's federal structure, the authority to make laws and regulations is divided between the federal and provincial governments by the Canadian Constitution although, in some areas of shared jurisdiction, both federal and provincial laws may apply.

For reasons rooted in history, Canada has two legal traditions, the civil law tradition of codified law in the province of Quebec, and the common law tradition of judge-made law in the other provinces of Canada. The province of Quebec, as Canada's only province whose majority population is French speaking, has also adopted *a Charter of the French Language* making French the official language of Quebec. Quebec also collects its own income taxes and has shared jurisdiction over immigration to Quebec with the federal government. A more detailed discussion of the laws of the province of Quebec is contained in the Blakes guide, *Doing Business in Quebec*.

The discussion under each heading in this Guide is intended to provide only general guidance and is not an exhaustive description of all provisions of federal, provincial and local law with which a business might be required to comply. Particular businesses or industries may also be subject to specific legal requirements not referred to in this Guide. For this reason, the reader should not rely solely upon this Guide in planning any specific transaction or undertaking, but should seek the advice of qualified counsel.

**The law is stated as of July 1, 2018. This guide provides a general overview of the opportunity that Canada offers to Italian investors. Therefore, it is not exhaustive and will be subject to further updates.**

# Business Entities and Alternative Methods of Carrying on Business in Canada

1

A consideration of the different forms of business enterprises available under federal and provincial law will assist the investor in determining the most suitable arrangement for conducting business in Canada. Provincial law generally governs the forms of business organization although corporations may also be incorporated federally under the laws of Canada.

## 1 Corporations

A corporation with share capital is the most common form of business entity in Canada and enjoys advantages that make it the most practical form of business organization in most instances. Corporations may also be incorporated without share capital, generally for not-for-profit purposes. A corporation is a separate legal entity, distinct from its shareholders and management, that can hold property, carry on business and incur contractual and legal obligations.

### 1.1 What types of corporations are available in Canada?

#### 1.1.1 Will the Canadian subsidiary be a private or public corporation?

Canadian legislation governing corporations distinguishes between non-offering corporations (commonly referred to as private or closely held corporations) and public offering corporations. Private corporations generally are subject to restrictions on the transfer of their shares, a maximum permitted number of shareholders, excluding certain classes of individuals such as employees, and prohibitions against the issue of securities to the public. Public corporations do not have these restrictions and have taken steps under applicable provincial securities laws and stock exchange rules to permit their securities to be offered to, and traded by, the public.

Because shareholders of private corporations often participate actively in the management of the corporation, they do not require the same statutory protections that are essential for shareholders of public corporations. Many rules that apply to public corporations with respect to directors, insider trading, proxy solicitation, filing of financial statements, appointment of auditors, take-over bids and public disclosure do not apply to private corporations. However, all shareholders have substantial rights with respect to fundamental changes affecting the corporation, including, in some cases, dissent and appraisal rights and a very broad oppression remedy.

#### 1.1.2 Should the subsidiary be incorporated federally or provincially?

Corporations wishing to carry on business in more than one province or in foreign countries may prefer to incorporate under federal law. This permits the corporation to use its corporate name in every province in Canada (with the use of the French form of its name also being required in Quebec). Also, federally incorporated corporations may be more widely recognized and accepted outside Canada, though there is no legal basis for this perception. Registration would be required to carry on business in any particular province in Canada.

When a corporation incorporates in a province, it must register and may be required to obtain an extraprovincial licence in any other province where it carries on business. Unlike a federal corporation, its corporate name may not be available for use in every other province or territory in Canada, in which case, it would be required to operate under an assumed name in that jurisdiction.

There may be additional factors affecting the decision of whether to incorporate federally or provincially. For example, differences in residency requirements for directors may be relevant in some cases. As well, U.S. investors may be interested in the possibility of incorporating an "unlimited liability company" (ULC) in British Columbia, Alberta or Nova Scotia to achieve certain U.S. tax objectives.

### 1.1.3 What are the specific procedures for incorporation? How long does the process take?

A corporation is formed in Canada by filing certain prescribed documents with the appropriate authorities under the *Canada Business Corporations Act* or the corporations act of one of the Canadian provinces (in Ontario, the *Business Corporations Act*).

The most important document under the *Canada Business Corporations Act* and similar provincial statutes is the "articles of incorporation," which sets out the name of the corporation, its share capital, any restrictions on share transfer, the number of directors and any restrictions on the business to be undertaken. In British Columbia, the "notice of articles" sets out the company's name, its authorized capital, whether a class of shares has any special rights or restrictions, the names and addresses of the company's directors, and the "articles" govern the conduct of the company's internal affairs. In most other jurisdictions, matters in the "articles" of a British Columbia corporation are dealt with in bylaws passed by the directors and shareholders following incorporation. Under most statutes, corporations are given the capacity and rights of a natural person and it is not necessary to specify the objects for which the corporation is incorporated. The name of the corporation is strictly regulated in all jurisdictions to avoid names that are too general or misleading. There is a government screening process in some jurisdictions and it is sometimes possible to pre-clear a name prior to application for incorporation. In addition, the Quebec *Charter of the French Language* requires that a corporation carrying on business in Quebec use a French version of its name. Once the required documents are filed and fees paid, incorporation is automatic. The corporation comes into existence on the date of issue of a certificate of incorporation by the regulators.

The government cost of establishing and maintaining a Canadian corporation is relatively modest in most jurisdictions. In Nova Scotia, however, the fee to incorporate an unlimited liability company is much higher than average, as is the annual fee. Modest registration fees may also be payable upon commencing business in various provinces.

## 1.2 Supervision and management of a corporation

### 1.2.1 Who is responsible for the corporation?

A Canadian corporation acts through its board of directors and officers. The directors are elected by the shareholders, and subject to any "unanimous shareholders agreement," manage the business and affairs of the corporation. Unanimous shareholder agreements are discussed in 1.2.2, "Residency requirements for directors or unanimous shareholder agreements." Corporate statutes may require that a certain number of Canadian directors be present. Under the federal statute, at least 25 per cent of the directors at a meeting must be resident Canadians or, if there are fewer than four directors, at least one must be a resident Canadian (other than for corporations engaged in certain prescribed business sectors, which require a majority of the directors present to be resident Canadians). There are a number of general rules governing the qualifications and number of directors, such as a requirement that each director be at least a specified age and not bankrupt, but (unlike many other countries) there is no requirement that the director hold any shares in the corporation unless the incorporating documents provide otherwise. These rules apply equally to non-resident and resident directors. There are also additional rules that relate only to directors of public corporations. Under the Ontario statute, a private corporation must have at least one director, and a public corporation at least three.

Directors and officers have a duty to act honestly and in good faith with a view to the best interests of the corporation. They must exercise their powers with due care, diligence and skill, and must comply with the governing statutes, regulations, incorporating documents, and any unanimous shareholder agreements. They are also subject to conflict of interest rules. Where directors and officers neglect their duties, they may be subject to personal liability. They may also be subject to other liabilities, such as with respect to certain unpaid taxes and employee wages. A corporation may purchase and maintain insurance for the benefit of directors and officers for certain liabilities incurred in such capacity.

Directors appoint officers and delegate some of their powers to officers who conduct the day-to-day management of the corporation. It is rare for a Canadian corporation to have a "managing director," although such a role is specifically recognized in some Canadian corporate statutes. The senior operating officer would generally be described as the "president," with the chief financial officer often being the "vice president, finance" or the "treasurer." Normally, there is also a secretary. One person may hold two or more offices, and officers need not be resident Canadians. Canadian immigration rules must be satisfied in respect of the transfer of non-resident employees to Canada to work for a Canadian subsidiary.

### 1.2.2 Residency requirements for directors or unanimous shareholder agreements

As noted in 1.2.1, "Who is responsible for the corporation?", the federal and the Ontario corporate statutes include a Canadian residency requirement for directors of 25 per cent, except where there are fewer than four directors, in which case at least one must be a resident Canadian. There are exceptions in the federal statute to this general rule for corporations in certain sectors. Some jurisdictions (being British Columbia, Quebec, New Brunswick, Nova Scotia, Prince Edward Island, Nunavut, the Northwest Territories and Yukon) do not impose residency requirements for directors. There are no residency requirements for officers in any Canadian jurisdiction.

A foreign parent corporation will generally deal with the residency requirement of directors in the following way. It may find Canadian individuals to represent it on the board of the subsidiary, either Canadian resident employees or professional advisers (who will generally seek indemnification from the parent for agreeing to act). In some cases, the foreign parent will take the further step of entering into a "unanimous shareholders agreement" with respect to the corporation. Many Canadian corporate statutes (including the federal and Ontario statutes) provide for such agreements, under which the powers of the directors to manage the corporation's business and affairs may be transferred in whole or in part to its shareholders. To the extent that the directors' powers are restricted, their responsibilities and liabilities are correspondingly reduced and transferred to the shareholders.

## 1.3 How may a corporation be capitalized?

### 1.3.1 Shares

A share represents a portion of corporate capital and entitles the holder to a proportional right to corporate assets on dissolution. Shares must be fully paid before they can be issued (although calls on shares are permitted in Nova Scotia and Prince Edward Island, as well as under Quebec law for certain pre-existing companies). Under the federal statute and the corporate statutes of most provinces, a corporation is prohibited from issuing shares having a par value.

There is no minimum or maximum amount of share capital that a corporation is allowed to issue, unless otherwise specified in its incorporating documents. "One shareholder" companies are permissible under Canadian law.

Canadian corporate law provides great flexibility in developing the appropriate capital structure for a corporation. The articles of incorporation specify the permitted classes of shares and their key terms. Shares may be voting or non-voting, or they may have limited voting or disproportionate voting rights. The incorporating documents may attach various conditions to the payment of dividends and will stipulate rights on dissolution of the corporation. Absent specific provision in the articles, under the Ontario and federal statutes, shareholders do not have any pre-emptive rights in respect of future share offerings.

Redemption or purchase of shares by a corporation and payment of dividends are subject to statutory solvency tests. Financial assistance by the corporation in favour of shareholders and other insiders is also regulated in some provinces but is no longer regulated under the federal or Ontario statutes.

### 1.3.2 Debt financing

Corporate capital may also be raised by borrowing. Directors may authorize borrowing unless the incorporating documents or a unanimous shareholders agreement restricts them. Restrictions upon corporate directors, however, will usually not protect the corporation against third parties in the case of unauthorized borrowing by directors. Corporations also have the power to grant security interests over their property and to give guarantees.

## 1.4 What are the basic procedures governing shareholder participation?

Shareholder meetings are usually held annually in a place determined by the directors or stipulated in the documents that govern the corporation. At the annual meeting, the financial statements for the year will be presented to the shareholders and any necessary resolutions passed (such as for the election of directors). Some corporate statutes require meetings to be held in their jurisdiction unless the documents that govern the corporation provide otherwise or the shareholders agree to hold meetings elsewhere. However, shareholders may act by way of written resolution rather than at a meeting. The practice with respect to non-resident wholly owned subsidiaries is for all shareholder matters to be carried out through written resolutions.

Where a corporation has only one class of shares, each share entitles the holder to one vote at all shareholder meetings. Where there is more than one class of shares, the voting rights are set out in the articles of incorporation. Shareholders may vote personally or by proxy.

## 2 Corporations and Partnerships in Canada

In Canada, a partnership is not a separate legal entity but a relationship between persons (which may be individuals, corporations, trusts or other partnerships) carrying on business in common with a view to profit.

A corporation is free to enter into partnerships in Canada. The resources each partner contributes to a partnership would commonly be money, but could also be skills, labour, intellectual property or other property. The relationship of the partners is established by contract and is also subject to applicable provincial laws. Some provinces require that partnerships be registered. A partnership may take one of three forms, a "general partnership", a "limited partnership" or a "limited liability partnership".

Subject to the terms of their agreement, all partners in a general partnership are entitled to participate in ownership and management, and each assumes unlimited liability for the partnership's debts and liabilities. To the extent that each partner in a general partnership is itself a limited liability corporation, the liability risk for such partners would be reduced (but not eliminated).

In a limited partnership, there is a separation between the partners who manage the business (general partners) and those who contribute only capital (limited partners). A limited partnership must have at least one general partner, who will be subject to unlimited liability for the debts of the partnership. Limited partners are liable only to the extent of their capital contribution to the partnership provided they do not participate in the management of the business.

A third type of partnership is the limited liability partnership (LLP). In Canada, a limited liability partnership is only available in certain provinces, is governed by specific provincial legislation and is often only available to groups of professionals, such as lawyers, accountants and doctors. In British Columbia (unlike other provinces), any kind of business may be carried on through an LLP. A limited liability partnership is a general partnership in which the liability of its partners is limited. This type of partnership provides greater liability protection for partners as only the assets of the partner who worked on, or with, a particular client would be at a risk if that client sued the partnership (and the assets of the other partners would be protected).

A partnership would generally be entered into by a foreign corporation, directly or through a subsidiary, only if it wished to establish a joint venture arrangement with another person or corporation. The income or loss of the business will be calculated at the partnership level as if the partnership were a separate person, but the resulting net income or loss will then flow-through to the partners and be taxable in their hands. Partnerships themselves are not taxable entities for Canadian income tax purposes. Because of its flow-through nature, a partnership might be appropriate if a joint venture business is expected to generate disproportionately large expenses in its early years, as the partnership structure would allow the individual co-venturers to take advantage of the tax write-offs arising from these expenses. In the case of a limited partner, the amount of losses which may be available is limited by the amount which the limited partner is considered to have "at risk" in the partnership.

## 3 Joint Venture Structuring

Two or more parties may engage in a joint venture or syndicate where they collaborate in a business venture. There is no specific statutory definition or regulatory scheme for joint ventures, at either the provincial or federal level, although they are not uncommon in certain industries such as construction and natural resources. A joint venture generally denotes an association of two or more persons, usually governed by a contract, pursuant to which such persons agree to combine their money, property, knowledge, skills and other resources in furtherance of a desired venture, typically agreeing to share the profits and losses, with each having some degree of control over the venture.

To help avoid the presumption that a partnership has been formed, the joint venture agreement should declare that a partnership is not intended. The agreement should also set out the scope of the venture and the method of control and decision-making. It should stipulate the rights and obligations of the participants and provide mechanisms for the settlement of disputes. Unlike a corporation, a joint venture is not a distinct legal entity. It cannot sue or be sued. Such rights and liabilities are attached to the entities involved in the joint venture.

# 4 Alternative Methods of Carrying on Business

## 4.1 Branch office

Organizations with foreign ownership may conduct business in Canada through branch offices, so long as the *Investment Canada Act* and provincial registration and licensing requirements are complied with. The foreign corporation must register in all provinces in which it will carry on business.

A branch office operates as an arm of the foreign business, which may enjoy tax advantages from such an arrangement. See Section 5, "Tax." However, the foreign business's liability for the debts and obligations incurred in its Canadian operations is not limited as it would be if the Canadian operations were conducted by a separate corporation (other than a British Columbia, Alberta or Nova Scotia unlimited liability corporation or company) of which the foreign business was the shareholder.

## 4.2 Agents and distributors

As an initial step, a foreign enterprise may wish to offer its products or services in Canada by means of an independent agent or distributor. An agent usually would be given limited authority to solicit orders for acceptance at the foreign head office, and would not normally take title to the goods or provide services to the customer. A distributor, on the other hand, usually takes title to the goods and offers them for resale, either directly to the customer or through dealers or retailers. In both cases, the foreign enterprise will likely seek to avoid establishing a permanent establishment in Canada for tax purposes. See Section 5, "Tax."

The relationship with an agent or distributor should be established by contract. Although provincial law does not generally prohibit the termination of an agent or distributor, the courts will require reasonable notice to be given, or damages in place of notice, in the absence of an agreed contractual term for the relationship. The nature of the relationship should be reviewed to determine whether the arrangements are subject to franchise legislation. See 4.3, "Franchising."

## 4.3 Franchising

Franchising is not as heavily regulated in Canada as it is in a number of other jurisdictions, including the United States. In Canada, franchising is a purely provincial matter and, currently, six provinces have franchise legislation in effect: Alberta, British Columbia, Manitoba, Ontario, Prince Edward Island and New Brunswick. On February 1, 2017, British Columbia became the sixth Canadian province to have franchise legislation in effect. While there are slight differences in the legislation and regulatory requirements of each province, they are all ultimately derived from the U.S. model of mandated disclosure by a franchisor to prospective franchisees, coupled with a duty of good faith and fair dealing owed by each party to the other, and a right of franchisees to associate freely amongst themselves.

Unlike the United States, no Canadian province requires either the registration of franchisors or the public filing of their disclosure documents. There is no government agency in Canada which is charged with the task of regulating or overseeing compliance with franchise legislation, with the result that there is no body (save the court) from whom any permission must be sought or any comfort may be obtained (regarding compliance with or the non-application of franchise legislation, the availability of a disclosure exemption or otherwise).

Put simply, a franchise relationship is an ongoing relationship that is found to exist under provincial franchise legislation where the franchisor grants the franchisee the right to use the franchisor's trade-marks and other intellectual property and business methodology (typically at a specific location or within a specific territory only) in exchange for a fee. In a franchise relationship, the parties are independent contractors and neither party is an agent for the other, but the franchisor generally retains control over the use of its marks and a certain degree of control over the franchisee's manner of carrying on its business. This designation as a "franchise" is fact-based and occurs whether a company intends to operate as a "franchise" or not. Provincial franchise legislation in Canada defines "franchise" broadly and the term may apply to distribution arrangements not generally perceived to be franchises. As such, when utilizing distributorships or granting licenses in Canada, it is important to consider the implications of franchise legislation and the extent of a company's involvement in and/or control over the operation of the new distributor or retailer.

Among the most significant features of franchise legislation is the disclosure obligation which requires that franchisors deliver detailed pre-sale disclosure documents to prospective franchisees at least 14 days before an agreement is signed or any fees are paid. The disclosure document must contain all of the information prescribed by provincial regulations (which are substantially similar across provinces with franchise legislation) and any additional material facts about the franchise that could reasonably be expected to influence the prospective franchisee's assessment of the value of the franchise or decision to enter into a franchise arrangement. If the disclosure document does not comply with the legislative requirements, is delivered late or is not delivered at all, then the franchisee has the right for a specific period of time to rescind the franchise agreement and the franchisor is required to compensate the franchisee for all losses incurred in establishing and operating the franchised business (in addition, in certain provinces, to repurchase obligations). Franchisees can also bring a claim for damages for misrepresentation if the franchisor does not meet the applicable disclosure requirements.

Generally speaking, franchise legislation is remedial legislation enacted to protect franchisees and accordingly, it is not possible to contract out of its provisions. This means that properly identifying one's business as a franchise system that is subject to franchise legislation is an important step in determining the applicable legislative requirements.

## 4.4 Licensing

Licensing is a contractual relationship between two parties in which a licensor grants a licensee the right to use trademarks, patents or other intellectual property. While franchising typically involves the licensing of trademarks, know-how and the use of a franchise system, it is distinguished from pure licensing arrangements by the franchisor's control over the franchisees' manner of carrying on its business. The licensing relationship does not dictate the licensee's method of operation but would often establish standards applicable to the licensee's use of the licensed marks. The relationship is governed predominantly by the general law of contracts but the federal legislation regulating the relevant form of intellectual property would also be relevant.

# Trade and Investment Regulation

2

1

## General Rules on Foreign Investments

### 1.1 Are there special rules governing foreign investment?

The *Investment Canada Act* is a federal statute of broad application regulating investments in Canadian businesses by non-Canadians. Except with respect to cultural businesses, the Investment Review Division (Investment Canada) administers the *Investment Canada Act* under the direction of the Minister of Innovation, Science and Economic Development Canada. The Minister of Canadian Heritage is responsible for cultural businesses (i.e., business activities relating to Canada's cultural heritage, such as publishing, film, video, music and broadcasting). In some cases investments are reviewed by both the Minister of Innovation, Science and Economic Development Canada and the Minister of Canadian Heritage where only part of the business activities of the Canadian business involve Canada's cultural heritage.

Investments by non-Canadians to acquire control over existing Canadian businesses or to establish new ones are either reviewable or notifiable under the *Investment Canada Act*. The rules relating to an acquisition of control and whether an investor is a "Canadian" are complex and comprehensive.

A "direct acquisition" for the purpose of the *Investment Canada Act* is the acquisition of a Canadian business by virtue of the acquisition of all or substantially all of its assets or a majority (or, in some cases, one-third or more) of the voting interests (shares) of the entity carrying on the business in Canada. Subject to certain exceptions discussed below, a direct acquisition is reviewable where the value of the acquired assets is C$5-million or more.

An "indirect acquisition" for the purpose of *the Investment Canada Act* is the acquisition of control of a Canadian business by virtue of the acquisition of a non-Canadian parent entity. Subject to certain exceptions discussed below, an indirect acquisition is reviewable where (a) the value of the Canadian assets is less than or equal to 50 per cent of the value of all the assets acquired in the transaction and the value of the Canadian assets is C$50-million or more, or (b) the value of the Canadian assets is greater than 50 per cent of the value of all the assets acquired in the transaction and the value of the Canadian assets is C$5-million or more.

The acquisition of control of an existing Canadian business or the establishment of a new one may also be reviewable, regardless of asset values, if it falls within a prescribed business activity related to Canada's cultural heritage or relates to national security.

Special rules apply with respect to investments made by state-owned enterprises (SOEs):

- The Minister of Innovation, Science and Economic Development Canada has the power to determine that an SOE has acquired "control in fact" of a Canadian business or that a Canadian business is "controlled in fact" by one or more SOEs (notwithstanding the control rules otherwise set out in the statute), with the potential result that certain investments may be subject to a ministerial review and approval requirement where they otherwise would not have been.
- SOEs' investments in the Canadian oil sands are limited by a federal government policy introduced in December 2012. Specifically, reviewable acquisitions of control (including acquisitions of "control in fact") of oil sands businesses by SOEs will not receive approval from the Minister of Innovation, Science and Economic Development Canada, except on an "exceptional basis."

The *Investment Canada Act* defines an SOE broadly as including foreign governments and their agencies and entities that are controlled or influenced, directly or indirectly, by such governments or agencies. It also includes "an individual who is acting under the direction of" or "who is acting under the influence of" such a government or agency. An SOE investor, as with any other investor, will also have to consider the potential application of the national security review regime to the proposed investment.

## 1.2 How are WTO members treated differently?

The *Investment Canada Act* reflects commitments made by Canada as a member of the World Trade Organization (WTO). In the case of a direct acquisition by or from a (non-Canadian) "WTO investor" (that is, an investor controlled by persons who are residents of WTO member countries) that is not an SOE, the C$5-million threshold for direct investments increases to an "enterprise value" of C$1-billion.

The regulations set out the precise manner in which the "enterprise value" is calculated. In general terms:

- For acquisitions of control of publicly traded entities, the enterprise value of the assets of the Canadian business is equal to the market capitalization of the entity plus liabilities, minus cash and cash equivalents
- For acquisitions of control of private companies and for asset acquisitions, the enterprise value is the purchase price, plus liabilities, minus cash and cash equivalents

The higher threshold applicable to WTO investors does not apply where the Canadian business is considered to be carrying on a "cultural business."

Where the investor is an SOE WTO investor, the threshold is an asset value based test, which is C$379-million, based on the book value of the assets of the Canadian business.

An indirect acquisition of a Canadian business by a non-SOE WTO investor is not reviewable but only subject to a notification obligation (provided that the Canadian business is not considered to be carrying on a cultural business).

## 1.3 How are trade agreement investors treated differently?

A direct acquisition by a trade agreement investor is subject to a higher review threshold. Trade agreement investors refer to investors whose country of ultimate control is party to a trade agreement with Canada (such as the Canada-European Union Comprehensive Economic and Trade Agreement Implementation Act (CETA), the North American Free Trade Agreement (NAFTA), or bilateral trade agreements (e.g., Canada-Chile Free Trade Agreement Implementation Act; Canada-Korea Economic Growth and Prosperity Act).

Starting September 21, 2017, when a Canadian business is being acquired by a trade agreement investor, the threshold for review is an "enterprise value" of C$1.5-billion (which is higher than the C$1-billion threshold for WTO investors). The threshold will be adjusted annually to account for growth in nominal GDP, starting January 1, 2019.

The threshold does not apply to investments by SOEs or where the Canadian business is considered to be carrying on a "cultural business".

## 1.4 If a review is required, what is the process?

A reviewable transaction may not be completed unless the investment has been reviewed and the relevant minister is satisfied that the investment is likely to be of "net benefit to Canada." The non-Canadian proposing the investment must make an application to Investment Canada setting out particulars of the proposed transaction. There is then an initial waiting period of up to 45 days; the minister may unilaterally extend the period for up to 30 days and then only with the consent of the investor (although in effect this can be an indefinite period since, with a few exceptions, the investor cannot acquire the Canadian business until it has received, or is deemed to have received, the minister's "net benefit to Canada" decision). If the waiting period is not renewed and the transaction is not expressly rejected, the minister is deemed to be satisfied that the investment is likely to be of net benefit to Canada. Failure to comply with these rules opens the investor to enforcement proceedings that can result in fines of up to C$10,000 per day.

The principal practical negative effects of a review are the reality of delay and negotiation. It is often difficult to get the minister's approval before the expiration of the initial 45-day period. In addition, the minister will usually seek undertakings (see 1.5, "What is required for an investment to be of "net benefit to Canada"?") as a condition of approval.

Special review requirements and timing considerations apply to transactions, whether already implemented or proposed, which potentially raise national security considerations.

The term "national security" is not defined in the *Investment Canada Act*. However, in December 2016, the federal government released guidelines on national security reviews, as part of a new transparency initiative intended to encourage foreign investment by providing investors more information about (a) the types of transactions that may require a national security review; and (b) the factors considered by the government when assessing national security risk. Relevant factors identified in the guidelines include: the effect on Canada's defence capabilities, transfers of sensitive technology or know-how, critical infrastructure, the enablement of foreign surveillance or espionage, the hindering of law enforcement operations, the potential involvement of illicit actors (such as terrorists or organized crime syndicates), the impact on the supply of critical goods and services to Canadians, the supply of goods and services to the federal government, and the impact of an investment on Canada's international interests.

Where a national security review is required, the parties may be required to provide the minister with any information considered necessary for the review. The minister may then either:

- Inform the parties that no further action will be taken, if the minister is satisfied that the investment would not be injurious to national security (in which case the transaction may proceed), or
- Refer the transaction to the governor-in-council (the federal cabinet), if the minister is satisfied that the investment would be injurious to national security or the minister is not able to make such a determination

Where the transaction is referred to the governor-in-council, the governor-in-council may take any measures considered advisable to protect national security including blocking the transaction, authorizing the transaction on the basis of written undertakings or other terms and conditions or ordering a divestiture of the Canadian business.

Where a "net benefit to Canada" review is concurrently underway, the minister will have up to an additional 30 days to complete that review once the governor-in-council has cleared the investment on national security grounds.

## 1.5 What is required for an investment to be of "net benefit to Canada"?

The *Investment Canada Act* requires the relevant minister to take these factors into account, where relevant, when determining if an investment is likely to be of "net benefit to Canada":

- The effect of the investment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada
- The degree and significance of participation by Canadians in the Canadian business and in any industry or industries in Canada of which the Canadian business forms a part
- The effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada
- The effect of the investment on competition within any industry or industries in Canada
- The compatibility of the investment with national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment, and
- The contribution of the investment to Canada's ability to compete in world markets

Typically, during the 45-day period, the investor will negotiate with Investment Canada and/or Canadian Heritage a suitable set of undertakings to be provided in connection with the minister's approval of the transaction. These undertakings comprise commitments by the investor concerning its operation of the Canadian business following the completion of the transaction. With respect to SOEs, the government has issued guidelines whereby such enterprises may be subject to certain additional obligations designed to ensure that their governance is in line with Canadian standards and that the Canadian businesses that they acquire maintain a commercial orientation.

Commitments provided to the minister by a foreign investor may, among other things, obligate the investor to keep the head office of the Canadian business in Canada, ensure that a majority of senior management of the Canadian business is comprised of Canadians, maintain certain employment levels, make specified capital expenditures and conduct research and development activities based on specified budgets, and make a certain level of charitable contributions, all over a period of usually three years. According to guidelines established by Investment Canada, these undertakings will be reviewed by Investment Canada or Canadian Heritage, as the case may be, on a 12- to 18-month basis for up to three to five years in the ordinary course to confirm the investor's performance.

## 1.6 Are there any requirements for investments that are not "reviewable"?

If the acquisition of an existing business or the establishment of a new business is not reviewable, the investment will be "notifiable." Notification requires the non-Canadian investor to provide certain specific information to Investment Canada, including information on the parties to the transaction, the number of employees of the business in question, and the value of its assets or market capitalization of the investment. Notification may be given before or within 30 days after the closing of the transaction.

## 1.7 Are there other statutes that regulate foreign investments in particular sectors?

In addition to the *Investment Canada Act*, other federal statutes regulate and restrict foreign investment in specialized industries and sectors, such as telecommunications, broadcasting, rail and air transportation and financial institutions.

# 2 International Trade Agreements

## 2.1 Trade agreements as a constitution for international business regulation

The International Trade Agreements to which Canada is a party act like a constitution, placing limits on the laws, regulations, procedures, decisions, and actions that all levels of government and their agents may undertake. While these agreements do not automatically invalidate laws that breach their obligations, they all provide sanctions for non-compliance.

## 2.2 Key principles of trade agreements

The guiding principle of all trade agreements is non-discrimination. This general principle is enforced through a number of specific rules that appear in most trade agreements with varying degrees of force. The underlying rationale is that discriminating between the goods, investments, persons, or services of different countries distorts trade and results in a less efficient utilization of resources and comparative advantages, ultimately to the detriment of all.

The two most prevalent rules are most favoured nation and national treatment. Most favoured nation treatment prohibits discrimination in the treatment of goods, persons, or companies, as the case may be, of other parties to the agreement. For instance, most favoured nation treatment requires that Canada must give as favourable a duty rate to imports from the European Union (EU) as from Brazil. National treatment prohibits giving more favourable treatment to domestic persons, investments, services or goods than is offered to persons, investments, services or goods from other countries. It does not require treating them the same as nationals, as long as the treatment is as favourable.

There are many other rules that address more subtle or specific forms of discriminatory and trade-distorting practices. Some of these are discussed below.

## 2.3 Using trade agreements as business tools

Historically, trade agreements focussed on reducing tariffs, which are the most obvious form of trade discrimination in which a country imposes a "tax" on imported goods. As trade negotiations have succeeded in reducing tariffs, other, often more subtle, trade barriers have grown in importance. These non-tariff barriers can include all manner of domestic regulation such as labelling, environmental, and even food safety requirements that directly or indirectly affect the import, export and sale of goods, foreign investment, and the ability of companies to move people across borders to provide a service.

Today, these domestic regulations, policies and programs can interfere significantly with business operations. Canada's trade obligations under the various agreements to which it is a party offer effective tools for the business community to respond to these obstacles. Some agreements, like the North American Free Trade Agreement (NAFTA), provide investors with a direct means of challenging barriers to establishing, acquiring or managing a Canadian company. Canada is a strong advocate of multilateral trade rules that seek to ensure that the development of new laws and the application of current regulations are consistent with international trade law obligations.

International trade agreements are a relatively new business tool. Identifying how these agreements can be leveraged into the achievement of strategic business objectives is a subtle and specialized skill that can help uncover potential market opportunities.

## 2.4 Canada's trade agreements

Canada is a party to many trade agreements. The list of countries with which Canada enjoys trade agreements continues to expand through ongoing negotiations. Canada's current and anticipated trade agreements are summarized below.

### 2.4.1 WTO agreements

Canada is a member of the World Trade Organization (WTO) and has committed to respect the rules of the agreements adopted by WTO members, effective January 1, 1995. The WTO administers the rules governing trade among the organization's 164 members.

The WTO Agreements encompass a structure with six principal parts: the Agreement Establishing the WTO; agreements on trade in goods; the General Agreement on Trade in Services (GATS); the Agreement on Trade-Related Aspects of Intellectual Property Rights; dispute settlement; and reviews of governments' trade policies. The WTO Agreements set out rules that governments must follow in regulating a wide range of business activities including procurement, investment, agriculture and industrial goods trade, and subsidies and anti-dumping decisions. The WTO's Agreement on Government Procurement is often reviewed when advising clients in procurement matters. A revamped Agreement on Government Procurement (sometimes referred to as the Revised Agreement on Government Procurement) has been in force since April 6, 2014 and is binding on those states, including Canada, that have completed the ratification process.

The current round of multilateral negotiations, commonly known as the Doha round, aimed at strengthening the rules of the WTO agreements, remains stalled largely as a result of differences between the Member States on measures relating to agricultural products. Nevertheless, the WTO Agreements continue to apply and impose rules governing the laws, regulations and practices of member countries that affect trade in goods or services.

The WTO Agreements place limits on actions that WTO member governments and their agents may undertake. If, for example, European, U.S. or Chinese laws, policies or practices adversely affect a business in Canada in contravention of the WTO rules, Canada may use the WTO dispute settlement process to ensure that a WTO member abides by its obligations under the WTO Agreements. While the WTO complaints mechanism is available only to sovereign states (or to a regional grouping of states, such as the EU), private companies confronting WTO unlawful barriers in their activities may request that their governments make use of the system.

In December 2017, Canada requested WTO dispute consultations with the United States on the basis that it considers certain U.S. measures relating to anti-dumping and countervailing duty proceedings to be inconsistent with its obligations under the WTO Agreements. In June 2018, Canada and the EU requested WTO dispute consultations with the United States, claiming that recently imposed U.S. duties on steel and aluminum products are inconsistent with the WTO Agreements. These disputes are currently ongoing under the WTO dispute settlement process.

### 2.4.2 CUSMA / NAFTA[3]

The CUSMA is the new regional free trade agreement that replaces NAFTA, the 1994 North American Free Trade Agreement. The CUSMA was signed by Canada, the United States and Mexico on November 30, 2018. It preserves key elements of the trading relationship between the three countries and incorporates new and updated provisions that address 21st-century trade issues and promote opportunities for the nearly half a billion people who live in the region. The new free trade agreement supports mutually

beneficial trade leading to freer, fairer markets, and to robust economic growth in the region. It aims to further strengthen the close economic relationship between the three economies and to incentivize the production and sourcing of goods and materials in the region. It also establishes a clear, transparent, and

[3] A new trade agreement has been reached between Canada, the United States and Mexico known as the United States-Mexico-Canada Agreement (USMCA), in Canada CUSMA – formerly known as NAFTA. CUSMA is designed give workers, farmers, ranchers, and businesses a high-standard trade agreement that will result in freer markets, fairer trade and robust economic growth in our region. It will strengthen the middle class, and create well-paying jobs and new opportunities for the nearly half billion North American people. It is anticipated that the CUSMA will take effect on January 1, 2020. For more information, refer to Blakes Bulletin, *The Ins and Outs of Canada's New Trade Agreement and NAFTA Replacement, the USMCA*.

predictable legal and commercial framework for business planning that supports further expansion of trade and investment. Since 1994, NAFTA has generated economic growth and rising standards of living for the people of all three member countries. In 2017, total trilateral merchandise trade (the total of each country's imports from one another) reached nearly US$1.1 trillion, while total merchandise trade between Canada and the United States has more than doubled since 1993, and has grown over nine-fold between Canada and Mexico. Canada, the United States and Mexico are now undertaking their domestic process towards ratification and implementation of the CUSMA. Canada's internal process with respect to the ratification of the CUSMA is expected to take up to 21 sitting days of the House of Commons after the Minister of Foreign Affairs tables the Agreement in the House. Although debates may follow, the Cabinet is the ultimate controlling authority with respect to Canada's ratification process. Once Canada ratifies the CUSMA, the Agreement will have to pass Canada's own legislative process to become a law enforceable in Canada. Legislative steps in the Parliament include the government's introduction of a bill implementing the treaty and making consequential amendments to the statutes affected by the treaty if necessary, debates and voting. If the House ultimately votes in favor of the bill, the bill will be submitted to the Senate for consideration and passing. If passed by the Senate, the bill will undergo Royal Assent and come into force, consistent with Canada's law-making process.

#### 2.4.2.1 NAFTA investment rules

Pending CUSMA implementation, NAFTA Chapter 11 provides rules relating to the treatment of investments and investors of other NAFTA parties. These rules are more detailed than those provided for in the WTO's Trade-Related Investment Measures Agreement. Most importantly, the NAFTA investor-state arbitration mechanism enables aggrieved investors of a NAFTA country to submit a claim for damages against the country complained of without any approval or involvement of the investor's government.

Claims can only be brought against the government of another NAFTA party; an investor cannot complain of its own government's actions. Either party may seek judicial review of the arbitration panel's decision.

NAFTA Chapter 11 extends national and most favoured nation treatment to investors and investments of another NAFTA party so that laws, regulations and government actions cannot discriminate between investors of any of the three countries. Chapter 11 also enables investors to make claims that government measures have effectively expropriated their investment. These claims may recoup the value of the expropriated investment, including lost profits.

To pursue a claim under NAFTA Chapter 11, the company involved typically must be incorporated in one of the NAFTA countries. An investor cannot make a claim on behalf of a company unless they are a controlling shareholder. However, NAFTA investors may bring claims for damages to their investment (i.e., a drop in share price), and in certain cases, these claims may be made in respect of investments in companies that were incorporated elsewhere but operate in a NAFTA country.

#### 2.4.2.2 NAFTA services rules

Under NAFTA, businesses seeking to provide services must be extended national treatment in all service sectors, except those specifically excluded (under the WTO GATS, national treatment is extended only in those service sectors specifically included). National treatment means that each country must accord to service providers of another NAFTA country treatment no less favourable than it accords to its own service providers. No local presence is required to provide a service cross-border. NAFTA countries must also ensure that licensing and regulations relate principally to competence or ability and do not have the purpose or effect of discriminating against nationals of another NAFTA country. NAFTA countries can maintain existing restrictions on cross-border services where such restrictions have been listed in an annex to the Agreement.

NAFTA also eases restrictions on the entry of "business persons" for the purposes of providing marketing, training, and before and after sales and service for their products and services.

### 2.4.3 Canada-U.S. Agreement on Government Procurement

Outside the context of NAFTA, in 2010, Canada and the U.S. entered into an Agreement on Government Procurement, which had the effect of liberalizing access to sub-central government procurements in both countries. In addition, the agreement provides for exemptions for Canada from "Buy American" provisions of the *American Recovery and Reinvestment Act of 2009* in relation to certain programs, in exchange for temporary Canadian procurement commitments for certain construction projects not included in the WTO Agreement on Government Procurement. Canada and the U.S. also committed to explore the scope of a long-term government procurement agreement to deepen, on a reciprocal basis, procurement commitments beyond those under the WTO Agreement and NAFTA.

### 2.4.4 Free Trade Agreements (FTAs)

FTAs generally provide for preferential tariff rates on imported goods and services and enhanced market access to goods and services of the member parties. Such agreements may also provide for protection such as most favoured nation and national treatment. FTAs may go beyond the scope and extent of coverage of the WTO Agreements. Moreover, FTAs may cover areas not addressed by WTO Agreements, such as protection of investments and investors. FTAs generally include dispute settlement mechanisms.

Canada has entered into FTAs with numerous countries besides the U.S. and Mexico, including Colombia, Costa Rica, Chile, Honduras, Israel, Jordan, Korea, Panama, Peru, and the European Free Trade Association (EFTA) countries (Iceland, Norway, Switzerland and Liechtenstein). After 14 rounds of negotiations spanning nearly 10 years, Canada concluded the Canada-Korea Free Trade Agreement (CKFTA), which came into force on January 1, 2015. The CKFTA is Canada's first free trade deal with an Asia-Pacific country and is considered to be an important gateway to other markets in the region. On July 11, 2016, Canada and Ukraine signed the Canada-Ukraine Free Trade Agreement (CUFTA), which was implemented on August 1, 2017.

Canada is in the process of negotiating FTAs with a number of other countries, including Singapore, Japan, the Dominican Republic, Morocco, Guatemala, Nicaragua, El Salvador and the Caribbean Community countries. In 2010, Canada and India began the negotiation of a possible Comprehensive Economic Partnership Agreement (CEPA). The two countries have since held 10 rounds of negotiations, the latest in August 2017, but have not yet reached an agreement.

#### 2.4.4.1 Comprehensive Economic and Trade Agreement (CETA)

On October 30, 2016, Canada and the EU signed CETA. The European Parliament approved CETA on February 15, 2017. In Canada, legislation implementing CETA received royal assent on May 16, 2017, and CETA came into force provisionally on September 21, 2017. Provisions related to the elimination of tariffs and customs duties already apply, also in the framework of the provisional application of the agreement. Notably, the EU and Canada have agreed to eliminate customs duties for imports of goods originating in the EU and Canada either when CETA comes into force or gradually within 3, 5 or 7 years for almost all goods. For a few sensitive agricultural product lines, special treatment or exclusions from tariff reductions occurs. Overall, duties on 98.6% of all Canadian tariff lines and 98.7% of all EU tariff lines will ultimately be fully eliminated. This occurred since the provisional application of the agreement for 98.2% of the Canadian tariff lines and for 97.7% of the EU tariff lines. All other products identified for liberalization will have their tariffs brought to zero within 3, 5 or 7 years. In particular, A) Industrial tariffs: 100% of tariff lines on industrial products for both sides will be fully eliminated, of which 99.6% upon provisional application in the case of Canada and 99.4% upon provisional application in the case of the EU; B) Fisheries: Both sides will fully eliminate all tariffs on fisheries products; C) Agriculture: Canada eliminated duties on 90.9% of all its agricultural tariff lines since the provisional application of CETA. Within 7 years, the tariffs for 91.7% of agricultural lines will be eliminated. The remainder are sensitive products, which will either be treated with Tariff Rate Quotas (dairy) or excluded altogether from liberalization commitments (chicken and turkey meat, eggs and egg products). The EU eliminated 92.2% of its agricultural tariffs since the provisional application of CETA. Within 7 years, 93.8% of the agricultural tariffs will be eliminated. For more details please refer to https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22017A0114(01). However, CETA will not take full effect until it is ratified by all EU Member States and as of January 3, 2019, the following 12 EU Countries have ratified it: Czech Republic, Denmark, Estonia, Spain, UK, Croatia, Lithuania, Latvia, Malta, Portugal, Sweden, Finland.

#### 2.4.4.2 Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)

In October 2012, Canada joined the Trans-Pacific Partnership (TPP), an agreement designed to promote free trade between Asia and the Americas. The original signatories to the TPP included Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United

States and Vietnam. The agreement was signed on February 4, 2016, but was not ratified and did not take effect, as U.S. President Donald Trump issued a Presidential Memorandum on January 23, 2017, withdrawing the U.S. from the TPP.

In May 2017, the remaining signatories of the TPP agreed to proceed with the trade deal without the participation of the United States. The 11 remaining countries signed the CPTPP on March 13, 2018. The agreement came into force on December 30, 2018 among the first six countries that ratified it: Canada, Australia, Japan, Mexico, New Zealand, and Singapore.

Canada's involvement in CPTPP, NAFTA, CETA and its free trade agreement with South Korea makes it the only G7 nation with free trade access to the Americas, Europe and the Asia-Pacific region. Since CETA's provisional application, Canada has free trade agreements with all of the G7 countries except Japan.

### 2.4.5 Foreign Investment Protection Agreements (FIPAs)

A FIPA is a bilateral agreement aimed at protecting and promoting foreign investment through legally binding rights and obligations. FIPAs accomplish their objectives by setting out the respective rights and obligations of the countries that are signatories to the treaty with respect to the treatment of foreign investment.

Typically, there are agreed exceptions to the obligations. FIPAs seek to ensure that foreign investors will not be treated worse than similarly situated domestic investors or other foreign investors; they will not have their investments expropriated without prompt and adequate compensation; and they will not be subject to treatment lower than the minimum standard established in customary international law. As well, in most circumstances, investors should be free to invest capital and repatriate their investments and returns.

Canada began negotiating FIPAs in 1989 to secure investment liberalization and protection commitments on the basis of a model agreement developed by the Organization for Economic Co-operation and Development (OECD). In 2003, Canada updated its FIPA model to reflect and incorporate the results of its experience with the implementation and operation of the investment chapter of NAFTA. This model provides for a high standard of investment protection and incorporates several key principles: treatment that is non-discriminatory and that meets a minimum standard; protection against expropriation without compensation and restraints on the transfer of funds; transparency of measures affecting investment; and dispute settlement procedures. The new model serves as a template for Canada in negotiations with investment partners on bilateral investment rules.

Currently, Canada has FIPAs in force with 37 countries including Russia, Poland, Venezuela, Argentina, Barbados, Benin, China, Costa Rica, Jordan, Kuwait, and Tanzania, and has concluded negotiations with a number of countries, including Albania, Bahrain, Madagascar, Moldova, and Zambia. Negotiations of a FIPA with India are ongoing. Canada has updated its FIPAs with Latvia, the Czech Republic, Slovakia, and Romania and is in the process of updating its FIPAs with Hungary and Poland to bring them into conformity with EU law. FIPAs with Burkina Faso, Guinea and Mongolia have recently come into force, and agreements have been signed with Nigeria and Kosovo that are not yet in force. Canada has also recently concluded negotiations of a FIPA with the United Arab Emirates.

### 2.4.6 Trade within Canada

In addition to Canada's international trade agreements, there are several significant agreements and recent developments relating to trade within Canada, summarized below.

#### 2.4.6.1 Canadian Free Trade Agreement (CFTA)

The CFTA came into force on July 1, 2017, and replaced the Agreement on Internal Trade (AIT). The CFTA is an agreement among the federal, provincial and territorial governments designed to reduce barriers to the free movement of persons, goods, services and investment within Canada and to establish an open, efficient and stable domestic market. The CFTA seeks to reduce costs to Canadian businesses by making internal trade more efficient, increasing market access and facilitating labour mobility.

Unlike the AIT, which covered only those sectors that were specifically listed, the CFTA uses a "negative list approach," meaning that the agreement applies to all sectors except those that are specifically excluded. Chapter 8 of the CFTA lists the types of measures that are subject to general exception, such as measures concerning Aboriginal Peoples, national security, taxation, water, social services, tobacco control, language, culture, gambling and betting, collective marketing arrangements for agricultural goods and passenger transportation services.

The CFTA contains formal dispute settlement mechanisms in Chapter 10. Only companies with a "substantial and direct" connection to a party to the agreement may bring forward a complaint under the CFTA. The CFTA does not trump Canada's international agreements and does not create any obligations to foreign suppliers.

#### 2.4.6.2 Inter-provincial trade barriers

Despite the CFTA, internal trade barriers continue to exist within Canada. One example is various provincial restrictions on alcohol imports and sales. In its 2018 decision in *R v. Comeau*, the Supreme Court of Canada confirmed that Canadian provinces are afforded considerable discretion to manage the passage of goods across their borders when legislating to address particular conditions and priorities in each province. While the *Constitution Act, 1867* prohibits explicit inter-provincial trade barriers such as the imposition of tariffs, regulating goods for different purposes that indirectly affect inter-provincial trade is permissible.

Regarding the particular example of alcohol imports and sales, the CFTA established an Alcoholic Beverages Working Group, tasked with identifying opportunities and making recommendations to enhance trade in alcoholic beverages within Canada. The working group is to submit its recommendations to the Committee on Internal Trade in July, 2018.

#### 2.4.6.3 New West Partnership Trade Agreement (NWPTA)

The NWPTA, formerly known as the Trade, Investment and Labour Mobility Agreement, is an agreement between Alberta, British Columbia, Saskatchewan and Manitoba designed to remove barriers to trade, investment and labour mobility. Originally signed by Alberta and British Columbia and effective in 2007, Saskatchewan and Manitoba joined the agreement in 2010 and 2016, respectively.

The NWPTA applies to all government measures (e.g., legislation, regulations, standards, policies, procedures, guidelines, etc.) affecting trade, investment and labour mobility. Certain special provisions have been established for some sectors, such as investment, business subsidies, labour mobility, procurement, energy and transportation. There are also a limited number of sectors that have been excluded from the coverage of the NWPTA, such as water, taxation, social policy, and renewable and alternative energy.

The NWPTA requires the signatory provinces to provide open and non-discriminatory access to procurements in excess of minimum thresholds by various government entities, including departments, ministries, agencies, Crown corporations, municipal governments, school boards and publicly funded academic, health, and social service entities.

The NWPTA's dispute resolution provisions are available to companies registered under the laws of one of the parties to the agreement. Where a government measure is considered to be inconsistent with both the CFTA and NWPTA, the NWPTA provides that the dispute resolution process under either agreement may be selected, but once chosen, there is no recourse to the other process in respect of the same issue. The maximum penalty is C$5-million and applies only to the provincial governments that are parties to the NWPTA.

#### 2.4.6.4 Trade and Cooperation Agreement between Ontario and Quebec

In 2009, Ontario and Quebec entered into the Trade and Cooperation Agreement between Ontario and Quebec with the intention of eliminating and reducing barriers that restrict trade, investment and labour mobility. Under the agreement, the two provinces have pledged to cooperate on a number of matters falling under the general categories of economic, regulatory and energy cooperation. The agreement also contains commitments related to labour mobility, financial services, transportation, government procurement, agriculture and food goods, and environmental and sustainable development.

In May 2015, amendments to the agreement's chapter on government procurement were announced to bring its scope into alignment with the government procurement chapter contained in CETA. The thresholds applied under the revised chapter will be lower than those available under the CFTA or CETA. The revised government procurement chapter entered into force in two phases: on January 1, 2016 for ministries and agencies, and on September 1, 2016 for all other entities.

#### 2.4.6.5 Pipeline and related disputes between Alberta and British Columbia

The Trans Mountain Pipeline currently carries approximately 300,000 barrels of oil per day from Alberta to British Columbia for the purposes of export. In November 2016, the federal government approved the Trans Mountain Pipeline Expansion Project, which would increase the capacity of the pipeline to approximately 890,000 barrels per day. Following the 2017 election, the new British Columbia NDP government expressed concerns regarding the environmental risks of the pipeline expansion project. In January 2018, British Columbia proposed a restriction on the increase of diluted bitumen transportation pending further consideration of these risks. British Columbia subsequently submitted a reference question to the British Columbia Court of Appeal to confirm whether the regulation of the impacts of heavy oil is within provincial jurisdiction.

In response to British Columbia's delays to the project, Alberta has implemented a number of retaliatory measures, including a temporary ban on the import of British Columbia wine, the suspension of negotiations for the purchase of electricity from British Columbia and the passage of the *Preserving Canada's Economic Prosperity Act* (PCEPA). The PCEPA allows Alberta to restrict the transport of energy products to British Columbia by requiring that energy exporters obtain a licence before they engage in export activities. In May 2018, British Columbia filed a lawsuit alleging that PCEPA is unconstitutional. The PCEPA lawsuit and the reference question before the British Columbia Court of Appeal are ongoing as of January 2019.

## 2.5 Importing goods into Canada

The importation of goods into Canada is regulated by the federal government. The *Customs Tariff* imposes tariffs on imported goods, while the *Customs Act* sets out the procedures that importers must follow when importing goods, and specifies how customs duties payable on imported goods are to be calculated and remitted.

Under NAFTA, barriers to trade in goods between Canada, the U.S. and Mexico have largely been removed. Tariffs between Canada and the U.S. have been generally eliminated since January 1, 1998, and tariffs on most goods flowing between Canada and Mexico were eliminated by January 1, 2003. However, despite a previous exemption, President Trump recently imposed tariffs on Canadian steel and aluminum products. In response, Prime Minister Justin Trudeau introduced tariffs on U.S. steel and aluminum products and certain other goods from the U.S. such as maple syrup, beer kegs and whiskey. The tariffs imposed by President Trump are linked to his dissatisfaction with the progress of NAFTA renegotiations.

In order for goods to be duty-free under NAFTA, they must satisfy "rules of origin," which require a certain level of North American value-added. These rules are complex and are based on changes in tariff classification and regional value content, the latter calculated by either transaction value or the net cost method. Goods not meeting these requirements will remain subject to Canadian, U.S., or Mexican tariffs. These rules do not depend on the ownership of the business importing or exporting the goods, so they apply equally to foreign-owned Canadian companies. In the case of services, NAFTA's provisions are generally applicable to enterprises of other NAFTA members, even if controlled by non-NAFTA nationals, as long as the enterprise carries on substantive business activities in a NAFTA country.

A more detailed discussion of the steps involved in importing goods and the applicable legislation is set out below.

### 2.5.1 Tariff classification

All goods imported into Canada are subject to the provisions of Canada's customs laws, including the provisions of the *Customs Act* and the *Customs Tariff*. To determine the rate of duty, if any, applicable on the imported goods, the goods must be classified among the various tariff items set out in the List of Tariff Provisions of the *Customs Tariff*. Canada and the U.S. are signatories to the *Convention on* the *Harmonized Commodity Description and Coding System*; therefore, tariff classifications up to the sixth digit should be identical between Canada and the U.S.

### 2.5.2 Tariff treatment

Once the tariff classification of imported goods is determined, the List of Tariff Provisions under the *Customs Tariff* indicates the various tariff treatments available in respect of the goods, depending on their country of origin. For instance, where no preferential tariff treatment is claimed, the most favoured nation tariff treatment applies.

However, as a result of Canada's participation in several bilateral, plurilateral and multilateral trade agreements in recent years, various preferential tariff treatments are available to goods from certain countries. For example, all customs duties on goods originating in the U.S. have been eliminated pursuant to NAFTA.

In addition to the preferential tariff treatment that Canada affords to imports from countries with which Canada has established a free trade agreement, Canada also affords preferential tariff treatment to imports of goods originating in developing countries, as part of an effort to encourage foreign development in those countries. For instance, the General Preferential Tariff (GPT) treatment provides partial duty relief to goods originating in certain developing countries. In 2018, the GPT treatment is accorded to qualifying imports from 106 countries. Similarly, through the Least Developed Country Tariff (LDCT), Canada grants duty-free access to the Canadian market to goods that originate in certain specified Least Developed Countries. In 2018, the LDCT treatment is accorded to qualifying imports from 49 countries. To claim one of the preferential rates of duty, the importer must establish that the goods qualify for the claimed treatment pursuant to the relevant rules of origin and must obtain proper proof of origin, usually from the exporter.

### 2.5.3 How are tariffs calculated?

The amount of customs duties payable on any importation is a function of the rate of duty (determined as set out above) and the valuation of the goods. This is because most of Canada's tariff rates are imposed on an *ad valorem* (or percentage) basis. In Canada, the primary method for customs valuation is the "transaction value" system, under which the value for duty is the price paid for the goods when sold for export to a purchaser in Canada, subject to specified adjustments. A non-resident may qualify as a "purchaser in Canada" where the non-resident imports goods for its own use and not for resale, or for resale if the non-resident has not entered into an agreement to sell the goods prior to its acquisition from the foreign seller. Otherwise, customs value will be based on the sale price charged by the non-resident seller to the customer who is resident, or who has a permanent establishment, in Canada.

The transaction value method may not be available in certain other circumstances, such as where the buyer and seller do not deal at arm's length, or where title to the goods passes to the buyer in Canada. In these circumstances, other valuation methods will be considered in the following order: (1) transaction value of identical goods; (2) transaction value of similar goods; (3) deductive value; (4) computed value; and (5) residual method.

If applicable, the transaction value method begins with the sale price charged to the purchaser in Canada. However, the customs value is determined by considering certain statutory additions and permitted deductions. For instance, selling commissions, assists, royalties, and subsequent proceeds must be added to arrive at the customs value of the goods. The value of post-importation services may be deducted from the customs value of the goods.

If the importer's goods originate primarily from suppliers with whom the importer is related and the importer wishes to use the transaction value method of valuation, the importer is frequently requested to demonstrate that the relationship did not influence the transfer price between the importer and the vendor. In such a situation, documentation may be required to establish that the transfer price reflects the transaction value.

### 2.5.4 How are tariffs assessed?

Canada has a self-assessment customs system. Importers and their authorized agents are responsible for declaring and paying customs duties on imported goods. In addition, importers are required to report any errors made in their declarations of tariff classification, valuation, or origin when they have "reason to believe" that an error has been made. This obligation lasts for four years following the importation of any goods. The *Customs Act* imposes severe penalties for non-compliance with this and other provisions, up to C$25,000 per occurrence.

### 2.5.5 What penalties are imposed for non-compliance with customs laws?

Where a person has failed to comply with the provisions of the *Customs Act*, the Canada Border Services Agency (CBSA) is authorized to take several enforcement measures, including seizures, ascertained forfeitures, or the imposition of administrative monetary penalties under the Administrative Monetary Penalty System (AMPS). Seizures and ascertained forfeitures are applied to the more serious offences under the *Customs Act*, such as intentional non-compliance, evasion of customs duties, and smuggling.

Importers may be liable for penalties of up to C$25,000 per contravention in accordance with the AMPS. The CBSA maintains a "compliance history" for each importer. The retention period for an individual contravention is either one or three years for penalty calculation purposes only. However, the contravention remains on the AMPS system for six years plus the current year. Repeat offenders may be subject to increased penalties.

### 2.5.6 Country of origin marking rules

Certain goods listed in regulations made pursuant to the *Customs Tariff* must be marked with their country of origin in order to be imported into Canada. In the case of goods imported from a NAFTA country, the relevant regulations base the determination of origin on tariff shift rules, which are in turn dependent on the tariff classification of components and the finished product. In the case of goods imported from any country other than a NAFTA country, the country of origin is the country in which the goods were "substantially manufactured."

### 2.5.7 Which products are subject to import controls?

Almost all goods may be imported into Canada, subject to compliance with certain conditions imposed by the federal and provincial governments. Goods over which Canada imposes import controls and requires import permits are listed in the Import Control List. Other Canadian laws that must be complied with in relation to imports include labelling laws for goods intended for retail sale; emission control standards for vehicles; and health and sanitary conditions for food and agricultural imports. Certain goods, for example, electrical appliances, must be certified by a recognized certification body. Imports of liquor, wine and beer may require prior authorization from the appropriate provincial liquor commission.

## 2.6 Domestic trade remedy actions

### 2.6.1 Anti-dumping and anti-subsidy investigations

The *Special Import Measures Act* (SIMA) contains measures designed to protect businesses in Canada from material injury due to unfair import competition. SIMA's provisions are based on Canada's rights and obligations set out in the WTO agreements.

SIMA allows Canadian producers to file a complaint against unfairly traded imports and to request relief in the form of anti-dumping or countervailing duties where material injury results from: (1) imports that are "dumped" (i.e., sold at lower prices in Canada than in the exporter's home market); or (2) imports that are unfairly subsidized by the government of the exporter's country.

Canada's trade remedy regime establishes a bifurcated process under which the CBSA has jurisdiction over determinations of dumping and subsidization and the Canadian International Trade Tribunal (CITT) enquires into and considers the issue of whether any dumping or subsidization is causing or is likely to cause material injury to the affected Canadian industry.

If the CITT makes a preliminary determination of injury and the CBSA makes preliminary and final determinations of dumping or subsidization, the CITT goes on to consider whether there is "material injury." If the CITT makes a finding of material injury, an anti-dumping duty (equal to the margin of dumping found by the CBSA) or a countervailing duty (equal to the margin of subsidization found by the CBSA) will be imposed on all importations of the subject goods for a period of five years. During this time, the CBSA may initiate re-investigations to update the margin of dumping or subsidization, and the CITT may review its finding if the circumstances warrant. At the expiry of the five-year period, the CITT may review its finding and may rescind or continue the finding for an additional period of five years (with no limit on the number of continuation orders permissible).

The CBSA implemented a new normal value review process in June, 2018. Normal value reviews are conducted by the CBSA to ensure that export prices accurately reflect current market conditions, and normal values are used to make determinations regarding the margin of dumping or subsidization.

Importers may request a formal scope ruling from CBSA as to whether certain goods are subject to an anti-dumping or countervailing duty. A scope ruling may be appealed to the CITT. A final determination from the CBSA or CITT is subject to judicial review by the Federal Court of Appeal. Where a dumping or subsidy investigation involves U.S. or Mexican goods, an aggrieved party may choose to request a review of the CBSA or CITT finding by a NAFTA ad hoc panel of trade law experts. A review of final anti-dumping or countervailing duty determinations with respect to U.S. or Mexican goods must be undertaken by an ad hoc NAFTA panel, as NAFTA provides that there is no recourse to judicial review from final determinations.

### 2.6.2 Safeguard protection

SIMA applies only in the case of unfairly traded (i.e. dumped or subsidized) imports that are causing material injury to a Canadian industry. However, the Canadian International Trade Tribunal Act and the Customs Tariff provide for a trade remedy in the case of fairly traded goods that nevertheless are causing or threatening to cause "serious injury" to a Canadian industry. These are called "safeguard" actions. In such cases, the CITT may hold an inquiry and may make recommendations to the finance minister. The finance minister is authorized, in appropriate cases, to take certain safeguard actions against such imports, including imposing surtaxes or quotas for a limited time.

## 2.7 Procurement (government contracts) review

NAFTA, CETA, the CFTA and the WTO Revised Agreement on Government Procurement (AGP) require the signatories to the agreements to provide open access to government procurement for certain goods and services. These agreements also require signatory governments to maintain an independent bid challenge authority to receive complaints. The CITT is Canada's complaint authority.

Parliament has enacted legislation designed to ensure that the procurements covered by NAFTA, CETA, the CFTA or the AGP are conducted in an open, fair and transparent manner and, wherever possible, in a way that maximizes competition. While there is considerable overlap in the scope and coverage of procurements covered by these international agreements, several areas have significant differences. The most notable differences are the goods and services included, and the minimum monetary thresholds for goods, services, and construction services contracts. These monetary thresholds are subject to periodic review.

The federal government has agreed to provide potential suppliers equal access to federal government procurement for contracts involving certain goods and services bought by approximately 100 government departments, agencies and Crown corporations. Still, on occasion, a potential domestic or foreign supplier may have reason to believe that a contract has been or is about to be awarded improperly or illegally, or that the potential supplier has been wrongfully denied a contract or an opportunity to compete for one. The CITT provides an opportunity for redress for Canadian and foreign suppliers concerned about the propriety of the procurement process relating to contracts covered by NAFTA, CETA, the CFTA or the AGP.

As discussed above, the NWPTA requires the governments of Alberta, British Columbia, Saskatchewan and Manitoba to provide open and non-discriminatory access to procurements by government entities in excess of minimum thresholds.

## 2.8 Export controls, economic sanctions and industry-specific trade laws

### 2.8.1 Which products are subject to export controls?

Canada's export controls are based on several international agreements and arrangements, such as the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technology, and the Treaty on the Non-Proliferation of Nuclear Weapons (NPT).

Canada's *Export Control List* (ECL) identifies specific goods and technology that may only be exported from Canada to specified destinations if an export permit is obtained. The ECL is divided into seven groups of items: dual-use, munitions, nuclear non-proliferation, nuclear-related dual-use, miscellaneous goods and technology, missile technology control regime, and chemical and biological weapons non-proliferation.

Canadian businesses must determine whether their exports are subject to the ECL. Under the *Export and Import Permits Act* (EIPA), a corporation with its head office in Canada or operating a branch office in Canada may apply to the Minister of Foreign Affairs for a permit to export ECL goods.

Some goods and technology on the ECL may be exempted from the permit requirement if they are being shipped to certain countries. For example, goods or technology that are manufactured in the U.S., imported into Canada, and are proposed for export to a country other than Cuba, Iran, North Korea, Syria, or a country on the Area Control List are covered by General Export Permit No. 12 and do not require individual export permits. However, as a condition of authorizing exports of certain goods or technology to a Canadian company, the U.S. government may require that company to obtain an explicit re-export authorization before exporting the items from Canada.

In addition to the ECL, the *Area Control List* restricts the export of all products to specified countries, currently only North Korea. The export of any goods or technology to North Korea requires an export permit. Belarus was removed from the *Area Control List* in 2017.

The *Export Act* imposes export duties on certain logs and pulpwood, ores, petroleum in its crude or partly manufactured state, and intoxicating liquors.

### 2.8.2 Economic sanctions

Certain activities and the export of certain goods are subject to United Nations (UN) trade sanctions or arms embargoes against particular countries and regions. Under the *United Nations Act* (UNA), Canada has implemented regulations that are necessary to facilitate compliance with measures taken by the United Nations Security Council. These regulations prohibit certain exports, principally arms and related material, to the following countries: the Central African Republic, the Democratic Republic of the Congo, Eritrea, Iran, Iraq, Lebanon, Libya, North Korea, Somalia, South Sudan, Sudan and Yemen. In some cases, UNA sanctions prohibit dealing with listed persons and entities. Listed persons and entities are normally associated with the subject country's government. Therefore, exports and other transactions should be carefully reviewed so that UNA sanctions are not violated.

The *Special Economic Measures Act* (SEMA) empowers Canada to take unilateral action, including embargoes, against a country in specified circumstances. SEMA gives the Canadian government authority to impose orders or regulations to restrict or prohibit persons in Canada, or Canadians outside Canada, from:

- Dealing in property of a foreign state (or its residents or nationals)
- Exporting, selling or shipping goods to a foreign state
- Transferring technical data to a foreign state
- Importing or acquiring goods from a foreign state, and
- Providing or acquiring any financial or other services to, or from, a foreign state

Currently, Canada has imposed economic measures under SEMA against Myanmar/Burma, Iran, Libya, North Korea, Russia, South Sudan, Syria, Ukraine, Venezuela and Zimbabwe. Canadian companies are prohibited from making new investments in some, but not all, countries subject to measures under SEMA.

Where UNA or SEMA sanctions apply, it may be possible to obtain a permit allowing an otherwise prohibited transaction. While humanitarian assistance is often allowed, the Canadian government may be willing to issue permits for certain types of non-humanitarian commercial transactions, depending on the government's specific priorities and policies in respect of the country subject to sanctions.

In 2016, Canada announced significant amendments to its economic sanctions imposed on Iran. Previously, Canada imposed a ban on all imports from and exports to Iran, subject to certain humanitarian exceptions. The amendments removed the blanket import and export prohibitions, although the export of specific goods deemed to be proliferation-sensitive is still prohibited.

### 2.8.3 Sector-specific trade laws

Canada has certain trade laws that are specific to individual industries. For example, in the forestry industry, there are restrictions on the export of logs and softwood lumber from Canada. Similarly, permits are required for the export of steel and import controls are in place in respect of certain goods including steel, agricultural goods and textile products.

Moreover, numerous Canadian laws directly and indirectly impose trade controls. For example, consumer product safety laws and environmental regulations impact sales of specified types of goods by prohibiting or restricting importation into Canada unless the goods first comply with applicable Canadian standards. In some cases, the manufacture or sale of goods may be subject to Canadian standards even where those goods are intended solely for export.

Other government departments may also control the export of goods, requiring additional permits even where an export permit has already been granted pursuant to the EIPA. Departments that exercise controls over exports include Canadian Heritage, Natural Resources Canada, Fisheries and Oceans, Health Canada, the Canadian Wheat Board, Agriculture and Agri-Food Canada, Environment Canada, and the Canadian Food Inspection Agency. The circumstances that require additional departmental approvals are frequently not intuitive, and care must be taken to ensure compliance with all export controls.

### 2.8.4 *International Traffic In Arms Regulations* and the Canadian exemption

The U.S. *International Traffic in Arms Regulations* (ITAR) generally regulates the export and licensing of certain defence articles and services from the U.S. For exports of defence articles and services to Canada for end-use in Canada, ITAR contains a very limited exemption for "Canadian-registered persons." For a Canadian business to qualify for exemption from the licensing requirements under ITAR, it must be registered under the Canadian *Defence Production Act*. A list of registered businesses is maintained by the Canadian Controlled Goods Directorate.

There is a process to extend this exemption to the employees of a registered business. However, this exemption may not be available to employees who are dual citizens of a listed country if the employee has "substantive contacts" with the listed country. Employers are required to screen dual-citizen employees for such "substantive contacts." When such employees are identified, a risk of technology diversion is presumed and the employer may not give such employee access to the defence articles or information unless the U.S. Directorate of Defence Trade Controls grants a discretionary individual exemption.

The *Controlled Goods Regulations* under the *Defence Production Act* set out the process for the registration of Canadian businesses in the Controlled Goods Program, described in greater detail in the following section.

## 2.9 Controlled Goods Program

The Controlled Goods Program is intended to safeguard potentially sensitive goods and technology and prevent them from falling into the wrong hands. The program requires companies dealing with specified civilian or military goods to register with the Controlled Goods Directorate, undergo security assessments, develop and implement a security plan, control access to the specified goods, report security breaches, and maintain extensive records on all such goods for the duration of registration and for five years after registration expires. In determining whether to register a business, the directorate must consider, on the basis of a security assessment, the risk that the applicant poses of transferring the controlled goods to someone not registered or exempt from registration.

Goods subject to the Controlled Goods Program include a number of goods that are listed on Canada's ECL, as well as U.S. goods that are "defense articles," or goods produced using "technical data" of U.S. origin, as those terms are defined in ITAR. The specific goods and technology that are subject to the Controlled Goods Program are contained in the Controlled Goods List, which is included in the schedule to the *Defence Production Act*. The inclusion of "technology" means that technical information such as documents or emails relating to these goods may also be captured.

While the procedures under the Controlled Goods Program can be very onerous, penalties for non-compliance are severe. Companies that fail to comply can have their registration revoked, and the company and individuals involved may receive fines from C$25,000 to C$2-million or a term of imprisonment not exceeding 10 years, or both.

The breadth of the goods involved, coupled with the severity of the potential penalties, make it imperative that companies doing business in Canada ensure that they are not dealing with controlled goods or technology if they have not registered with the Controlled Goods Program.

## 2.10 *Foreign Extraterritorial Measures Act* (FEMA) and doing business with Cuba

FEMA is largely an enabling statute to protect Canadian interests against foreign courts and governments wishing to apply their laws extraterritorially in Canada by authorizing the attorney general to make orders relating to measures of foreign states or foreign tribunals affecting international trade or commerce. The attorney general has issued such an order with respect to extraterritorial measures of the U.S. that adversely affect trade or commerce between Canada and Cuba. The order was originally issued in retaliation for certain amendments to the U.S. *Cuban Assets Control Regulations* and was further amended in retaliation for the enactment of the U.S. *Cuban Liberty and Democratic Solidarity (LIBERTAD) Act*, both of which aim to prohibit the activities of U.S.-controlled entities domiciled outside the U.S. (e.g., Canadian subsidiaries of U.S. companies) with Cuba.

The FEMA order imposes two main obligations on Canadian corporations. First, it requires Canadian corporations (and their directors and officers) to give notice to the Attorney General of any directive or other communication relating to an extraterritorial measure of the U.S. in respect of any trade or commerce between Canada and Cuba that the Canadian corporation has received from a person who is in a position to direct or influence the policies of the Canadian corporation in Canada. Second, the FEMA order prohibits any Canadian corporation from complying with any such measure of the U.S. or with any directive or other communication relating to such a measure that the Canadian corporation has received from a person who is in a position to direct or influence the policies of the Canadian corporation in Canada.

This means that Canadian companies wishing to carry on business with or in Cuba and whose goods are regulated under the U.S. *Cuban Assets Control Regulations*, for example, could be in conflict with U.S. law. On the other hand, if the Canadian company decided not to do business in Cuba because a U.S. extraterritorial measure prohibited such conduct, the company could be in violation of FEMA. The conflict of U.S. and Canadian trade sanctions can result in legal liability for both individuals and corporations, not to mention public relations challenges.

For example, in January 2015, the federal government issued an order pursuant to FEMA in relation to a dispute with the State of Alaska over the construction of a ferry terminal in British Columbia that is leased by Alaska. Alaska had planned to complete the project using only American iron and steel. The FEMA order was intended to prohibit any person in Canada from complying with the Alaskan "Buy America" measures. However, two days after the FEMA order was issued, the State of Alaska cancelled its plans to construct the new terminal.

More recently, in 2017, the U.S. Office of Foreign Assets Control (OFAC) fined a U.S. company when its Canadian subsidiary approved and financed lease agreements between an unaffiliated dealership and the Cuban Embassy in Ottawa. OFAC determined that the lease agreements violated the U.S. Cuban Assets Control Regulations; however, the transactions were permitted under Canadian law and FEMA applied so as to prevent the company from refusing to enter the transaction on the basis of the U.S. law.

## 2.11 Canadian anti-bribery legislation

There are two statutes in Canada that address bribery and corruption, namely the *Corruption of Foreign Public Officials Act* (CFPOA), which criminalizes corruption of foreign public officials, and the Canadian *Criminal Code*, which criminalizes corruption of Canadian public officials and corrupt behaviour in certain transactions among private parties. In both the CFPOA and the *Criminal Code*, all relevant offences are criminal offences.

### 2.11.1 Criminal Code

The *Criminal Code* contains a number of provisions that regulate conduct in relation to Canadian government officials. In particular, it contains several sections prohibiting the provision of a loan, reward, advantage or benefit of any kind (collectively a "benefit") to a government official by those who do business with the government. The *Criminal Code* is applicable to offences within Canada and offences that occur outside of Canada, provided there is a real and substantial connection between the offence and Canada. In essence, the *Criminal Code* can apply to any offence, provided some part of the formulation, initiation or commission of the offence has taken place within Canada.

Under the *Criminal Code,* "government official" is defined broadly to include provincial and federal employees and officials (including elected officials, ministers, judges, police, military, employees of regulatory bodies, etc.), as well state corporations if they are acting as an agent of the federal or a provincial government. Bribery of municipal officials and employees is also regulated by section 123 of the *Criminal Code.* The definition of "official" has also been applied to Aboriginal Band officials and employees under the *Criminal Code* breach of trust offence, designed to ensure that holders of public office use their offices only for the public good. The secret commissions offence is applicable to all employees and agents, regardless of whether they are in the public or private sector.

Subsection 121(1)(a) of the *Criminal Code* prohibits the offering or giving a benefit to any government official, or any member of his family, as consideration for cooperation, assistance, the exercise of influence or an act or omission in connection with the transaction of business with the government. This provision is targeted at prohibiting overt forms of corruption. Case law from the Supreme Court of Canada has confirmed that this subsection is designed to prevent the provision of benefits in exchange for influence or an advantage in doing business with the government. It is not illegal under this subsection to provide a benefit *per se*, unless the benefit is in exchange for cooperation or assistance.

Subsections 121(1)(b) and (c) of the *Criminal Code* are much broader than the other anti-corruption sections of the *Criminal Code,* which require an element of a *quid pro quo* arrangement. Subsection 121(1)(b) prohibits the provision of a benefit to government officials with whom the provider has business dealings, even if there are "no strings attached." Subsection 121(1)(c) prohibits the receipt of such a benefit. Crucially, it is not an offence under these subsections to provide or receive a benefit that has been pre-approved, in writing, by the head of the branch of government dealing with the party that provided the benefit.

Penalties for violation of the anti-corruption offences in the *Criminal Code* include unlimited fines for corporations, up to five years imprisonment for individuals (including directors and officers that participate in or knowingly assist or encourage the commission of the offence), and forfeiture of any proceeds (not just profits) obtained by the illegal act. Under the Public Works and Government Services Canada Integrity Regime (Integrity Regime) and section 750 of the *Criminal Code*, conviction of a section 121 offence will result in debarment or incapacity to contract with the Canadian government indefinitely. Under the same regime, being charged with a section 121 offence may result in an 18-month suspension from contracting with the Canadian government.

### 2.11.2 CFPOA

The CFPOA is Canada's equivalent to the United States' *Foreign Corrupt Practices Act,* (FCPA). While similar in many respects, there are some notable differences between the CFPOA and the FCPA, which include the prohibition of facilitation payments and lack of civil enforcement under the CFPOA.

The CFPOA forbids transferring or offering to transfer any type of benefit for the purpose of influencing a foreign official to misuse his or her power or influence with the purpose of obtaining or retaining a business advantage. There is also an accounting offence under the CFPOA such that it is an offence to keep secret accounts, falsely record, not record or inadequately identify transactions, enter liabilities with incorrect identification of their object, use false documents, or destroy accounting books and records earlier than permitted by law for the purpose of concealing bribery of a foreign public official.

Under the CFPOA, the actions of Canadian citizens, permanent residents, corporations, societies, firms, or partnerships on a worldwide basis are deemed to be acts within Canada for the purpose of the Act. As a result, Canadian citizens and companies are subject to worldwide regulation by Canadian authorities under the CFPOA, regardless of whether the entirety of the alleged misconduct occurred abroad. For individuals and entities that are not Canadian, the CFPOA may still apply if there is a real and substantial connection between Canada and the alleged misconduct.

A foreign public official is defined in the CFPOA as a person who performs public duties or functions for a foreign state. This definition has broad application and includes a person employed by a board, commission, corporation or other body or authority that is performing a duty or function on behalf of the foreign state, or is established to perform such a duty or function. It also includes employees of wholly or partially state-owned or controlled corporations, and may extend to employees and members of political parties if they perform public duties or functions for a foreign state.

On October 31, 2017, the Federal Government of Canada repealed an exemption for facilitation payments under the CFPOA. Facilitation payments, often referred to as "grease payments," are small payments made to government officials to secure or expedite "acts of a routine nature." These payments are typically demanded by lower-level government officials, such as customs officials, for the provision of services that the provider of the payment would otherwise be entitled to. This is an important development for organizations that comply with the CFPOA and FCPA, as compliance with the FCPA alone will no longer prevent prosecution by Canadian authorities. These organizations must review their compliance programs to ensure they positively prohibit facilitation payments, even though they are still exempt under the FCPA.

A CFPOA violation can result in imprisonment for up to 14 years. An individual or corporation convicted of a CFPOA offence can also be subject to significant fines. There is no limit to the fines that can be imposed on corporations and the quantum is left to the discretion of the court. In addition, Canadian courts can and have ordered corporate probationary terms, including appointment of a third-party monitor. Under the Integrity Regime noted above, CFPOA convictions result in a maximum 10-year debarment period, and being charged with a CFPOA offence may result in an 18-month suspension from contracting with the Canadian government. Any proceeds (not just profits) or property obtained as a result of a CFPOA offence may be ordered to be forfeited to the Crown.

### 2.11.3 Canada's New Resolution Regime

On February 27, 2018, Public Services and Procurement Canada announced the federal government would introduce legislation to implement remediation agreements, known as deferred prosecution agreements in the United States and United Kingdom. Remediation agreements are agreements between an accused organization and the prosecutor, whereby the prosecutor agrees to suspend or defer prosecution of an offence in exchange for cooperation and compliance with certain conditions. Admissions made by an organization as a result of a remediation agreement, or during its negotiations, are not admissible as evidence in civil or criminal proceedings besides the remediation agreement itself. Once the terms of a remediation agreement are complete, charges against the organization are withdrawn without a criminal conviction or debarment consequences. In the event that an accused organization violates the conditions of a remediation agreement, enforcement may resume through traditional means, including a full criminal conviction.

Amendments to the *Criminal Code* that allow for and govern the use of remediation agreements in Canada were included in Bill C-74 (Resolution Regime). These amendments come into force on September 19, 2018. The Resolution Regime will apply retroactively and will be available for offences committed prior to it coming into force. The Resolution Regime only applies to certain offences, including section 121 and 123 *Criminal Code* offences and CFPOA offences. At this time, the Resolution Regime does not apply to *Competition Act* offences.

Before these amendments, organizations charged with the *Criminal Code* and CFPOA offences set out above had three avenues for resolution:

- **i.** Convince the authorities not to proceed with criminal charges (such as by attempting to persuade the authorities to pursue individual rogue employees instead of the organization)
- **ii.** Plead guilty to a criminal offence
- **iii.** Fight the matter at trial

The Resolution Regime provides a welcome fourth option for organizations accused with an offence under the CFPOA or *Criminal Code*.

Under the Resolution Regime, prosecutors must initiate negotiations. Prosecutors can only enter into negotiations for a remediation agreement with an accused organization if they are of the opinion there is a reasonable prospect of conviction for the offence and that negotiating a remediation agreement is appropriate in the circumstances and in the public interest. Prosecutors must consider several factors to determine if negotiating a remediation agreement is appropriate in the circumstances and in the public interest, including:

- The circumstances in which the alleged offence was brought to the attention of authorities (i.e., whether an organization self-reported the offence)
- Whether the organization has made reparations or taken other measures to remedy harm caused by the alleged offence and to prevent the occurrence of similar issues in the future
- Whether the organization has identified, or expressed a willingness to identify, any individuals involved with the offence
- Whether the organization or its representatives have been convicted of, or entered into a remediation agreement with respect to, similar offences in the past

The Resolution Regime requires that remediation agreements receive court approval. Specifically, a court must be satisfied that a remediation agreement is fair, reasonable and proportionate, as well as in the public interest. Once approved, remediation agreements will be published by the courts and must include, among other items:

- A statement of facts
- An obligation to cooperate in identifying individuals or acts of wrongdoing involved in or related to the relevant conduct
- An obligation to cooperate in any investigation or prosecution resulting from the relevant conduct, including providing information or testimony
- An obligation to pay a penalty and make reparations (where appropriate)

Remediation agreements can also include additional terms, such as third-party compliance monitors or an obligation to reimburse the government for any costs related to the investigation and prosecution that led to the remediation agreement.

# Acquiring a Canadian Business 3

## 1 General Considerations

The threshold question in any acquisition is whether to purchase shares or assets. This will be dictated by a variety of factors, including timing, ease of implementation and tax considerations. A share purchase is generally simpler and quicker to complete than an asset acquisition, as it avoids many of the practical problems associated with the transfer of particular assets and the common requirement to obtain consents of third parties. A share purchase may also have tax advantages from the vendor's perspective, as it generally permits the vendor to obtain capital gains treatment with respect to any gain on the sale of the shares, thereby reducing overall tax liability.

A sale of assets will generally be less favourable for the vendor, as a result of potential income inclusions in areas such as the recapture of depreciation on the assets being sold. On the other hand, from the purchaser's perspective, asset acquisitions may have some advantages, particularly where the purchaser wishes to exclude certain parts of the business or its liabilities from the transaction or to step up the tax cost of depreciable assets.

In either case, the purchaser will be concerned about the condition of the underlying business, the title of the vendor to its assets, the status of contracts with third parties and compliance with environmental and other laws. The purchaser will seek to protect itself by conducting a due diligence review of the vendor's business and obtaining appropriate representations, warranties and covenants in the purchase agreement, and potentially through obtaining representation and warranty insurance.

## 2 Share Acquisitions

### 2.1 What approvals are required for an acquisition of shares of a Canadian company by a non-resident?

The securities rules applicable to a purchase of shares depend on whether the purchase is of a private or a public company (see 2.4, "Are there any special rules that apply to the acquisition of shares of public companies?"). In the case of large acquisitions, pre-clearance under the Canadian competition laws is required. Apart from this, the principal authorization that might be required is approval under the *Investment Canada Act*. See Section 3.1, "General Rules on Foreign Investments."

### 2.2 What are the tax consequences of a share purchase?

There are no stamp duties or similar taxes payable in Canada upon an acquisition of shares. The shares' vendor may be subject to payment of capital gains tax. To ensure that non-residents of Canada pay any taxes owing in respect of a sale of "taxable Canadian property," which can include some shares (e.g., if the shares derive their value principally from Canadian real property), the *Income Tax Act* requires the purchaser of taxable Canadian property to undertake a "reasonable inquiry" and satisfy itself as to the vendor's Canadian resident status (normally through representations in the purchase agreement). If the vendor is a non-resident, it might need to provide the purchaser with a certificate issued by the tax authorities, which will be granted when appropriate arrangements are made to ensure payment of any tax liability. If the certificate is not provided, the purchaser might need to withhold and remit to the tax authorities 25 per cent of the purchase price, whether or not any tax would be payable by the vendor on the sale. Shares that are listed on a "recognized stock exchange" can be "taxable Canadian property" in certain circumstances; however, it is not necessary to obtain a certificate with respect to the sale of such shares.

## 2.3 Can one freely dismiss directors and officers of the acquired Canadian company?

Directors may be removed by shareholders' resolution, which would enable a non-resident purchaser to replace the acquired company's board of directors as the purchaser sees fit, subject to the qualification and Canadian residency requirements for directors, discussed in 1.2.1, "Who is responsible for the corporation?"

Officers and other employees of the target may be dismissed, subject to the provisions of Canadian law and any employment contracts or collective agreements. Specifically, unless their employment contracts set out their entitlements upon termination of employment, at common law and under the *Civil Code of Québec*, employees whose employment is terminated without cause would be entitled to reasonable notice of termination or pay in lieu of notice. Depending on the employee's length of service, position, compensation, age, and availability of similar employment, the required notice of termination (or pay in lieu of notice) could range between one month and 24 months or more.

A typical condition of closing may require the board and designated officers to resign their corporate offices and directorships and provide releases.

## 2.4 Are there any special rules that apply to the acquisition of shares of public companies?

The acquisition of shares of a public company could trigger the application of the "take-over bid" requirements of Canadian corporate and securities legislation. In Canada, the rules governing take-over bids are now harmonized across all provincial jurisdictions. Negotiated public company acquisitions in Canada are typically commenced by a non-binding letter of intent from the offeror indicating an interest in purchasing the outstanding securities of the target, and a confidentiality and standstill agreement between the parties, followed by the negotiation of a comprehensive support agreement.

### 2.4.1 Regulation of take-over bids

The threshold for a take-over bid is 20 per cent of the issued voting shares or "equity" shares (essentially non-voting common shares) of any class or series of the issuer. This threshold applies regardless of whether the offeror will obtain effective control of the company. Disclosure of the acquisition of 10 per cent or more of the voting or equity shares of a company (or securities convertible into voting or equity securities), and of subsequent acquisitions of two per cent or more within the 10 to 20 per cent range, is required under the "early warning" rules of Canadian securities legislation.

The offeror may determine the number of shares for which it wishes to bid. On a partial bid, shares must be taken up *pro rata*. Conditions may be attached to the bid (other than a "financing" condition). It is common to make a purchase conditional upon attaining a minimum level of acceptance, frequently two-thirds (the threshold for approval of certain fundamental corporate transactions in most jurisdictions) or 90 per cent (the level that gives the offeror the right to acquire the balance of the shares outstanding). There is a minimum tender requirement of 50 per cent of the securities subject to the bid (excluding securities held by the bidder and its joint actors).

Unless an exemption applies, a take-over bid must be made to all shareholders pursuant to a disclosure document (comprising a take-over bid offer and a circular). The circular must set out prescribed information about the offer and the parties, including shareholdings and past dealings by the bidder and related parties in shares of the target. If the target company has Quebec shareholders, which will often be the case, then unless a *de minimis* exemption applies, the circular must also be prepared in the French language for the purposes of mailings to such Quebec holders. The circular must be delivered to the target company and filed with the securities commissions, but is not subject to any pre-clearance review. The offeror is generally free to determine the price at which it chooses to bid and the consideration may be either cash or securities (or a combination of cash and securities).

Where the purchase price consists of securities of the offeror, the circular must contain prospectus-level disclosure regarding the offeror's business and financial results and *pro forma* financial statements assuming completion of the offer. For companies in the resource sector, technical reports on the offeror's properties or oil and gas resources may be required. Issuing securities will make the offeror a "reporting issuer," subjecting the offeror to certain ongoing disclosure requirements.

The target company's directors must deliver their own circular to shareholders in response to the bid. There are a number of corporate rules and securities commission policies that affect the target company's ability to undertake defensive measures in response to a bid, though recent amendments to the law are designed to provide more power to the target board. A bid subject to full regulation under provincial legislation must be made in accordance with certain timing and other procedural rules, including a compulsory minimum offer period. The minimum offer period is 105 days, except in certain circumstances where the target board agrees to waive that period in favour of a shorter period (not less than 35 days) or unless the target enters into certain alternative transactions in response to the bid (in which case the period moves to 35 days).

### 2.4.2 Exempt take-over bids

Exemption from the statutory take-over bid rules is available in certain circumstances. As noted above, purchases of private companies are generally exempt from the take-over rules.

One of the most important exemptions relating to public companies is the "private agreement" exemption. Purchases may be made by way of private agreements with a small number of vendors without complying with the take-over bid rules, which would otherwise require the offer to be made to all shareholders. However, the rules exempt such purchases *only* if they are made with not more than five persons in the aggregate (including persons located outside Canada) and the purchase price (including brokerage fees and commissions) does not exceed 115 per cent of the average closing price of the shares during the 20 days preceding the date of the bid.

### 2.4.3 Arrangements

Friendly acquisitions of public companies are now generally effected in Canada by way of a plan of arrangement. An arrangement is a court-approved transaction governed by corporate legislation and requires shareholder approval (generally 66-2/3 per cent) by the companies involved. The parties enter into an arrangement agreement setting out the basis for the combination, following that an application is made to the court for approval of the process. The court order will require the calling of shareholders' meetings and specify the approval thresholds and — in most cases — dissent rights. A detailed circular will be sent to shareholders that provides broadly equivalent disclosure to that which would be provided by a take-over bid circular.

Arrangements have a number of advantages. In particular, they can: facilitate dealing with multiple securities (particularly convertible instruments); provide for acquisition of 100 per cent of the target company without the need for a follow-up offer or second-stage transaction; and, if securities are to be offered to the target company's shareholders, provide an exemption under U.S. securities laws from the requirement to file a registration statement. On the negative side, arrangements leave control of the process in the hands of the target company and can provide opportunities for interested parties to intervene in the court proceedings (though this rarely happens in Canada).

### 2.4.4 Amalgamations

Acquisitions are sometimes effected by "amalgamations." An amalgamation is akin to a merger under U.S. law, however, the amalgamated corporation is considered to be the successor of both amalgamating entities and the amalgamated entity succeeds to the assets and liabilities of the amalgamating entities. Similar to negotiated take-over bids, amalgamations are typically commenced by the execution of a non-binding letter of intent from the offeror indicating an interest in amalgamating with the target company, and a confidentiality and standstill agreement between the parties, followed by the negotiation of a comprehensive amalgamation agreement.

Generally, all securityholders whose legal rights are affected by a proposed amalgamation will be entitled to vote on the transaction. The approval thresholds are usually 66-2/3 per cent of the securities represented by class at the securityholders' meeting. The information to be provided to those entitled to vote on the amalgamation must be sufficient to allow them to form a reasoned judgment as to whether to support or vote against the proposal. Proxy circulars are not subject to regulatory review in Canada. Securityholders have the right to dissent from an amalgamation transaction and to be paid "fair value" for their securities. Subject to regulatory approvals, the amalgamation process typically takes 60 to 90 days. Subject to the availability of financial information and related preparation time, preparation of securityholder meeting documentation may take three to four weeks.

A statutory amalgamation provides certainty in an acquisition transaction that the acquirer will obtain 100 per cent of the shares of the target. However, completion time is often longer than if the transaction were undertaken by a take-over bid. Amalgamations are used less often than arrangements as the time and documentation required is virtually identical but amalgamations do not provide the structuring flexibility afforded by an arrangement or the benefit of a court decision as to the fairness of the transaction.

## 2.5 What rights of compulsory acquisition of the minority are available after a successful take-over bid?

An offeror that acquires substantially all of a class of shares of a company (generally 90 per cent of the shares of the class not held by the offeror and its associates at the time of the bid) may generally buy out the remaining shareholders of the class at the offer price or, if the shareholder objects, at a court-determined "fair value." If an offeror intends to exercise its right of compulsory acquisition, it must state its intent to do so in the circular and follow certain steps within a fixed period (generally 180 days) after the bid.

There are other ways by which a minority can be removed from a company, such as amalgamation, arrangement or consolidation, which results in the shareholder losing his participating interest in the business. Securities and corporate laws provide protection for minority shareholders in these circumstances, but if an offeror acquires 66-2/3 per cent of the shares under a bid, it will generally be able to eliminate the minority.

# 3 Asset Acquisitions

## 3.1 What approvals are required in the case of a purchase of assets of a Canadian business by a non-resident or by its Canadian subsidiary?

The review mechanisms of the *Investment Canada Act*, which are discussed under Section 3.1, "General Rules on Foreign Investments," also apply to the purchase of "all or substantially all of the assets used in carrying on a Canadian business."

In addition to the statutory approvals, consents of landlords, equipment owners, creditors and shareholders may be necessary. Under most Canadian corporate statutes, if a sale involves the disposition of all or substantially all of a corporation's assets, shareholders must approve the transaction by special resolution.

## 3.2 What are the tax consequences of an asset purchase?

Two different sets of tax rules must be examined in this context: liability with respect to income tax, and the application of federal and provincial sales taxes. If real property is involved, land transfer taxes may also be payable.

### 3.2.1 Canadian income tax issues

Capital assets used by a vendor in a Canadian business will generally be "taxable Canadian property." As discussed in Section 5, "Tax," the purchaser should protect itself from possible tax liability by making "reasonable inquiries" to confirm that the vendor is a Canadian resident. For this purpose, an appropriate representation will generally be obtained in the purchase agreement. If the vendor is a non-resident, a certificate from the tax authorities might be required.

The allocation of the purchase price among the various assets being acquired will also have Canadian tax implications. The allocation is a matter of negotiation between the parties, and they should agree that they will file their income tax returns in a manner consistent with such allocation, to minimize the risk that the Canadian tax authorities will re-allocate the purchase price in a manner that may be disadvantageous to the parties.

Accumulated tax losses and credits in connection with a business are not available to the purchaser on an asset transaction.

### 3.2.2 Sales tax

Both federal and provincial governments impose sales taxes; the province at the retail level and the federal government through the Goods and Services Tax (GST)/Harmonized Sales Tax (HST) discussed in 6.1, "Federal sales and excise tax."

In a sale of the assets of a business, an election may be available so that no GST/HST or Quebec Sales Tax (QST) will apply to the transaction. The election is available when the seller is selling a business or part of a business, and where the subject of the sale is all or substantially all of the assets that are reasonably considered to be necessary to operate a business. Where the election applies, the sale of the assets of a business may be made free of GST/HST and QST, the rationale being that the recipient would in any event be able to claim a full input tax credit or refund for the tax otherwise payable.

There are two principal conditions that must be met before the election is available. The assets being sold must constitute a "business or part of a business" that was established, carried on, or acquired by the seller. In addition, the recipient must be acquiring at least 90 per cent of the assets reasonably necessary to carry on the business. An indication of the sale of a qualifying business is the existence of an agreement that deals with issues normally found in acquisition arrangements, such as the sale of goodwill and intellectual property, dealings with employees, etc., in addition to the sale of equipment and inventory.

Provincial sales tax exposure, if any, will depend on the province in which the assets are located. For example, currently Manitoba, Saskatchewan and British Columbia impose tax at the rates of eight, five and seven per cent respectively, upon taxable transfers of tangible personal property. There is a wide range of exemptions, particularly for transfers of inventory, provided the goods are purchased for resale or further manufacture. If the purchaser is acquiring assets of a business, it may also be liable for the vendor's accrued sales tax exposure unless clearance certificates are obtained from the retail sales tax authorities indicating that all taxes have been collected and paid to date.

### 3.3 What are the purchaser's obligations regarding third parties?

Canadian law provides protection for creditors of a business that might affect an acquisition of assets. To begin with, creditors who have a security interest over real or personal property will continue to have priority with respect to the relevant assets as against the purchaser. There are security registration statutes in Canada and searches can be conducted to determine the existence of such security interests. Unless the purchaser is to acquire the assets subject to existing security interests, which might be the case with respect to real property and major items of financed personal property, the vendor's obligations should be paid and the security interests discharged at the time of the purchase. Because of time lags in the registration systems, it may be necessary to withhold a portion of the purchase price until confirming searches have been conducted.

## 4 Employee Considerations

Employees' rights in the case of an acquisition depend on the nature of the acquisition, and the labour relations and employment laws of the jurisdiction that apply to the employees. The Ontario rules may be taken by way of illustration.

In the case of a share acquisition, unless otherwise provided in an employment contract, there are no changes to the employment relationship as the purchaser essentially becomes the employer for all employment purposes. Accordingly, there is no termination of employment as a result of the purchase of shares and existing employment contracts remain in place, unless otherwise provided in an employment contract.

In the case of an asset purchase, at common law the sale often results in a termination of employment with the vendor company. That is, if an employee is not offered employment by the purchaser or chooses not to accept such an offer, an asset sale often results in the constructive dismissal of the vendor's employees at the time of the sale. After all, as a practical matter, once the vendor's assets have been sold, there will no longer be any work for the employees to perform. In most instances, the vendor will *actually* terminate the employment of employees who are not offered or who do not accept the purchaser's employment offers. In order to minimize termination liabilities, a vendor may insist on provisions in the purchase agreement that require the purchaser to make employment offers to all of the in-scope employees on terms and conditions that are substantially similar to their current terms and conditions in order to induce the employees to accept those offers. In the event that an employee does not accept such an employment offer, this will also reduce vendor termination costs as a result of the failure of the employee to mitigate common law wrongful dismissal damages by accepting the purchaser's offer.

For provincially regulated businesses in Ontario, where some of the employees are unionized, the *Labour Relations Act*, 1995 provides that the purchaser of the acquired "business" is placed in the role of employer for the purposes of the union's bargaining rights and any collective agreement. The effect of this provision is to require the purchaser to comply with the requirements of the collective agreement and to continue to recognize the bargaining rights of the collective bargaining agent. A "business" is defined to include "a part or parts thereof" and the transfer of any portion of a business as a going-concern would be caught.

In addition, the Ontario *Employment Standards Act, 2000* (ESA) establishes certain minimum obligations in respect of both union and non-union employees. More beneficial terms of employment, whether express (as, for example, in a collective agreement or a written contract of employment) or implied (as, for example, by the common law of wrongful dismissal), will take precedence over the minimum requirements of the employment standards legislation.

To avert a situation where companies buy and sell assets in order to avoid employment-related liabilities, the ESA stipulates that employees of a vendor who are hired by the purchaser following an asset sale carry forward their prior service for any subsequent calculation of the employees' service or length of employment, such as establishing entitlement to severance pay and notice of termination by the purchaser. However, this does not apply to employees who are hired by the purchaser more than 13 weeks after the individual's last day of employment with the vendor or the date of the sale, whichever is earlier. The ESA also sets out minimum notice and severance pay requirements that apply in the event of the termination of employees, including specific requirements in the case of mass terminations of 50 employees or more within a period of four weeks or less. Mass terminations also oblige the employer to give notice to the Ministry of Labour. Employees who have five or more years of service at the time of their dismissal are entitled to severance pay if their employer has a payroll of $C2.5-million or more, or if the dismissal is part of a discontinuance of all or part of a business involving the termination of 50 or more employees in a period of six months or less. If employees are terminated prior to the transfer of the business, the vendor, as terminating employer will be responsible for the termination costs.

# Tax

4

1

## Typical Organizational Structures

A number of forms of organization could theoretically be used by an Italian entity in establishing a Canadian business enterprise.

Of these, however, the three most commonly considered are:

1. Sales representatives based in Canada
2. Canadian branch of the Italian entity
3. Canadian subsidiary corporation

While there are some similarities in the basic rules for the computation of income subject to taxation under these possible forms of organization, it is most common for a substantial business undertaking to be organized using a Canadian-incorporated subsidiary.

In some cases, a British Columbia, Alberta or Nova Scotia "unlimited liability company" might be chosen to achieve U.S. tax objectives. The decision will, of course, depend on the circumstances of each case and consultation with both Canadian and foreign tax counsel is essential.

### 1.1 Sales representatives based in Canada

#### 1.1.1 Are entities with representatives exempt from tax if activities are limited?

It is possible for an Italian entity to extend the scope of its business to Canada without becoming subject to Canadian tax on its business profits if the types of activities carried on in Canada are sufficiently limited.

Under the Canadian *Income Tax Act* (ITA) every non-resident person, as defined by the ITA, who carries on a business in Canada is required to file a Canadian tax return and to pay an income tax computed in accordance with the ITA on the taxable income earned in Canada by such non-resident person for the year.

However, the provisions of the ITA relating to income tax on Canadian source business profits (but not the requirement to file a Canadian return) are overridden, in the case of an Italian enterprise qualifying for benefits under the Canada-Italy Tax Convention (Convention), by Article VII of the Convention which provides as follows:

> "The business profits of a resident of a Contracting State shall be taxable only in that State unless the resident carries on business in the other Contracting State through a permanent establishment situated therein. If the resident carries on, or has carried on, business as aforesaid, the business profits of the resident may be taxed in the other State but only so much of them as is attributable to that permanent establishment."

#### 1.1.2 How is a "permanent establishment" defined? Does an office or a sales agent create this status? What about a storage facility?

The term "permanent establishment" is defined in Article V of the Convention to mean a "fixed place of business through which the business of a resident of a Contracting State is wholly or partly carried on," and there is also a concept of a deemed permanent establishment that can result from performing services in Canada.

The Convention goes on to specifically include the following in the definition of permanent establishment: any place of management, a branch, an office, a factory, a workshop and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources or the presence in Canada of a non-independent agent who has and habitually exercises the authority to contractually bind the non-resident corporation. The Convention then goes on to specifically exclude the following from the definition of "permanent establishment":

1. Facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the resident (i.e., the Italian, among others, entity)
2. The maintenance of a stock of goods or merchandise belonging to the resident for the purposes of storage, display or delivery
3. The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another enterprise

Therefore, an Italian entity will not have a permanent establishment in Canada by reason only of having sales representatives in Canada to offer products for sale, provided that these agents (i) do not have the authority to conclude contracts on behalf of the Italian entity or (ii) are independent and acting in the ordinary course of their business. If the Italian entity contemplates establishing a fixed centre for its Canadian operations, care should be taken to ensure that the centre is not a permanent establishment.

## 1.2 Canadian branch

If it is undesirable for the Italian entity to restrict its Canadian business in the manner described above to avoid having a permanent establishment in Canada, an alternative would be to establish and operate a Canadian branch out of office premises situate in Canada.

### 1.2.1 Advantage of a branch operation

One advantage to the use of a branch operation would normally arise when it is anticipated that the branch will incur substantial losses in the first several years of operation. In this case, organization through a branch might enable such losses to be included in the tax return of the Italian entity or its parent corporation and deducted against income from other sources. In general, a branch may be useful where a "flow-through" structure is desirable from the Italian tax perspective.

### 1.2.2 What are the disadvantages? How would a branch be taxed as between Italy and Canada?

It is clear that if an Italian enterprise were to establish a divisional branch in Canada, it would have a "permanent establishment" within the meaning of the Convention, and would be required, pursuant to the ITA, the Convention and Canadian provincial tax legislation, to pay Canadian income tax on taxable income earned in Canada, which is attributable to the branch. Any employee resident in Canada and, subject to certain exemptions in the Convention, branch employees not resident in Canada, would be required to pay Canadian income tax, and the Italian enterprise would be required to deduct and remit to the Receiver General amounts from the wages and salaries of such persons.

Despite potential tax savings, our experience has been that there are, in some cases, a number of practical difficulties with a branch operation. The most important has been the problem of preparing financial statements for the branch, which determine its income earned in Canada in a manner satisfactory to both the Canada Revenue Agency (CRA) and the foreign tax authority.

Finally, Canada imposes a branch tax on the after-tax income of the branch operation of an Italian corporation. The branch tax rate under the ITA is 25 per cent, but this rate is reduced under the Convention to five per cent for qualifying Italian residents. The branch tax is effectively the equivalent of the five per cent non-resident withholding tax which would be applicable under the Convention if the Italian corporation carried on business in Canada through a subsidiary corporation and the subsidiary repatriated its retained earnings to the parent by means of a dividend.

### 1.2.3 If a branch turns profitable, how can it become a subsidiary corporation?

It would be possible, if a branch were initially used, to transfer the Canadian business to a subsidiary corporation after it becomes profitable. There are, however, several difficulties in accomplishing this result and, in particular, there may be Italian tax consequences. In addition, the complexity of a sale of assets, assignment of contracts and transfer of employees to a new corporation after a significant business has been established may be considerable.

A non-resident may transfer real property, interests in real property and most other assets used in the business of a Canadian branch to a Canadian corporation, as part of the incorporation of the branch, on a Canadian income tax deferred basis. However, the transfer by an Italian entity to a Canadian corporation of real property or interests in real property not used in the business of a Canadian branch would have to take place at fair market value, giving rise to a potential recapture of capital cost allowance (i.e., depreciation) and/or capital gain.

In summary, therefore, unless there are important Italian tax reasons to the contrary, it may be advisable to organize the Canadian business through a subsidiary corporation. We note again that the choice of organizational form depends on individual circumstances and that consultation with Italian and Canadian tax counsel is advised.

## 1.3 Canadian subsidiary corporation

If the Canadian business enterprise is carried on through a corporation incorporated in Canada (including a British Columbia, Alberta or Nova Scotia unlimited liability company), the corporation will be a "resident" within the meaning of the ITA and will be required to pay Canadian income tax on its worldwide income each taxation year. Canadian provincial income taxes will also apply. Where dividends are paid by the subsidiary corporation to a qualifying Italian resident corporation that controls directly or indirectly at least 10 per cent or more of the voting stock, the Canadian withholding tax rate applicable to the dividends under the Convention is five per cent. The following comments address several of the most important provisions of the ITA, which would apply to the new corporation.

# 2 Income Computation

The computation of income from business for Canadian tax purposes starts with a computation of the profit from the business. A number of rules must then be applied to adjust the profit computation to arrive at taxable income. The main provisions in this regard are set out below.

## 2.1 How is depreciable property amortized?

### 2.1.1 Capital cost allowance

ITA's system for amortizing the cost of depreciable property is known as capital cost allowance. All tangible and intangible depreciable assets must be included in one of the classes prescribed by Regulation. Each class is given a maximum rate, which may or may not be based on the useful life of the assets in the class. The rate for a class is applied to the total capital cost of the assets in that class to calculate the maximum deduction that may be claimed in each year. The actual deduction taken in a year may be any amount that is equal to or less than the maximum deduction available. The capital cost of a class is reduced by the amount of the actual deduction taken with respect to that class each year. Therefore, unused deductions are effectively carried forward as they do not reduce the capital cost of the class. There are also provisions as to the recapture of capital cost allowance from the disposition of capital assets that have been depreciated for tax purposes below their realizable value.

## 2.2 Licensing fees, royalties, dividends and interest

### 2.2.1 Transfer pricing rules for related corporations

Particular scrutiny is normally given by the CRA to licensing fees, royalties, interest, management charges and other amounts of a like nature paid to non-residents with whom the Canadian taxpayer does not deal at arm's length. For this purpose, if an Italian entity controls a Canadian company, either by owning a majority of the voting shares or by having sufficient direct or indirect influence to result in control, the two entities will be considered not to deal at arm's length. The tax authorities' first concern will be to determine whether the amount paid by the Canadian corporation should be allowed as a deduction in computing income.

Canadian transfer pricing rules require that, for tax purposes, non-arm's-length parties conduct their transactions under terms and conditions that would have prevailed if the parties had been dealing at arm's length. The rules also require contemporaneous documentation of such transactions to provide the CRA with the relevant information supporting the transfer prices. The rules provide that taxpayers may be liable to pay penalties where the transfer pricing adjustments under the rules exceed a certain threshold and the taxpayer did not make reasonable efforts (including contemporaneous documentation) to use appropriate transfer prices.

### 2.2.2 What are the withholding tax rules?

Under the Convention, the Canadian entity must withhold 10 per cent of some "royalties" paid to Italian residents. The Convention also provides for a 5 per cent withholding rate on "royalties" paid to qualifying Italian residents which are payments for the use of or the right to use (i) computer software or (ii) any patent or any information concerning industrial, commercial or scientific experience (but not including information provided in connection with a rental or franchise agreement).

Reasonable management fees for services rendered outside Canada are not subject to withholding tax as the CRA regards these as business profits of the Italian entity and therefore not taxable under Article VII of the Convention. The CRA will allow a management fee to include a mark-up over the Italian entity's costs only in limited circumstances.

Under the Convention, the rate of withholding tax on dividends is 15 per cent, although the lower rate of five per cent applies if the shareholder is a qualifying Italian resident company that controls directly or indirectly 10 per cent or more of the voting stock.

## 2.3 What are the limits on thin capitalization?

A statutory thin capitalization provision limits the amount of interest-bearing debts that may be owed by a Canadian corporation to certain non-resident creditors. The limit is set by requiring the Canadian company to have a debt-to-equity ratio of not more than 1.5:1 where debt and equity have particular definitions. In making the necessary calculation, equity includes the paid-up capital of shares of the Canadian corporation owned by non-resident shareholders described below as well as retained earnings and other surplus accounts.

Debt includes only interest-bearing debt held by non-resident shareholders who, alone or together with affiliates, own shares of the capital stock of the corporation representing 25 per cent or more by votes or fair market value of all shares of the corporation or their affiliates. There are special timing rules regarding when the different debt and equity elements are determined.

Not included as debt are amounts owed to residents of Canada or amounts owed to non-residents who are neither shareholders nor related to shareholders (unless they are part of a "back-to-back" arrangement whereby the non-resident shareholder or related party lends to a third party on the condition that it make an advance to the Canadian corporation). Also excluded from the definition of debt for this purpose are amounts loaned to the Canadian corporation by arm's-length entities where the loans are guaranteed by a shareholder.

The sanction for exceeding the maximum ratio is that interest on the amount of debt in excess of the permitted limit is not allowed as a deduction in computing the Canadian corporation's income. In addition, the excess interest is treated as a dividend for Canadian withholding tax purposes.

## 2.4 How can operating losses be used?

Operating losses from a particular source can be used by the taxpayer to offset income from other sources. In addition, if an operating loss is realized for a particular year, it may be carried back three taxation years and carried forward 20 taxation years as a deduction in computing taxable income of those other years. If the loss is not used within this statutory period, it expires and can no longer be used in computing taxable income. Special rules restrict the availability of these losses following an acquisition of control of the corporation.

## 2.5 Capital gains and losses

One-half of any capital gain realized by a Canadian taxpayer (referred to as a "taxable capital gain") is included in the taxpayer's income and is subject to tax at normal rates. One-half of any capital loss may be deducted in computing income, but only against taxable capital gains. Capital losses, to the extent that they cannot be used as a deduction in the year in which they are incurred, may be carried back three years and carried forward indefinitely. Capital losses of a corporation are extinguished on an acquisition of control of that corporation.

## 2.6 Should a single subsidiary be used when there are several lines of business?

Under the Canadian tax system, it is not possible under any circumstances for two or more corporations to file a consolidated tax return. As a result, the profits of one corporation in a related group cannot be offset by losses in another. It is generally desirable, therefore, unless there are compelling reasons to the contrary, to carry on as many businesses as possible within a single corporate entity. As well, non-residents establishing a corporate group in Canada should consider planning to minimize Canadian provincial income tax.

## 2.7 How is income taxed among the different provinces?

The taxable income of a corporation with operations in more than one province is allocated for provincial income tax purposes among those provinces in which the corporation has a permanent establishment. The allocation is achieved by means of formulae that are generally based on the salaries and wages paid to employees associated with each permanent establishment and gross revenues attributable to each permanent establishment.

# 3 Rates of Taxation

Corporate income tax is levied in Canada by both the federal and provincial governments. The effective rate of federal tax is currently 15 per cent, after taking into account a reduction in rate that partially offsets the impact of provincial taxation.

Provincial tax rates can vary substantially depending on the province and the type of income earned by the corporation. For example, the general rate imposed by the province of Ontario is currently 11.5 per cent. In some cases, Canadian provincial income tax liabilities may be substantially reduced by inter-provincial tax planning appropriate to the proposed Canadian operations.

Several reductions in federal and provincial rates are possible depending on the circumstances of the particular case. The most substantial of these reductions relates to active business income earned in Canada by a small "Canadian controlled private corporation" (CCPC).

However, a corporation will not be a CCPC if it is "controlled, directly or indirectly, in any manner whatever, by one or more non-resident persons."

Another tax reduction occurs if a corporation carries on a manufacturing or processing business, as it may be entitled to provincial tax reductions.

# 4 Other Income Tax Considerations

## 4.1 Are tax credits available for research and development?

An "investment tax credit" against income tax otherwise payable is provided under the ITA in respect of certain expenditures on qualifying scientific research and experimental development carried out in Canada. An enhanced credit is available to CCPCs.

## 4.2 How are distributions treated?

A corporation may generally return to a shareholder the shareholder's investment in "paid-up capital" of the corporation (other than a public corporation) as a Canadian tax-free receipt. The ITA provides that all other distributions to shareholders of a corporation resident in Canada (including share redemptions and liquidating dividends) are treated as dividends to the extent that funds paid out of the company on a reorganization, share reduction or liquidation exceed the paid-up capital of the shares. Such distributions are treated as dividends regardless of the type of surplus or profits from which they are paid and regardless of whether the company has any undistributed income.

Dividends paid by a Canadian corporation to its non-resident shareholders are subject to withholding tax under the ITA. The withholding tax rate under the Convention is five per cent for dividends paid to a qualifying Italian parent corporation. Stock dividends are equivalent to cash dividends and are generally valued at the related increase in the corporation's paid-up capital.

The ITA contains other rules for dividends paid to Canadian residents that are beyond the scope of this Guide. Dividends between affiliated Canadian companies are tax-free in some cases (although recent developments have called into question the scope of this treatment).

## 4.3 Loans to shareholders

A loan made by a corporation to any of its shareholders or to persons connected with such shareholders (other than corporations resident in Canada) that is not repaid by the end of the taxation year following the year in which such loan was made is, with limited exceptions, (including a possible election out of this rule), considered to be income received in the hands of the shareholder.

More stringent rules apply to indebtedness of a non-resident to a Canadian affiliate arising under a "running account" between the two companies. Amounts deemed to be paid to non-resident shareholders as income are subject to non-resident withholding tax as though the amounts were dividends. There is, however, a refund of withholding tax to a non-resident if the debt is subsequently repaid, subject to certain limitations.

A loan that is not included in income as described above may give rise to imputed interest income for the Canadian corporation at prescribed rates and a taxable benefit in the hands of the shareholder or connected person (other than a corporation resident in Canada) if the rate of interest paid on the loan is less than the market rate applicable at the time of the loan. Some loans that rely on a special exception from the shareholder loan rules will result in imputed interest income for the Canadian corporation at higher prescribed rates.

# 5 Capital and Payroll Taxes

## 5.1 Capital taxes

Federal and provincial corporate capital taxes are now imposed only on financial institutions.

A non-resident corporation with no "permanent establishment," as defined in the capital tax legislation, will not be subject to capital tax.

## 5.2 Payroll taxes

Employers are generally required to make contributions on behalf of their Canadian employees to the Canada or Quebec Pension Plan and to the federal Employment Insurance plan. Certain provinces also impose employer health taxes or premiums. Contributions to provincial Workers' Compensation Boards are also obligatory for most businesses.

# 6 Commodity Tax and Customs Tariffs

## 6.1 Federal sales and excise tax

The federal Goods and Services Tax (GST) is a form of value-added tax that applies to most goods and services at the rate of five per cent. Unlike income tax, the GST is a tax on consumption rather than profits.

### 6.1.1 How is the GST collected?

Generally speaking, each registered supplier of taxable goods and services collects the applicable tax from its purchasers at the time of sale. The supplier must collect the GST as agent for the government, while the purchaser is legally responsible for the payment of the tax. Suppliers deduct from their collections any GST they have paid on their own purchases (called "input tax credits") and remit the difference to the federal government. If the supplier paid more tax than was collected, the supplier is entitled to a refund of the difference. The result is that the tax is imposed on the value added to the product at each stage of production and distribution and the final consumer ultimately bears the full amount of the tax. In Ontario and British Columbia, certain types of registrants are subject to restricted input tax credits for specified types of purchases. These rules, which claw back the input tax credits otherwise available, are temporary measures that are scheduled to be eliminated gradually after eight years.

Currently, five provinces (Ontario, Prince Edward Island, New Brunswick, Nova Scotia, and Newfoundland and Labrador) have harmonized their individual provincial sales tax bases with that of the GST and the combined tax is called the Harmonized Sales Tax (HST), imposed at rates ranging from 13 to15 per cent; therefore, most of the discussion that follows applies equally to the HST. Quebec has also largely harmonized its provincial sales tax base with that of the GST; however, unlike the HST provinces, the Quebec Sales Tax or QST is imposed pursuant to a separate Quebec statute at the rate of 9.975 per cent.

### 6.1.2 Who is exempt from registration requirements?

Generally speaking, most persons who carry on business in Canada must register to collect and remit GST. By way of exception, small suppliers with sales of less than C$30,000 per year are generally not required to register for GST purposes and cannot claim input tax credits. In determining whether this threshold has been met, sales of associated corporations are included.

Non-residents who in Canada solicit orders or offer for sale prescribed goods (such as books, newspapers or magazines) to be sent to persons in Canada by mail or courier are deemed to carry on business in Canada. Accordingly, they must register to collect and remit GST on their sales.

Non-residents who do not carry on business in Canada, or small suppliers with sales of less than C$30,000 per year, are permitted to voluntarily register to collect and remit tax if, among other activities, they regularly solicit orders for the supply of goods for delivery in Canada. Non-residents may wish to register in such cases to obtain input tax credits in respect of GST paid on purchases in Canada.

### 6.1.3 Zero-rated supplies

Certain supplies, defined as "zero-rated supplies," are effectively tax-free supplies and taxed at a zero rate. These supplies include basic groceries, prescription drugs, most medical devices and, generally speaking, goods which are sold for export. Services of an agent on behalf of a non-resident are also tax-free in some cases as are legal and consulting services supplied to assist a non-resident in taking up residence or setting up a business in Canada. Suppliers of tax-free goods and services do not charge tax on their sales, but are entitled to input tax credits for the GST paid on purchases used in supplying taxable and tax-free goods.

### 6.1.4 Exempt supplies

The legislation also provides for a class of goods known as "exempt supplies." No tax is charged on exempt supplies. However, unlike zero-rated supplies, suppliers of exempt goods and services do not receive input tax credits for the GST paid on their purchases to the extent they are used in making the exempt supplies. Examples of exempt supplies include resales of residential property, long-term residential leases, many health and dental services, educational services, domestic financial services and daycare services.

### 6.1.5 Special rules for non-residents

To encourage non-residents to do business in Canada, the legislation provides relief from the GST in connection with certain transactions.

#### 6.1.5.1 What if goods are imported by the non-resident and delivered in Canada?

A non-resident who sells goods to a Canadian customer on a "delivered" basis and also acts as importer of record will be required to pay GST on the importation of the goods. Where the non-resident is not a GST registrant, the non-resident will not be able to obtain an input tax credit (i.e., refund) of the GST. In effect, the GST legislation would increase the non-resident supplier's costs and the price to the Canadian customer would include GST.

This is contrary to the intent of the GST legislation. As a result, the Canadian customer is permitted to claim an input tax credit in respect of the GST paid at the border by the non-resident supplier, where the customer obtains proof of payment of the GST from the non-resident. Therefore, its customer will reimburse the non-resident for the GST paid at the border, and the customer will claim the GST input tax credit as if the goods were purchased from a Canadian supplier. This levels the playing field between Canadian customers who deal with non-resident suppliers and those who deal with Canadian suppliers. This is referred to as the "flow-through" mechanism.

#### 6.1.5.2 Will the non-resident have to collect GST from its customer?

A second relieving provision is referred to as the "non-resident override rule." This rule applies to a supply of personal property or a service in Canada made by a non-resident, and deems it to be made outside Canada and therefore beyond the scope of the GST. This provision applies where the non-resident supplier does not carry on business in Canada and is not registered for GST purposes. The "non-resident override rule" relieves the non-resident from any obligation to register and charge and collect GST on supplies that otherwise would be considered to be made in Canada. However, the Canadian customer may be required to self-assess GST on such supplies, in certain circumstances.

#### 6.1.5.3 What if goods are sold by a non-resident, but sourced from and delivered by a resident third party?

A third relieving provision is referred to as the "drop shipment" rule. In general, this rule applies where a non-resident sells goods to a Canadian customer, sources those goods from a Canadian supplier, and arranges for delivery by the Canadian supplier directly to the Canadian customer. In these circumstances, the Canadian supplier to the non-resident seller must collect GST on the sale to the non-resident, and if the sale is to an individual consumer, the GST will be collected on the non-resident's re-sale price to the consumer. The drop shipment rule applies to deem the sale by the Canadian supplier to the non-resident re-seller to be made outside Canada and therefore not subject to GST, where the non-resident's customer provides a "drop shipment certificate" to the Canadian supplier. This places the Canadian customer in the same position as if the goods were purchased directly from a Canadian supplier.

#### 6.1.5.4 What if the goods are sold by a GST registered non-resident in a sale made outside Canada?

Where the non-resident supplier of goods delivers the goods or makes them available outside Canada, the non-resident should avoid also acting as the importer of record of the goods, as the non-resident will not be permitted to claim an input tax credit in respect of the GST paid at the border. There is an exception to this rule where the supplier and customer in Canada enter into an election to permit the non-resident to claim the credits, however, the non-resident will also be required to charge and collect the GST/HST on the invoice price of the goods sold to the customer.

### 6.1.6 GST on imports

GST is generally exigible on imported goods based upon their duty paid value. GST is generally not exigible on imported services and intangible property (such as patents and trade-marks), provided they are used exclusively in taxable commercial activities of the purchaser. Purchasers must self-assess tax on imported services and intangible property if such services and property are not used exclusively in taxable activities. It should be noted that, although customs duties on U.S.-origin and Mexico-origin goods have been eliminated under NAFTA, GST must still be paid on U.S. or Mexican goods imported into Canada.

### 6.1.7 Other federal excise taxes

In addition to GST, a limited range of goods is subject to excise duties or taxes at various rates based on the manufacturer's selling price. Examples of items subject to the *Excise Act*, 2001 include certain types of alcohol and tobacco. Examples of items subject to the *Excise Tax Act* include certain insurance premiums, air conditioners for motor vehicles, certain gasoline and other petroleum products.

#### 6.1.7.1 Cannabis taxation

As part of federal legislative initiatives to legalize the recreational use of cannabis, the federal government introduced legislation to establish a framework for the taxation of cannabis. The legislation, which received royal assent on June 21, 2018, imposes excise duties on cannabis pursuant to the *Excise Act*, 2001. The rules include a new tax licensing regime for cannabis producers, stamping and marking rules, ongoing reporting requirements, and applicable excise duties payable by licensed cannabis producers on both recreational and medical cannabis products.

## 6.2 Provincial sales and commodity taxes

### 6.2.1 When does provincial sales tax apply?

As set out above, five provinces (Ontario, Prince Edward Island, New Brunswick, Nova Scotia, and Newfoundland and Labrador) have harmonized their individual provincial sales tax bases with that of the GST, and the combined tax is called the Harmonized Sales Tax or HST, imposed at rates ranging from 13 to 15 per cent. Quebec has also largely harmonized its provincial sales tax base with that of the GST; however, unlike the HST provinces, the Quebec Sales Tax or QST is imposed pursuant to a separate Quebec statute at the rate of 9.975 per cent.

As a result, currently only Manitoba, Saskatchewan and British Columbia will continue to impose a sales tax at the provincial level. The following discussion provides general comments on provincial sales taxation in the referenced provinces. However, each province's legislation should be referred to for specific issues.

As a general rule, the provincial sales tax is levied on the purchaser of most tangible personal property purchased for consumption or use in the province or imported into the province, including most computer software. Certain services are also subject to this tax. Generally, the tax is based on the sale price of the taxable goods or services being sold at the retail level, calculated on the purchase price excluding the federal GST (and the GST is calculated on an amount excluding all provincial sales taxes).

The relevant provincial sales tax statutes generally provide that the vendor of the taxable goods or services is required to act as the agent for the provincial government in collecting the sales tax. In some cases, a non-resident vendor without a physical presence in the province is nevertheless required to register for purposes of the tax.

Various goods are exempt from the provincial sales tax, including certain foods, drugs and medicines, motor and heating fuels, certain production machinery and equipment, custom computer software, many items used in farming and fishing, and items to be shipped directly out of the province.

### 6.2.2 Which goods are subject to provincial commodity taxes?

The various provinces impose sales or transfer taxes on specific goods such as gasoline, fuel, and tobacco. These taxes are usually imposed as a specific tax (cents per litre or cents per cigarette) rather than on an ad valorem (i.e., a percentage) basis. Certain provinces have enacted specific statutes to impose taxes on certain services such as accommodation, admissions, insurance premiums, gambling, etc. As well, land transfer taxes are imposed on transfers of land.

## 6.3 Customs tariffs

### 6.3.1 What are the treaties governing tariffs?

Canada is a member of the World Trade Organization (WTO). In accordance with the WTO, it grants most favoured nation tariff status to other WTO members. Goods are classified in Canada's List of Tariff Provisions according to the *Harmonized Commodity Description and Coding System Convention*, which Canada adopted in the late 1980s. See Section 3, "Trade and Investment Regulation."

**ITALIAN TRADE COMMISSION**
DELEGATION COMMERCIALE D'ITALIE

Toronto, 26 October 2018

The continuous growth of bilateral trade between Italy and Canada, equal to $10 Billion CAD in 2017, is supplemented each year by increasing FDI activity between the two countries. According to Statistics Canada, the stock of Italian direct investment in Canada increased 7.2% to $1.5 Billion CAD in 2017, while the stock of Canadian direct investment in Italy rose 34% to $795 million in 2017.

A stable presence of Italian companies in Canada is an essential condition in order to grow and expand business in this vibrant market. This is true for all Italian companies, particularly those involved in capital intensive industries and intercontinental procurement, sectors in which technical assistance, components services and after-sales services are key factors.

This guide is the result of a collaborative effort between the great expertise of Blakes, one of Canada's foremost international corporate law firms, and Italian institutions in Canada, coordinated by the Italian Embassy to facilitate bilateral investments. This guide equips prospective Italian investors with actionable intelligence for international investment in Canada: a business-friendly market that is open to trade, investments, ideas and talent, with solid investor protections.

Canada's economy is one of the fastest-growing among the G7 group with a highly educated workforce, a competitive research & development sector and a stable financial system. I invite prospective Italian investors to Canada to contact our teams to learn more about how they can benefit by investing in Canada.

Matteo Picariello

## About Blakes

Blake, Cassels & Graydon LLP (Blakes) is a full-service business law firm that serves a diverse national and international client base from our integrated network of offices worldwide. We have capabilities in virtually every area of business law in addition to deep industry sector specialization.

We focus on building long-term relationships with clients and do so by providing unparalleled client service and the highest standard of legal advice, always informed by the business context.

Thanks to our clients, Blakes continued to receive a number of awards and top rankings in 2018. For the fourth time and third year running, Blakes is ranked as having the leading law firm brand in the Acritas Canadian Law Firm Index. We also received the highest number of ranked lawyers of any Canadian law firm for the second consecutive year in *Chambers Global: The World's Leading Lawyers for Business 2018*. In 2017, Blakes was awarded Canada Law Firm of the Year by Who's Who Legal for the ninth year in a row. In addition, our lawyers continue to be recognized as leaders in their fields in *The Canadian Legal Lexpert Directory*, Canada's leading guide to lawyers. Blakes was also named as one of Canada's Best Diversity Employers for 2018 by Mediacorp Canada Inc., an honour we have received eight times since 2008.

## About the Italian Trade Commission

Established in 1926, the Italian Trade Agency promotes the development and internationalization of Italian companies abroad and supports the attraction of foreign investments in Italy. It operates a worldwide network of offices from its headquarters in Rome, and its Canadian branch, known as The Italian Trade Commission - Délégation Commerciale d'Italie (ITC), has two offices located in Toronto and Montreal. ITC provides information, assistance and consulting services to Italian companies involved in international business and investments.

# Contact Us

**John Leopardi**

**Partner | Montréal**
john.leopardi@blakes.com
Montréal: +1-514-982-5030

**Jennifer Maxwell**

**Partner | London**
jennifer.maxwell@blakes.com
London: +44-20-7429-3558

---

**H.E. Claudio Taffuri**

**Ambassador of Italy to Canada**
segreteria.ottawa@esteri.it
Ottawa: +1-613-232-2401 ext.225

**Matteo Picariello**

**Italian Trade Commissioner to Canada**
toronto@ice.it
Toronto: +1-416-598-1566

**Embassy of Italy**

275 Slater St.,
21st floor
Ottawa, Ontario, K1P 5H9
Canada

ambasciata.ottawa@esteri.it
+1-613-232-2401

**Italian Trade Commission - Délégation Commerciale d'Italie**

**Toronto Office**
480 University Ave
Suite #800
Toronto, Ontario, M5G 1V2
Canada

toronto@ice.it
+1-416-598-1566

**Montreal Office**
1000, rue Sherbrooke ouest
bureau 1720
Montréal, Québec, H3A 3G4
Canada

montreal@ice.it
+1-514-284-0265