



Tax: Canada: International Joint Ventures

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1. Are partnerships tax transparent in your jurisdiction?

Yes. A partnership is not considered to be a separate legal entity for the purposes of Canadian income tax. Partnership income or loss is calculated at the partnership level as if it were a separate taxpayer and retains its source. The income or loss calculated is allocated to the partners for tax purposes according to the terms of the partnership agreement. A partner must report income or loss allocated to it from a partnership regardless of whether any amounts are actually distributed by the partnership. An annual information return must be filed by the partnership with the Canada Revenue Agency.

2. Can losses of a foreign partnership be offset against the profits of a corporate partner that is tax resident in your country?

Generally, yes. Each member of a partnership must include in income the member's allocable share of the income or loss of the partnership (see *Question 1*). However, where a Canadian resident company becomes a partner in a partnership that previously did not have a partner resident in Canada, certain rules prevent the allocation of an unrealised loss to that Canadian partner. Special rules also apply to limited partners that may, in certain circumstances, restrict a limited partner's ability to claim losses allocated to it by the limited partnership based on the partner's "at-risk" amount.

3. Do partnerships that are tax resident in your country generally receive similar benefits to companies under double tax treaties?

A partnership is transparent for Canadian tax purposes and therefore is not "liable to tax" in Canada. The availability of treaty benefits to a Canadian resident partner depend on whether the source state will look through the partnership and apply the treaty benefits at the partner level.

4. Does your country have rules that restrict the proportion of a company's capital that is comprised of loans by affiliates (thin capitalisation rules)? If so, please explain in what circumstances these rules apply and whether they can be circumvented.

Thin capitalisation rules do exist. They apply to restrict the deduction of a portion of interest on debts owing to specified non-

resident shareholders of a Canadian company. If a specified non-resident shareholder (meaning a non-resident shareholder that owns 25% or more of the Canadian company (measured by both votes and value)) is owed debt in excess of two times the relevant equity of the company, the company's ability to deduct interest expense is restricted. For these purposes, equity is calculated by reference to paid up capital attributable to, and contributed surplus contributed by, the non-resident shareholder and retained earnings of the company.

5. If a company that is tax resident in your country transfers assets (including shares) to a company that is tax resident in another country, what taxes might arise? Are reliefs potentially available? (Please distinguish, if relevant, between assets that are located in your country and assets located in a foreign country.)

Income tax

A specified proportion of gains realised by a Canadian resident company on the sale of capital assets located anywhere in the world is included in income of the company for tax purposes. This proportion is currently one-half of the gains.

Capital losses realised on the sale of capital assets can be offset only against capital gains. An additional amount may be required to be recaptured where amounts have been previously deducted in respect of the depreciation of certain capital assets. The full amount of the gain realised on the sale of an asset held on income account must be included in computing income.

Tax deferral on gains may be available where shares of a foreign affiliate (see *Question 12*) are disposed of to a buyer that is, immediately after the disposition, also a foreign affiliate of the Canadian company.

Goods and services tax

The federal goods and services tax (GST) is potentially applicable to the transfer of assets (other than shares and other exempt or zero-rated assets). Relief may be available where a supply of a business or part of a business is made as a going concern and the seller and buyer execute a joint election.

Provincial retail sales tax

With the exception of Alberta, all provinces in Canada have a form of sales tax on sales of goods. The provinces of British Columbia, Ontario, Nova Scotia, New Brunswick, and Newfoundland and Labrador have harmonised their sales tax system with the federal GST. In these provinces, the harmonised tax is administered and collected by the federal government in the same manner as the GST.



6. Is any tax or duty payable on the issue of shares by a company that is incorporated in your country?

No.

7. What rate of tax do companies pay in your jurisdiction and how is it assessed?

Both the federal government and the provincial governments impose tax on the worldwide taxable income of companies resident in Canada.

The general federal corporate tax rate for 2010 is 18%. In 2011, the general federal rate is expected to decrease to 16.5%. A lower preferential rate applies to a maximum of C\$500,000 (as at 1 September 2010, C\$1 was about EURO.74), each year, of the business income of Canadian-controlled private corporations. The provincial corporate tax rates vary, depending on the particular province and industry, between 2.5% and 16%. If a company carries on business in more than one province, its income is allocated among those provinces on the basis of revenue and salaries attributable to each province.

8. Can losses of a company that is tax resident in your country be surrendered for tax purposes to another company. If so, what conditions apply? Can losses be carried forward for tax purposes?

There are no provisions under Canadian tax legislation to permit the consolidation of income or loss among companies in a commonly controlled group.

A business loss realised for tax purposes in a particular year may be applied to reduce taxable income in the previous three years and the following 20 years. Capital losses can be carried back three years and forward indefinitely to be deducted from capital gains. If control of a company is acquired, certain provisions limit the carrying forward of prior business losses and prohibit the carrying forward of prior capital losses.

9. Are interest payments tax deductible in your country?

Generally, yes. Interest payments made in respect of a legal obligation to pay interest on borrowed amounts used for the purpose of earning income from a business or from property are deductible provided the amount is reasonable in the circumstances.

10. Are withholding taxes applied to dividends, interest and/or other payments made by a company that is tax resident in your country to a foreign company? If so, what rates apply? Can they be reduced or eliminated in any circumstances?

Dividends paid by a Canadian resident company to non-resident shareholders are subject to withholding tax at a rate of 25%.

Certain amounts paid to shareholders by a Canadian company on redemption of shares, reduction of capital and winding up are considered to be paid as dividends for tax purposes, and so are subject to withholding tax when paid to a non-resident shareholder.

Withholding tax at a rate of 25% also applies to other specified amounts paid by a Canadian company to a non-resident, such as interest, management fees, rent and royalties. Interest paid to arm's-length non-resident lenders is exempt from withholding tax provided such interest is not participating. (Participating debt interest means interest that is paid or payable on an obligation, all or any portion of which is contingent or dependent on the use of or production from property in Canada or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion, or by reference to dividends paid or payable to shareholders of any class of shares of the capital stock of a company.)

Withholding tax may be reduced or eliminated under the terms of an applicable double tax treaty.

11. What is the tax treatment of dividends paid by a company that is tax resident in your country to a corporate shareholder (domestic or foreign)?

Canadian-resident companies are not generally taxed on dividends received from other Canadian companies (although private companies and certain other companies can be subject to a refundable tax on some dividends received). However, a number of statutory rules impose tax on the payer and recipient of dividends on certain types of preferred shares.

Dividends received by a foreign corporate shareholder are subject to withholding taxes as described in *Question 10*.

12. What is the tax treatment of dividends received by a company that is tax resident in your country from a foreign company?

Dividends received by a Canadian resident company from a non-resident company are fully includable in income subject to certain deductions permitted under the foreign affiliate rules (described below) and subject to the application of the foreign tax credit rules.

Dividends received by a Canadian resident company from a foreign company in which it holds, either alone or together with related persons, at least a 10% direct or indirect interest in any class of shares fall under the foreign affiliate rules.

The foreign affiliate rules generally provide for a joint exemption and credit system. In general terms, a dividend from active business income earned by a foreign affiliate is exempt from Canadian tax if the affiliate is resident and carries on its business in a country with which Canada has a tax treaty or has entered into a



Tax Information Exchange Agreement. If a foreign affiliate is not resident or does not carry on its business in such a jurisdiction, the income is generally included in income of the Canadian company subject to a foreign tax credit.

partnership is deemed not to have made reasonable efforts to determine and use an arm's length transfer price for the purposes of application of the penalty if the Contemporaneous Documentation requirements have not been complied with.

13. Are there any circumstances in which (undistributed) profits of a company in a foreign country can be imputed to a corporate shareholder in your country by tax authorities (controlled foreign company rules)?

Yes, under Canada's foreign accrual property income (FAPI) rules, a shareholder is taxable on an accrual basis on amounts of certain types of income earned by a "controlled foreign affiliate". Relief is provided for any foreign tax paid on the income. Income imputed under the FAPI rules includes, generally, passive income, amounts deemed to be passive income and 50% of the capital gains realised on the sale of certain property.

14. Does your country have transfer pricing rules? If so, please explain broadly how they apply?

Yes. The terms and conditions of transactions between a Canadian taxpayer or partnership and a non-arm's length non-resident must be similar to those which would have existed had the parties been dealing with each other at arm's length. If the terms and conditions of the non-arm's length transaction differ from those that would have existed between arm's length persons, the terms and conditions may be adjusted to reflect those that would have existed had the parties been dealing at arm's length. Persons who are "related" for Canadian tax purposes are deemed not to deal with each other at arm's length; whether persons who are not "related" deal with each other at arm's length is a question of fact.

The following must file an annual information return regarding transactions with non-arm's length non-residents:

- Canadian residents.
- Non-residents of Canada that carry on business in Canada.
- Partnerships in which a Canadian resident is a member or which carry on business in Canada.

The Canada Revenue Agency's administrative position on determining an arm's length transfer price generally mirrors the guidelines of the Organisation for Economic Co-operation and Development. A Canadian taxpayer must make or obtain certain documentation (Contemporaneous Documentation) in the year in which a transaction with a non-arm's length non-resident is entered into and in every subsequent year in which the transaction continues.

A penalty may be imposed equal to 10% of the net result of certain adjustments if reasonable efforts to determine an arm's length transfer price are not made by the Canadian taxpayer or a partnership of which the taxpayer is a member. A taxpayer or