Income and Other Taxes

2022

Doing Business in Canada

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In Canada, taxes are levied at the federal, provincial and municipal levels of government. At the federal level, the government generates most of its revenue by way of income taxes and excise taxes imposed on the distribution and consumption of goods and services in Canada. The provinces and territories also impose income taxes and sales taxes, whereas municipalities generally levy taxes on real property. There are no stamp duties levied by any government in Canada.

The rates of income taxation to which a taxpayer will be subject will vary according to a number of factors, including: (a) the character of the income; (b) the nature of the business activity; (c) the jurisdiction in which that activity is carried on; and (d) the identity of the taxpayer in question.

TYPES OF INCOME

Under the *Income Tax Act* (Canada) ("**ITA**"), the residence of a person and the source of income are the key factors in determining liability for income tax. Non-resident persons are liable for Canadian income tax only in respect of income earned in Canada. The ITA imposes income tax on a non-resident who is employed in Canada, carries on business in Canada or disposes of certain types of Canadian property. Income resulting from the disposition of capital property gives rise to a capital gain, currently only one-half of which is included in income and taxed at the taxpayer's rate of taxation as otherwise determined.

INDIVIDUALS

Individuals are liable for tax under the ITA on their worldwide income if they are resident in Canada. The tests for determining residency are not easily applied. Generally speaking, an individual's residency status arises from his or her "connection" with Canada, generally whether such individual is ordinarily resident in Canada. An individual may also be deemed to be resident in Canada for a particular year where the person sojourns (which generally means to visit or temporarily stay) in Canada for 183 days or more in a calendar year.

In Canada, individuals pay tax at graduated rates based on their income levels. In Ontario, individuals are liable to a 20% surtax on provincial tax payable in excess of C$4,991, and an additional 36% surtax on provincial tax payable in excess of C$6,387. The top marginal rate of tax for an individual resident in Ontario for 2022 is 53.53%.

Because of tax credits, the top marginal rate of tax on dividends received by an individual resident in Ontario from a taxable Canadian corporation is 47.74% for non-eligible dividends, while the top marginal rate of tax for eligible dividends is 39.34%. The effective top marginal tax rate on capital gains realized by an individual resident in Ontario is 26.76%. The top marginal rates vary between provinces and territories.

CORPORATIONS

Under the ITA, the taxation of a corporation varies depending on the jurisdiction of incorporation, the type of corporation, the type of income and the activities carried on by the corporation. As discussed in the context of individuals above, a corporation resident in Canada is liable for tax in Canada on its worldwide income. Credit for Canadian taxes is generally available in respect of foreign taxes paid in respect of foreign source income. A corporation is deemed to be resident in Canada if it is incorporated in Canada. A corporation will also be resident in Canada if its "central management and control" is exercised from within Canada.

In general, a corporation's income for purposes of the ITA is its income computed in accordance with generally accepted accounting principles, as modified by specific rules in the ITA. For instance, corporate income for tax purposes is not computed on a consolidated basis. Also, the ITA provides rules in respect of depreciation (referred to as capital cost allowance), which may differ from depreciation for accounting purposes. In addition, the ITA provides deductions and credits in respect of scientific research carried on in Canada and a special regime for Canadian resource exploration and development. Various rules restrict the deductibility of certain expenses, particularly in non-arm's-length situations.

The combined federal and provincial corporate income tax rates vary from a high of 31% in Prince Edward Island to a low of 23% in Alberta. The combined federal and provincial corporate income tax rate in Ontario is 26.5%. These tax rates are reduced under the ITA for small businesses that are Canadian-controlled private corporations ("CCPCs") and for corporations that carry on manufacturing or processing activities. A CCPC is a private corporation that is a Canadian corporation, other than a corporation controlled directly or indirectly by a non-resident, by one or more public corporations or by a combination of non-residents and public corporations. Depending on the facts, a corporation which is 50% owned by Canadians and 50% owned by non-residents may qualify as a CCPC and therefore be subject to a reduced rate of tax.

A CCPC is generally subject to a reduced rate of tax on the first C$500,000 of business income it earns each year. In Ontario, the combined federal and provincial corporate income tax rate for a CCPC on such income is 12.2% for 2022. If certain income and capital tests are exceeded, the benefits of this low rate of tax may be lost. Where a non-CCPC earns income eligible for the manufacturing and processing deduction, the combined federal and provincial tax rate on such income in Ontario is 25%.

Ontario also has a corporate minimum tax ("**CMT**"), which will apply to all large corporations in Ontario with gross revenues of at least C$100 million and total assets of at least C$50 million. Subject to certain adjustments, the CMT rate is 2.7%.

PARTNERSHIPS

For Canadian income tax purposes, a partnership acts as a flow-through vehicle unless it is a "SIFT partnership" for purposes of the ITA. Unlike a trust, a partnership is not a taxable entity. While not a separate legal entity per se, the ITA requires that a partnership calculate its income or loss from each source as if it were a separate person resident in Canada before flowing through the income (or loss) from each source through to the partners in their respective proportions. Such income (or loss) retains its character in the hands of each partner and is then reported in each partner's tax return with such income being taxed at each partner's respective tax rate.

TRUSTS

Generally speaking, the scheme of the ITA allows a trust having only Canadian resident beneficiaries to determine whether the income of the trust will be taxed in the hands of the trust or flowed through to its beneficiaries to be taxed in their hands.

Income that is received by a trust and paid or payable to beneficiaries in the year is included in the income of the beneficiary and deductible by the trust. Losses of a trust may not be flowed through to the beneficiaries. On the other hand, income that is received by the trust and not paid or payable to the beneficiaries is taxed in the trust as if the trust were an individual. However, most *inter vivos* trusts are taxed at the top marginal rate and are not entitled to individual tax credits.

Real Estate Investment Trusts ("**REITs**") and other forms of business trusts had become quite common in the early 2000s. However, beginning in 2007, certain publicly-traded business trusts which meet the definition of "SIFT trust," other than trusts which meet the definition of "real estate investment trust," as defined in the ITA, became subject to tax on certain income. Where this tax applies, the SIFT trust essentially loses its ability to flow-through income to beneficiaries in respect of such income. As a result of the tax on SIFT trusts, most business trusts other than REITs converted to corporations before the end of 2010.

OTHER TAXES

The Canadian tax system also includes federal and provincial sales taxes, payroll taxes, and land transfer taxes (addressed in the discussion under Real Estate). Individuals owning personal real property may also be subject to property taxes on the ownership or transfer of such property.

GST/HST AND PROVINCIAL SALES TAXES

Canada imposes a 5% federal goods and services tax ("**GST**") on taxable supplies made in Canada. The tax generally applies to supplies of most goods and services made in Canada. Suppliers are liable to collect the tax from recipients of the supplies and remit such tax to the government. In some instances (notably certain imports), the recipient of supplies may have an obligation to self-assess and remit the tax.

Taxpayers may be entitled to an input tax credit if the tax is paid in respect of supplies acquired for use, consumption or supply in the course of commercial activities.

Most provinces (other than Alberta) also have a provincial sales tax. Some provinces, such as Manitoba and Saskatchewan, directly impose the tax on certain sales of goods and services. Others, like Ontario and Nova Scotia, have harmonized their provincial sales taxes with the federal GST to create a harmonized sales tax ("**HST**"). Ontario imposes the HST at 13% on all goods and services that would be subject to the GST (other than a few enumerated exceptions). Quebec has a sales tax which is similar to, but not identical to, the GST.

Persons paying the HST in Ontario are entitled to an input tax credit in respect of tax paid on supplies acquired for use, consumption or supply exclusively in the course of commercial activities.

Non-residents of Canada that register for GST/HST purposes but do not have a permanent establishment in Canada are required to provide a security deposit equal to 50% of the net tax remittable or refundable to the non-resident for the immediately preceding 12-month period. For the first year after registration, the non-resident is required to estimate its net tax

for security purposes. Thereafter, the security will be 50% of the net tax remittable or refundable in the previous fiscal year. The maximum amount of security required is C$1 million while the minimum amount is C$5,000. A non-resident may post security in the form of cash, certified cheque or money order and certain types of bonds. However, no security need be provided if the annual taxable supply of a non-resident does not exceed C$100,000 and the annual net tax (whether remittable or refundable) is less than C$3,000.

PAYROLL TAXES

Payroll taxes include employer and employee contributions towards the Canada Pension Plan and Employment Insurance, and, in Ontario, the Employer Health Tax.

Canada Pension Plan contributions are required when an employee is at least 18 years of age but younger than 70, is in pensionable employment during the year, and does not receive a Canada Pension Plan or Quebec Pension Plan retirement or disability pension.

Canada Pension Plan contributions are deducted from most types of remuneration payable, including salaries, wages, bonuses and commissions. An employer is required to deduct contributions from the amounts and benefits paid and provided to employees. The same amount must also be contributed by the employer as its share of the Canada Pension Plan contributions. The maximum employee contribution for 2022 is C$3,499.80.

An employer must deduct employment insurance premiums from an employee's insurable earnings if the employee is in insurable employment during the year. Insurable employment includes most employment in Canada under a contract of service. There is no age limit for deducting employment insurance premiums. An employer is required to pay 1.4 times the amount of an employee's premium as its contribution towards employment insurance. The maximum annual employee premium for 2022 is C$952.74. The maximum annual employer premium per employee for 2022 is C$1,333.84.

Ontario levies Employer Health Tax on employers who have annual total remuneration exceeding an enumerated amount and the remuneration is paid to employees or former employees who report for work at a permanent establishment of the employer in Ontario or do not report for work at a permanent establishment of the employer but are paid from or through a permanent establishment of the employer in Ontario.

The first C$1 million of annual remuneration is exempt from tax for this purpose if the employer is a private sector employer. The exemption is eliminated for private sector employers with annual Ontario payrolls (including the payroll of any associated employers) over C$5 million. Remuneration includes all payments, benefits and allowances required to be included under sections 5-7 of the ITA in the income of the employee from an office or employment, or would be required to be included if the employee were a resident of Canada. Payments of salaries and wages would be considered remuneration for this purpose.

The rate of tax varies from 0.98% on Ontario payroll less than C$200,000 to up to 1.95% for payroll in excess of C$400,000.

CAPITAL TAXES & SPECIAL FINANCIAL INSTITUTION TAXES

There is no capital tax under the ITA nor does any province impose a tax on the capital of a taxpayer other than a financial institution.

A flat capital tax of 1.25% is levied on a financial institution's taxable capital employed in Canada in excess of its capital deduction for the year. The amount of the capital deduction is C$1 billion. A financial institution can also offset its capital tax payable by its federal income tax payable for that fiscal year.

Banks and life insurer groups are additionally subject to an additional tax of 1.5% of taxable income that is in excess of C$100 million, and for 2022 they are subject to a special one-time tax (the Canada Recovery Dividend) equal to 15% on taxable income in excess of C$1 billion in respect of the 2021 taxation year, which tax is payable in equal amounts over five years.

STAMP DUTIES

Canada does not impose stamp duties.

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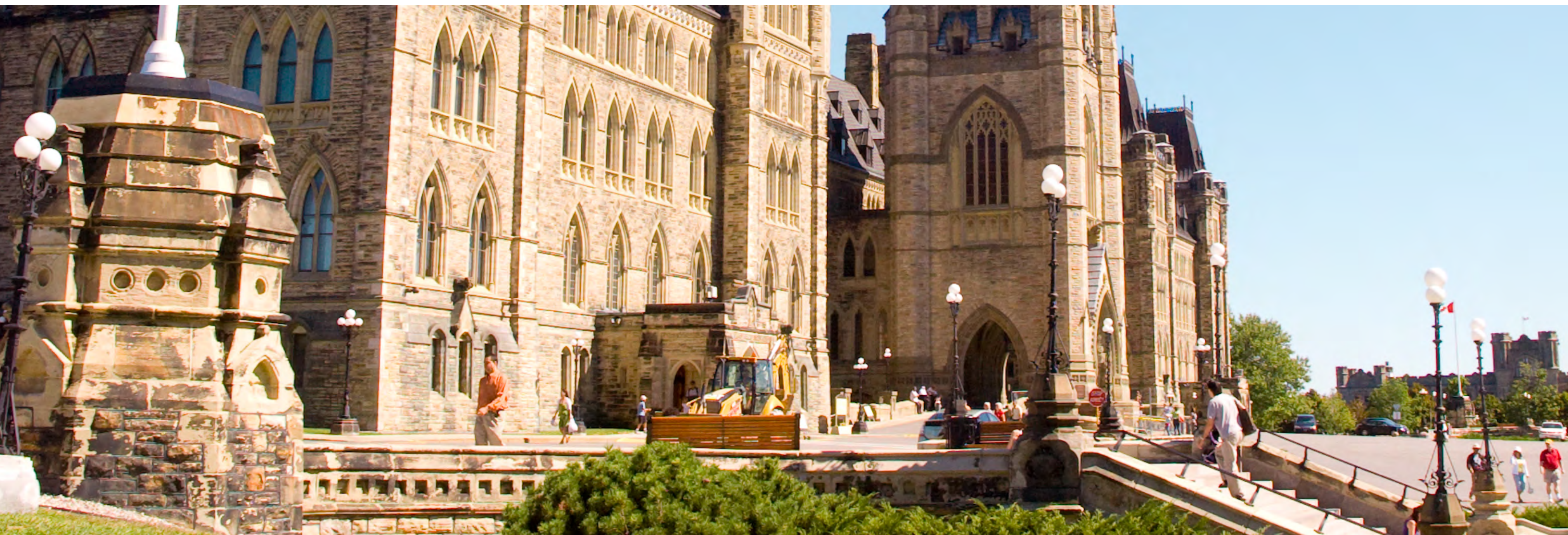

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