Miller Canfield

DOING BUSINESS IN NORTH AMERICA

VOLUME THREE: **Canada**

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The information in this booklet provides an overview of the fundamental legal considerations to be addressed when acquiring or establishing a business in Canada. This publication is for general information only and should not be used as a basis for specific action without obtaining legal advice.

DISCLOSURE UNDER TREASURY CIRCULAR 230:
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INVESTMENT AND COMPETITION ISSUES

➤ Investment Canada

Every non-Canadian that starts a new business activity in Canada or acquires control of an existing Canadian business must file notification under the Investment Canada Act. Transactions that meet certain thresholds require review by Investment Canada.

Any direct investment more than $5 million or indirect investment more than $50 million are subject to review. However, investors from WTO-member countries benefit from higher thresholds. These review thresholds are revisited annually. For 2013, the new threshold for review of direct investment for WTO member investors, or where a Canadian business is ultimately controlled by a non-Canadian WTO member prior to its acquisition, has been determined to be $344 million dollars.

Indirect acquisitions by WTO-member investors are not reviewable, but are nonetheless subject to notification.

Investment in so-called "cultural businesses" is subject to a full review by the Department of Canadian Heritage, rather than Industry Canada. These businesses are those involved in the publishing and distribution of books, magazines, periodicals and music in print or machine readable form, and the production, sale or exhibition of film, audio or video products. The review thresholds for investment in cultural businesses are the same as those for other businesses, except no preferences are given to WTO-member investors.

Industry Canada can perform a National Security Review of any investment regardless of size or value. It also has published some specific guidelines for reviewable acquisitions in the oil and gas sectors.

An investment in a Canadian company might be subject to review if it meets certain threshold values.

➤ State-owned Enterprises

Industry Canada has specific guidelines for reviewable transactions involving state-owned enterprises (SOEs), i.e. any enterprise that is owned, controlled or influenced directly or indirectly by a foreign government. Under Canadian law, all investors are required to identify their controller, including any direct or indirect state ownership or control.

The Canadian government reviews the governance and commercial orientation of SOE investors to determine whether their control of a Canadian company would be a net benefit to Canada. In doing so, SOE investors are expected to address in their plans and undertakings along with their inherent characteristics, in particular, their susceptibility to state influence. Investors will also need to demonstrate their strong commitment to transparent commercial operations.

The Minister will apply the principles already embedded in the Investment Canada Act to determine whether a reviewable acquisition of control by a non-Canadian SOE is of net benefit to Canada. Under the Investment Canada Act, the burden of proof is on foreign investors to demonstrate to the Minister's satisfaction that proposed investments are likely to be of "net benefit" to Canada.

Whether an SOE investment is likely to be a net benefit to Canada depends on several key factors including:

- The effect of the investment on the Canadian economy;
- Participation by Canadians in the investment;
- The contribution of the investment to Canada's technological and productive profile; and
- Whether the investment is consistent with certain government policies.

ANTI-COMPETITION ISSUES

Investors may also need to comply with Canadian competition and anti-trust rules laid out in the Competition Act. The rules include systems for pre-merger notification and substantive review of proposed mergers. Not all transactions are subject to file a pre-merger notification, but some that don't require notification may still be subject to a substantive review.

➤ Pre-Merger Notification

The Competition Bureau must be notified of any merger, either by purchase of assets or shares, if both of the following thresholds are exceeded: the "size of the parties" and the "size of the transaction" thresholds.

The "size of parties" threshold requires that the parties to the transaction, together with their affiliates, collectively have assets in Canada or gross revenues from annual sales in, from or into Canada that exceed $400 million in aggregate value. Care must be taken to assess which entities are to be included in the determination of each corporate family involved in a merger.

The "size of transaction" threshold requires that the aggregate value of Canadian assets to be acquired or gross revenues from sales in or from Canada exceeds $80 million. For acquisitions of assets in Canada, the threshold is met if the aggregate value of the assets being acquired, or the annual gross revenues in or from Canada generated from the assets, exceeds $80 million.

A notification may also be required under certain circumstances where a foreign investor is acquiring voting shares. If the transaction would result in the investor owning more than 20 percent of a publicly traded corporation, more than 35 percent of a private corporation, or more than 50 percent of the corporation where the foreign investor already owned 20 percent of the target, the investor must file a pre-merger notification.

➤ Substantive Review

The Competition Bureau may review any transaction regardless of whether pre-merger notification was required. Reviewed transactions will be evaluated based on whether they are likely to substantially prevent or lessen competition.

> Any transaction can be subject to a substantive review under the Competition Act, regardless of whether pre-merger notification was required.

Factors to be considered as part of the Bureau's review include:

- Whether the merger removes an effective competitor from the market;
- Whether there will be effective competition in the market post-merger;
- Barriers to entry in the market to potential competitors;
- Availability of substitute products;
- Importance of innovation in the market affected; and
- The financial state of the firm being acquired.

SECURITIES LAWS

The sources of securities law in Canada are (i) provincial securities regulators in ten provinces and three territories; (ii) national securities rules; (iii) other regulatory authorities; and (iv) court decisions.

Efforts are being made in Canada to create one national securities regulator. To date, most provinces support a national regulator with a few exceptions.

While efforts are being made to create one national securities regulator, Canadian securities laws may vary depending on where your transaction is based.

The Canadian securities system is considered to be a "closed" system because all trades in securities that are "distributions" under applicable securities legislation must be qualified by a prospectus or must rely on an exemption from prospectus requirements. The most commonly used exemption from prospectus requirements is the "accredited investor" exemption (NI 45-106). Accredited investors include banks, trust companies, insurance companies, pension funds, governments, companies with net assets of at least $ 5 million and individuals alone or with a spouse with financial assets of no less than $1 million or net assets of at least $5 million.

Which rules apply to a transaction hinges on whether the target of the transaction is a public or private company. Purchasing 20 percent of a public company can trigger "take-over bid" requirements under various Canadian corporate and securities legislation.

Acquisitions can also occur through a "business combination," which is a statutory process such as an amalgamation or plan of arrangement. An amalgamation requires approval of two-thirds of securities represented by a class of security holders. An arrangement is a court-approved process which also requires approval of two-thirds of securities.

CHOICE OF BUSINESS ENTITY

Business entity options in Canada are similar to those available in the US:

- Corporations;
- General Partnerships;
- Limited Partnerships;
- Branch of a foreign person; and
- Joint Ventures (which vary in legal structure and are often corporations).

Corporations

Businesses can be incorporated federally (a Canada Co.) or in one of the provinces or territories. A federally incorporated entity can use its corporate name in every province and territory, subject to registration as an extra-provincial corporation in each province or territory where it does business. This process is often a one-page notification filing in each province which must be maintained annually.

Corporations formed in a specific province must obtain a license to do business in every other province or territory and may or may not be entitled to carry on business using the corporate name registered in Ontario.

Most jurisdictions have residency requirements for directors. In the federal, Ontario and Alberta jurisdictions, 25 percent of the directors of a corporation must reside in Canada. Nova Scotia, British Columbia and New Brunswick are examples of provinces which permit a fully non-resident board of directors.

Private companies are not legally required to have either officers or shareholders reside in Canada.

Other things to know about Canadian corporations:

- Canada permits single shareholder corporations;
- Directors need not be shareholders;
- Directors can be personally liable for a number of obligations under corporate law statutes and taxation statutes;
- Minority shareholders in most corporations have a wide range of rights, powers and remedies under Canadian corporate law; and
- Corporate books and records must be maintained in Canada

Partnerships

Partnerships are formed under provincial or territorial law and can be general or limited. Limited partnerships can provide some limited liability protection, like shareholders in a corporation, but at least one partner of a limited partnership must be a general partner, usually a specific purpose corporation. Limited partners cannot participate in the operation or management of the business of the limited partnership.

Companies can be incorporated federally in Canada, or in any of the provinces or territories.

Branch

A branch of a foreign entity is formed at the provincial level by filing an "Application for Registration as an Extra Provincial Corporation." In most provinces, a foreign entity seeking registration will be required to name an agent in each province or territory to receive notice on behalf of the entity.

TAXATION

In Canada, income tax is imposed at both the federal level and provincial/territorial level. Income tax is levied on the worldwide income of every Canadian resident, subject to the application of various treaties and conventions. It is also levied on Canadian-based income of non-residents who are employed in Canada, who do business in Canada, or who gained from the sale of certain Canadian properties. Provinces and territories generally levy tax on those who do business in the province or territory.

The combined federal and provincial tax rate on corporations varies depending on the size and type of the business and where it is operating. In 2012, for example, an Ontario non-manufacturing corporation that didn't qualify for a small business deduction was taxed at a general combined rate of 26.5 percent.

For a non-resident, certain Canadian-sourced income that is not subject to ordinary income tax, such as management fees, royalties, interest and dividends, may be subject to withholding tax of 25 percent unless the amount reduced or eliminated by a tax treaty. For parties dealing at arm's length, the withholding tax on interest payments has largely been eliminated by recent amendments to the Income Tax Act.

A non-resident corporation doing business in Canada may also be subject to branch profits tax, which is intended to approximate the withholding tax that would have been payable on dividends if the non-resident had done business through a Canadian subsidiary. The Income Tax Act requires that the non-resident taxpayer doing business in Canada calculate income or loss from its Canadian business. Expenses incurred exclusively for the Canadian business should in most cases be deductible in computing branch profit income tax purposes.

Other applicable taxes in Canada include goods and services tax, provincial retail sales tax or, in some provinces, harmonized sales tax which is a combination of the goods and services tax and provincial sales tax. These are value-added taxes that generally apply to the end consumer of most goods and services in Canada. Some jurisdictions also require payment of employer health tax.

Income derived from Canadian sources can be taxed at both the federal and provincial or territorial levels.

Other key tax considerations in doing business in Canada include:

- *Transfer pricing* – Transfer pricing rules require that Canadians and non-arm's length non-residents conduct their transactions in a manner and at prices similar to what they would have done if they were at arm's length. If the terms and conditions differ from what would have been typical for an arm's length transaction, the tax rules allow for the terms to be readjusted. In order to avoid an unexpected readjustment of terms, contemporaneous documentation of all transactions should be maintained with support showing the transactions under arm's length terms.
- *Thin Capitalization* – Canada has "thin capitalization" rules for those using a Canadian subsidiary. These rules disallow the deduction for interest payable by a Canadian subsidiary for debt owing to specified non-residents where that debt exceeds the subsidiaries equity by a ratio of 2:1.
- *Minimum Capitalization* – Canada has no minimum capitalization rules.

EMPLOYMENT AND LABOUR

Employment Law (Non-Unionized)

Unlike the United States, Canada does not recognize the concept of "at-will" employment. Termination of employment in Canada is considered "wrongful dismissal" even where it is for purely economic reasons such as a slow down in business. A new employer can reduce its risk of liability for wrongful dismissal by taking pro-active steps before starting the business or by utilizing employment contracts that limit obligations upon termination.

But, even using employment contracts, an employer cannot evade the minimum employment standards for terminating employees. Each province has minimum statutory requirements for notice of termination and, in some instances, payment of severance pay. Common and civil law may impose additional obligations on employers.

In Canada, provincial law governs 95 percent of employment situations, with only a handful of industries, such as banking and telecommunications, being federally regulated. But some federal laws, such as Canada Pension Plan and Employment Insurance, impact all employer/employee relationships.

Virtually all provinces have legislation that deal with employment standards, workplace safety and insurance, pay equity, human rights and occupational health and safety. All jurisdictions in Canada have legislation prohibiting discriminatory practices in the workplace on the basis of factors such as creed, race, colour, ethnic origin, sex, sexual orientation, marital status, family status, place of origin, disability and record of offences. All Canadian jurisdictions also have insurance systems in place to compensate employees for workplace injuries. For most employers participation is mandatory.

Effective and strategic advance planning can significantly reduce risk in the realm of employment law. It is important not to overlook this aspect of a business plan in terms of the legal ramifications that flow from the acquisition of a business, or even when starting a new business.

Labour Law (Unionized Sector)

The right of Canadian employees to join unions and to participate in their lawful activities is protected by law, but the rules governing union certification vary among provinces. Employers facing union certification activities may not make threats or promises intended to influence an employee's decision. In some jurisdictions, if this occurs, the labour relations tribunal has the authority to automatically certify the union.

Once a union is certified, parties must bargain in good faith to reach a collective bargaining agreement.

In recent years, the rate of unionization in the private sector has been on the decline. Though the overall rate of unionization is roughly 31 percent, most union activity is seen in the public sector. While 71 percent of public sector employees belong to a union, only 16 percent of their private sector counterparts are unionized.

Unionization rates vary by province, with Quebec being the highest at 39.3 percent and Alberta the lowest at 23.2 percent overall. Ontario is at the mid-point at 27.8 percent.

A new employer can reduce its risk of liability for wrongful dismissal by taking pro-active steps before starting the business or by utilizing employment contracts that limit obligations upon termination.

General Considerations for unionized and non-unionized workplaces

A purchaser of a Canadian business generally becomes a successor employer for purposes of employment law. This means that the purchaser can inherit a number of employee-related liabilities from a vendor including, but not limited to, termination costs, employment standards violations, workers' compensation costs, collective bargaining agreements and pay equity adjustments. Purchasers should perform careful due diligence of a target's employee obligations in considering the acquisition of any Canadian business. This is true even in the case of an asset purchase.

IMMIGRATION

A travel visa may be required for temporary entry into Canada prior to arrival, but a number of countries are exempt from the visa requirement. A list of exempt countries and qualifications for the exemptions can be found on Citizenship and Immigration Canada's website. **(http://www.cic.gc.ca/english/visit/visas.asp)**

American citizens and resident aliens, for example, are exempt from Canadian visa requirements. In Poland, a biometric passport holder is exempt from the visa requirement, but a non-biometric passport holder must first obtain a visa to enter Canada. China is not on the list of exempt countries; thus, a Chinese passport holder must first obtain a visa to enter Canada.

Because Canada has closed or consolidated several consulates and offices in recent years, visa processing times have significantly increased. Any visitor to Canada should plan well in advance of their entry and inquire through the consulate office responsible for their processing. The CIC's website also has a list of places to apply for a travel visa if one is required. **(http://www.cic.gc.ca/english/information/offices/apply-where.asp)**

Business Visitors

A "business visitor" is someone entering for business or trade activities in Canada. The person must have no intent to enter Canadian labour market or hold gainful Canadian employment. His business activity must is international in scope (cross-border), and his primary source of pay for the work performed must be foreign. His employer's principal location and profit must also be foreign.

The common types of business visitors are:

- Sales representatives for products made outside of Canada;
- Someone providing intra-company training, if the person is not paid by a Canadian branch of the company and she doesn't perform any hands-on building and construction;
- A director attending a board of directors meeting;
- Foreign company employees, when controlling and inspecting quality of product being produced in Canada, and they remain on the payroll of the foreign employer and the benefits from their assignment and the employer's principal business is located outside of Canada;

- After-sales service, including installation, warranty repair, after-warranty service, third party warranties and third party service or repairs, any and all of which must have been set out in the original contract for a product produced outside of Canada.

A business visitor should generally bring a comfort or introduction letter from his employer and the Canadian host business with whom he'll be working. The visitor should be prepared to answer a customs agent's questions related to the introduction letter, and those that sign it should be aware that she is coming to Canada in case they are called by a customs agent to verify the information and purpose of the visit.

She may also want to bring additional supporting documents with him, such as brochures, business cards and be prepared to use the company's web page. A frequent traveler is more likely to need such additional documentation.

Any person entering Canada as a business visitor must understand the consequences of being less than truthful with customs. Misrepresenting the purpose of her entry may result in the business visitor being barred from future entry of any type, and the person and his employer that supported the visitor's misrepresentation may be flagged in the immigration database, making it difficult for other employees to enter in the future. She should always check with legal counsel or an experienced human resources professional to ensure her entry is properly supported or whether additional documentation, such as a work permit, will be required to legally perform her job while in Canada.

Work Permits

Labour Market Opinion

To hire a foreign national, an employer must first obtain a positive "Labour Market Opinion (LMO)," a ruling by Service Canada that a foreign national is needed to fill the job and that no Canadian worker is available to do it. The LMO process is continually being changed. In April 2013, the process of obtaining a Labour Market Opinion takes approximately four months.

If an employer obtains a positive LMO, the foreign national must still be screened for "criminal inadmissibility" and possible "medical inadmissibility." A criminal inadmissibility screening reviews a person's criminal acts and convictions no matter how remote. Not all crimes and convictions will result in a person being denied entry. But, most notably, a conviction for driving a motorized vehicle while under the influence of drugs or alcohol will result in a person being denied entry into Canada.

In some cases, a finding of criminal inadmissibility can be overcome by showing the person has been rehabilitated or pardoned. But this is a lengthy and uncertain process, which requires a lot of planning to determine whether the person may be eligible.

Medical inadmissibility may arise if the foreign national is seeking to work in a medical-related field or with children, or where a person has recently traveled to designated countries where the Canadian government is concerned about the spreading of disease. A list of such countries is posted on the Canadian immigration website at **http://www.cic.gc.ca/english/information/medical/dcl.asp.**

Canada has treaties with certain countries that could shorten the entry process for a foreign national seeking to work in Canada, depending on the nationality and profession of the applicant.

Every year, Canadian employers hire more than 150,000 temporary workers with specific skills.

Source: Citizenship and Immigration Canada

Intra-company Transfers (ICT)

Under certain circumstances, executives, senior managers and employees with specialized knowledge can receive a work permit to transfer to a Canadian subsidiary, sister company, branch or company under common control. The companies must do business in Canada and a foreign country, and the person must be able to show he is a current employee who has held a similar position as he's being offered in Canada for a full-time, continuous one year period within the past three years. The maximum period of an executive or managerial ICT's initial work permit is three years, which can be extended as long as seven years.

A worker with specialized knowledge seeking an ICT permit must also show his specialized knowledge is critical to the ongoing Canadian operations of the company. This requirement is highly scrutinized and a detailed explanation should be provided. The maximum allowed stay by a worker with specialized knowledge is five years.

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