INVESTING AND ESTABLISHING A BUSINESS IN CANADA: A SMOOTH & EASY PATH

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Non-Canadian investors seeking to establish a business in Canada are subject to regulations imposed by federal and provincial legislation that take into consideration the nature and scope of their proposed investment. Whether setting up a new business or investing in an existing Canadian corporation, foreign investors will be required to comply with various procedures summarized in this article. However, the path to completing all of the documentation and processes is indeed “smooth and easy”, and for the most part only requiring a notification to the relevant agency, Canada is also a jurisdiction offering favourable conditions and incentives for foreign investment that are amongst the best in the world. The following sections will examine the applicable laws and regulations that will come into play in evaluating investments that may require ministerial review or a notification process, list the types of corporate structures and requirements for shareholders and directors, and provide some guidance on immigration and tax matters as they apply to foreign investments in Canada.

This article is for general informational purposes only and does not constitute legal advice.

Current Regulatory Environment

Legislation

Investment Canada Act

The Investment Canada Act ("**ICA**") serves as a guideline for conducting significant foreign investment in Canadian corporations in a manner that encourages investment, economic growth and employment opportunities in Canada. The ICA guides the notification and review process of investments initiated by non-Canadian citizens or permanent residents and protects against potential threats to national security. Under certain circumstances, the proposed transaction may be subject to government approval pursuant to an economic or national security review. The section below explains the applicable procedures in all three instances.

Foreign investments that fall under the scope of the ICA fall into three (3) categories:

1. Investments Subject to Notification
2. Reviewable Investments
3. Investments Injurious to National Security

Context and Past Decisions

Of the foreign investments that fell under the ambit of the ICA between 2016 and 2017, five noteworthy decisions highlight the factors that may prevent a transaction from receiving approval from the regulatory authorities. Prior to that, three transactions were blocked subsequent to a national security review, and in the case of two completed transactions the investors were ordered to divest themselves on the grounds that the investments were injurious to national security.

The most recent rejection of a foreign investment on national security grounds prevented CCCC International Holding Limited ("**CCCI**") from acquiring Aecon Group Inc. ("**Aecon**") in May 2018. This was only the third order preventing a proposed takeover based on concerns about national security. Three cases required divestiture in 2016-2017, and two transactions were allowed to proceed subject to conditions imposed to mitigate the identified national security risks while permitting the investment to proceed. Factors cited by the regulatory agencies conducting the national security review as to the reasons for blocking a takeover, ordering a divestiture, or imposing conditions include:

- the potential for injury to Canada's defence capabilities;
- the potential for transfer of sensitive dual-use technology or know-how outside of Canada;
- the potential to enable foreign surveillance or espionage;
- the potential for injury to Canada's international interests;
- the potential of the investment to involve or facilitate organized crime; and
- the potential to negatively impact the supply of critical services to Canadians or the Government.

It can therefore be seen that the regime under the ICA is not one that is a discouragement to foreign business.

1. Investments Subject to Notification

Any investment by a non-Canadian that establishes a new Canadian business or acquires control of an existing Canadian business and does not surpass the review thresholds must be notified prior to or within thirty (30) days of closing.

Canadian Business is defined as an entity that has:

a) a place of business in Canada;
b) an individual or individuals in Canada who are employed or self-employed in connection with the business; and
c) assets in Canada used in carrying on the business.

Prospective investors are required to fill out a notification form including information about the investor(s), their board of directors, officers, ultimate beneficial ownership, any connections to foreign states, the nature of the business activity(ies), the value of the investment, and whether it is a direct or indirect acquisition. Following receipt of the notification form, the Ministry will acknowledge receipt of the completed notice or identify any further information that is required. Once considered complete by the Ministry, the notification with be certified as non-reviewable in writing by the Ministry. The investor need not take any further action unless they subsequently receive a notice of review within twenty-one (21) days of certification.

As shown in Figure 1, the large majority of foreign investments fall into the notification category and will not be subject to the economic review process outlined in the next section. Out of 737 investment filings in 2016-2017, 715 notifications were certified, and all 22 applications that required further economic review were approved. Of the 715 notifications, 186 related to establishing a new business and 529 were for the acquisition of an existing Canadian business. With the threshold amounts for economic review increasing annually based on an index tied to

GDP growth, transactions requiring only notification and no further economic review will likely continue to increase in the years to come.

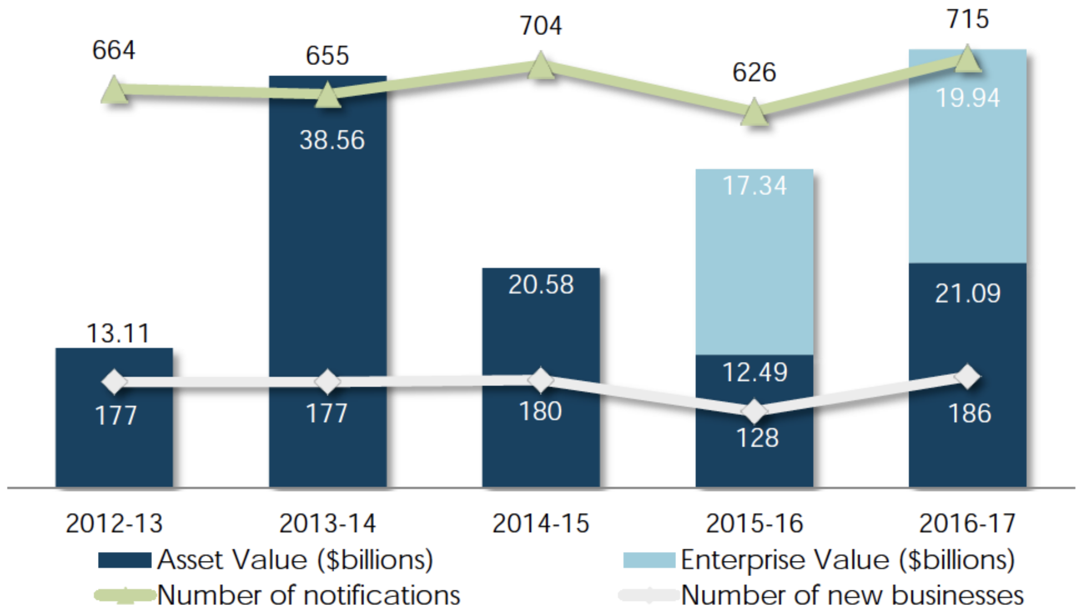

Figure 1. *Source: Investment Canada Act Annual Report 2016-2017.*

Direct acquisitions of Canadian businesses where the thresholds are not met, and indirect WTO investments, including by state-owned enterprises ("**SOEs**"), are subject to *notification* only and not subject to economic review. However, a review may be initiated with respect to such transactions on national security grounds.

2. Investments Subject to Review

Depending on the enterprise value of the Canadian business that is the subject of foreign investment, investors may be required to receive approval prior to closing. The thresholds differ depending on what category the investor falls into.

Private Sector WTO Investors

Private sector WTO investors are defined as individuals who are nationals or permanent residents of a WTO member state or non-Canadian entities controlled by a WTO investor. The 2019 review threshold for private WTO investors is $1.045 billion in enterprise value, calculated according to the following formulas:

In the case of the acquisition of *shares* in *publicly-traded* Canadian entities, the enterprise value equals: Market Capitalization + Total Liabilities (excluding operating liabilities) – Cash & Cash Equivalents.

For the acquisition of *shares* in a *non-publicly traded* Canadian entity, the enterprise value is equal to: Acquisition Value + Total Liabilities (excluding operating liabilities) – Cash & Cash Equivalents.

For the acquisition of *assets*, the enterprise value is equal to Acquisition Value + Assumed Liabilities – Cash & Cash Equivalents.

In sum, the investment is subject to review if the following criteria are met:

- ✓ Individual investor who is a WTO national or permanent resident of a WTO member state;
- ✓ Corporate investor incorporated in a WTO member state that is not a state-owned enterprise;
- ✓ Non-WTO investors that are not state-owned enterprises where the Canadian business that is the subject of the investment is, immediately prior to the implementation of the investment, "controlled by a WTO investor";
- ✓ Enterprise value of the acquisition target is greater than $1.045 billion.

Private Sector Trade Agreement Investors

The threshold for review for trade agreement investors is $1.685 billion as of 1 January 2019, to be indexed annually based on GDP growth. This threshold applies to investments by

1. trade agreement investors that are not state-owned enterprises; and
2. by non-trade agreement investors that are not state-owned enterprises where the Canadian business that is the subject of the investment is, immediately prior to the implementation of the investment, “controlled by a trade agreement investor”.

The ICA provides a list of trade agreements[1] of which entities or individuals of the ratifying member states are considered to be trade agreement investors. With the entry into force of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership on December 30th 2018, private investors whose country of ultimate control is Australia, Japan, New Zealand or Singapore are now considered private sector trade agreement investors subject to economic review only past the $1.685 billion threshold.

State-Owned Enterprise WTO Investors

SOE WTO investors include WTO investors that are state-owned enterprises and non-WTO investors that are state-owned enterprises where the Canadian business that is the subject of the investment is, immediately prior to the implementation of the investment, controlled by a WTO

[1] Comprehensive and Progressive Agreement for Trans-Pacific Partnership; Canada-European Union Comprehensive Economic and Trade Agreement Implementation Act; North American Free Trade Agreement; Canada-Chile Free Trade Agreement Implementation Act; Canada-Peru Free Trade Agreement Implementation Act; Canada-Colombia Free Trade Agreement Implementation Act; Canada-Panama Economic Growth and Prosperity Act; Canada-Honduras Economic Growth and Prosperity Act; Canada-Korea Economic Growth and Prosperity Act.

investor. The review threshold for SOE WTO investors is $416 million in asset value of the target Canadian business.

The threshold is indexed annually based on the nominal change in Canada's GDP.

In sum, the investment is subject to review if the following criteria are met:

- ✓ Investor is a state-owned enterprise of a WTO member state;

  or

- ✓ Non-WTO investors that are state-owned enterprises where the Canadian business that is the subject of the investment is, immediately prior to the implementation of the investment controlled by a WTO investor;

  and

- ✓ Asset value of the acquisition target is greater than $416 million.

Non-WTO Investors/Cultural Businesses

If the investor is not a WTO investor as defined in the ICA, or if the investment is made by any non-Canadian investor to acquire control of a "cultural business", the threshold for review is $5 million in asset value for direct investments and $50 million in asset value for indirect transactions.[2]

3. Investments Injurious to National Security

Certain investments may be scrutinized for their impact on Canada's national security. Under the ICA, the government may initiate a national security review where it has reason to believe that an investment may be "injurious to national security". A broader range of investments are subject to the ICA's national security regime, not just where there is an acquisition of control of a Canadian entity, but for minority investments as well. After completing the review, the investment will either be authorized, with or without conditions, directed to not be implemented, or, if already implemented, require divestiture.

[2] "Cultural business" is defined in the ICA as: a Canadian business that carries on any of the following activities, namely, (a) the publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine readable form, other than the sole activity of printing or typesetting of books, magazines, periodicals or newspapers, (b) the production, distribution, sale or exhibition of film or video recordings, (c) the production, distribution, sale or exhibition of audio or video music recordings, (d) the publication, distribution or sale of music in print or machine readable form, or (e) radio communication in which the transmissions are intended for direct reception by the general public, any radio, television and cable television broadcasting undertakings and any satellite programming and broadcast network services.

4. Application and Review Process

Economic Review

Investments under economic review are subjected to a net benefits analysis that weighs whether the transaction is likely to be of net benefit to Canada.

In examining the likely net benefit of a proposed investment, the Ministry considers six factors that provide predictable guidance for investors while maintaining the flexibility required to ensure economic benefit to Canada:

i. the investment's effect on the level and nature of economic activity in Canada, including employment, resource processing, and the utilization of parts, components and services;
ii. the degree and significance of participation by Canadians in the Canadian business;
iii. the investment's effect on productivity, industrial efficiency, technological development, and product innovation and variety;
iv. the investment's effect on competition;
v. its compatibility with industrial, economic and cultural policies; and
vi. its contribution to Canada's ability to compete in world markets.

The Ministry has released the following Guidelines offering more specific guidance to investors in particular sectors:

- Guidelines on Investment by state-owned enterprises — Net benefit assessment
- Guidelines on Acquisitions of Oil and Gas Interests
- Guidelines on Administrative Procedures

Economic reviews have a deadline of 45 days, but occasionally take longer as they can be extended with the consent of the parties.

National Security Review

Unlike the notification and economic review procedures, which are initiated by the investors themselves either prior to or shortly after closing a transaction, a national security review can be initiated by the government at any point and in relation to a broader range of investments to determine whether they may be injurious to national security.

The following factors will be taken into consideration for the purposes of a national security review:

i. The potential effects of the investment on Canada's defence capabilities and interests;
ii. The potential effects of the investment on the transfer of sensitive technology or know-how outside of Canada;
iii. Involvement in the research, manufacture or sale of goods/technology identified in Section 35 of the *Defence Production Act*;

iv. The potential impact of the investment on the security of Canada's critical infrastructure. Critical infrastructure refers to processes, systems, facilities, technologies, networks, assets and services essential to the health, safety, security or economic well-being of Canadians and the effective functioning of government;
v. The potential impact of the investment on the supply of critical goods and services to Canadians, or the supply of goods and services to the Government of Canada;
vi. The potential of the investment to enable foreign surveillance or espionage;
vii. The potential of the investment to hinder current or future intelligence or law enforcement operations;
viii. The potential impact of the investment on Canada's international interests, including foreign relationships; and,
ix. The potential of the investment to involve or facilitate the activities of illicit actors, such as terrorists, terrorist organizations or organized crime.[3]

Under the revised ICA regulations, the national security review could take up to 200 days, which can be extended with the consent of the parties.

Provinces

In addition to complying with the ICA, investors will be required to comply with provincial requirements with regards to local resident directors.

Residency Requirements for Local Directors

The provinces of Alberta, Manitoba, Newfoundland, Ontario, and Saskatchewan as well as the federal Canada Business Corporations Act ("**CBCA**") require that a minimum of 25% of the directors of a Canadian corporation be resident in Canada. A Canadian resident is a Canadian citizen or permanent resident who is ordinarily resident in Canada.

British Columbia, New Brunswick, Nova Scotia, Prince Edward Island and Quebec do not require a minimum number of local directors to be appointed.

These requirements do not apply to officers or shareholders, who may be non-Canadian.

Note that the requirements are higher in certain industries. Book publishing and uranium mining companies have a higher residency requirement for directors, for example.

Corporate Ownership Restrictions

In certain strategic or sensitive industries, federal and provincial legislation imposes limits on foreign corporate ownership.

[3] Guidelines on the National Security Review of Investments (2016).

Financial Institutions may not be owned by a foreign bank holding greater than 10% of any class of shares in a Canadian bank or its subsidiaries, except with ministerial approval or under specific exceptions.

Broadcasting Corporations may not grant broadcasting licences to non-Canadians or companies that are effectively controlled by non-Canadians.

Telecommunications Common Carriers must be Canadian owned and controlled and incorporated in Canada either federally or provincially.

Air Transportation Licences are only issued to corporations controlled by Canadians if 51% of the voting interests in the corporation are in fact owned and controlled by Canadians. International airline service licenses may be issued to a non-Canadian air transportation entity If the non-Canadian applicant satisfied certain eligibility requirements.

Corporate Structures

Federally incorporated corporations are governed by the CBCA, while provincially incorporated entities are governed by provincial legislation. However, even federally-incorporated entities must register in each province in which they intend to carry out business, and will be subject to the provincial regulations of each province or territory in which they carry out their activities. Corporations that register using a provincial corporations' law must register in each province where they are doing business as well.

Provincial or Federal Incorporation?

	Federal Incorporation	Provincial Incorporation
Cost	• $200-250 incorporation filing fee • $75 name search report • $20 annual filing fee	• Different in each province • Generally higher than federally
Nature and Scope of Business	• May do business across Canada, not limited to a specific province • Advisable if the nature of the business involves selling products internationally • Permitted to use "Canada" in the corporation's name	• Limited to doing business in the province of registration
Administrative	• Automatically registered with the Canadian Revenue Agency ("**CRA**")	• Must register separately in the province of incorporation for tax and administrative matters

	• Must file annual returns with the CRA	

The principal types of corporate entities that exist in Canada are:

- Public business corporations
- Private business corporations
- Not-for-profit corporations
- Partnerships
- Proprietorships
- Limited Partnerships
- Limited Liability Partnerships
- Joint Ventures

Immigration

Investor Work Permits

Federal programs that allow foreign investors to obtain work permits in Canada include:

- **Temporary Foreign Worker Program**: allows highly skilled individuals with sufficient assets to purchase or acquire a majority interest in a Canadian business to obtain a renewable 12-24 month temporary work visa.
- **Immigrant Investor Venture Capital Program**: provides a route to permanent residency for high net-worth individuals. Candidates must meet the minimum net worth requirements and invest a minimum amount in a qualifying investor venture capital fund.
- **Start-Up Visa Program**: grants work permits to qualified immigrant entrepreneurs in certain targeted sectors.

Global Talent Stream

Started in 2017and part of the Temporary Foreign Worker Program, the Global Talent Stream ("**GTS**") initiative enables qualifying Canadian businesses that have been referred to the programme and that require unique and specialized foreign employees to carry on their business in Canada. A "unique and specialized" position is one for which the annual salary is at least $80,000, requires advanced knowledge of the industry and an advanced specialized degree, and a minimum of five (5) years' experience in the field. The programme has pre-identified certain occupations that qualify as unique and specialized. This list may be found here: https://www.canada.ca/en/employment-social-development/services/foreign-workers/global-talent/requirements.html#ust.

Employers applying through the GTS must complete an application that includes a Labour Market Benefits Plan demonstrating the employer's commitment to activities that will positively impact the Canadian labour market in the long term. Positive impacts to highlight in the Labour Market

Benefits Plan include a commitment to job creation, increasing skills and training investments for Canadian residents, transferring knowledge, enhancing company performance and implementing best practices or policies as an employer in a specific industry. GTS participants must undergo annual progress reviews to demonstrate their compliance with the benefits plan and achievements of the stated objectives.

The processing fee for each GTS application is $1000 and may take anywhere between ten (10) business days to one (1) month.

Tax

Canada has one of the lowest tax rates for businesses in the G7 countries. A corporation is considered resident in Canada for tax purposes and therefore subject to federal and provincial/territorial taxes if it is either incorporated in Canada or if its central management and control is located in Canada.

Resident corporations are taxed on worldwide income, which includes business/trading income, investment income and capital gains. The income of foreign controlled affiliates and non-residents may also be taxed based on income derived from carrying on business in Canada and capital gains from the disposition of taxable Canadian property.

Business expenses and dividends from resident corporations and foreign controlled affiliates may be deducted from the corporate income tax.

Foreign tax credits are available both provincially and federally where Canada has treaties with an investor country for the avoidance of double tax. This allows eligible corporations to credit income tax paid in another country against Canadian tax on the same profits. Regional and industry incentives are available in the form of income tax credits at both the provincial and federal level.

It is advisable to consult with a tax accountant or expert so as to structure a business in a most tax effective way given the nature of the business.

Incentives

Regional and industry-specific tax incentives are offered to reduce the corporate taxes payable at both the federal and provincial/territorial level.

Regional Incentives

Incentives are for the most part offered on a provincial or regional basis. It is therefore prudent to discuss your proposed business with representatives of a particular region or provinces, as well as cities (for example “Montreal International”).

A specific example is the Gaspé region and the Atlantic provinces (including the Atlantic offshore region) which offer incentives on foreign-source income in the form of an income tax credit (“**ITC**”). For corporations operating in these regions, an ITC of 10% is available federally for particular types of capital investments, namely in new buildings, machinery and equipment, and clean energy generation equipment used primarily in manufacturing, processing, logging, farming, or fishing. This particular ITC may be carried back up to three (3) years if previously unclaimed, or forward twenty (20) years to be applied against taxes owing, or may be refundable up to 40% to Canadian-controlled private corporations.

“Tax holidays” are another form of tax incentive to encourage business development in target industries in particular provinces. For example, Ontario and Quebec offer incentives for the commercialization of intellectual property, and Prince Edward Island for aviation and marine technology. Newfoundland and Labrador offer tax benefits for corporations satisfying the conditions of provincial job creation initiatives.

It is advisable to verify with provincial representatives from the place where an investment is being considered and discuss any geographical or other incentives that may be available.

Industry Incentives

Tax incentives are available federally and provincially to encourage growth and innovation in the following industries:

- Research and development;
- Film, media, computer animation and special effects, interactive digital media, and multimedia productions;
- Manufacturing and processing; and
- Environmental sustainability.

An example is the Scientific Research and Economic Development (“**SR&ED**”) tax credit, which is available federally and in most provinces and territories. Resident corporations may claim a refundable tax credit of 35% for qualifying SR&ED expenditures totalling up to $3 million per year (i.e. a maximum of $1,050,000 in tax refunds). Canadian subsidiaries of foreign corporations are also eligible to deduct qualifying SR&ED expenditures for a 15% tax credit. A further SR&ED tax credit is claimable provincially in all provinces and territories except Prince Edward Island, Nunavut and the Northwest Territories.