Expanding Your Business to Canada

Fiona Brown
Partner
T 416.865.3078
fbrown@airdberlis.com

Aaron Baer
Partner
T 416.865.4636
abaer@airdberlis.com

AIRD BERLIS

Aird & Berlis LLP | Lawyers
Brookfield Place, 181 Bay Street, Suite 1800, Toronto, Canada M5J 2T9
T 416.863.1500 F 416.863.1515 | airdberlis.com

1. Understanding Canada's Legal Landscape

Canada has 10 provinces and three territories. Certain matters, such as healthcare and education, are largely within the jurisdiction of each individual province. Other matters, such as interprovincial trade, are largely within the jurisdiction of the federal government. And in many cases, there is substantial overlap. For example:

Corporate Law: Businesses can incorporate under the laws of the applicable province's/territory's corporate statute, or they can incorporate federally under the Government of Canada's corporate statute.

Tax: Taxes are a blend of federal and provincial components. Canada has a VAT-like tax that includes a federal component (GST) as well as a provincial component (PST). In some most provinces, including Ontario, the GST and PST have been integrated, meaning consumers simply pay a harmonized sales tax (HST). Similarly, income tax rates vary from province-to-province.

Privacy: While Canada's main privacy law that applies to companies is federal, certain provinces have their own privacy legislation that – while substantially similar – may contain additional requirements that businesses targeting customers in those provinces must comply with.

While statutes vary from province-to-province, corporate law and employment law are largely similar across the country (with the exception of Quebec, the only Canadian province that uses a civil law system). Just as Louisiana is the only civil law jurisdiction in the United States, Quebec is the only civil law jurisdiction in Canada (stemming from its French heritage). The other Canadian provinces and territories are governed by common law (stemming from their English heritage).

2. Incorporation Considerations

> **Do I need a Resident-Canadian Director to Incorporate a Canadian Company? (Answer: No)**

If you incorporate in Ontario or under federal law (as well as in many other Canadian provinces), your company is required to have a resident-Canadian director. However, there are several provinces (including British Columbia and Nova Scotia) that do not have resident-Canadian director requirements. *As a result, for most of our foreign clients who are seeking to create a Canadian subsidiary company, we incorporate in either British Columbia or Nova Scotia to avoid director residency restrictions.*

> **Does It Make a Big Difference if I Incorporate Federally Instead of Under the Laws of a Particular Province? (Answer: No)**

When establishing a wholly-owned Canadian subsidiary, there are generally no meaningful disadvantages to incorporating provincially vs. incorporating federally. The statutes are substantially similar, and there are no significant cost differences. Incorporating federally does provide slightly stronger legal name protection, but it can be challenging and time-consuming to obtain federal corporate approval (vs. provincial approval), and clients seeking strong brand protection should look to register a trademark to properly protect their intellectual property rights. As noted above, to incorporate federally, you are required to have a resident-Canadian director.

> **What Type of Corporation Should I Incorporate? (Answer: It Depends)**

Most of our clients who establish a Canadian subsidiary incorporate a standard Canadian corporation. Unlike in the U.S., where companies have to determine whether to establish a C Corp, S Corp or LLC, in Canada the choice is quite simple. In most provinces, the only option is a standard corporation. A standard corporation provides limited liability and is a separate legal entity from its parent company.

However, some clients may decide to establish an unlimited liability corporation (ULC). Both British Columbia and Nova Scotia allow for the creation of ULCs and do not require a resident-Canadian director. While ULCs are taxed the same as a standard Canadian corporation, there may be some foreign tax reasons (especially for some U.S. clients) that incentivize businesses to establish a ULC instead of a standard corporation. There is no difference from a Canadian tax standpoint between a ULC and a standard Canadian corporation. Many clients seek guidance from our firm's renowned cross-border tax group to help make this decision.

> **Do I Need a Bank Account to Incorporate? (Answer: No)**

You do not need a bank account in Canada in order to incorporate a Canadian company. While this appears to be a requirement in some jurisdictions (as this question comes up quite frequently), it certainly is not a Canadian requirement. You will not be able to establish a bank account for the Canadian subsidiary until the incorporation is complete (as the bank will require a copy of the Articles of Incorporation that are created at the time of incorporation).

> **How Long Does It Take to Incorporate? (Answer: Within 24 Hours)**

We're always confused when we hear from a potential client that they spoke with another law firm and were told it would take several weeks to incorporate. Once we have the required information from you, we promptly prepare the incorporation documents. As soon as we have them signed (whether by electronic signature, Docusign or otherwise), we proceed to incorporate electronically. No original signatures are required from you.

Structuring decisions can hold up the process. Many clients seek out cross-border tax advice before incorporating (and we certainly recommend this approach). However, once the appropriate structure is determined, we are able to incorporate extremely quickly after.

> **Is There a Minimum Investment Required to Incorporate? (Answer: No)**

There is no minimum investment that you are required to make to incorporate a Canadian company. Technically, a nominal amount has to be paid in order for the initial shares of the Canadian subsidiary to be issued to the parent company. We document the initial share subscription as being for $1 in the aggregate. While the amount should technically be paid at closing, since there will not be a bank account opened, it is generally paid in practice once the bank account is opened. Additional funds can be contributed to the subsidiary at a later date through either debt (loans) or equity.

> **Does the Province in Which I Incorporate Affect the Tax Rate? (Answer: No*)**

We regularly encounter companies that are looking to set up an office in Toronto, Ontario, but are unsure where in Canada to incorporate. Some companies are under the impression that the jurisdiction of incorporation is determinative for tax purposes, but this is not the case. While tax rates do vary by province (as set out above), the determination of the applicable tax rate is based on the province or provinces in which the corporation has a permanent establishment (very generally, a fixed place of business).

*Technically, if a Canadian subsidiary is not considered to have a permanent establishment in a province, then the permanent establishment is based on where the head office/registered office in Canada is located. However, if the Canadian subsidiary is running an active business (which is the case for all our clients who are setting up a Canadian subsidiary to sell products or to perform R&D activities), then the Canadian subsidiary will be deemed to have a permanent establishment, and the jurisdiction of incorporation will not be relevant.

3. How to Reduce Exposure to Liability as Employer

Employee or Independent Contractor?

Whether a worker is deemed an employee/dependent contractor or independent contractor has significant implications on what rights the worker is entitled to under Canadian law. For instance, many employees are entitled to notice of termination or pay in lieu, public holiday pay, vacation pay, and overtime pay, while independent contractors may not be entitled to any of these things.

In Canada, reviewing bodies strictly scrutinize independent contractor relationships and regularly deem workers to be employees or dependent contractors notwithstanding their own characterization of the relationship. While there is no universal test and no one factor is determinative, caselaw makes it clear that exclusivity and economic dependence are hallmarks of the employment and dependent contractor relationship. Reviewing bodies evaluate the underlying relationship (rather than the characterization of the relationship) between the parties and consider an array of factors. We commonly see individuals engaged as independent contractors allege that they were actually an employee or a dependent contractor following a termination of the relationship or an injury of the relationship. In that event, should the reviewing body agree with the individual, the company doesn't have the benefit of an employment agreement restricting the employee's entitlements and the individual will be entitled to, among other things, common law reasonable notice of termination, accrued and unpaid public holiday pay, vacation pay and overtime.

As a result, we work closely with our clients to determine whether an arrangement should be structured as an independent contractor relationship or as an employee relationship and, in either event, contractually limit certain liabilities.

Exposure to Overtime Pay

Employment standards legislation sets out minimum standards for most employees regarding, among other things, overtime pay. In Ontario, overtime for many positions begins after overtime eligible employees have worked 44 hours in a work week. Overtime pay is 1½ times the employee's regular rate of pay. While most employees are entitled to overtime, some employees have jobs that are exempt from the overtime provisions, including: i) information technology professionals; ii) certain salespersons; and iii) managers and supervisors. Caution should be exercised in identifying an employee as falling with the scope of the exemptions. In recent years, Canada has seen a proliferation of class action lawsuits concerning claims for overtime pay on the basis that the employees were misclassified as overtime exempt.

Prior to classifying an employee as exempt from overtime, employers should review the worker's job description carefully to ensure that the employee`s duties do in fact bring them within one of these exempt categories. In the event the employees do not fall within the scope of one of the legislative exemptions, there are a number of additional ways employers can structure their arrangements to reduce overtime pay, including, for example: (a) the parties can agree in writing that the employee will receive paid time off work instead of overtime pay; and (b) an employer and an employee can agree in writing to average the employee's hours of work over a specified period of two or more weeks for the purposes of calculating overtime pay.

Drafting Effective Employment Agreements

It is very important to have employees sign *properly drafted* employment agreements that address, among other things, the amount of notice and payment required in the event of a termination, assignment of intellectual property and post-termination obligations, such as non- competition, non-solicitation, non-disparagement and return of company property. A properly worded employment agreement can significantly reduce potential employment liabilities.

One of the most important provisions to include in an employment agreement is a restriction on payments in the event of a termination. For our American employers, there is no "at will" employment in Canada. Rather, the determination of how much notice or pay in lieu is required is determined by whether the common law has been waived, the employee's length of service and the employer's payroll. In Ontario, upon a termination without cause, employers are obligated to provide employees with i) certain statutory entitlements and, also, ii) common law reasonable notice. The employment standards legislation establishes the bare minimum employee entitlements. Common law reasonable notice represents the *far more* significant liability. *Employers may contract out of common law notice*. For example, under the employment standards legislation, an employee employed for 8 years or more prior to termination without cause is only entitled to 8 weeks of statutory notice of termination and, depending on the size of an employer`s payroll, an additional 8 weeks of severance pay. By contrast, if common law entitlements are not waived, that same employee can be entitled to more than 8 months (approximately 32 weeks) of common law notice. That said, consideration should be given to market retention and increasing the payments for higher level employees.

Courts strictly scrutinize provisions which limit employee entitlements and, accordingly, it is very important to ensure the provisions contain the correct language. We work very closely with our clients to prepare employment agreements that limit unnecessary employment liabilities.

4. How to Canadianize Your Agreements

We are often asked by our foreign clients to Canadianize their agreements. In some cases, we review distribution agreements, services agreements and supply agreements so that we can make the necessary tweaks for the Canadian market. Often, there are slight differences (if not substantial differences) between Canadian law and foreign law that can make a meaningful difference from a legal standpoint. For example, while a U.S. contract may exclude all implied warranties, in Canada, a service provider will want to exclude all implied warranties and *conditions*. What seems like a minor, technical difference can end up having significant implications. Similarly, intellectual property law concepts differ between countries (e.g. the treatment of moral rights is quite different in Canada vs. the United States, while the U.S. concept of a *work made for hire* does not exist in Canada).

Similarly, Canadian privacy laws are not identical to those in Europe (though they are quite similar to the *GDPR* in many respects) and are substantially more developed than most U.S. privacy laws. Clients often ask us to review their privacy policies and terms of service, as well as to provide guidance on how to comply with Canada's anti-spam laws (which apply to the sending of commercial electronic messages).

Intellectual property registrations in other countries do not extend to Canada. For this reason, many of our clients seek to formally register their trademarks in Canada. Trademark registration is a low-cost way to obtain substantial trademark protection across all of Canada.

5. How to Draft Effective Intercompany Agreements for Transfer Pricing

When a foreign company establishes a Canadian subsidiary, transfer pricing comes into play.

Imagine a scenario where the Canadian subsidiary charges $1,000,000,000 per hour to provide services to the foreign company. The result would be that the foreign company pays no tax, as its profit would be negative. The government of the foreign country would not be happy.

Similarly, imagine a scenario in which the Canadian subsidiary charges $.0000000001 per hour to provide services to the foreign company. The Canadian company would pay essentially no tax (assuming this was its sole source of revenue), as its revenue would be artificially deflated. The government of Canada would not be happy.

Transactions between a parent company and its subsidiary are subject to transfer pricing rules in the *Income Tax Act* (Canada). To comply with these rules, the transactions must occur under arm's-length terms and conditions (i.e. not the prices used in the examples above, as those would not be reasonable prices agreed to by two arm's-length parties). There are also requirements for parties to keep documentation of their transactions that are subject to transfer pricing.

While we don't provide advice on what price will meet the requirements of the transfer pricing rules, we work closely with our clients to provide the necessary legal agreements and frameworks that are required to ensure that companies are compliant with transfer pricing requirements prices while also protecting their legal needs. For example, our clients typically enter into (between the parent company and the Canadian subsidiary) one or more of the following: a trademark licence, software licence, R&D/cost-sharing agreement and a services agreement.

6. Understanding Canadian Regulations

In addition to adhering to the laws of the jurisdiction of incorporation, certain business activities must also comply with industry- or product-specific regulations in Canada. For example, banks, trust and loan companies, and insurance companies are subject to separate legislations. Industries such as broadcasting, telecommunication, transportation, mining, energy, and food and drugs are specifically regulated.

In most cases, businesses will need to obtain certain permits and licences to operate. BizPal (https://www.bizpal.ca/) is a useful online tool (jointly managed by the federal, provincial, territorial and municipal governments) to search for the type of permit or licence your business may need to operate in Canada.

Our firm has lawyers that specialize in different regulatory areas, and our foreign clients regularly seek our advice on how these regulations apply to their businesses.

For more information on how we can help you, visit our website at airdberlis.com.

Contacts

Fiona Brown
Partner
T 416.865.3078
fbrown@airdberlis.com

Fiona is known for her commitment to outstanding client service. Fiona's practice focuses on advising clients with respect to employment issues related to compliance with employment standards, human rights, pay equity and occupational health and safety requirements. She also coordinates a team of lawyers to assist her clients in corporate commercial matters, litigation, intellectual property, and other areas. Fiona's responsiveness, dedication to clear communication, and hands-on approach show that she is personally invested in the success of her clients.

Fiona frequently advises international clients expanding into Canada. She works closely with lawyers and patent agents in all major practice areas and many industries, including technology, cannabis, energy, retail, manufacturing, infrastructure, construction, and others to provide her clients with a full range of legal services to take their business to the next level.

Fiona is a practical lawyer who enjoys working with clients to develop workable business solutions.

Aaron Baer
Partner
T 416.865.4636
abaer@airdberlis.com

With a strong education and background in business, Aaron brings a sensibility for framing his legal advice from the perspective of a business professional. The underlying question that consistently guides his work is whether he is adding value to his clients and furthering their business objectives.

Aaron has helped dozens of companies from the U.S., Europe, and Central and South America establish Canadian subsidiaries. He works closely with Aird & Berlis tax experts to ensure subsidiaries are set-up in a tax efficient manner. As a member of the firm's Privacy & Data Security Group, Aaron regularly advises companies that are establishing Canadian operations about Canadian privacy matters.

Aaron has a keen interest in legal technology and has played a leading role in the firm's adoption of artificial intelligence, legal project management, and data analytics tools that are transforming the practice of law. In 2018, Aaron was seconded to Diligen, a leading AI contract review company based in Toronto. Aaron is an active member of the firm's Technology Advisory Committee and an advisor to a number of leading legal tech startups.